

**BUREAU OF CONSUMER FINANCIAL PROTECTION**

**12 CFR Part 1040**

**[Docket No. CFPB-2016-0020]**

**RIN 3170-AA51**

**Arbitration Agreements**

**AGENCY:** Bureau of Consumer Financial Protection.

**ACTION:** Proposed rule with request for public comment.

**SUMMARY:** Pursuant to section 1028(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Public Law 111-203), the Bureau of Consumer Financial Protection (Bureau) is proposing to establish 12 CFR part 1040, which would contain regulations governing two aspects of consumer finance dispute resolution. First, the proposed rule would prohibit covered providers of certain consumer financial products and services from using an agreement with a consumer that provides for arbitration of any future dispute between the parties to bar the consumer from filing or participating in a class action with respect to the covered consumer financial product or service. Second, the proposal would require a covered provider that is involved in an arbitration pursuant to a pre-dispute arbitration agreement to submit specified arbitral records to the Bureau. The Bureau proposes that the rule would apply to certain consumer financial products and services. The Bureau is also proposing to adopt official interpretations to the proposed regulation.

**DATES:** Comments must be received on or before [INSERT DATE 90 DAYS AFTER PUBLICATION IN THE **FEDERAL REGISTER**].

**ADDRESSES:** You may submit comments, identified by Docket No. CFPB-2016-0020 or RIN

3170-AA51, by any of the following methods:

- *Email:* [FederalRegisterComments@cfpb.gov](mailto:FederalRegisterComments@cfpb.gov). Include Docket No. CFPB-2016-0020 or RIN 3170-AA51 in the subject line of the email.
- *Electronic:* <http://www.regulations.gov>. Follow the instructions for submitting comments.
- *Mail:* Monica Jackson, Office of the Executive Secretary, Consumer Financial Protection Bureau, 1700 G Street, NW., Washington, DC 20552.
- *Hand Delivery/Courier:* Monica Jackson, Office of the Executive Secretary, Consumer Financial Protection Bureau, 1275 First Street, NE., Washington, DC 20002.

*Instructions:* All submissions should include the agency name and docket number or Regulatory Information Number (RIN) for this rulemaking. Because paper mail in the Washington, DC area and at the Bureau is subject to delay, commenters are encouraged to submit comments electronically. In general, all comments received will be posted without change to <http://www.regulations.gov>. In addition, comments will be available for public inspection and copying at 1275 First Street, NE., Washington, DC 20002, on official business days between the hours of 10 a.m. and 5 p.m. eastern time. You can make an appointment to inspect the documents by telephoning (202) 435-7275.

All comments, including attachments and other supporting materials, will become part of the public record and subject to public disclosure. Sensitive personal information, such as account numbers or Social Security numbers, should not be included. Comments generally will not be edited to remove any identifying or contact information.

**FOR FURTHER INFORMATION CONTACT:** Owen Bonheimer, Benjamin Cady, Lawrence Lee, Nora Rigby, Counsels; Eric Goldberg, Senior Counsel, Office of Regulations,

Consumer Financial Protection Bureau, at 202-435-7700.

## **SUPPLEMENTARY INFORMATION:**

### **I. Summary of the Proposed Rule**

The Bureau of Consumer Financial Protection (Bureau) is proposing regulations governing agreements that provide for the arbitration of any future disputes between consumers and providers of certain consumer financial products and services. Congress directed the Bureau to study these pre-dispute arbitration agreements in the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank or Dodd-Frank Act).<sup>1</sup> In 2015, the Bureau published and delivered to Congress a study of arbitration.<sup>2</sup> In the Dodd-Frank Act, Congress also authorized the Bureau, after completing the Study (hereinafter Study), to issue regulations restricting or prohibiting the use of arbitration agreements if the Bureau found that such rules would be in the public interest and for the protection of consumers.<sup>3</sup> Congress also required that the findings in any such rule be consistent with the Bureau's Study.<sup>4</sup>

In accordance with this authority, the Bureau is now issuing this proposal and request for public comment. The proposed rule would impose two sets of limitations on the use of pre-dispute arbitration agreements by covered providers of consumer financial products and services.

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<sup>1</sup> Public Law 111-203, 124 Stat. 1376 (2010), section 1028(a).

<sup>2</sup> Bureau of Consumer Fin. Prot., *Arbitration Study: Report to Congress, Pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act § 1028(a)* (2015), available at [http://files.consumerfinance.gov/f/201503\\_cfpb\\_arbitration-study-report-to-congress-2015.pdf](http://files.consumerfinance.gov/f/201503_cfpb_arbitration-study-report-to-congress-2015.pdf). Specific portions of the Study are cited in this proposal where relevant, and the entire Study will be included in the docket for this rulemaking at [www.regulations.gov](http://www.regulations.gov). See Bureau of Consumer Fin. Prot., Request for Information Regarding Scope, Methods and Data Sources for Conducting Study of Pre-Dispute Arbitration Agreements, 77 FR 25148 (Apr. 27, 2012) (hereinafter Arbitration Study RFI). Before releasing the Study, the Bureau released preliminary results in late 2013. Bureau of Consumer Fin. Prot., *Arbitration Study Preliminary Results* (Dec. 12, 2013) (hereinafter Preliminary Results), available at [http://files.consumerfinance.gov/f/201312\\_cfpb\\_arbitration-study-preliminary-results.pdf](http://files.consumerfinance.gov/f/201312_cfpb_arbitration-study-preliminary-results.pdf).

<sup>3</sup> Dodd-Frank section 1028(b).

<sup>4</sup> *Id.*

First, it would prohibit providers from using a pre-dispute arbitration agreement to block consumer class actions in court and would require providers to insert language into their arbitration agreements reflecting this limitation. This proposal is based on the Bureau's preliminary findings – which are consistent with the Study – that pre-dispute arbitration agreements are being widely used to prevent consumers from seeking relief from legal violations on a class basis, and that consumers rarely file individual lawsuits or arbitration cases to obtain such relief.

Second, the proposal would require providers that use pre-dispute arbitration agreements to submit certain records relating to arbitral proceedings to the Bureau. The Bureau intends to use the information it collects to continue monitoring arbitral proceedings to determine whether there are developments that raise consumer protection concerns that may warrant further Bureau action. The Bureau intends to publish these materials on its website in some form, with appropriate redactions or aggregation as warranted, to provide greater transparency into the arbitration of consumer disputes.

The proposal would apply to providers of certain consumer financial products and services in the core consumer financial markets of lending money, storing money, and moving or exchanging money, including most providers that are engaged in:

- extending or regularly participating in decisions regarding consumer credit under Regulation B implementing the Equal Credit Opportunity Act (ECOA), engaging primarily in the business of providing referrals or selecting creditors for consumers to obtain such credit, and the acquiring, purchasing, selling, or servicing of such credit;
- extending or brokering of automobile leases as defined in Bureau regulation;

- providing services to assist with debt management or debt settlement, modify the terms of any extension of consumer credit, or avoid foreclosure;
- providing directly to a consumer a consumer report as defined in the Fair Credit Reporting Act, a credit score, or other information specific to a consumer from a consumer report, except for adverse action notices provided by an employer;
- providing accounts under the Truth in Savings Act and accounts and remittance transfers subject to the Electronic Fund Transfer Act;
- transmitting or exchanging funds (except when integral to another product or service not covered by the proposed rule), certain other payment processing services, and check cashing, check collection, or check guaranty services consistent with the Dodd-Frank Act; 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.

Consistent with the Dodd-Frank Act, the proposed rule would apply only to agreements entered into after the end of the 180-day period beginning on the regulation's effective date.<sup>5</sup>

The Bureau is proposing an effective date of 30 days after a final rule is published in the *Federal Register*. To facilitate implementation and ensure compliance, the Bureau is proposing language that providers would be required to insert into such arbitration agreements to explain the effect of the rule. The proposal would also permit providers of general-purpose reloadable prepaid cards

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<sup>5</sup> Dodd-Frank section 1028(d).

to continue selling packages that contain non-compliant arbitration agreements, if they give consumers a compliant agreement as soon as consumers register their cards and the providers comply with the proposed rule's requirement not to use an arbitration agreement to block a class action.

## **II. Background**

Arbitration is a dispute resolution process in which the parties choose one or more neutral third parties to make a final and binding decision resolving the dispute.<sup>6</sup> Parties may include language in their contracts, before any dispute has arisen, committing to resolve future disputes between them in arbitration rather than in court or allowing either party the option to seek resolution of a future dispute in arbitration. Such pre-dispute arbitration agreements – which this proposal generally refers to as “arbitration agreements”<sup>7</sup> – have a long history, primarily in commercial contracts, where companies typically bargain to create agreements tailored to their needs.<sup>8</sup> In 1925, Congress passed what is now known as the Federal Arbitration Act (FAA) to require that courts enforce agreements to arbitrate, including those entered into both before and after a dispute has arisen.<sup>9</sup>

In the last few decades, companies have begun inserting arbitration agreements in a wide variety of standard-form contracts, such as in contracts between companies and consumers, employees, and investors. The use of arbitration agreements in such contracts has become a contentious legal and policy issue due to concerns about whether the effects of arbitration

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<sup>6</sup> *Arbitration*, Black's Law Dictionary (10th ed. 2014).

<sup>7</sup> Proposed § 1040.2(d) would define the phrase “pre-dispute arbitration agreement.” When referring to the definition, in proposed § 1040.2(d), this proposal will use the full term or otherwise clarify the intended usage.

<sup>8</sup> See *infra* Part II.C.

<sup>9</sup> 9 U.S.C. 1 *et seq.*

agreements are salient to consumers, whether arbitration has proved to be a fair and efficient dispute resolution mechanism, and whether arbitration agreements effectively discourage the filing or resolution of certain claims in court or in arbitration.

In light of these concerns, Congress has taken steps to restrict the use of arbitration agreements in connection with certain consumer financial products and services and other consumer and investor relationships. Most recently, in the 2010 Dodd-Frank Act, Congress prohibited the use of arbitration agreements in connection with mortgage loans,<sup>10</sup> authorized the Securities and Exchange Commission (SEC) to regulate arbitration agreements in contracts between consumers and securities broker-dealers or investment advisers,<sup>11</sup> and prohibited the use of arbitration agreements in connection with certain whistleblower proceedings.<sup>12</sup>

In addition, and of particular relevance here, Congress directed the Bureau to study the use of arbitration agreements in connection with other, non-mortgage consumer financial products and services and authorized the Bureau to prohibit or restrict the use of such agreements if it finds that such action is in the public interest and for the protection of consumers.<sup>13</sup> Congress also required that the findings in any such rule be consistent with the Study.<sup>14</sup> The Bureau solicited input on the appropriate scope, methods, and data sources for the Study in 2012<sup>15</sup> and released results of its three-year study in March 2015.<sup>16</sup> Part III of this proposed rule summarizes the Bureau's process for completing the Study and its results. To place these results

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<sup>10</sup> Dodd-Frank section 1414(e) (codified as 15 U.S.C. 1639c(e)).

<sup>11</sup> Dodd-Frank sections 921(a) and 921(b) (codified as 15 U.S.C. 78o(o) and 15 U.S.C. 80b-5(f)).

<sup>12</sup> Dodd-Frank section 922(b) (codified as 18 U.S.C. 1514A(e)).

<sup>13</sup> Dodd-Frank section 1028(b).

<sup>14</sup> *Id.*

<sup>15</sup> Arbitration Study RFI, *supra* note 2.

<sup>16</sup> Study, *supra* note 2. The Bureau also delivered the Study to Congress. *See also* Letter from Catherine Galicia, Ass't Dir. of Legis. Aff., Bureau of Consumer Fin. Prot. to Hon. Jeb Hensarling, Chairman, Comm. on Fin. Serv. (Mar. 10, 2015) (on file with the Bureau).

in greater context, this Part provides a brief overview of: (1) consumers' rights under Federal and State laws governing consumer financial products and services; (2) court mechanisms for seeking relief where those rights have been violated, and, in particular, the role of the class action device in protecting consumers; and (3) the evolution of arbitration agreements and their increasing use in markets for consumer financial products and services.

#### *A. Consumer Rights Under Federal and State Laws Governing Consumer Financial Products and Services*

Companies often provide consumer financial products and services under the terms of a written contract. In addition to being governed by such contracts and the relevant State's contract law, the relationship between a consumer and a financial service provider is typically governed by consumer protection laws at the State level, Federal level, or both, as well as by other State laws of general applicability (such as tort law). Collectively, these laws create legal rights for consumers and impose duties on the providers of financial products and services that are subject to those laws.

#### *Early Consumer Protection in the Law*

Prior to the twentieth century, the law generally embraced the notion of *caveat emptor* or "buyer beware."<sup>17</sup> State common law afforded some minimal consumer protections against fraud, usury, or breach of contract, but these common law protections were limited in scope. In the first half of the twentieth century, Congress began passing legislation intended to protect

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<sup>17</sup> *Caveat emptor* assumed that buyer and seller conducted business face to face on roughly equal terms (much as English common law assumed that civil actions generally involved roughly equal parties in direct contact with each other). J.R. Franke & D.A. Ballam, *New Applications of Consumer Protection Law: Judicial Activism or Legislative Directive?*, 32 Santa Clara L. Rev. 347, 351-55 (1992).



consumers, such as the Wheeler-Lea Act of 1938.<sup>18</sup> The Wheeler-Lea Act amended the Federal Trade Commission Act of 1914 (FTC Act) to provide the FTC with the authority to pursue unfair or deceptive acts and practices.<sup>19</sup> These early Federal laws did not provide for private rights of action, meaning that they could only be enforced by the government.

### *Modern Era of Federal Consumer Financial Protections*

In the late 1960s, Congress began passing consumer protection laws focused on financial products, beginning with the Consumer Credit Protection Act (CCPA) in 1968.<sup>20</sup> The CCPA included the Truth in Lending Act (TILA), which imposed disclosure and other requirements on creditors.<sup>21</sup> In contrast to earlier consumer protection laws such as the Wheeler-Lea Act, TILA permits private enforcement by providing consumers with a private right of action, authorizing consumers to pursue claims for actual damages and statutory damages and allowing consumers who prevail in litigation to recover their attorney's fees and costs.<sup>22</sup>

Congress followed the enactment of TILA with several other consumer financial protection laws, many of which provided private rights of action for at least some statutory violations. For example, in 1970, Congress passed the Fair Credit Reporting Act (FCRA), which promotes the accuracy, fairness, and privacy of consumer information contained in the files of consumer reporting agencies, as well as providing consumers access to their own information.<sup>23</sup>

In 1976, Congress passed ECOA to prohibit creditors from discriminating against applicants

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<sup>18</sup> Wheeler-Lea Act of 1938, Public Law 75-447, 52 Stat. 111 (1938).

<sup>19</sup> See FTC Act section 5. Prior to the Wheeler-Lea Act, the FTC had the authority to reach “unfair methods of competition in commerce” but only if they had an anticompetitive effect. See *FTC v. Raladam Co.*, 283 U.S. 643, 649 (1931).

<sup>20</sup> Public Law 90-321, 82 Stat. 146 (1968).

<sup>21</sup> *Id.* at Title I.

<sup>22</sup> 15 U.S.C. 1640(a).

<sup>23</sup> Public Law 91-508, 84 Stat. 1114-2 (1970).

with respect to credit transactions.<sup>24</sup> In 1977, Congress passed the Fair Debt Collection Practices Act (FDCPA) to promote the fair treatment of consumers who are subject to debt collection activities.<sup>25</sup>

Also in the 1960s, States began passing their own consumer protection statutes modeled on the FTC Act to prohibit unfair and deceptive practices. Unlike the Federal FTC Act, however, these State statutes typically provide for private enforcement.<sup>26</sup> The FTC encouraged the adoption of consumer protection statutes at the State level and worked directly with the Council of State Governments to draft the Uniform Trade Practices Act and Consumer Protection Law, which served as a model for many State consumer protection statutes.<sup>27</sup> Currently, forty-nine of the fifty States and the District of Columbia have State consumer protection statutes modeled on the FTC Act that allow for private rights of action.<sup>28</sup>

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<sup>24</sup> Public Law 94-239, 90 Stat. 251 (1976).

<sup>25</sup> Public Law 95-109, 91 Stat. 874 (1977). Other such Federal consumer protection laws include those enumerated in the Dodd-Frank Act and made subject to the Bureau's rulemaking, supervision, and enforcement authority: Alternative Mortgage Transaction Parity Act of 1982, 12 U.S.C. 3801; Consumer Leasing Act of 1976, 15 U.S.C. 1667; Electronic Fund Transfer Act (EFTA), 15 U.S.C. 1693 (except with respect to § 920 of that Act); Fair Credit Billing Act, 15 U.S.C. 1666; Home Mortgage Disclosure Act of 1975, 12 U.S.C. 2801; Home Owners Protection Act of 1998, 12 U.S.C. 4901; Federal Deposit Insurance Act, 12 U.S.C. 1831t (b)-(f); Gramm-Leach-Bliley Act 15 U.S.C. 6802-09 (except with respect to section 505 as it applies to section 501(b) of that Act); Home Ownership and Equity Protection Act of 1994 (HOEPA), 15 U.S.C. 1601; Interstate Land Sales Full Disclosure Act, 15 U.S.C. 1701; Real Estate Settlement Procedures Act of 1974 (RESPA), 12 U.S.C. 2601; S.A.F.E. Mortgage Licensing Act of 2008, 12 U.S.C. 5101; Truth in Savings Act (TISA), 12 U.S.C. 4301, and section 626 of the Omnibus Appropriations Act of 2009, 15 U.S.C. 1638. Federal consumer protection laws also include the Bureau's authority to take action to prevent a covered person or service provider from committing or engaging in an unfair, deceptive, and abusive acts or practices, Dodd-Frank section 1031, and its disclosure authority, Dodd-Frank section 1032.

<sup>26</sup> Victor E. Schwartz & Cary Silverman, *Common-Sense Construction of Consumer Protection Acts*, 54 U. Kan. L. Rev. 1, 15-16 (2005).

<sup>27</sup> *Id.*

<sup>28</sup> *Id.* at 16. Every State that adopted a version of FTC Act prohibits deception; some prohibit unfair practices as well. See Carolyn L. Carter, *Consumer Protection in the States*, Nat'l Consumer L. Ctr. (2009) at 5, available at [https://www.nclc.org/images/pdf/udap/report\\_50\\_states.pdf](https://www.nclc.org/images/pdf/udap/report_50_states.pdf).

## *Class Actions Pursuant to Federal Consumer Protection Laws*

In 1966, shortly before Congress first began passing consumer financial protection statutes, the Federal Rules of Civil Procedure (Federal Rules or FRCP) were amended to make class actions substantially more available to litigants, including consumers. The class action procedure in the Federal Rules, as discussed in detail in Part II.B below, allows a representative individual to group his or her claims together with those of other, absent individuals in one lawsuit under certain circumstances. Because TILA and the other Federal consumer protection statutes discussed above permitted private rights of action, those private rights of action were enforceable through a class action, unless the statute expressly prohibited it.<sup>29</sup>

Congress calibrated enforcement through private class actions in several of the consumer protection statutes by specifically referencing class actions and adopting statutory damage schemes that are pegged to a percentage of the defendants' net worth.<sup>30</sup> For example, when consumers initially sought to bring TILA class actions, a number of courts applying Federal Rule 23 denied motions to certify the class because of the prospect of extremely large damages resulting from the aggregation of a large number of claims for statutory damages.<sup>31</sup> Congress addressed this by amending TILA in 1974 to cap class action damages in such cases to the lesser of 1 percent of the defendant's assets or \$100,000.<sup>32</sup> Congress has twice increased the cap on class action damages in TILA: to \$500,000 in 1976 and \$1,000,000 in 2010.<sup>33</sup> Many other

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<sup>29</sup> See, e.g., *Wilcox v. Commerce Bank of Kansas City*, 474 F.2d 336, 343-44 (10th Cir. 1973).

<sup>30</sup> A minority of Federal statutes provide private rights of action but do not cap damages in class action cases. For example, the Telephone Consumer Protection Act (47 U.S.C. 227(b)(3)), the FCRA (15 U.S.C. 1681n, 1681o), and the Credit Repair Organizations Act (15 U.S.C. 1679g) do not cap damages in class action cases.

<sup>31</sup> See, e.g., *Ratner v. Chem. Bank N.Y. Trust Co.*, 54 F.R.D. 412, 416 (S.D.N.Y. 1972).

<sup>32</sup> See Public Law 93-495, 88 Stat. 1518, section 408(a).

<sup>33</sup> Truth in Lending Act Amendments, Public Law 94-240, 90 Stat. 260 (1976); Dodd-Frank section 1416(a)(2).

statutes similarly cap damages in class actions.<sup>34</sup> Further, the legislative history of other statutes indicates a particular intent to permit class actions given the potential for a small recovery in many consumer finance cases for individual damages.<sup>35</sup> Similarly, many States permit class action litigation to vindicate violations of their versions of the FTC Act.<sup>36</sup> A minority of States expressly prohibit class actions to enforce their FTC Acts.<sup>37</sup>

### *B. History and Purpose of the Class Action Procedure*

The default rule in United States courts, inherited from England, is that only those who appear as parties to a given case are bound by its outcome.<sup>38</sup> As early as the medieval period, however, English courts recognized that litigating many individual cases regarding the same issue was inefficient for all parties and thus began to permit a single person in a single case to

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<sup>34</sup> For example, ECOA provides for the full recovery of actual damages on a class basis and caps punitive damages to the lesser of \$500,000 or 1 percent of a creditor's net worth; RESPA limits total class action damages (including actual or statutory damages) to the lesser of \$1,000,000 or 1 percent of the net worth of a mortgage servicer; the FDCPA limits class action recoveries to the lesser of \$500,000 or 1 percent of the net worth of the debt collector; and EFTA provides for a cap on statutory damages in class actions to the lesser of \$500,000 or 1 percent of a defendant's net worth and lists factors to consider in determining the proper amount of a class award. *See* 15 U.S.C. 1691e(b) (ECOA), 12 U.S.C. 2605(f)(2) (RESPA), 15 U.S.C. 1692k(a)(2)(B) (FDCPA) & 15 U.S.C. 1693m(a)(2)(B) (EFTA).

<sup>35</sup> *See, e.g.*, Electronic Fund Transfer Act, H. Rept. No. 95-1315, at 15 (1978). The Report stated: "Without a class-action suit an institution could violate the title with respect to thousands of consumers without their knowledge, if its financial impact was small enough or hard to discover. Class action suits for damages are an essential part of enforcement of the bill because, all too often, although many consumers have been harmed, the actual damages in contrast to the legal costs to individuals are not enough to encourage a consumer to sue. Suits might only be brought for violations resulting in large individual losses while many small individual losses could quickly add up to thousands of dollars."

<sup>36</sup> The laws of at least 14 States expressly permit class action lawsuits. *See, e.g.*, Cal. Bus. & Professions Code 17203 (2016); Haw. Rev. Stat. Ann. § 480-13.3 (2015); Idaho Code Ann. § 48-608(1) (2015); Ind. Code Ann. § 24-5-0.5-4(b) (2015); Kan. Stat. Ann. § 50-634(c)-(d) (2012); Mass. Gen. Laws ch. 93A, § 9(2) (2016); Mich. Comp. Laws § 445.911(3) (2015); Mo. Rev. Stat. § 407.025(2)-(3) (2015); N.H. Rev. Stat. § 358-A:10-a (2015); N.M. Stat. § 57-12-10(E) (2015); Ohio Rev. Code § 1345.09(B) (2016); R.I. Gen. Laws § 6-13.1-5.2(b) (2015); Utah Code § 13-11-19 & 20 (2015); Wyo. Stat. § 40-12-108(b) (2015).

<sup>37</sup> *See, e.g.*, Ala. Code § 8-19-10(f) (2002); Ga. Code Ann. § 10-1-399 (2015); La. Rev. Stat. Ann. § 51:1409(A) (2006); Mont. Code Ann. § 30-14-133(1) (2003); S.C. Code Ann. § 37-5-202(1) (1999).

<sup>38</sup> *Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 832-33 (1999).

represent a group of people with common interests.<sup>39</sup> English courts later developed a procedure called the “bill of peace” to adjudicate disputes involving common questions and multiple parties in a single action. The process allowed for judgments binding all group members – whether or not they were participants in the suit – and contained most of the basic elements of what is now called class action litigation.<sup>40</sup>

The bill of peace was recognized in early United States case law and ultimately adopted by several State courts and the Federal courts.<sup>41</sup> Nevertheless, the use and impact of that procedure remained relatively limited through the nineteenth and into the twentieth centuries. In 1938, the Federal Rules were adopted to govern civil litigation in Federal court, and Rule 23 established a procedure for class actions.<sup>42</sup> That procedure’s ability to bind absent class members was never clear, however.<sup>43</sup>

That changed in 1966, when Rule 23 was amended to create the class action mechanism that largely persists in the same form to this day.<sup>44</sup> Rule 23 was amended at least in part to promote efficiency in the courts and to provide for compensation of individuals when many are

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<sup>39</sup> For instance, in early English cases, a local priest might represent his parish, or a guild might be represented by its formal leadership. Samuel Issacharoff, *Assembling Class Actions*, 90 Wash U. L. Rev. 699, 704 (2014) (citing Stephen C. Yeazell, *From Medieval Group Litigation to the Modern Class Action* 40 (1987)).

<sup>40</sup> Wright, Miller & Kane, 7A Fed. Prac. & Proc. Civ. 1751 (3d. ed.).

<sup>41</sup> *Id.* Federal Equity Rule 48, in effect from 1842 to 1912, officially recognized representative suits where parties were too numerous to be conveniently brought before the court, but did not bind absent members to the judgment. *Id.* In 1912, Federal Equity Rule 38 replaced Rule 48 and allowed absent members to be bound by a final judgment. *Id.*

<sup>42</sup> See Fed. R. Civ. P. 23 (1938).

<sup>43</sup> See *American Pipe & Constr. Co. v. Utah*, 414 U.S. 538, 545-46 (1974) (“The Rule [prior to its amendment] . . . contained no mechanism for determining at any point in advance of final judgment which of those potential members of the class claimed in the complaint were actual members and would be bound by the judgment.”).

<sup>44</sup> See, e.g., Robert H. Klonoff, *The Decline of Class Actions*, 90 Wash. U. L. Rev. 729, 746-47 (2013) (“The Rule 23(a) and (b) criteria, by their terms, have not changed in any significant way since 1966, but some courts have become increasingly skeptical in reviewing whether a particular case satisfies those requirements”).

harmful by the same conduct.<sup>45</sup> The 1966 revisions to Rule 23 prompted similar changes in most States. As the Supreme Court has since explained, class actions promote efficiency in that “the . . . device saves the resources of both the courts and the parties by permitting an issue potentially affecting every [class member] to be litigated in an economical fashion under Rule 23.”<sup>46</sup> As to small harms, class actions provide a mechanism for compensating individuals where “the amounts at stake for individuals may be so small that separate suits would be impracticable.”<sup>47</sup> Class actions have been brought not only by individuals, but also by companies, including financial institutions.<sup>48</sup>

### *Class Action Procedure Pursuant to Rule 23*

A class action can be filed and maintained under Rule 23 in any case where there is a private right to bring a civil action, unless otherwise prohibited by law. Pursuant to Rule 23(a), a class action must meet all of the following requirements: (1) a class of a size such that joinder of

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<sup>45</sup> See *American Pipe*, 414 U.S. at 553 (“A contrary rule allowing participation only by those potential members of the class who had earlier filed motions to intervene in the suit would deprive Rule 23 class actions of the efficiency and economy of litigation which is a principal purpose of the procedure.”).

<sup>46</sup> *Califano v. Yamasaki*, 442 U.S. 682, 701 (1979).

<sup>47</sup> *Amchem Prod., Inc. v. Windsor*, 521 U.S. 591, 616 (1997), citing Fed. R. Civ. P. 23 advisory committee’s note, 28 U.S.C. app. at 698 (stating that a class action may be justified under Rule 23 where “the class may have a high degree of cohesion and prosecution of the action through representatives would be quite unobjectionable, or the amounts at stake for individuals may be so small that separate suits would be impracticable”). See also *id.* at 617 (citing *Mace v. Van Ru Credit Corp.*, 109 F.3d 338, 344 (7th Cir. 1997) (“The policy at the very core of the class action mechanism is to overcome the problem that small recoveries do not provide the incentive for any individual to bring a solo action prosecuting his or her own rights. A class action solves this problem by aggregating the relatively paltry potential recoveries into something worth someone’s (usually an attorney’s) labor.”)).

<sup>48</sup> See, e.g., Financial Institution Plaintiffs’ Consol. Class Action Compl. at 1, 5, *In re: The Home Depot, Inc. Customer Data Breach Litig.*, MDL No. 14-02583 (N.D. Ga. May 27, 2015), Dkt. No. 104 (complaint filed on behalf of putative class of “similarly situated banks, credit unions, and other financial institutions” that had “issued and owned payment cards compromised by the Home Depot data breach”); Mem. & Order at 2, 14, *In re: Target Corp. Customer Data Security Breach Litig.*, MDL No. 14-2522 (D. Minn. Sept. 15, 2015), Dkt. No. 589 (granting certification to plaintiff class made up of banks, credit unions, and other financial institutions that had “issued payment cards such as credit and debit cards to consumers who, in turn, used those cards at Target stores during the period of the 2013 data breach,” noting that “given the number of financial institutions involved and the similarity of all class members’ claims, Plaintiffs have established that the class action device is the superior method for resolving this dispute”); *In re TJX Cos. Retail Security Breach Litig.*, 246 F.R.D. 389 (D. Mass. 2007) (denying class certification in putative class action by financial institutions).

each member as an individual litigant is impracticable; (2) questions of law or fact common to the class; (3) a class representative whose claims or defenses are typical of those of the class; and (4) that the class representative will adequately represent those interests.<sup>49</sup> The first two prerequisites – numerosity and commonality – focus on the absent or represented class, while the latter two tests – typicality and adequacy – address the desired qualifications of the class representative. Pursuant to Rule 23(b), a class action also must meet one of the following requirements: (1) prosecution of separate actions risks either inconsistent adjudications that would establish incompatible standards of conduct for the defendant or would, as a practical matter, be dispositive of the interests of others; (2) defendants have acted or refused to act on grounds generally applicable to the class; or (3) common questions of law or fact predominate over any individual class member’s questions, and a class action is superior to other methods of adjudication.

These and other requirements of Rule 23 are designed to ensure that class action lawsuits safeguard absent class members’ due process rights because they may be bound by what happens in the case.<sup>50</sup> Further, the courts may protect the interests of absent class members through the exercise of their substantial supervisory authority over the quality of representation and specific aspects of the litigation. In the typical Federal class action, an individual plaintiff (or sometimes several individual plaintiffs), represented by an attorney, files a lawsuit on behalf of that individual and others similarly situated against a defendant or defendants.<sup>51</sup> Those similarly situated individuals may be a small group (as few as 40 or even less) or as many as millions that

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<sup>49</sup> Fed. R. Civ. P. 23(a)(1) – (4).

<sup>50</sup> See, e.g., *Amchem Prod., Inc.*, 521 U.S. at 619-21.

<sup>51</sup> Rule 23 also permits a class of defendants.

are alleged to have suffered the same injury as the individual plaintiff. That individual plaintiff, typically referred to as a named or lead plaintiff, cannot properly proceed with a class action unless the court certifies that the case meets the requirements of Rule 23, including the requirements of Rule 23(a) and (b) discussed above. If the court does certify that the case can go forward as a class action, potential class members who do not opt out of the class are bound by the eventual outcome of the case.<sup>52</sup> If not certified, the case proceeds only to bind the named plaintiff.

A certified class case proceeds similarly to an individual case, except that the court has an additional responsibility in a class case, pursuant to Rule 23 and the relevant case law, to actively supervise classes and class proceedings and to ensure that the lead plaintiff keeps absent class members informed.<sup>53</sup> Among its tasks, a court must review any attempts to settle or voluntarily dismiss the case on behalf of the class,<sup>54</sup> may reject any settlement agreement if it is not “fair, reasonable and adequate,”<sup>55</sup> and must ensure that the payment of attorney’s fees is “reasonable.”<sup>56</sup> The court also addresses objections from class members who seek a different outcome to the case (*e.g.*, lower attorney’s fees or a better settlement). These requirements are designed to ensure that all parties to class litigation have their rights protected, including defendants and absent class members.

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<sup>52</sup> In some circumstances, absent class members are not given an opportunity to opt out. *E.g.*, Fed. R. Civ. P. 23(b)(1)(B) (providing for “limited fund” class actions when claims are made by numerous persons against a fund insufficient to satisfy all claims); Fed. R. Civ. P. 23(b)(2) (providing for class actions in which the plaintiffs are seeking primarily injunctive or corresponding declaratory relief).

<sup>53</sup> Fed. R. Civ. P. 23(g).

<sup>54</sup> *See, e.g.*, Fed. R. Civ. P. 23(e) (“The claims, issues, or defenses of a certified class may be settled, voluntarily dismissed, or compromised only with the court’s approval.”). This does not apply to settlements with named plaintiffs reached prior to the certification of a class.

<sup>55</sup> Fed. R. Civ. P. 23(e)(2).

<sup>56</sup> Fed. R. Civ. P. 23(h).



### *Developments in Class Action Procedure over Time*

Since the 1966 amendments, Rule 23 has generated a significant body of case law as well as significant controversy.<sup>57</sup> In response, Congress and the Advisory Committee on the Federal Rules of Civil Procedure (which has been delegated the authority to change Rule 23 under the Rules Enabling Act) have made a series of targeted changes to Rule 23 to calibrate the equities of class plaintiffs and defendants. Meanwhile, the courts have also addressed concerns about Rule 23 in the course of interpreting the rule and determining its application in the context of particular types of cases.

For example, Congress passed the Private Securities Litigation Reform Act (PSLRA) in 1995. Enacted partially in response to concerns about the costs to defendants of litigating class actions, the PSLRA reduced discovery burdens in the early stages of securities class actions.<sup>58</sup> In 2005, Congress again adjusted the class action rules when it adopted the Class Action Fairness Act (CAFA) in response to concerns about abuses of class action procedure in some State courts.<sup>59</sup> Among other things, CAFA expanded the subject matter jurisdiction of Federal courts to allow them to adjudicate most large class actions.<sup>60</sup> The Advisory Committee also periodically reviews and updates Rule 23. In 1998, the Advisory Committee amended Rule 23 to permit interlocutory appeals of class certification decisions, given the unique importance of

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<sup>57</sup> See, e.g., David Marcus, *The History of the Modern Class Action, Part I: Sturm und Drang, 1953–1980*, 90 Wash. U. L. Rev. 587, 610 (participants in the debate “quickly exhausted virtually every claim for and against an invigorated Rule 23”).

<sup>58</sup> Private Securities Litigation Reform Act of 1995, Public Law 104-67, 109 Stat. 737 (1995).

<sup>59</sup> Class Action Fairness Act of 2005, Public Law 109-2, 119 Stat. 4 (2005).

<sup>60</sup> 28 U.S.C. 1332(d), 1453, and 1711-15.

the certification decision, which can dramatically change the dynamics of a class action case.<sup>61</sup> In 2003, the Advisory Committee amended Rule 23 to require courts to define classes that they are certifying, increase the amount of scrutiny that courts must apply to class settlement proposals, and impose additional requirements on class counsel.<sup>62</sup> In 2015, the Advisory Committee further identified several issues that “warrant serious examination” and presented “conceptual sketches” of possible further amendments.<sup>63</sup>

Federal courts have also shaped class action practice through their interpretations of Rule 23. In the last five years, the Supreme Court has decided several major cases refining class action procedure. In *Wal-Mart Stores, Inc. v. Dukes*, the Court interpreted the commonality requirement of Rule 23(a)(2) to require that the common question that is the basis for certification be central to the disposition of the case.<sup>64</sup> In *Comcast Corp. v. Behrend*, the Court reaffirmed that district courts must undertake a “rigorous analysis” of whether a putative class satisfies the predominance requirements in Rule 23(b)(3) and reinforced that individual damages issues may foreclose class certification altogether.<sup>65</sup> In *Campbell-Ewald Co. v. Gomez*, decided this term, the Court held that a defendant cannot moot a class action by offering complete relief to an individual plaintiff before class certification (unless the individual plaintiff agrees to accept

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<sup>61</sup> Fed. R. Civ. P. 23(f). See also Newberg on Class Actions § 7:41; Committee Notes on Rules, 1998 Amendment (“This permissive interlocutory appeal provision is adopted under the power conferred by 28 U.S.C. 1292(e). Appeal from an order granting or denying class certification is permitted in the sole discretion of the court of appeals. No other type of Rule 23 order is covered by this provision.”). See 28 U.S.C. app. at 163 (2014).

<sup>62</sup> Fed. R. Civ. P. 23(c)(2)(B). See also 28 U.S.C. app. at 168 (2014) (“Rule 23(c)(2)(B) is revised to require that the notice of class certification define the certified class in terms identical to the terms used in (c)(1)(B).”).

<sup>63</sup> See, e.g., Rule 23 Subcomm. Rept., in Adv. Comm. on Civil Rules Agenda Book for April 9-10, 2015 at 243-97, available at <http://www.uscourts.gov/rules-policies/archives/agenda-books/advisory-committee-rules-civil-procedure-april-2015>.

<sup>64</sup> 564 U.S. 338, 131 S. Ct. 2541 (2011); see also Klonoff, *supra* note 44, at 775.

<sup>65</sup> 133 S. Ct. 1426 (2013).

that relief).<sup>66</sup> In *Tyson Foods, Inc. v. Bouaphakeo*, the Court held that statistical techniques presuming that all class members are identical to the average observed in a sample can be used to establish classwide liability where each class member could have relied on that sample to establish liability had each brought an individual action.<sup>67</sup> Finally, in a case not yet decided as of the date of this proposal with implications for certain types of class actions, *Spokeo, Inc. v. Robins*, the Court is considering whether a plaintiff has standing to sue if they allege a violation of a Federal statute that allows for statutory damages – in this case, FCRA – and claim only those damages without making a claim for actual damages.<sup>68</sup>

### *C. Arbitration and Arbitration Agreements*

As described above at the beginning of Part II, arbitration is a dispute resolution process in which the parties choose one or more neutral third parties to make a final and binding decision resolving the dispute.<sup>69</sup> The typical arbitration agreement provides that the parties shall submit any disputes that may arise between them to arbitration. Arbitration agreements generally give each party to the contract two distinct rights. First, either side can file claims against the other in arbitration and obtain a decision from the arbitrator.<sup>70</sup> Second, with some exceptions, either side can use the arbitration agreement to require that a dispute proceed in arbitration instead of

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<sup>66</sup> *Campbell-Ewald Co. v. Gomez*, 136 S. Ct. 1036, 1046-48 (Jan. 20, 2016).

<sup>67</sup> *Tyson Foods, Inc. v. Bouaphakeo*, 136 S.Ct. 663, 670 (Mar. 22, 2016).

<sup>68</sup> *Spokeo Inc. v. Robins*, 135 S. Ct. 1892 (2015) (noting that the question before the court is “[w]hether Congress may confer Article III standing upon a plaintiff who suffers no concrete harm, and who therefore could not otherwise invoke the jurisdiction of a Federal court, by authorizing a private right of action based on a bare violation of a Federal statute”).

<sup>69</sup> See *supra* note 6.

<sup>70</sup> *Id.*

court.<sup>71</sup> The typical agreement also specifies an organization called an arbitration administrator. Administrators, which may be for-profit or non-profit organizations, facilitate the selection of an arbitrator to decide the dispute, provide for basic rules of procedure and operations support, and generally administer the arbitration.<sup>72</sup> Parties usually have very limited rights to appeal from a decision in arbitration to a court.<sup>73</sup> Most arbitration also provides for limited or streamlined discovery procedures as compared to those in many court proceedings.<sup>74</sup>

### *History of Arbitration*

The use of arbitration to resolve disputes between parties is not new.<sup>75</sup> In England, the historical roots of arbitration date to the medieval period, when merchants adopted specialized rules to resolve disputes between them.<sup>76</sup> English merchants began utilizing arbitration in large numbers during the nineteenth century.<sup>77</sup> However, English courts were hostile towards arbitration, limiting its use through doctrines that rendered certain types of arbitration agreements unenforceable.<sup>78</sup> Arbitration in the United States in the eighteenth and nineteenth centuries reflected both traditions: it was used primarily by merchants, and courts were hostile

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<sup>71</sup> As described in the Study, however, most arbitration agreements in consumer financial contracts contain a “small claims court carve-out” that provides the parties with a contractual right to pursue a claim in small claims court. Study, *supra* note 2, section 2 at 33-34.

<sup>72</sup> See *id.*, section 2 at 34.

<sup>73</sup> See 9 U.S.C. 9. See also *Hall Street Assocs., L.L.C. v. Mattel, Inc.*, 552 U.S. 576, 584 (2008) (holding that parties cannot expand the grounds for vacating arbitration awards in Federal court by contract); Preliminary Results, *supra* note 2 at 6, n.4.

<sup>74</sup> See Study, *supra* note 2, section 4 at 16-17.

<sup>75</sup> The use of arbitration appears to date back at least as far as the Roman Empire. See, e.g., Amy J. Schmitz, *Ending a Mud Bowl: Defining Arbitration’s Finality Through Functional Analysis*, 37 Ga. L. Rev. 123, 134-36 (2002); Derek Roebuck, *Roman Arbitration* (2004).

<sup>76</sup> See, e.g., Jeffrey W. Stempel, *Pitfalls of Public Policy: The Case of Arbitration Agreements*, 22 St. Mary’s L.J. 259, 269-70 (1990).

<sup>77</sup> *Id.*

<sup>78</sup> See, e.g., Schmitz, *supra* note 75, at 137-39.

toward it.<sup>79</sup> Through the early 1920s, U.S. courts often refused to enforce arbitration agreements and awards.<sup>80</sup>

In 1920, New York enacted the first modern arbitration statute in the United States, which strictly limited courts' power to undermine arbitration decisions and arbitration agreements.<sup>81</sup> Under that law, if one party to an arbitration agreement refused to proceed to arbitration, the statute permitted the other party to seek a remedy in State court to enforce the arbitration agreement.<sup>82</sup> In 1925, Congress passed the United States Arbitration Act, which was based on the New York arbitration law and later became known as the Federal Arbitration Act (FAA).<sup>83</sup> The FAA remains in force today. Among other things, the FAA makes agreements to arbitrate "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."<sup>84</sup>

#### *Expansion of Consumer Arbitration and Arbitration Agreements*

From the passage of the FAA through the 1970s, arbitration continued to be used in commercial disputes between companies.<sup>85</sup> Beginning in the 1980s, however, companies began

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<sup>79</sup> See, e.g., Stempel, *supra* note 76 at 273-74.

<sup>80</sup> David S. Clancy & Matthew M.K. Stein, *An Uninvited Guest: Class Arbitration and the Federal Arbitration Act's Legislative History*, 63 Bus. Law. 55, 58 & n.11 (2007) (citing, *inter alia*, *Haskell v. McClintic-Marshall Co.*, 289 F. 405, 409 (9th Cir. 1923) (refusing to enforce arbitration agreement because of a "settled rule of the common law that a general agreement to submit to arbitration did not oust the courts of jurisdiction, and that rule has been consistently adhered to by the federal courts"); *Dickson Manufacturing Co. v. Am. Locomotive Co.*, 119 F. 488, 490 (C.C.M.D. Pa. 1902) (refusing to enforce an arbitration agreement where plaintiff revoked its consent to arbitration)).

<sup>81</sup> 43 N.Y. Stat. 833 (1925).

<sup>82</sup> *Id.*

<sup>83</sup> 9 U.S.C. 1, *et seq.* The FAA was codified in 1947. Public Law 282, 61 Stat. 669 (July 30, 1947). James E. Berger & Charlene Sun, *The Evolution of Judicial Review Under the Federal Arbitration Act*, 5 N.Y.U. J. Law & Bus. 745, 754 n.45 (2009).

<sup>84</sup> 9 U.S.C. 2.

<sup>85</sup> See, e.g., Soia Mentschikoff, *Commercial Arbitration*, 61 Colum. L. Rev. 846, 850 (1961) (noting that, as of 1950, nearly one-third of trade associations used a mechanism like the American Arbitration Association as a means of dispute resolution between trade association members, and that over one-third of other trade associations saw members make their own individual arrangements for arbitrations); see also *id.* at 858 (noting that AAA heard about

to use arbitration agreements in contracts with consumers, investors, employees, and franchisees that were not negotiated.<sup>86</sup> By the 1990s, some financial services providers began including arbitration agreements in their form consumer agreements.<sup>87</sup>

One notable feature of these agreements is that they could be used to block class action litigation and often class arbitration as well.<sup>88</sup> The agreements could block class actions filed in court because, when sued in a class action, companies could use the arbitration agreement to dismiss or stay the class action in favor of arbitration. Yet the agreements often prohibited class arbitration as well, rendering plaintiffs unable to pursue class claims in either litigation or arbitration.<sup>89</sup> More recently, some consumer financial providers themselves have disclosed in

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240 commercial arbitrations a year from 1947 to 1950, comparable to the volume of like cases before the U.S. District Court of the Southern District of New York in the same time period). Arbitration was also used in the labor context where unions had bargained with employers to create specialized dispute resolution mechanisms pursuant to the Labor Management Relations Act. 29 U.S.C. 401-531.

<sup>86</sup> Stephen J. Ware, *Arbitration Clauses, Jury-Waiver Clauses and Other Contractual Waivers of Constitutional Rights*, 67 Law & Contemp. Problems 179 (2004).

<sup>87</sup> Sallie Hofmeister, *Bank of America is Upheld on Consumer Arbitration*, N.Y. Times, Aug. 20, 1994 (“‘The class action cases is where the real money will be saved [by arbitration agreements],’ Peter Magnani, a spokesman for the bank, said.”); John P. Roberts, *Mandatory Arbitration by Financial Institutions*, 50 Cons. Fin. L.Q. Rep. 365, 367 (1996) (identifying an anonymous bank “ABC” as having adopted arbitration provisions in its contracts for consumer credit cards, deposit accounts, and safety deposit boxes); Hossam M. Fahmy, *Arbitration: Wiping Out Consumers Rights?*, 64 Tex. B.J. 917, 917 (2001) (citing Barry Meier, *In Fine Print, Customers Lose Ability to Sue*, N.Y. Times, Mar. 10, 1997, at A1 (noting in 2001 that “[t]he use of consumer arbitration expanded eight years ago when Bank of America initiated its current policy,” when “notices of the new arbitration requirements were sent along with monthly statements to 12 million customers, encouraging thousands of other companies to follow the same policy”))).

<sup>88</sup> See, e.g., Alan S. Kaplinsky & Mark J. Levin, *Excuse Me, But Who’s the Predator? Banks Can Use Arbitration Clauses as a Defense*, 7 Bus. L. Today 24 (1998) (“Lenders that have not yet implemented arbitration programs should promptly consider doing so, since each day that passes brings with it the risk of additional multimillion-dollar class action lawsuits that might have been avoided had arbitration procedures been in place.”); see also Bennet S. Koren, *Our Mini Theme: Class Actions*, 7 Bus. L. Today 18 (1998) (industry attorney recommends adopting arbitration agreements because “[t]he absence of a class remedy ensures that there will be no formal notification and most claims will therefore remain unasserted.”).

<sup>89</sup> Even if a pre-dispute arbitration agreement does not prohibit class arbitration, an arbitrator may not permit arbitration to go forward on a class basis unless the arbitration agreement itself shows the parties agreed to do so. See *Stolt-Nielsen S.A. v. AnimalFeeds Int’l Corp.*, 559 U.S. 662, 684 (2010) (“[A] party may not be compelled under the FAA to submit to class arbitration unless there is a contractual basis for concluding that the party *agreed* to do so.”) (emphasis in original). Both the AAA and JAMS class arbitration procedures reflect the law; both require an initial determination as to whether the arbitration agreement at issue provides for class arbitration before a putative

their filings with the SEC that they rely on arbitration agreements for the express purpose of shielding themselves from class action liability.<sup>90</sup>

Since the early 1990s, the use of arbitration agreements in consumer financial contracts has become widespread, as shown by Section 2 of the Study (which is discussed in detail in Part III.D below). By the early 2000s, a few consumer financial companies had become heavy users of arbitration proceedings to obtain debt collection judgments against consumers. For example, in 2006 alone, the National Arbitration Forum (NAF) administered 214,000 arbitrations, most of which were consumer debt collection proceedings brought by companies.<sup>91</sup>

### *Legal Challenges to Arbitration Agreements*

The increase in the prevalence of arbitration agreements coincided with various legal challenges to their use in consumer contracts. One set of challenges focused on the use of arbitration agreements in connection with debt collection disputes. In the late 2000s, consumer groups began to criticize the fairness of debt collection arbitration proceedings administered by

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class arbitration can move forward. *See* AAA, Supplementary Rules for Class Arbitrations, Rule 3 (effective Oct. 8, 2003) (“Upon appointment, the arbitrator shall determine as a threshold matter, in a reasoned, partial final award on the construction of the arbitration clause, whether the applicable arbitration clause permits the arbitration to proceed on behalf of or against a class (the “Clause Construction Award.”); JAMS Class Action Procedures, Rule 2: Construction of the Arbitration Clause (effective May 1, 2009) (“[O]nce appointed, the Arbitrator, following the law applicable to the validity of the arbitration clause as a whole, or the validity of any of its terms, or any court order applicable to the matter, shall determine as a threshold matter whether the arbitration can proceed on behalf of or against a class.”)

<sup>90</sup> *See, e.g.*, Discover Financial Services, Annual Report (Form 10-K) (Feb. 25, 2015) at 43 (“[W]e have historically relied on our arbitration clause in agreements with customers to limit our exposure to consumer class action litigation . . . .”); Synchrony Financial, Annual Report (Form 10-K) (Feb. 23, 2015) at 45 (“[H]istorically the arbitration provision in our customer agreements generally has limited our exposure to consumer class action litigation . . . .”).

<sup>91</sup> Carrick Mollenkamp, et al., *Turmoil in Arbitration Empire Upends Credit-Card Disputes*, Wall St. J., Oct. 16, 2009. *See also* Public Citizen, *The Arbitration Trap: How Credit Card Companies Ensnare Consumers* (2007), available at <http://www.citizen.org/publications/publicationredirect.cfm?ID=7545>.

the NAF, the most widely used arbitration administrator for debt collection.<sup>92</sup> In 2008, the San Francisco City Attorney's office filed a civil action against NAF alleging that NAF was biased in favor of debt collectors.<sup>93</sup> In 2009, the Minnesota Attorney General sued NAF, alleging an institutional conflict of interest because a group of investors with a 40 percent ownership stake in an affiliate of NAF also had a majority ownership stake in a debt collection firm that brought a number of cases before NAF.<sup>94</sup> A few days after the filing of the lawsuit, NAF reached a settlement with the Minnesota Attorney General pursuant to which it agreed to stop administering consumer arbitrations completely, although NAF did not admit liability.<sup>95</sup> Further, a series of class actions filed against NAF were consolidated in a multidistrict litigation and NAF settled those in 2011 by agreeing to suspend \$1 billion in pending debt collection arbitrations.<sup>96</sup> The American Arbitration Association (AAA) likewise announced a moratorium on administering company-filed debt collection arbitrations, articulating significant concerns about due process and fairness to consumers subject to such arbitrations.<sup>97</sup>

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<sup>92</sup> See Mollencamp, *supra* note 91. In addition to cases relating to debt collection arbitrations, NAF was later added as a defendant to the *Ross v. Bank of America* case, a putative class action pertaining to non-disclosure of foreign currency conversion fees; NAF was alleged to have facilitated an antitrust conspiracy among credit card companies to adopt arbitration agreements. NAF settled those allegations. See Order Preliminarily Approving Class Action Settlement as to Defendant National Arbitration Forum Inc., *In re Currency Conversion Fee Antitrust Litig.*, MDL 1409 (S.D.N.Y. Dec. 13, 2011).

<sup>93</sup> *California v. National Arbitration Forum, Inc.*, No. 473-569 (S.F. Sup. Ct. Mar. 2009).

<sup>94</sup> See Complaint at 2, *State of Minnesota v. National Arbitration Forum, Inc.* No. 27-cv-0918550 (4th Jud. Dist. Minn. July 14, 2009), available at [https://www.nclc.org/images/pdf/unreported/naf\\_complaint.pdf](https://www.nclc.org/images/pdf/unreported/naf_complaint.pdf).

<sup>95</sup> Press Release, State of Minnesota, Office of the Attorney General, *National Arbitration Forum Barred from Credit Card and Consumer Arbitrations Under Agreement with Attorney General Swanson* (July 19, 2009), available at <http://pubcit.typepad.com/files/nafconsentdecree.pdf>. NAF settled the City of San Francisco's claims in 2011 by agreeing to cease administering consumer arbitrations in California in perpetuity and to pay a \$1 million penalty. News Release, City Attorney Dennis Herrera, *Herrera Secures \$5 Million Settlement, Consumer Safeguards Against BofA Credit Card Subsidiary* (Aug. 22, 2011).

<sup>96</sup> Mem. and Order, *In re National Arbitration Forum Trade Practices Litigation*, No. 10-md-02122 (D. Minn. Aug. 8, 2011).

<sup>97</sup> See AAA Press Release, *The American Arbitration Association Calls for Reform of Debt Collection Arbitration* (July 23, 2009), available at <https://www.nclc.org/images/pdf/arbitration/testimonysept09-exhibit3.pdf>. See also



A second group of challenges asserted that the invocation of arbitration agreements to block class actions was unlawful. Because the FAA permits challenges to the validity of arbitration agreements on grounds that exist at law or in equity for the revocation of any contract,<sup>98</sup> challengers argued that provisions prohibiting arbitration from proceeding on a class basis – as well as other features of particular arbitration agreements – were unconscionable under State law or otherwise unenforceable.<sup>99</sup> Initially, these challenges yielded conflicting results. Some courts held that class arbitration waivers were not unconscionable.<sup>100</sup> Other courts held that such waivers were unenforceable on unconscionability grounds.<sup>101</sup> Some of these decisions also held that the FAA did not preempt application of a state’s unconscionability doctrine.<sup>102</sup>

Before 2011, courts were divided on whether arbitration agreements that bar class proceedings were unenforceable because they violated some states’ laws. Then, in 2011, the Supreme Court held in *AT&T Mobility v. Concepcion* that the FAA preempted application of California’s unconscionability doctrine to the extent it would have precluded enforcement of a

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American Arbitration Association, *Consumer Debt Collection Due Process Protocol Statement of Principles* (2010), available at [https://www.adr.org/aaa/ShowProperty?nodeId=%2FUCM%2FADRSTG\\_003865](https://www.adr.org/aaa/ShowProperty?nodeId=%2FUCM%2FADRSTG_003865). JAMS has reported to the Bureau that it only handles a small number of debt collection claims and often those arbitrations are initiated by consumers.

<sup>98</sup> 9 U.S.C. 2 (providing that agreements to arbitrate “shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.”).

<sup>99</sup> See, e.g., Opening Br. on the Merits, *Discover Bank v. Superior Court*, No. S113725, 2003 WL 26111906, at 5 (Cal. 2005) (“[A] ban on class actions in an adhesive consumer contract such as the one at issue here is unconscionable because it is one-sided and effectively non-mutual - that is, it benefits only the corporate defendant, and could never operate to the benefit of the consumer.”)

<sup>100</sup> See, e.g., *Strand v. U.S. Bank N.A.*, 693 N.W.2d 918 (N.D. 2005); *Edelist v. MBNA America Bank*, 790 A.2d 1249 (Sup. Ct. of Del., New Castle Cty. 2001).

<sup>101</sup> See, e.g., *Brewer v. Missouri Title Loans, Inc.*, 323 S.W.3d 18 (Mo. 2010) (en banc); *Feeney v. Dell, Inc.*, 908 N.E.2d 753 (Mass. 2009); *Fiser v. Dell Computer Corp.*, 188 P.3d 1215 (N.M. 2008); *Tillman v. Commercial Credit Loans, Inc.*, 655 S.E.2d 362 (N.C. 2008); *Dale v. Comcast Corp.*, 498 F.3d 1216 (11th Cir. 2007) (holding that class action ban in arbitration agreement substantively unconscionable under Georgia law); *Scott v. Cingular Wireless*, 161 P.3d 1000 (Wash. 2007) (en banc); *Kinkel v. Cingular Wireless LLC*, 857 N.E.2d 250 (Ill. 2006); *Muhammad v. Cnty. Bank of Rehoboth Beach, Del.*, 912 A.2d 88 (N.J. 2006); *Discover Bank v. Superior Court*, 113 P.3d 1100 (Cal. 2005).

<sup>102</sup> See, e.g., *Feeney*, 908 N.E.2d at 767-69; *Scott*, 161 P.3d at 1008-09; *Discover Bank*, 113 P.3d at 1110-17.

consumer arbitration agreement with a provision prohibiting the filing of arbitration on a class basis. The Court concluded that any State law – even one that serves as a general contract law defense – that “[r]equir[es] the availability of classwide arbitration interferes with fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA.”<sup>103</sup> The Court reasoned that class arbitration eliminates the principal advantage of arbitration – its informality – and increases risks to defendants (due to the high stakes of mass resolution combined with the absence of multilayered review).<sup>104</sup> As a result of the Court’s holding, parties to litigation could no longer prevent the use of an arbitration agreement to block a class action in court on the ground that a prohibition on class arbitration in the agreement was unconscionable under the relevant State law.<sup>105</sup> The Court further held, in a 2013 decision, that a court may not use the “effective vindication” doctrine – under which a court may invalidate an arbitration agreement that operates to waive a party’s right to pursue statutory remedies – to invalidate a class arbitration waiver on the grounds that the plaintiff’s cost of individually arbitrating the claim exceeds the potential recovery.<sup>106</sup>

### *Regulatory and Legislative Activity*

As arbitration agreements in consumer contracts became more common, Federal regulators, Congress, and State legislatures began to take notice of their impact on the ability of consumers to resolve disputes. One of the first entities to regulate arbitration agreements was the

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<sup>103</sup> *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 344 (2011).

<sup>104</sup> *Id.* at 348-51.

<sup>105</sup> See Robert Buchanan Jr., *The U.S. Supreme Court’s Landmark Decision in AT&T Mobility v. Concepcion: One Year Later*, Bloomberg Law, May 8, 2012, available at <http://www.bna.com/att-v-concepcion-one-year-later/> (noting that 45 out of 61 cases involving a class waiver in an arbitration agreement were sent to arbitration). The Court did not preempt all State law contract defenses under all circumstances; rather, these doctrines remain available provided that they are not applied in a manner that disfavors arbitration.

<sup>106</sup> *American Express Co. v. Italian Colors Restaurant*, 133 S. Ct. 2304, 2309 (2013).

National Association of Securities Dealers – now known as the Financial Industry Regulatory Authority (FINRA) – the self-regulating body for the securities industry that also administers arbitrations between member companies and their customers.<sup>107</sup> Under FINRA’s Code of Arbitration for customer disputes, FINRA members have been prohibited since 1992 from enforcing an arbitration agreement against any member of a certified or putative class unless and until the class treatment is denied (or a certified class is decertified) or the class member has opted out of the class or class relief.<sup>108</sup> FINRA’s code also requires this limitation to be set out in any member company’s arbitration agreement. The SEC approved this rule in 1992.<sup>109</sup> In addition, since 1976, the regulations of the Commodities Futures Trading Commission (CFTC) implementing the Commodity Exchange Act have required that arbitration agreements in commodities contracts be voluntary.<sup>110</sup> In 2004, the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) – government-sponsored enterprises that purchase a large share of mortgages – ceased purchasing mortgages that contained arbitration agreements.<sup>111</sup>

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<sup>107</sup> See FINRA Arbitration and Mediation, <https://www.finra.org/arbitration-and-mediation>.

<sup>108</sup> FINRA Code of Arbitration Procedure for Customer Disputes 12204(d). For individual disputes between brokers and customers, FINRA requires individual arbitration.

<sup>109</sup> See S.E.C., Order Approving Proposed Rule Change Relating to the Exclusion of Class Actions From Arbitration Proceedings, 57 FR 52659-52661 (Nov. 4, 1992) (citing Securities and Exchange Act, section 19(b)(1) and Rule 19b-4). In a separate context, the SEC has opposed attempts by companies to include arbitration agreements in their securities filings in order to force shareholders to arbitrate disputes rather than litigate them in court. See, e.g., Carl Schneider, *Arbitration Provisions in Corporate Governance Documents*, Harv. L. Sch. Forum on Corp. Governance and Fin. Reg. (Apr. 27, 2012), available at <https://corpgov.law.harvard.edu/2012/04/27/arbitration-provisions-in-corporate-governance-documents/> (“According to published reports, the SEC advised Carlyle that it would not grant an acceleration order permitting the registration statement to become effective unless the arbitration provision was withdrawn.”). Carlyle subsequently withdrew its arbitration provision.

<sup>110</sup> Arbitration or Other Dispute Settlement Procedures, 41 FR 42942, 42946 (Sept. 29, 1976); 17 CFR 166.5(b).

<sup>111</sup> See Kenneth Harney, *Fannie Follows Freddie in Banning Mandatory Arbitration*, Wash. Post., Oct. 9, 2004, available at <http://www.washingtonpost.com/wp-dyn/articles/A18052-2004Oct8.html>.

Since 1975, FTC regulations implementing the Magnuson-Moss Warranty Act (MMWA) have barred the use, in consumer warranty agreements, of arbitration agreements that would result in binding decisions.<sup>112</sup> Some courts in the late 1990s disagreed with the FTC's interpretation, but the FTC promulgated a final rule in 2015 that "reaffirm[ed] its long-held view" that the MMWA "disfavors, and authorizes the Commission to prohibit, mandatory binding arbitration in warranties."<sup>113</sup> In doing so, the FTC noted that the language of the MMWA presupposed that the kinds of informal dispute settlement mechanisms the FTC would permit would not foreclose the filing of a civil action in court.<sup>114</sup>

More recently, the Centers for Medicare and Medicaid Services (CMS) proposed a rule that would revise the requirements that long-term health care facilities must meet to participate in the Medicare and Medicaid programs.<sup>115</sup> Among the new proposed rules are a number of requirements for any arbitration agreements between long-term care facilities and residents of those facilities, including that there be a stand-alone agreement signed by the resident; that care at the facility not be conditioned on signing the agreement; and that the agreement be clear in form, manner and language as to what arbitration is and that the resident is waiving a right to

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<sup>112</sup> 10 CFR 703.5(j). The FTC's rules do permit warranties that require consumers to resort to an informal dispute resolution mechanism before proceeding in a court, but decisions from such informal proceedings are not binding and may be challenged in court. (By contrast, most arbitration awards are binding and may only be challenged on very limited grounds as provided by the FAA.) The FTC's rulemaking was based on authority expressly delegated by Congress in its passage of the MMWA pertaining to informal dispute settlement procedures. 15 U.S.C. 2310(a)(2). Until 1999, courts upheld the validity of the rule. *See* 80 FR 42719; *see also* Jonathan D. Grossberg, *The Magnuson-Moss Warranty Act, the Federal Arbitration Act, and the Future of Consumer Protection*, 93 Cornell L. Rev. 659, 667 (2008). After 1999, two appellate courts questioned whether the MMWA was intended to reach arbitration agreements. *See* Final Action Concerning Review of the Interpretations of Magnuson-Moss Warranty Act, 80 FR 42710, 42719 & nn.115-116 (July 20, 2015) (citing *Davis v. Southern Energy Homes, Inc.*, 305 F.3d 1268 (11th Cir. 2002); *Walton v. Rose Mobile Homes, LLC*, 298 F.3d 470 (5th Cir. 2002)).

<sup>113</sup> *See* FTC Final Action Concerning Review of the Interpretations of Magnuson-Moss Warranty Act, 80 FR 42710, 42719 (July 20, 2015).

<sup>114</sup> *See id.*

<sup>115</sup> Centers for Medicare & Medicaid Services, Medicare and Medicaid Programs, Reform of Requirements for Long-Term Care Facilities, 80 FR 42168 (July 16, 2015).

judicial relief and that arbitration be conducted by a neutral arbitrator in a location that is convenient to both parties.<sup>116</sup> Finally, the Department of Education recently announced that it is proposing options in the context of a negotiated rulemaking to limit the impact of arbitration agreements in certain college enrollment agreements, specifically by addressing the use of arbitration agreements to bar students from bringing group claims.<sup>117</sup>

Congress has also taken several steps to address the use of arbitration agreements in different contexts. In 2002, Congress amended Federal law to require that, whenever a motor vehicle franchise contract contains an arbitration agreement, arbitration may be used to resolve the dispute only if, after a dispute arises, all parties to the dispute consent in writing to the use of arbitration.<sup>118</sup> In 2006, Congress passed the Military Lending Act (MLA), which, among other things, prohibited the use of arbitration provisions in extensions of credit to active servicemembers, their spouses, and certain dependents.<sup>119</sup> As first implemented by Department of Defense (DoD) regulations in 2007, the MLA applied to “[c]losed-end credit with a term of 91 days or fewer in which the amount financed does not exceed \$2,000.”<sup>120</sup> In July 2015, DoD promulgated a final rule that significantly expanded that definition of “consumer credit” to cover

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<sup>116</sup> See *id.* at 42264-65; see also *id.* at 42211.

<sup>117</sup> See U.S. Dep’t of Education Press Release, *U.S. Department of Education Takes Further Steps to Protect Students from Predatory Higher Education Institutions* (Mar. 11, 2016), available at <https://www.ed.gov/news/press-releases/us-department-education-takes-further-steps-protect-students-predatory-higher-education-institutions>.

<sup>118</sup> 21st Century Department of Justice Appropriations Authorization Act, Public Law 107-273, section 11028(a)(2), 116 Stat. 1835 (2002), codified at 15 U.S.C. 1226(a)(2). The statute defines “motor vehicle franchise contract” as “a contract under which a motor vehicle manufacturer, importer, or distributor sells motor vehicles to any other person for resale to an ultimate purchaser and authorizes such other person to repair and service the manufacturer’s motor vehicles.” *Id.* at section 11028(a)(1)(B), 116 Stat. 1835, codified at 15 U.S.C. 1226(a)(1)(B).

<sup>119</sup> John Warner National Defense Authorization Act for Fiscal Year 2007, Public Law 109-364, 120 Stat. 2083 (2006).

<sup>120</sup> Limitations on Terms of Consumer Credit Extended to Service Members and Dependents, 72 FR 50580 (Aug. 31, 2007) (codified at 32 CFR 232).

closed-end loans that exceeded \$2,000 or had terms longer than 91 days as well as various forms of open-end credit, including credit cards.<sup>121</sup> In 2008, Congress amended federal agriculture law to require, among other things, that livestock or poultry contracts containing arbitration agreements disclose the right of the producer or grower to decline the arbitration agreement; the Department of Agriculture issued a final rule implementing the statute in 2011.<sup>122</sup>

As previously noted, Congress again addressed arbitration agreements in the 2010 Dodd-Frank Act. Dodd-Frank section 1414(a) prohibited the use of arbitration agreements in mortgage contracts, which the Bureau implemented in its Regulation Z.<sup>123</sup> Section 921 of the Act authorized the SEC to issue rules to prohibit or impose conditions or limitations on the use of arbitration agreements by investment advisers.<sup>124</sup> Section 922 of the Act invalidated the use of arbitration agreements in connection with certain whistleblower proceedings.<sup>125</sup> Finally, and as discussed in greater detail below, section 1028 of the Act required the Bureau to study the use of arbitration agreements in contracts for consumer financial products and services and authorized

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<sup>121</sup> See 32 CFR 232.8(c). Creditors must comply with the requirements of the rule for transactions or accounts established or consummated on or after October 3, 2016, subject to certain exemptions. 32 CFR 232.13(a). The rule applies to credit card accounts under an open-end consumer credit plan only on October 3, 2017. 32 CFR 232.13(c)(2). Earlier, Congress passed an appropriations provision prohibiting Federal contractors and subcontractors receiving Department of Defense funds from requiring employees or independent contractors arbitrate certain kinds of employment claims. See Department of Defense Appropriations Act of 2010, Public Law No. 111-118, 123 Stat. 3454 (2010), section 8116.

<sup>122</sup> Food, Conservation, and Energy Act of 2008, Public Law 110-234, section 11005, 122 Stat. 1356–58 (2008), codified at 7 U.S.C. 197c; Implementation of Regulations Required Under Title XI of the Food, Conservation and Energy Act of 2008; Suspension of Delivery of Birds, Additional Capital Investment Criteria, Breach of Contract, and Arbitration, 76 FR 76874, 76890 (Dec. 9, 2011).

<sup>123</sup> See Dodd-Frank section 1414(a) (codified as 15 U.S.C. 1639c(e)(1)) (“No residential mortgage loan and no extension of credit under an open end consumer credit plan secured by the principal dwelling of the consumer may include terms which require arbitration or any other nonjudicial procedure as the method for resolving any controversy or settling any claims arising out of the transaction.”); 12 CFR 1026.36(h)(1).

<sup>124</sup> Dodd-Frank section 921(b).

<sup>125</sup> Dodd-Frank section 922(c)(2).

this rulemaking.<sup>126</sup> The authority of the Bureau and the SEC are similar under the Dodd-Frank Act except that the SEC does not have to complete a study before promulgating a rule. State legislatures have also taken steps to regulate the arbitration process. Several States, most notably California, require arbitration administrators to disclose basic data about consumer arbitrations that take place in the State.<sup>127</sup> States are constrained in their ability to regulate arbitration because the FAA preempts conflicting State law.<sup>128</sup>

### *Arbitration Today*

Today, the AAA is the primary administrator of consumer financial arbitrations.<sup>129</sup> The AAA's consumer financial arbitrations are governed by the AAA Consumer Arbitration Rules, which includes provisions that, among other things, limit filing and administrative costs for consumers.<sup>130</sup> The AAA also has adopted the AAA Consumer Due Process Protocol, which creates a floor of procedural and substantive protections and affirms that “[a]ll parties are entitled to a fundamentally-fair arbitration process.”<sup>131</sup> A second entity, JAMS, administers consumer

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<sup>126</sup> Dodd-Frank section 1028(a).

<sup>127</sup> Cal. Civ. Proc. Code § 1281.96 (amended effective Jan. 1, 2015); D.C. Code §§ 16-4430; Md. Comm. L. Code, §§ 14-3901-05; 10 M.R.S.A. § 1394 (Maine).

<sup>128</sup> See *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681, 687 (1996) (“Courts may not, however, invalidate arbitration agreements under state laws applicable only to arbitration provisions.”); *Perry v. Thomas*, 482 U.S. 483, 492 n.9 (1987) (“[S]tate law, whether of legislative or judicial origin, is applicable *if* that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally. A state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with this requirement of [FAA] § 2.”).

<sup>129</sup> See *infra* Part III.D.

<sup>130</sup> AAA, *Consumer Arbitration Rules*.

<sup>131</sup> AAA, *Consumer Due Process Protocol Statement of Principles*, Principle 1. Other principles include that all parties are entitled to a neutral arbitrator and administrator (Principle 3), that all parties retain the right to pursue small claims (Principle 5), and that face-to-face arbitration should be conducted at a “reasonably convenient” location (Principle 6). The AAA explained that it adopted these principles because, in its view, “consumer contracts often do not involve arm’s length negotiation of terms, and frequently consist of boilerplate language.” The AAA further explained that “there are legitimate concerns regarding the fairness of consumer conflict resolution mechanisms required by suppliers. This is particularly true in the realm of binding arbitration, where the courts are displaced by private adjudication systems.” *Id.* at 4.

financial arbitrations pursuant to the JAMS Streamlined Arbitration Rules & Procedures<sup>132</sup> and the JAMS Consumer Minimum Standards. These administrators' procedures for arbitration differ in several respects from the procedures found in court, as discussed in Section 4 of the Study and summarized below at Part III.D.

Further, although virtually all arbitration agreements in the consumer financial context expressly preclude arbitration from proceeding on a class basis, the major arbitration administrators do provide procedures for administering class arbitrations and have occasionally administered them in class arbitrations involving providers of consumer financial products and services.<sup>133</sup> These procedures, which are derived from class action litigation procedures used in court, are described in Section 4.8 of the Study. These class arbitration procedures will only be used by the AAA or JAMS if the arbitration administrator first determines that the arbitration agreement can be construed as permitting class arbitration. These class arbitration procedures are not widely used in consumer financial services disputes: reviewing consumer financial arbitrations pertaining to six product types filed over a period of three years, the Study found only three.<sup>134</sup> Industry has criticized class arbitration on the ground that it lacks procedural

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<sup>132</sup> JAMS, *Streamlined Arbitration Rules & Procedures* (effective July 1, 2014), available at <http://www.jamsadr.com/rules-streamlined-arbitration/>. If a claim or counterclaim exceeds \$250,000, the JAMS Comprehensive Arbitration Procedures, not the Streamlined Rules & Procedures, apply. *Id.* Rule 1(a).

<sup>133</sup> See AAA Class Arbitration dockets, available at [https://www.adr.org/aaa/faces/services/disputeresolutionservices/casedocket?\\_afLoop=368852573510045&\\_afWindowMode=0&\\_afWindowId=null](https://www.adr.org/aaa/faces/services/disputeresolutionservices/casedocket?_afLoop=368852573510045&_afWindowMode=0&_afWindowId=null).

<sup>134</sup> Study, *supra* note 2, section 5, at 86-87. The review of class action filings in five of these markets also identified one of these two class arbitrations, as well as an additional class action arbitration filed with JAMS following the dismissal or stay of a class litigation. *Id.*, section 6, at 59.



safeguards. For example, class arbitration generally has limited judicial review of arbitrator decisions (for example, on a decision to certify a class or an award of substantial damages).<sup>135</sup>

### **III. The Arbitration Study**

Section 1028(a) of the Dodd-Frank Act directed the Bureau to study and provide a report to Congress on “the use of agreements providing for arbitration of any future dispute between covered persons and consumers in connection with the offering or providing of consumer financial products or services.” Pursuant to section 1028(a), the Bureau conducted a study of the use of pre-dispute arbitration agreements in contracts for consumer financial products and services and, in March 2015, delivered to Congress its *Arbitration Study: Report to Congress, Pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act § 1028(a)*.<sup>136</sup>

This Part describes the process the Bureau used to carry out the Study and summarizes the Study’s results.

#### *A. April 2012 Request for Information*

At the outset of its work, on April 27, 2012, the Bureau published a Request for Information (RFI) in the *Federal Register* concerning the Study.<sup>137</sup> The RFI sought public comment on the appropriate scope, methods, and data sources for the Study. Specifically, the Bureau asked for input on how it should address three topics: (1) the prevalence of arbitration agreements in contracts for consumer financial products and services; (2) arbitration claims

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<sup>135</sup> In a recent amicus curiae filing, the U.S. Chamber of Commerce argued that “[c]lass arbitration is a worst-of-all-worlds Frankenstein’s monster: It combines the enormous stakes, formality and expense of litigation that are inimical to bilateral arbitration with exceedingly limited judicial review of the arbitrators’ decisions.” Br. of the Chamber of Commerce of the United States of America as Amicus Curiae in Support of Pl.-Appellants at 9, *Marriott Ownership Resorts, Inc. v. Sterman*, No. 15-10627 (11th Cir. Apr. 1, 2015).

<sup>136</sup> Study, *supra* note 2.

<sup>137</sup> Arbitration Study RFI, *supra* note 2.

involving consumers and companies; and (3) other impacts of arbitration agreements on consumers and companies, such as impacts on the incidence of consumer claims against companies, prices of consumer financial products and services, and the development of legal precedent. The Bureau also requested comment on whether and how the Study should address additional topics. In response to the RFI, the Bureau received and reviewed 60 comment letters. The Bureau also met with numerous commenters and other stakeholders to obtain additional feedback on the RFI.

The feedback received through this process substantially affected the scope of the study the Bureau undertook. For example, several industry trade association commenters suggested that the Bureau study not only consumer financial arbitration but also consumer financial litigation in court. The Study incorporates an extensive analysis of consumer financial litigation – both individual litigation and class actions.<sup>138</sup> Commenters also advised the Bureau to compare the relationship between public enforcement actions and private class actions. The Study included extensive research into this subject, including an analysis of public enforcement actions filed over a period of five years by State and Federal regulators and the relationship, or lack of relationship of these cases to private class litigation.<sup>139</sup> Commenters also recommended that the Bureau study whether arbitration reduces companies’ dispute resolution costs and the relationship between any such cost savings and the cost and availability of consumer financial products and services. To investigate this, the Study includes a “difference-in-differences” regression analysis using a representative random sample of the Bureau’s Credit Card Database

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<sup>138</sup> See generally Study, *supra* note 2, sections 6 and 8.

<sup>139</sup> *Id.*, section 9.

(CCDB), to look for price impacts associated with changes relating to arbitration agreements for credit cards, an analysis that had never before been conducted.<sup>140</sup>

In some cases, commenters to the RFI encouraged the Bureau to study a topic, but the Bureau did not do so because certain effects did not appear measurable. For example, some commenters suggested that the Bureau study the effect of arbitration agreements on the development, interpretation, and application of the rule of law. The Bureau did not identify a robust data set that would allow empirical analysis of this phenomenon. Nonetheless, legal scholars have subsequently attempted to quantify this effect in relation to consumer law.<sup>141</sup>

#### *B. December 2013 Preliminary Report*

In December 2013, the Bureau issued a 168-page report summarizing its preliminary results on a number of topics (Preliminary Results).<sup>142</sup> One purpose of releasing the Preliminary Results was to solicit additional input from the public about the Bureau's work on the Study to date. In the Preliminary Results, the Bureau also included a section that set out a detailed roadmap of the Bureau's plans for future work, including the Bureau's plans to address topics that had been suggested in response to the RFI.<sup>143</sup>

In February 2014, the Bureau invited stakeholders for in-person discussions with staff regarding the Preliminary Results, as well as the Bureau's future work plan. Several external

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<sup>140</sup> *Id.*, section 10 at 7-14.

<sup>141</sup> See Myriam Gilles, *The End of Doctrine: Private Arbitration, Public Law and the Anti-Lawsuit Movement*, (Benjamin N. Cardozo Sch. of L. Faculty Research Paper No. 436, 2014), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2488575](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2488575) (analyzing cases under “counterfactual scenarios” as to “what doctrinal developments in antitrust and consumer law . . . would not have occurred over the past decade if arbitration clauses had been deployed to the full extent now authorized by the Supreme Court”).

<sup>142</sup> Preliminary Results, *supra* note 2.

<sup>143</sup> *Id.* at 129-31.

stakeholders, including industry associations and consumer groups, took that opportunity and provided additional input regarding the Study.

*C. Comments on Survey Design Pursuant to the Paperwork Reduction Act*

In the Preliminary Results, the Bureau indicated that it planned to conduct a survey of consumers. The purpose of the survey was to assess consumer awareness of arbitration agreements, as well as consumer perceptions of, and expectations about, dispute resolution with respect to disputes between consumers and financial services providers.<sup>144</sup> Pursuant to the Paperwork Reduction Act, the Bureau also undertook an extensive public outreach and engagement process in connection with its consumer survey (the results of which are published in Section 3 of the Study). The Bureau obtained approval for the consumer survey from the Office of Management and Budget (OMB), and each version of the materials submitted to OMB during this process included draft versions of the survey instrument.<sup>145</sup> In June 2013, the Bureau published a *Federal Register* notice that solicited public comment on its proposed approach to the survey and received 17 comments in response. In July 2013, the Bureau hosted two roundtable meetings to consult with various stakeholders including industry groups, banking trade associations, and consumer advocates. After considering the comments and conducting two focus groups to help refine the survey, but before undertaking the survey, the Bureau published a second *Federal Register* notice in May 2014, which generated an additional seven comments.

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<sup>144</sup> *Id.* at 129.

<sup>145</sup> The survey was assigned OMB control number 3170-0046.

#### *D. The March 2015 Arbitration Study*

The Bureau ultimately focused on nine empirical topics in the Study:

1. The prevalence of arbitration agreements in contracts for consumer financial products and services and their main features (Section 2 of the Study);
2. Consumers' understanding of dispute resolution systems, including arbitration and the extent to which dispute resolution clauses affect consumer's purchasing decisions (Section 3 of the Study);
3. How arbitration procedures differ from procedures in court (Section 4 of the Study);
4. The volume of individual consumer financial arbitrations, the types of claims, and how they are resolved (Section 5 of the Study);
5. The volume of individual and class consumer financial litigation, the types of claims, and how they are resolved (Section 6 of the Study);
6. The extent to which consumers sue companies in small claims court with respect to disputes involving consumer financial services (Section 7 of the Study);
7. The size, terms, and beneficiaries of consumer financial class action settlements (Section 8 of the Study);
8. The relationship between public enforcement and consumer financial class actions (Section 9 of the Study); and
9. The extent to which arbitration agreements lead to lower prices for consumers (Section 10 of the Study).

As described further in each subsection below, the Bureau's research on several of these topics drew in part upon data sources previously unavailable to researchers. For example, the AAA voluntarily provided the Bureau with case files for consumer arbitrations filed from the

beginning of 2010, approximately when the AAA began maintaining electronic records, to the end of 2012. Compared to data sets previously available to researchers, the AAA case files covered a much longer period and were not limited to case files for cases resulting in an award. Using this data set, the Bureau conducted the first analysis of arbitration frequency and outcomes specific to consumer financial products and services.<sup>146</sup> Similarly, the Bureau submitted orders to financial service providers in the checking account and payday loan markets, pursuant to its market monitoring authority under Dodd-Frank section 1022(c)(4), to obtain a sample set of agreements of those institutions. Using these agreements, among others gathered from other sources, the Bureau conducted the most comprehensive analysis to date of the arbitration content of contracts for consumer financial products and services.<sup>147</sup>

The results of the Study also broke new ground because the Study, compared to prior research, generally considered larger data sets than had been reviewed by other researchers while also narrowing its analysis to consumer financial products and services. In total, the Study included the review of over 850 agreements for certain consumer financial products and services; 1,800 consumer financial services arbitrations filed over a three-year period; a random sample of the nearly 3,500 individual consumer finance cases identified as having been filed over a period of three years; and all of the 562 consumer finance class actions identified in Federal and selected State courts of the same time period. The study also included over 40,000 small claims court filings over the course of a single year. The Bureau supplemented this research by assembling and analyzing all of the more than 400 consumer financial class action settlements in

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<sup>146</sup> Study, *supra* note 2, section 5 at 19-68.

<sup>147</sup> See generally *id.*, section 2.

Federal courts over a five-year period and more than 1,100 State and Federal public enforcement actions in the consumer finance area.<sup>148</sup> The Study also includes the findings of the Bureau’s survey of over 1,000 credit card consumers, focused on exploring their knowledge and understanding of arbitration and other dispute resolution mechanisms. The sections below describe in detail the process the Bureau followed in undertaking each section of the Study and summarize the main results of each section.<sup>149</sup>

*Prevalence and Features of Arbitration Agreements (Section 2 of Study)*

Section 2 of the Study addresses two central issues relating to the use of arbitration agreements: how frequently such agreements appear in contracts for consumer financial products and services and what features such agreements contain. Among other findings, the Study determined that arbitration agreements are commonly used in contracts for consumer financial products and services and that the AAA is the primary administrator of consumer financial arbitrations.

To conduct this analysis, the Bureau reviewed contracts for six product markets: credit cards, checking accounts, general purpose reloadable (GPR) prepaid cards, payday loans, private student loans, and mobile wireless contracts governing third-party billing services.<sup>150</sup> Previous

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<sup>148</sup> Since the publication of the Study, the Bureau determined that 41 FDIC enforcement actions were inadvertently omitted from the results published in Section 9 of the Study. The corrected total number of enforcement actions reviewed in Section 9 was 1,191. Other figures, including the identification of public enforcement cases with overlapping private actions, were not affected by this omission.

<sup>149</sup> Overall, the markets assessed in the Study represent lending money (*e.g.*, small-dollar open-ended credit, small-dollar closed-ended credit, large-dollar unsecured credit, large-dollar secured credit), storing money (*i.e.*, consumer deposits), and moving or exchanging money. The Study also included debt relief and debt collection disputes arising from these consumer financial products and services. Study, *supra* note 2, section 1 at 7-9. While credit scoring and credit monitoring were not included in these product categories, settlements regarding such products were included in the Study’s analysis of class action settlements, as well as the Study’s analysis of the overlap between public enforcement actions and private class action litigation.

<sup>150</sup> Study, *supra* note 2, section 2 at 3.

studies that analyzed the prevalence and features of arbitration agreements in contracts for consumer financial products and services either relied on small samples or limited their study to one market.<sup>151</sup> As a result, the Bureau's inquiry in Section 2 of the Study represents the most comprehensive analysis to date of the arbitration content of contracts for consumer financial products and services.

The Bureau's sample of credit card contracts consisted of contracts filed by 423 issuers with the Bureau as required by the Credit Card Accountability, Responsibility and Disclosure Act (CARD Act) as implemented by Regulation Z.<sup>152</sup> Taken together, these contracts covered nearly all consumers in the credit card market. For deposit accounts, the Bureau identified the 100 largest banks and the 50 largest credit unions, and constructed a random sample of 150 small and mid-size banks. The Bureau obtained the deposit account agreements for these institutions by downloading them from the institutions' websites and through orders sent to institutions using the Bureau's market monitoring authority.

For prepaid cards, the Bureau's sample included agreements from two sources. The Bureau gathered agreements for 52 GPR prepaid cards that were listed on the websites of two major card networks and a website that provided consolidated card information as of August 2013. The Bureau also obtained agreements from GPR prepaid card providers that had been included in several recent studies of the terms of GPR prepaid cards and that continued to be available as of August 2014.<sup>153</sup> For the storefront payday loan market, the Bureau again used its market monitoring authority to obtain a sample of 80 payday loan contracts from storefront

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<sup>151</sup> *Id.*, section 2 at 4-6.

<sup>152</sup> 12 CFR 1026.58(c) (requiring credit card issuers to submit their currently-offered credit card agreements to the Bureau to be posted on the Bureau's website).

<sup>153</sup> Study, *supra* note 2, section 2 at 18.



payday lenders in California, Texas, and Florida.<sup>154</sup> For the private student loan market, the Bureau sampled seven private student loan contracts plus the form contract used by 250 credit unions that use a leading credit union service organization.<sup>155</sup> For the mobile wireless market, the Bureau reviewed the wireless contracts of the eight largest facilities-based providers of mobile wireless services<sup>156</sup> which also govern third-party billing services.<sup>157</sup>

The analysis of the agreements that the Bureau collected found that tens of millions of consumers use consumer financial products or services that are subject to arbitration agreements, and that, in some markets such as checking accounts and credit cards, large providers are more likely to have the agreements than small providers.<sup>158</sup> In the credit card market, the Study found that small bank issuers were less likely to include arbitration agreements than large bank issuers.<sup>159</sup> Likewise, only 3.3 percent of credit unions in the credit card sample used arbitration agreements.<sup>160</sup> As a result, while 15.8 percent of credit card issuers included such agreements in their contracts, 53 percent of credit card loans outstanding were subject to such agreements.<sup>161</sup>

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<sup>154</sup> *Id.*, section 2 at 21-22. This data was supplemented with a smaller, non-random sample of payday loan contracts from tribal, offshore, and other online payday lenders, which is reported in Appendix C of the Study.

<sup>155</sup> *Id.*, section 2 at 24.

<sup>156</sup> Facilities-based mobile wireless service providers are wireless providers that “offer mobile voice, messaging, and/or data services using their own network facilities,” in contrast to providers that purchase mobile services wholesale from facilities-based providers and resell the services to consumers, among other types of providers. Federal Communications Commission, *Annual Report and Analysis of Competitive Market Conditions with Respect to Mobile Wireless*, at 37-39 (2013), available at <https://www.fcc.gov/document/16th-mobile-competition-report>.

<sup>157</sup> Study, *supra* note 2, section 2 at 25-26. In mobile wireless third-party billing, a mobile wireless provider authorizes third parties to charge consumers, on their wireless bill, for services provided by the third parties. Because mobile wireless third-party billing involves the extension of credit to, and processing of payments for, consumers in connection with goods and services that the provider does not directly sell and that consumers do not purchase from the provider, the provision of mobile wireless third-party billing is a “consumer financial product or service” under the Dodd-Frank Act. 12 U.S.C. 5481(6), 15(A)(i) & (vii).

<sup>158</sup> Study, *supra* note 2, section 1 at 9.

<sup>159</sup> *Id.*, section 2 at 10.

<sup>160</sup> *Id.*

<sup>161</sup> *Id.* As the Study notes, the *Ross* settlement – a 2009 settlement in which four of the ten largest credit card issuers agreed to remove their arbitration agreements – likely impacts these results. Had the settling defendants in *Ross*

In the checking account market, the Study again found that larger banks tended to include arbitration agreements in their consumer checking contracts (45.6 percent of the largest 103 banks, representing 58.8 percent of insured deposits).<sup>162</sup> In contrast, only 7.1 percent of small- and mid-sized banks and 8.2 percent of credit unions used arbitration agreements.<sup>163</sup> In the prepaid card and payday loan markets, the Study found that the substantial majority of contracts – 92.3 percent of GPR prepaid card contracts and 83.7 percent of the storefront payday loan contracts – included such agreements.<sup>164</sup> In the private student loan and mobile wireless markets, the Study found that most of the large companies – 85.7 percent of the private student loan contracts, and 87.5 percent of the mobile wireless contracts – used arbitration agreements.<sup>165</sup>

In addition to examining the prevalence of arbitration agreements, Section 2 of the Study reviewed 13 features sometimes included in such agreements.<sup>166</sup> One feature the Bureau studied was which entity or entities were designated by the contract to administer the arbitration. The Study found that the AAA was the predominant arbitration administrator for all the consumer financial products the Bureau examined in the Study. The contracts studied specified the AAA as at least one of the possible arbitration administrators in 98.5 percent of the credit card contracts with arbitration agreements; 98.9 percent of the checking account contracts with arbitration agreements; 100 percent of the GPR prepaid card contracts with arbitration

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continued to use arbitration agreements, 93.6 percent of credit card loans outstanding would be subject to arbitration agreements. *Id.* section 2 at 11.

<sup>162</sup> *Id.*, section 2 at 14.

<sup>163</sup> *Id.*

<sup>164</sup> *Id.*, section 2 at 19, 22.

<sup>165</sup> *Id.*, section 2 at 24, 26.

<sup>166</sup> *Id.*, section 2 at 30.

agreements; 85.5 percent of the storefront payday loan contracts with arbitration agreements; and 66.7 percent of private student loan contracts with arbitration agreements.<sup>167</sup> The contracts specified the AAA as the sole option in 17.9 percent of the credit card contracts with arbitration agreements; 44.6 percent of the checking account contracts with arbitration agreements; 63.0 percent to 72.7 percent of the GPR prepaid card contracts with arbitration agreements; 27.4 percent of the payday loan contracts with arbitration agreements; and one of the private student loan contracts the Bureau reviewed.<sup>168</sup>

In contrast, JAMS is specified in relatively fewer arbitration agreements. The Study found that the contracts studied specified JAMS as at least one of the possible arbitration administrators in 40.9 percent of the credit card contracts with arbitration agreements; 34.4 percent of the checking account contracts with arbitration agreements; 52.9 percent of the GPR prepaid card contracts with arbitration agreements; 59.2 percent of the storefront payday loan contracts with arbitration agreements; and 66.7 percent of private student loan contracts with arbitration agreements. JAMS was specified as the sole option in 1.5 percent of the credit card contracts with arbitration agreements (one contract); 1.6 percent of the checking account contracts with arbitration agreements (one contract); 63.0 percent to 72.7 percent of the GPR prepaid card contracts with arbitration agreements; and none of the payday loan or private student loan contracts the Bureau reviewed.<sup>169</sup>

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<sup>167</sup> *Id.*, section 2 at 38.

<sup>168</sup> *Id.*, section 2 at 36. The prevalence of GPR prepaid cards with arbitration agreements specifying AAA as the sole option is presented as a range because two GPR prepaid firms studied each used two different form cardholder agreements, with different agreements pertaining to different features. Because of this it was unclear precisely how much of the prepaid market share represented by each provider was covered by a particular cardholder agreement. As such, for GPR prepaid cards, prevalence by market share is presented as a range rather than a single figure.

<sup>169</sup> *Id.*

The Bureau’s analysis also found, among other things, that nearly all the arbitration agreements studied included provisions stating that arbitration may not proceed on a class basis. Across each product market, 85 percent to 100 percent of the contracts with arbitration agreements – covering over 99 percent of market share subject to arbitration in the six product markets studied – included such no-class-arbitration provisions.<sup>170</sup> Most of the arbitration agreements that included such provisions also contained an “anti-severability” provision stating that, if the no-class-arbitration provision were to be held unenforceable, the entire arbitration agreement would become unenforceable as a result.<sup>171</sup>

The Study found that most of the arbitration agreements contained a small claims court “carve-out,” permitting either the consumer or both parties to file suit in small claims court.<sup>172</sup> The Study similarly explored the number of arbitration provisions that allowed consumers to “opt out” or otherwise reject an arbitration agreement. To exercise the opt-out right, consumers must follow stated procedures, which usually requires all authorized users on an account to physically mail a signed written document to the issuer (electronic submission is permitted only rarely), within a stated time limit. With the exception of storefront payday loans and private student loans, the substantial majority of arbitration agreements in each market studied generally did not include opt-out provisions.<sup>173</sup>

The Study analyzed three different types of cost provisions: provisions addressing the initial payment of arbitration fees; provisions that addressed the reallocation of arbitration fees in

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<sup>170</sup> *Id.*, section 2 at 44-47.

<sup>171</sup> *Id.*, section 2 at 46-47.

<sup>172</sup> *Id.*, section 2 at 33-34.

<sup>173</sup> *Id.*, section 2 at 31-32.

an award; and provisions addressing the award of attorney's fees.<sup>174</sup> Most arbitration agreements reviewed in the Study contained provisions that had the effect of capping consumers' up front arbitration costs at or below the AAA's maximum consumer fee thresholds. These same arbitration agreements took noticeably different approaches to the reallocation of arbitration fees in the arbitrator's award (approximately one-fifth of the arbitration agreements in credit card, checking account, and storefront payday loan markets permitted shifting company fees to consumers).<sup>175</sup> The Study also found only negligible market shares of relevant markets directed or permitted arbitrators to award attorney's fees to prevailing companies.<sup>176</sup> A significant share of arbitration agreements across almost all markets did not address attorney's fees.<sup>177</sup>

The Study found that many arbitration agreements permit the arbitrator to reallocate arbitration fees from one party to the other. About one-third of credit card arbitration agreements, one-fourth of checking account arbitration agreements, and half of payday loan arbitration agreements expressly permitted the arbitrator to shift arbitration costs to the consumer.<sup>178</sup> However, as the Study pointed out, the AAA's consumer arbitration fee schedule, which became effective March 1, 2013, restricts such reallocation.<sup>179</sup> With respect to another type of provision that affects consumers' costs in arbitration – where the arbitration must take place – the Study noted that most, although not all, arbitration agreements contained provisions

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<sup>174</sup> *Id.*, section 2 at 58. Many contracts – particularly checking account contracts – included general provisions about the allocation of costs and expenses arising out of disputes that were *not* specific to arbitration costs. Indeed, such provisions were commonly included in contracts without arbitration agreements as well. While such provisions could be relevant to the allocation of expenses in an arbitration proceeding, the Study did not address such provisions because they were not specific to arbitration agreements.

<sup>175</sup> *Id.*, section 2 at 62-66.

<sup>176</sup> *Id.*, section 2 at 67.

<sup>177</sup> *Id.*, section 2 at 66-76. As described *supra* when the arbitration agreement did not address the issue, the arbitrator is able to award attorney's fees when permitted elsewhere in the agreement or by applicable law.

<sup>178</sup> *Id.*, section 2 at 62-66.

<sup>179</sup> *Id.*, section 2 at 61-62.

requiring or permitting hearings to take place in locations close to the consumer's place of residence.<sup>180</sup>

Further, most of the arbitration agreements the Bureau studied contained disclosures describing the differences between arbitration and litigation in court. Most agreements disclosed expressly that the consumer would not have a right to a jury trial, and most disclosed expressly that the consumer could not be a party to a class action in court.<sup>181</sup> Depending on the product market, between one-quarter and two-thirds of the agreements disclosed four key differences between arbitration and litigation in court: no jury trial is available in arbitration; parties cannot participate in class actions in court; discovery is typically more limited in arbitration; and appeal rights are more limited in arbitration.<sup>182</sup> The Study found that this language was often capitalized or in boldfaced type.<sup>183</sup>

The Study also examined whether arbitration agreements limited recovery of damages – including punitive or consequential damages – or specified the time period in which a claim had to be brought. The Study determined that most agreements in the credit card, payday loan, and private student loan markets did not include damages limitations. However, the opposite was true of agreements in checking account contracts, where more than three-fourths of the market included damages limitations; prepaid card contracts, almost all of which included such limitations; and mobile wireless contracts, all of which included such limitations. A review of

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<sup>180</sup> *Id.*, section 2 at 53.

<sup>181</sup> *Id.*, section 2 at 72.

<sup>182</sup> *Id.*, section 2 at 72-79.

<sup>183</sup> *Id.*, section 2 at 72 & n.144.

consumer agreements *without* arbitration agreements revealed a similar pattern, albeit with damages limitations being somewhat less common.<sup>184</sup>

The Study also found that a minority of arbitration agreements in two markets set time limits other than the statute of limitations that would apply in a court proceeding for consumers to file claims in arbitration. Specifically, these types of provisions appeared in 28.4 percent and 15.8 percent of the checking account and mobile wireless agreements by market share, respectively.<sup>185</sup> Again, a review of consumer agreements without arbitration agreements showed that 10.7 percent of checking account agreements imposed a one-year time limit for consumer claims.<sup>186</sup> No storefront payday loan, private student loan, or mobile wireless contracts in the sample without arbitration agreements had such time limits.<sup>187</sup>

The Study assessed the extent to which arbitration agreements included contingent minimum recovery provisions, which provide that consumers would receive a specified minimum recovery if an arbitrator awards the consumer more than the amount of the company's last settlement offer. The Study found that such provisions were uncommon; they appeared in three out of the six private student loan agreements the Bureau reviewed, but, in markets other than student loans, they appeared in 28.6 percent or less of the agreements the Bureau studied.<sup>188</sup>

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<sup>184</sup> *Id.*, section 2 at 49. More than one-third (35 percent) of large bank checking account contracts without arbitration agreements included either a consequential damages waiver or a consequential damages waiver together with a punitive damages waiver. Similarly a third of prepaid card contracts without arbitration agreements included a consequential damages waiver, a punitive damages waiver, or both. The only mobile wireless contract without an arbitration agreement limited any damages recovery to the amount of the subscriber's bill. *Id.*

<sup>185</sup> *Id.*, section 2 at 50.

<sup>186</sup> *Id.*, section 2 at 51.

<sup>187</sup> *Id.*

<sup>188</sup> *Id.*, section 2 at 70-71 (albeit covering 43.0 percent of the storefront payday loan market subject to arbitration agreements and 68.4 percent of the mobile wireless market subject to arbitration agreements).

*Consumer Understanding of Dispute Resolution Systems, Including Arbitration (Section 3 of Study)*

Section 3 of the Study presented the results of the Bureau's telephone survey of a nationally representative sample of credit card holders.<sup>189</sup> The survey examined two main topics: (1) the extent to which dispute resolution clauses affected consumer's decisions to acquire credit cards; and (2) consumers' awareness, understanding, and knowledge of their rights in disputes against their credit card issuers. In late 2014, the Bureau's contractor completed telephone surveys with 1,007 respondents who had credit cards.<sup>190</sup>

The consumer survey found that when presented with a hypothetical situation in which their credit card issuer charged them a fee they knew to be wrongly assessed and in which they exhausted efforts to obtain relief from the company through customer service, only 2.1 percent of respondents stated that they would seek legal advice or consider legal proceedings.<sup>191</sup> Almost the same proportion of respondents stated that they would simply pay for the improperly assessed fee (1.7 percent).<sup>192</sup> A majority of respondents (57.2 percent) said that they would cancel their cards.<sup>193</sup>

Respondents also reported that factors relating to dispute resolution – such as the presence of an arbitration agreement – played little to no role when they were choosing a credit

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<sup>189</sup> The Bureau focused its survey on credit cards because credit cards offer strong market penetration with consumers across the nation. Further, because major credit card issuers are required to file their agreements with the Bureau (12 CFR 1026.58(c)), limiting the survey to credit cards permitted the Bureau to verify the accuracy of many of the respondents' default assumptions about their dispute resolution rights by examining the actual credit card agreements to which the consumers were subject to at the time of the survey. *Id.*, section 3 at 2.

<sup>190</sup> Based on the size of the Bureau's sample, its results were representative of the national population, with a sampling error of plus or minus 3.1 percent, though the sampling error is larger in connection with sample sets of fewer than the 1,007 respondents. *Id.*, section 3 at 10.

<sup>191</sup> *Id.*, section 3 at 18.

<sup>192</sup> *Id.*

<sup>193</sup> *Id.*



card. When asked an open-ended question about all the factors that affected their decision to obtain the credit card that they use most often for personal use, no respondents volunteered an answer that referenced dispute resolution procedures.<sup>194</sup> When presented with a list of nine features of credit cards – features such as interest rates, customer service, rewards, and dispute resolution procedures – and asked to identify those features that factored into their decision, respondents identified dispute resolution procedures as being relevant less often than any other option.<sup>195</sup>

As for consumers’ knowledge and default assumptions as to the means by which disputes between consumers and financial service providers can be resolved, the survey found that consumers generally lack awareness regarding the effects of arbitration agreements. Of the survey’s 1,007 respondents, 570 respondents were able to identify their credit card issuer with sufficient specificity to enable the Bureau to find the issuer’s standard credit card agreement and thus to compare the respondents’ beliefs with respect to the terms of their agreements with the agreements’ actual terms.<sup>196</sup> Among the respondents whose credit card contracts did not contain an arbitration agreement, when asked if they could sue their credit card issuer in court, 43.7 percent answered “Yes,” 7.7 percent answered “No,” and 47.8 percent answered “Don’t Know.”<sup>197</sup> At the same time, among the respondents whose credit card agreements *did* contain arbitration requirements, 38.6 percent of respondents answered “Yes,” while 6.8 percent

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<sup>194</sup> *Id.*, section 3 at 15.

<sup>195</sup> *Id.*

<sup>196</sup> *Id.*, section 3 at 18.

<sup>197</sup> *Id.*, section 3 at 18-20.

answered “No,” and 54.4 percent answered “Don’t Know.”<sup>198</sup> Even the 6.8 percent of respondents who stated that they could not sue their credit card issuers in court may not have had knowledge of the arbitration agreement: as noted above, a similar proportion of respondents *without* an arbitration agreement in their contract – 7.7 percent compared to 6.8 percent – reported that they could not sue their issuers in court.<sup>199</sup> When asked if they could participate in class action lawsuits against their credit card issuer, more than half of the respondents whose contracts had pre-dispute arbitration agreements thought they could participate (56.7 percent).<sup>200</sup>

Respondents were also generally unaware of any opt-out opportunities afforded by their issuer. Only one respondent whose current credit card contract permitted opting out of the arbitration agreement recalled being offered such an opportunity.<sup>201</sup>

#### *Comparison of Procedures in Arbitration and in Court (Section 4 of Study)*

While the Study generally limited its scope to empirical analysis of dispute resolution, Section 4 of the Study compared the procedural rules that apply in court and in arbitration. Particularly given changes to the AAA consumer fee schedule that took effect March 1, 2013, the procedural rules are relevant to understanding the context from which the Study’s empirical findings arise.

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<sup>198</sup> *Id.* These respondents were asked additional questions to account for the possibility that respondents who answered “Yes” meant suing their issuers in small claims court; that they meant they could bring a lawsuit even though they are subject to an arbitration agreement; or that they had previously “opted-out” of their arbitration agreements with their issuers. With those caveats in mind and after accounting for demographic weighting, the Study found that the consumers whose credit cards included arbitration requirements were wrong at least 79.8 percent of the time. *Id.*, section 3 at 20-21.

<sup>199</sup> *Id.*, section 3 at 18-20.

<sup>200</sup> *Id.*, section 3 at 25.

<sup>201</sup> *Id.*, section 3 at 21 & 21 n.44. Eighteen other respondents recalled being offered an opportunity to opt out of their arbitration requirements. But, for the respondents whose credit card agreements the Bureau could identify, none of their 2013 agreements actually contained opt-out provisions. In fact, four of the agreements did not even contain pre-dispute arbitration provisions.

The Study's procedural overview described court litigation as reflected in the Federal Rules and, as an example of a small claims court process, the Philadelphia Municipal Court Rules of Civil Practice. It compared those procedures to arbitration procedures as set out in the rules governing consumer arbitrations administered by the two leading arbitration administrators in the United States, the AAA and JAMS. The Study compared arbitration and court procedures according to eleven factors: the process for filing a claim, fees, legal representation, the process for selecting the decision maker, discovery, dispositive motions, class proceedings, privacy and confidentiality, hearings, judgments and awards, and appeals.

*Filing a Claim and Fees.* The Study described the processes for filing a claim in court and in arbitration. With respect to fees, the Study noted that the fee for filing a case in Federal court is \$350 plus a \$50 administrative fee – paid by the party filing suit, regardless of the amount being sought – and the fee for a small claims filing in Philadelphia Municipal Court ranges from \$63 to \$112.38.<sup>202</sup> In arbitration, under the AAA consumer fee schedule that took effect March 1, 2013, the consumer pays a \$200 administrative fee, regardless of the amount of the claim and regardless of the party that filed the claim; in JAMS arbitrations, when a consumer initiates arbitration against the company, the consumer is required to pay a \$250 fee.<sup>203</sup> Prior to March 1, 2013, arbitrators in AAA consumer arbitrations had discretion to reallocate fees in the ultimate award. After March 1, 2013, arbitrators can only reallocate arbitration fees in the award

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<sup>202</sup> *Id.*, section 4 at 10. As the Study noted, a federal statute permits indigent plaintiffs filing in Federal court to seek to have the court waive the required filing fees. *Id.* (citing 28 U.S.C. 1915(a)).

<sup>203</sup> *Id.*, section 4 at 11-12.

if required by applicable law or if the claim “was filed for purposes of harassment or is patently frivolous.”<sup>204</sup>

Parties in court generally bear their own attorney’s fees, unless a statute or contract provision provides otherwise or a party is shown to have acted in bad faith. However, under several consumer protection statutes, providers may be liable for attorney’s fees.<sup>205</sup> Under the AAA’s Consumer Rules, “[t]he arbitrator may grant any remedy, relief, or outcome that the parties could have received in court, including awards of attorney’s fees and costs, in accordance with the law(s) that applies to the case.”<sup>206</sup>

*Representation.* The Study noted that in most courts, individuals can either represent themselves or hire a lawyer as their representative.<sup>207</sup> In arbitration, the rules are more flexible than in many courts about the identity of any party representative. For example, the AAA Consumer Rules permit a party to be represented “by counsel or other authorized representative, unless such choice is prohibited by applicable law.”<sup>208</sup> Some states, however, prohibit non-attorneys to represent parties in arbitration.<sup>209</sup>

*Selecting the Decisionmaker.* The Study noted that court rules generally do not permit parties to reject the judge assigned to hear their case.<sup>210</sup> In arbitration, if the parties agree on the individual they want to serve as arbitrator, they can choose that person to decide their dispute; if

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<sup>204</sup> *Id.*, section 4 at 11-12.

<sup>205</sup> *See, e.g.*, 15 U.S.C. 1640(a)(3) (TILA).

<sup>206</sup> Study, *supra* note 2, section 4 at 12.

<sup>207</sup> *Id.*, section 4 at 13.

<sup>208</sup> *Id.*, section 4 at 13-14.

<sup>209</sup> *Id.*, section 4 at 14.

<sup>210</sup> *Id.*

the parties cannot agree on the arbitrator, the arbitrator is selected following the procedure specified in their contract or in the governing arbitration rules.<sup>211</sup>

*Discovery.* The Study stated that the Federal Rules provide a variety of means by which a party can discover evidence in the possession of the opposing party or a third party, while the right to discovery in arbitration is more limited.<sup>212</sup>

*Dispositive Motions.* The Study noted that the Federal Rules provide for a variety of motions by which a party can seek to dispose of the case, either in whole or in part, while arbitration rules typically do not expressly authorize dispositive motions.<sup>213</sup>

*Class Proceedings.* The Study described the procedural rules for class actions under Federal Rule 23 and noted that the Bureau was unaware of a class action procedure for small claims court.<sup>214</sup> The Study further noted that the AAA and JAMS have adopted rules, derived from Rule 23, for administering arbitrations on a class basis.<sup>215</sup>

*Privacy and Confidentiality.* The Study stated that court litigation (including small claims court) is a public process, with proceedings conducted in public courtrooms and the

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<sup>211</sup> *Id.*, section 4 at 15.

<sup>212</sup> Arbitration rules on discovery give the arbitrator authority to manage discovery “with a view to achieving an efficient and economical resolution of the dispute, while at the same time promoting equality of treatment and safeguarding each party’s opportunity to present its claims and defenses.” AAA Commercial Rules, Rule R-22, *cited in Study, supra* note 2, section 4 at 16-17. Arbitration rules do not allow for broad discovery from third parties, which were not parties to the underlying agreement to arbitrate disputes. Section 7 of the FAA, however, grants arbitrators the power to subpoena witnesses to appear before them (and bring documents). 9 U.S.C. 7. Appellate courts are split on whether Section 7 of the FAA authorizes subpoenas for discovery *before* an arbitral hearing. Study, *supra* note 2, section 4 at 17 n.78. As described above, many arbitration agreements highlighted the difference in discovery practices in arbitration proceedings as compared to litigation. *See id.*

<sup>213</sup> Study, *supra* note 2, section 4 at 18.

<sup>214</sup> *Id.*, section 4 at 18-20.

<sup>215</sup> *Id.*, section 4 at 20.

record generally available for public review; by comparison, arbitration is a private although not necessarily a confidential process.<sup>216</sup>

*Hearings.* The Study stated that if a case in court does not settle before trial or get resolved on a dispositive motion, it will proceed to trial in the court in which the case was filed. A jury may be available for these claims. On the other hand, if an arbitration filing does not settle, the arbitrator can resolve the parties' dispute based on the parties' submission of documents alone, by a telephone hearing, or by an in-person hearing.<sup>217</sup>

*Judgments/Awards.* The Study further noted that the outcome of a case in court is reflected in a judgment, which the prevailing party can enforce through various means of post-judgment relief, and that the outcome of a case in arbitration is reflected in an award, which, once turned into a court judgment, can be enforced the same as any other court judgment.<sup>218</sup>

*Appeals.* The Study stated that parties in court can appeal a judgment against them to an appellate court; by comparison, parties can challenge arbitration awards in court only on the more limited grounds set out in the FAA.<sup>219</sup>

#### *Consumer Financial Arbitrations: Frequency and Outcomes (Section 5 of Study)*

Section 5 of the Study analyzed arbitrations of consumer finance disputes between

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<sup>216</sup> *Id.*, section 4 at 21-22. A small minority of arbitration agreements, primarily in the checking account market, included provisions requiring that the proceedings remain confidential. *Id.*, section 2 at 51-53.

<sup>217</sup> *Id.*, section 4 at 22-24.

<sup>218</sup> *Id.*, section 4 at 24.

<sup>219</sup> Courts may vacate arbitration awards under the FAA

(1) where the award was procured by corruption, fraud, or undue means; (2) where there was evident partiality or corruption in the arbitrators, or either of them; (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or (4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

9 U.S.C. 10. *Cf. supra* notes 98-106 and accompanying text (identifying the narrow grounds upon which a court may determine an arbitration agreement to be unenforceable).

consumers and consumer financial services providers. This section tallied the frequency of such arbitrations, including the number of claims brought and a classification of which claims were brought. It also examined outcomes, including how cases were resolved and how consumers and companies fared in the relatively small share of cases that an arbitrator resolved on the merits. The Study performed this analysis for arbitrations concerning credit cards, checking accounts, payday loans, GPR prepaid cards, private student loans, and auto purchase loans. To conduct this analysis, the Bureau used electronic case files from the AAA.<sup>220</sup> Pursuant to a non-disclosure agreement, the AAA voluntarily provided the Bureau its electronic case records for consumer disputes filed during the years 2010, 2011, and 2012.<sup>221</sup> Because the AAA provided the Bureau with case records for all disputes filed in arbitration during this period, Section 5 of the Study provides a reasonably complete picture of the frequency and typology of claims that consumers and companies file in arbitration.<sup>222</sup>

The Study identified about 1,847 filings in total – about 616 per year – with the AAA for the six product markets combined.<sup>223</sup> According to the standard AAA claim forms, about 411 arbitrations per year were designated as having been filed by consumers alone; the remaining filings were designated as having been filed by companies or filed as mutual submission by both

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<sup>220</sup> See Christopher R. Drahozal & Samantha Zyontz, *An Empirical Study of AAA Consumer Arbitrations*, 25 Ohio St. J. on Disp. Res. 843, 845 (2010) (reviewing 301 AAA consumer disputes covering a nine-month period in 2007, but limiting analysis to disputes actually resolved by arbitrators); Drahozal & Zyontz, *Creditor Claims in Arbitration and in Court*, 7 Hastings Bus. L. J. 77 (2011) (follow-on study that compared debt collection claims by companies in AAA consumer arbitrations with debt collection claims in Federal court and in State court proceedings in jurisdictions in Virginia and Oklahoma).

<sup>221</sup> Study, *supra* note 2, section 5 at 17.

<sup>222</sup> While the analysis does not provide a window into how arbitrations are resolved in other arbitral fora, the AAA is the predominant administrator of consumer financial arbitrations. *Id.*, section 2 at 35.

<sup>223</sup> Study, *supra* note 2, section 5 at 9.

the consumer and the company.<sup>224</sup> Forty percent of the arbitration filings involved a dispute over the amount of debt a consumer allegedly owed to a company, with no additional affirmative claim by either party; in 31 percent of the filings, parties brought affirmative claims with no formal dispute about the amount of debt owed; in another 29 percent of the filings, consumers disputed alleged debts, but also brought affirmative claims against companies.<sup>225</sup>

Although claim amounts varied by product, in disputes involving affirmative claims by consumers, the average amount of such claims was approximately \$27,000 and the median amount of such claims was \$11,500.<sup>226</sup> About 25 disputes a year involved affirmative claims by consumers of \$1,000 or less.<sup>227</sup> In debt disputes, the average disputed debt amount was approximately \$15,700; the median was approximately \$11,000.<sup>228</sup> Across all six product markets, about 25 cases per year involved disputed debts of \$1,000 or less.<sup>229</sup>

Overall, consumers were represented by counsel in 63.2 percent of arbitration cases.<sup>230</sup> The rate of representation, however, varied widely based on the product at issue; in payday and student loan disputes, for example, consumers had counsel in about 95 percent of all cases

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<sup>224</sup> *Id.*, section 1 at 11. Under the AAA policies that applied during the period studied, a company could unilaterally file a debt collection dispute against a consumer in arbitration only if a preceding debt collection litigation had been dismissed or stayed in favor of arbitration. Companies could file disputes mutually with consumers; they could also file counterclaims in dispute filed by consumers against them. *Id.*, section 5 at 27 n.56. As noted in the Study, the Bureau did not attempt to verify whether the representation on the claim forms as to the party filing the case was accurate. For example, in a number of cases that were designated as having been filed by a consumer, the record indicates that the consumer failed to prosecute the action and that the company actually paid the fees and obtained a quasi-default judgment. In other cases, a law firm representing consumers filed a number of student loan disputes but indicated on the checkbox that the action was being filed by the company. *Id.*, section 5 at 19 n.38.

<sup>225</sup> *Id.*, section 1 at 11.

<sup>226</sup> *Id.*, section 5 at 10.

<sup>227</sup> *Id.*

<sup>228</sup> *Id.*

<sup>229</sup> *Id.*

<sup>230</sup> *Id.*, section 5 at 29.



filed.<sup>231</sup>

To analyze the outcomes in arbitration, the Bureau confined its analysis to claims filed in 2010 and 2011 in order to limit the number of cases that were pending at the close of the period for which the Bureau had data. The Bureau's analysis of arbitration outcomes was limited by a number of factors that are unavoidable in any review of dispute resolution.<sup>232</sup> Among other issues, settlement terms were rarely known if the parties settled their disputes. In many cases, even the fact that a settlement occurred was difficult to discern because the parties were not required to notify the AAA of a settlement.<sup>233</sup> Accordingly, an incomplete file could indicate a settlement, on the one hand, or that the proceeding was still in progress but relatively dormant, on the other hand. Because parties settle claims strategically, disputes that *did* reach an arbitrator's decision on the merits were not a representative sample of the disputes that were filed.<sup>234</sup> For example, if parties settled all strong consumer (or company) claims, then consumers (or companies) may appear to do poorly before arbitrators because only weak claims are heard at hearings. As the Study explained, these limitations are inherent in a review of this nature and unavoidable.

With those significant caveats noted, the Study determined that in 32.2 percent of the 1,060 disputes filed during the first two years of the study period (341 disputes) arbitrators resolved the dispute on the merits. In 23.2 percent of the disputes (246 disputes), the record

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<sup>231</sup> *Id.*, section 5 at 28-32.

<sup>232</sup> *Id.*, section 5 at 4-7. As a result, the Bureau was only able to determine a substantive outcome in 341 cases.

<sup>233</sup> *Id.*, section 5 at 6.

<sup>234</sup> *Id.*, section 5 at 7 (noting that it is "quite challenging to attempt to answer even the simple question of how well do consumers (or companies) fare in arbitration"). The Study notes further that the same selection bias concerns apply to disputes filed in litigation and that "[t]hese various considerations warrant caution in drawing conclusions as to how well consumers or companies fare in arbitration as compared to litigation." *Id.* For example, the Study found that the disputes that parties filed in arbitration differ from the disputes filed in litigation. *Id.*

shows that the parties settled. In 34.2 percent of disputes (362 disputes), the available AAA case record ends in a manner that is consistent with settlement – for example, a voluntary dismissal of the action – but the Bureau could not definitively determine that settlement occurred. In the remaining 10.5 percent of disputes (111 disputes), the available AAA case record ends in a manner suggesting the dispute is unlikely to have settled; for example, the AAA may have refused to administer the dispute because it determined that the arbitration agreement at issue was inconsistent with the AAA’s Consumer Due Process Protocol.<sup>235</sup>

As noted above, only a small portion of filed arbitrations reached a decision. The Study identified 341 cases filed in 2010 and 2011 that were resolved by an arbitrator and for which the outcome was ascertainable.<sup>236</sup> Of these 341 cases, 161 disputes involved an arbitrator decision on a consumer’s affirmative claim. Of the cases in which the Bureau could determine the results, the consumer obtained relief on their affirmative claims in 32 disputes (20.3 percent).<sup>237</sup> Consumers obtained debt forbearance in 19.2 percent of the cases in which an arbitrator could have provided some form of debt forbearance (46 cases).<sup>238</sup> The total amount of affirmative relief awarded in all cases was \$172,433 and total debt forbearance was \$189,107.<sup>239</sup> Of the 52 cases filed in 2010 and 2011 that involved consumer affirmative claims of \$1,000 or less, arbitrators resolved 19, granting affirmative relief to consumers in four such cases.<sup>240</sup> With

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<sup>235</sup> *Id.*

<sup>236</sup> *Id.*, section 5 at 13.

<sup>237</sup> *Id.*

<sup>238</sup> *Id.*

<sup>239</sup> Of the 244 cases in which companies made claims or counterclaims that the Bureau could determine were resolved by arbitrators, companies obtained relief in 227 disputes. The total amount of relief in those cases was \$2,806,662. These totals included 60 cases in which the company advanced fees for the consumer and obtained an award without participation by the consumer. Excluding those 60 cases, the total amount of relief awarded by arbitrators to companies was \$2,017,486. *Id.*, section 5 at 12.

<sup>240</sup> *Id.*

respect to disputes involving company claims, the Bureau could determine the terms of arbitrator awards relating to company claims in 244 of the 421 disputes involving company claims filed in 2010 and 2011.<sup>241</sup> Arbitrators provided companies some type of relief in 227, or 93.0 percent, of those disputes. In those 227 disputes, companies won a total of \$2,806,662.<sup>242</sup>

The Study found that consumers appealed very few arbitration decisions and companies appealed none. Specifically, it found four arbitral appeals filed between 2010 and 2012. Consumers without counsel filed all four. Three of the four were closed after the parties failed to pay the required administrator fees and arbitrator deposits. In the fourth, a three-arbitrator panel upheld an arbitration award in favor of the company after a 15-month appeal process.<sup>243</sup>

The Study also found that very few class arbitrations were filed. The Study identified only two filed between 2010 and 2012. One was still pending on a motion to dismiss as of September 2014. The other file contained no information other than the arbitration demand that followed a State court decision granting the company's motion seeking arbitration.<sup>244</sup>

The Study also found that, when there was a decision on the merits by an arbitrator, the average time to resolution was 179 days, and the median time to resolution was 150 days. When the record definitively indicated that a case had settled, the median time to settlement was 155 days from the filing of the initial claim.<sup>245</sup> Further, the Study found that more than half of the filings that reached a decision were resolved by "desk arbitrations," meaning that the

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<sup>241</sup> This includes cases filed by companies as well as cases in which companies asserted counterclaims in consumer-initiated disputes. *Id.*, section 5 at 14.

<sup>242</sup> *Id.*, section 5 at 43-44. Excluding 60 cases in which companies paid filing fees for consumers who failed to pay their initial fees – resulting in what appears to be decisions similar to default judgments – companies won a total of \$2,017,486. *Id.* at 44.

<sup>243</sup> *Id.*, section 5 at 85.

<sup>244</sup> *Id.*, section 5 at 86-87.

<sup>245</sup> *Id.*, section 5 at 71-73.

proceedings were resolved solely on the basis of documents submitted by the parties (57.8 percent). Approximately one-third (34.0 percent) of proceedings were resolved by an in-person hearing, 8.2 percent by telephonic hearings, and 2.4 percent through a dispositive motion with no hearing.<sup>246</sup> When there was an in-person hearing, the Study estimated that consumers travelled an average of 30 miles and a median of 15 miles to attend the hearing.<sup>247</sup>

*Consumer Financial Litigation: Frequency and Outcomes (Section 6 of Study)*

The Study's review of consumer financial litigation in court represents, the Bureau believes, the only analysis of the frequency and outcomes of consumer finance cases to date. While there is a large body of research regarding cases filed in court generally, preexisting studies of consumer finance cases either assessed only the number of filings – not typologies and outcomes, as the Study did – or focused on the frequency of cases filed under individual statutes.<sup>248</sup> The Study performed this analysis for individual court litigation concerning five of the same six product markets as those covered by its analysis of consumer financial arbitration: credit cards, checking accounts and debit cards; payday loans; GPR prepaid cards; and private student loans. In addition, the study analyzed class cases filed in these five markets and also with respect to automobile loans. This analysis focused on cases filed from 2010 to 2012, as an analogue to the years for which electronic AAA records were available, and captured outcomes reflected on dockets through February 28, 2014.

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<sup>246</sup> *Id.*, section 5 at 69-70.

<sup>247</sup> *Id.*, section 5 at 70-71.

<sup>248</sup> See, e.g., Thomas E. Willging, Laural L. Hooper & Robert J. Niemic, *Empirical Study of Class Actions in Four Federal District Courts: Final Report to the Advisory Committee on Civil Rules* (Fed. Judicial Ctr., 1996), available at <http://www.uscourts.gov/file/document/empirical-study-class-actions-four-federal-district-courts-final-report-advisory>; ACA International, *FDCPA Lawsuits Decline While FCRA and TCPA Filings Increase*, (reporting on January 2014 case filings under FDCPA as reported by Webrecon), available at <http://www.acainternational.org/news-fdcpa-lawsuits-decline-while-fcra-and-tcpa-filings-increase-31303.aspx>, cited in Study, *supra* note 2, section 6 at 9-11.

The Bureau's class action litigation analysis extended to all Federal district courts. To conduct this analysis, the Bureau collected complaints concerning these six products using an electronic database of pleadings in Federal district courts.<sup>249</sup> The Bureau also reviewed Federal multidistrict litigation (MDL) proceedings to identify additional consumer financial complaints filed in Federal court. After the Bureau identified its set of Federal class complaints concerning the six products and individual complaints concerning the five products, it collected the docket sheet from the Federal district court in which the complaint was filed in order to analyze relevant case events. The Bureau also collected State court class action complaints from three States (Utah, Oklahoma, and New York) and seven counties that had a public electronic database in which complaints were regularly available.<sup>250</sup> The Bureau determined that it was feasible to collect class action complaints from the State and county databases, but not complaints in individual cases from those databases.<sup>251</sup> Collectively, this State court sample accounted for 18.1 percent of the U.S. population as of 2010.<sup>252</sup>

The Study's analysis of putative class action filings identified 562 cases filed by consumers from 2010 through 2012 in Federal courts and selected State courts concerning the six products, or about 187 per year.<sup>253</sup> Of these 562 putative class cases, 470 were filed in Federal court, and the remaining 92 were filed in the State courts in the Bureau's State court sample

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<sup>249</sup> LexisNexis CourtLink, <http://www.lexisnexis.com/en-us/products/courtlink-for-corporate-or-professionals.page>.

<sup>250</sup> To determine what counties to include in the data set, the Bureau started with the Census Bureau's list of the ten most populous U.S. counties. The Bureau then excluded the two counties on that list that were already included in the State court sample (two in New York City) and one additional county that did not have a public electronic database in which complaints were regularly available. The remaining seven counties were the counties in the Bureau's data set.

<sup>251</sup> Study, *supra* note 2, Appendix L at 71.

<sup>252</sup> *Id.*, section 6 at 15; *see generally id.*, Appendix L.

<sup>253</sup> *Id.*, section 6 at 6. Due to limitations of the electronic database coverage and searchability of State court pleadings, the Bureau does not believe the electronic search of U.S. District Court pleadings identified a meaningful set of complaints filed in State court and subsequently removed to Federal court. *Id.*, section 6 at 13.

set.<sup>254</sup> In Federal court class cases, the most common claims were under the FDCPA and State UDAP statutes.<sup>255</sup> In State court class cases, State law claims predominated.<sup>256</sup> All Federal and State class cases sought monetary relief. Unlike the AAA arbitration rules, court rules of procedure generally do not require plaintiffs to identify specific claim amounts in their pleadings. Accordingly, the Bureau had limited ability to ascertain the number of “small” claims asserted in class action litigation, as compared to the 25 arbitration disputes each year in the markets analyzed in the AAA case set that included consumer affirmative claims of \$1,000 or less.<sup>257</sup> The Bureau was able to determine, however, that more than a third of the 562 class cases sought statutory damages only under Federal statutes that cap damages available in class proceedings (sometimes accompanied by claims for actual damages). In addition, nearly 90 percent of the 562 class cases did not seek statutory damages under Federal statutes that do not cap damages available in class proceedings.<sup>258</sup>

As with the Study’s analysis of the arbitration proceedings noted above, the Study set out a number of explicit and inherent limitations to its analysis of litigation outcomes.<sup>259</sup> While the available data indicated that most court cases were resolved by settlement or in a manner consistent with a settlement, the terms of any settlement were, for reasons noted previously, typically unavailable from the court record unless the settlement was on a class basis. The bulk

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<sup>254</sup> *Id.*, section 6 at 6. Because the Bureau’s State sample accounted for about one-fifth of the U.S. population, the actual number of State class filings would have been higher, but the Bureau cannot say by how much. *Id.*

<sup>255</sup> *Id.*

<sup>256</sup> *Id.*

<sup>257</sup> *Id.*

<sup>258</sup> *Id.*, section 6 at 22-26. The “capped” claims arose from five statutory schemes: the Expedited Funds Availability Act, EFTA, the FDCPA, TILA (including the Consumer Leasing Act and the Fair Credit Billing Act), and ECOA (which provides for punitive and actual damages but not statutory damages). *Id.*, section 6 at 23 n.45 (describing damages limitations). In over half of the cases in which Federal statutory damages were sought, the consumers also sought actual damages. *Id.*, section 6 at 25 n.48.

<sup>259</sup> *Id.*, section 6 at 2-5.

of cases, therefore, including individual cases and cases filed as a class action but that settled on an individual basis only, resulted in unknown substantive outcomes.<sup>260</sup> Other limitations, however, were unique to the review of litigation filings. For instance, the lack of specific information about claim amounts in court filings meant that the Study was unable to offer a meaningful analysis of recovery rates.<sup>261</sup> Further, some cases in court often could not be reduced to a single result because plaintiffs in those cases may have alleged multiple claims against multiple defendants and one case can have multiple outcomes across the different claims and parties. For this reason, the Study reported on several types of outcomes, more than one of which may have occurred in any single case.<sup>262</sup> In addition, while the Bureau stated that its data set of State court complaints appears to be the most robust available, the Bureau noted the dataset's limitations. For example, the three states and seven additional counties from which we collected complaints filed in State court may not be representative of the consumer financial litigation filed in State courts nationwide.<sup>263</sup>

Outside of case outcomes, however, the Study noted that even comparing frequency or process across litigation and arbitration proceedings was of limited utility.<sup>264</sup> The Study noted that differences in data may result from decisions consumers and companies make pertaining to arbitration and litigation, including but not limited to whether a relationship would be governed by a pre-dispute arbitration agreement; whether a case is filed and if so on a class or individual

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<sup>260</sup> *Id.*, section 6 at 8.

<sup>261</sup> *Id.*, section 6 at 3.

<sup>262</sup> *Id.*, section 6 at 3-4.

<sup>263</sup> *Id.*, section 6 at 15 n.34. *See also id.* at Appendix L.

<sup>264</sup> *Id.*, section 6 at 4.

basis; and whether to seek arbitration of cases filed in court.<sup>265</sup> With those caveats noted, the Study indicated that class filings result in myriad outcomes. Of the 562 class cases the Study identified, 12.3 percent (69 cases) had final class settlements approved by February 28, 2014.<sup>266</sup> As of April 2016, 18.1 percent of the filings (102 cases) featured final class settlements or class settlement agreements pending approval.

An additional 24.4 percent of the class cases (137 cases) involved a non-class settlement and 36.7 percent (206 cases) involved a potential non-class settlement.<sup>267</sup> In 10 percent of the class cases (56 cases), the action against at least one company defendant was dismissed as the result of a dispositive motion unrelated to arbitration.<sup>268</sup> In 8 percent of the 562 class cases (45 cases), all claims against a company were stayed or dismissed based on a company filing an arbitration motion.<sup>269</sup>

The Study also identified 3,462 individual cases filed in Federal court concerning the five product markets studied during the period, or 1,154 per year.<sup>270</sup> As with putative class filings, individual pleadings provide minimal information about the overall claim amounts sought by plaintiffs. Less than 6 percent of the overall individual litigation disputes were filed without counsel.<sup>271</sup>

The Bureau reviewed outcomes in all of the individual cases from four of the five

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<sup>265</sup> *Id.*

<sup>266</sup> *Id.*, section 6 at 7.

<sup>267</sup> *Id.* The Bureau deemed cases to be potential non-class settlements where a named plaintiff withdrew claims or the court dismissed claims for failure to serve or failure to prosecute, which could have occurred due to a non-class settlement; but the record did not disclose that such a settlement occurred. Litigants generally do not have an obligation to disclose non-class settlements. In addition, they have certain incentives not to do so.

<sup>268</sup> *Id.*

<sup>269</sup> *Id.*

<sup>270</sup> *Id.*, section 6 at 27-28. As noted above, the Study did not include data on individual cases in State courts, and the Study evaluated Federal cases in five product markets.

<sup>271</sup> *Id.*, section 6 at 7.



markets studied and a random sample of the cases filed in the fifth market, resulting in an analysis of 1,205 cases.<sup>272</sup> In 48.2 percent of those 1,205 cases (581 cases), the record reflected that a settlement had occurred, though the record only rarely (in around 5 percent of those 581 cases) reflected the monetary or other relief afforded by the settlement. In 41.8 percent of the 1,205 cases (504 cases), the record reflected a withdrawal by at least one consumer or another outcome potentially consistent with settlement, such as a dismissal for failure to prosecute or failure to serve (but where the plaintiff also might have withdrawn with no relief). In 6.8 percent of the cases (82 cases), a consumer obtained a judgment against a company party through a summary judgment motion, a default judgment (most common), or, in two cases, a trial. In 3.7 percent of cases (44 cases), the action against at least one company was dismissed via a dispositive motion unrelated to arbitration.<sup>273</sup>

Individual cases generally resolved more quickly than class cases. Aside from cases that were transferred to MDLs, Federal class cases closed in a median of approximately 218 days for cases filed in 2010 and 211 days for cases filed in 2011. Class cases in MDLs were markedly slower, closing in a median of approximately 758 days for cases filed in 2010 and 538 days for cases filed in 2011. State class cases closed in a median of approximately 407 days for cases filed in 2010 and 255 days for cases filed in 2011.<sup>274</sup> Aside from a handful of individual cases transferred to MDL proceedings, individual Federal cases closed in a median of approximately 127 days.<sup>275</sup>

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<sup>272</sup> Because the 3,462 cases the Study identified contained a high proportion of credit card cases, the Bureau reviewed outcomes in a 13.3 percent sample of the credit card cases. *Id.*, section 6 at 27-28.

<sup>273</sup> *Id.*, section 6 at 48.

<sup>274</sup> *Id.*, section 6 at 9.

<sup>275</sup> *Id.*

Notwithstanding the inherent limitations noted above, the Bureau’s large set of individual and class action litigations allowed the Study to explore whether motions seeking to compel arbitration were more likely to be asserted in individual filings or in putative class action filings. Across its entire set of court filings, the Study found that motions seeking to compel arbitration were much more likely to be asserted in cases filed as class actions. For most of the cases analyzed in the Study, it was not apparent whether the defendants in the proceedings had the option of moving to seek arbitration proceedings (*i.e.*, the Bureau was unable to determine definitively whether the contracts between the consumers and defendants contained arbitration agreements). The Bureau, however, was able to limit its focus to complaints against companies that it knew to use arbitration agreements in their consumer contracts in the year in which the cases were filed by limiting its sample set to disputes regarding credit cards. In the 40 class cases where the Study was able to ascertain that the case was subject to an arbitration agreement, motions seeking arbitration were filed 65 percent of the time.<sup>276</sup> In a comparable set of 140 individual disputes, motions seeking arbitration were filed one tenth as often, in only 5.7 percent of proceedings.<sup>277</sup> Overall, the Study identified nearly 100 Federal and State class action filings that were dismissed or stayed because companies invoked arbitration agreements by filing a motion to compel and citing an arbitration agreement in support.<sup>278</sup>

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<sup>276</sup> *Id.*, section 6 at 60-61. The court granted motions seeking arbitration in 61.5 percent of these disputes.

<sup>277</sup> *Id.*, section 6 at 61. The court granted motions seeking arbitration in five of the eight individual disputes in which motions seeking arbitration were filed (62.5 percent).

<sup>278</sup> *Id.*, section 6 at 58 (noting that companies moved to compel arbitration in 94 of the 562 class action cases in the Bureau’s dataset, and that the motion was granted in full or in part in 46 cases); *id.* at 58-59 (noting that the Bureau confirmed that motions to compel arbitration were granted in at least 50 additional class cases using a methodology described in Appendix P).

### *Small Claims Court (Section 7 of Study)*

As described above, Section 2 of the Study found that most arbitration agreements in the six markets the Bureau studied contained a small claims court “carve-out” that typically afforded either the consumer or both parties the right to file suit in small claims court as an alternative to arbitration. Commenters on the RFI urged the Bureau to study the use of small claims courts with respect to consumer financial disputes. The Bureau undertook this analysis, published the results of this inquiry in the Preliminary Results, and also included these results in Section 7 of the Study.

The Study’s review of small claims court filings represents the only study of the incidence and typology of consumer financial disputes in small claims court to date. Prior research suggests that companies make greater use of small claims court than consumers and that most company-filed suits in small claims court are debt collection cases.<sup>279</sup> The Study, however, was the first to assess the frequency of small claims court filings concerning consumer financial disputes across multiple jurisdictions.

The Bureau obtained the data for this analysis from online small claims court databases operated by States and counties. No centralized repository of small claims court filings exists.<sup>280</sup> The Bureau identified 14 State databases that purport to provide statewide data and that can be searched by year and party name, although this also included the District of Columbia and a

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<sup>279</sup> As described in the Study, for example, a 1990 analysis of the Iowa small claims court system found that many more businesses sued individuals than individuals sued businesses. Suzanne E. Elwell & Christopher D. Carlson, *The Iowa Small Claims Court: An Empirical Analysis*, 75 Iowa L. Rev. 433 (1990). In 2007, a working group of Massachusetts trial court judges and administrators “recognized that a significant portion of small claims cases involve the collection of commercial debts from defendants who are not represented by counsel.” Commonwealth of Massachusetts, District Court Department of the Trial Court, *Report of the Small Claims Working Group*, at 3 (Aug. 1, 2007), available at <http://www.mass.gov/courts/docs/lawlib/docs/smallclaimreport.pdf>.

<sup>280</sup> Study, *supra* note 2, section 7 at 5.

database for New York State that did not include New York City. This “State-level sample” covers approximately 52 million people. The Bureau also identified 17 counties with small claims court databases that met the same criteria (purporting to provide statewide data and being searchable by year and party name), including small claims courts for three of five counties in New York City. This “county-level sample” covers approximately 35 million people and largely avoids overlap with the State-level sample.<sup>281</sup> The Bureau searched each of these 31 jurisdictions’ databases for cases involving a set of ten large credit card issuers that the Bureau estimated to cover approximately 80 percent of credit card balances outstanding.<sup>282</sup> The Bureau cross-referenced the issuers’ advertising patterns to confirm that the issuers offered credit on a widespread basis to consumers in the jurisdictions the Bureau studied.<sup>283</sup>

The Study estimated that, in the jurisdictions the Bureau studied – with a combined population of approximately 85 million people – consumers filed no more than 870 disputes in 2012 against these ten institutions<sup>284</sup> (including the three largest retail banks in the United States).<sup>285</sup> This figure includes all cases in which an individual sued an issuer or a party with a name that a consumer might use to mean the issuer, without regard to whether the claim was consumer financial in nature.

As the Study noted, the number of claims brought by consumers that were consumer financial in nature was likely much lower. Out of the 31 jurisdictions studied, the Bureau was able to obtain underlying case documents on a systematic basis for only two jurisdictions:

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<sup>281</sup> *Id.*, section 7 at 5-6.

<sup>282</sup> *Id.*, section 7 at 6.

<sup>283</sup> Preliminary Results, *supra* note 2, at 156.

<sup>284</sup> Study, *supra* note 2, section 7 at 9.

<sup>285</sup> *Id.*, Appendix Q at 120-21.

Alameda County and Philadelphia County. The Bureau's analysis of all cases filed by consumers against the credit card issuers in its sample found 39 such cases in Alameda County and four such cases in Philadelphia County. When the Bureau reviewed the actual pleadings, however, only four of the 39 Alameda cases were clearly individuals filing credit card claims against one of the ten issuers, and none of the four Philadelphia cases were situations where individuals were filing credit card claims against one of the ten issuers. This additional analysis shows that the Bureau's broad methodology likely significantly overstated the actual number of small claims court cases filed by consumers against credit card issuers.<sup>286</sup>

The Study also found that in small claims court credit card issuers were more likely to sue consumers than consumers were to sue issuers. The Study estimated that, in these same jurisdictions, issuers in the Bureau's sample filed over 41,000 cases against individuals.<sup>287</sup> Based on the available data, it is likely that nearly all these cases were debt collection claims.<sup>288</sup>

#### *Class Action Settlements (Section 8 of Study)*

Section 8 of the Study contains the results of the Bureau's quantitative assessment of consumer financial class action settlements. As described above, Section 6 of the Study, which analyzes consumer financial litigation, includes findings about the frequency with which consumer financial class actions are filed and the types of outcomes reached in such cases. However, the dataset used for that analysis consisted of cases filed between 2010 and 2012 and outcomes of those cases through February 28, 2014.

To better understand the results of consumer financial class actions that result in

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<sup>286</sup> *Id.*, section 7 at 8-9.

<sup>287</sup> *Id.*, section 1 at 16.

<sup>288</sup> *Id.*

settlements, for Section 8, the Bureau conducted a search of class action settlements through an online database for Federal district court dockets. The Bureau searched this database using terms designed to identify final settlement orders finalized from 2008 to 2012 in consumer financial cases. The selection criteria for this data set differed from many other sections in the Study, in that it was not restricted to a discrete number of consumer financial products and services.<sup>289</sup> Rather, the Bureau reviewed these dockets and identified settlements where either: (1) the complaint alleged a violation of one of the enumerated consumer protection statutes under Title X of the Dodd-Frank Act; or (2) the plaintiffs were primarily consumers and the defendants were institutions selling consumer financial products or engaged in providing consumer financial services (other than consumer investment products and services), regardless of the basis of the claim. To the extent that the case involved *any* such consumer financial product or service – not only the six main product areas identified in the AAA and litigation sets – it was included in the data set.<sup>290</sup>

The set of consumer financial class action settlements overlaps with the data set used for the analysis of the frequency and outcomes of consumer financial litigation (Section 6 of the Study) insofar as cases filed in 2010 through 2012 had settled by the end of 2012. The analysis of class action settlements is larger because it encompasses a wider time period (settlements

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<sup>289</sup> Because Section 8 of the Study focused on settled class action disputes, the Bureau could begin its search with a relatively limited set of documents: all Federal class action settlements available on the Westlaw docket database, resulting in over 4,400 disputes settled between January 1, 2008 and December 31, 2012. *Id.*, Appendix R. In contrast, in exploring filings in Federal and State court in Section 6 of the Study, described above, the volume of court filings required the Bureau to rely on word searches that helped limit the set of documents that the Bureau manually reviewed to the six product groups mentioned previously. *Id.*, Appendix L.

<sup>290</sup> *Id.*, section 8 at 8-11. The Study did, however, exclude disputes involving residential mortgage lenders, where arbitration provisions are not prevalent, and another subset of disputes involving claims against defendants that are not “covered persons” regulated by the Bureau, such as claims against merchants under the Fair and Accurate Credit Transaction Act. *Id.*, section 8 at 9 n.25 & Appendix S.

finalized from 2008-12) to decrease the variance across years that could be created by unusually large settlements and to account for the impact of the April 2011 Supreme Court decision in *Concepcion*, which is discussed above.<sup>291</sup> The Bureau used this data set to perform a more detailed analysis of class settlement outcomes, including issues such as the number of class members eligible for relief in these settlements; the amount and types of relief available to class members; the number of class members who had received relief and the amount of that relief; and the extent to which relief went to attorneys. While several previous studies of class action settlements have been published, the Study is the first to comprehensively catalogue and analyze class action settlements specific to consumer financial markets.<sup>292</sup>

As the Study noted, there were limitations to the Bureau's analysis. The Study understates the number of class action settlements finalized, and the amount of relief provided, during the period under study because the Bureau could not identify class settlements in State court class action litigation. (The Bureau determined it was not feasible to do so in a systematic way.<sup>293</sup>) Further, the claims data on the settlements the Bureau identified is incomplete, as dockets are often closed when the final approved settlement order is issued, but final settlement orders may be issued in class action settlements before claims numbers are final.<sup>294</sup> In addition, not every settlement offered information on every data point or metric that was analyzed; the Study accounts for this by referencing, for every metric reported on, the number of settlements that provided the relevant number or estimate.<sup>295</sup>

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<sup>291</sup> *Concepcion*, 563 U.S. at 344.

<sup>292</sup> See Study, *supra* note 2, section 8 at 6-7.

<sup>293</sup> *Id.*, section 8 at 10.

<sup>294</sup> *Id.*, section 8 at 11.

<sup>295</sup> *Id.*, section 8 at 10.

The Bureau identified 422 Federal consumer financial class settlements that were approved between 2008 and 2012, resulting in an average of approximately 85 approved settlements per year.<sup>296</sup> The bulk of these settlements (89 percent) concerned debt collection, credit cards, checking accounts or credit reporting.<sup>297</sup> Of these 422 settlements, the Bureau was able to analyze 419.<sup>298</sup> The Bureau identified the class size or a class size estimate in 78.5 percent of these settlements (329 settlements). There were 350 million total class members in these settlements. Excluding one large settlement with 190 million class members (*In re TransUnion Privacy Litigation*),<sup>299</sup> these settlements included 160 million class members.<sup>300</sup>

These 419 settlements included cash relief, in-kind relief and other expenses that companies paid. The total amount of gross relief in these 419 settlements – that is, aggregate amounts promised to be made available to or for the benefit of damages classes as a whole, calculated before any fees or other costs were deducted – was about \$2.7 billion.<sup>301</sup> This estimate included cash relief of about \$2.05 billion and in-kind relief of about \$644 million.<sup>302</sup> These figures represent a floor, as the Bureau did not include the value, or cost to the defendant, of making agreed behavioral changes to business practices.<sup>303</sup>

Sixty percent of the 419 settlements (251 settlements) contained enough data for the

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<sup>296</sup> *Id.*, section 8 at 9.

<sup>297</sup> *Id.*, section 8 at 11.

<sup>298</sup> *Id.*, section 8 at 3 n.4. For the purposes of uniformity in analyzing data, the Bureau excluded three cases for which it was unable to find data on attorney's fees. These three cases would not have affected the results materially. *Id.*

<sup>299</sup> MDL No. 1350 (N.D. Ill. Sept. 17, 2008).

<sup>300</sup> Study, *supra* note 2, section 8 at 3.

<sup>301</sup> *Id.*, section 8 at 23-24. The Study defined gross relief as the total amount the defendants offered to provide in cash relief (including debt forbearance) or in-kind relief and offered to pay in fees and other expenses. *Id.*

<sup>302</sup> *Id.*, section 8 at 24.

<sup>303</sup> *Id.*, section 8 at 23. Accordingly, where cases did provide values for behavioral relief, such values were not included in the Study's calculations regarding attorney's fees as a proportion of consumer recovery. *Id.*, section 8 at 5 n.10.



Bureau to calculate the value of cash relief that, as of the last document in the case files, either had been or was scheduled to be paid to class members. Based on these cases alone, the value of cash payments to class members was \$1.1 billion. This excludes payment of in-kind relief and any valuation of behavioral relief.<sup>304</sup>

For 56 percent of the 419 settlements (236 settlements), the docket contained enough data for the Bureau to estimate, as of the date of the last filing in the case, the number of class members who were guaranteed cash payment because either they had submitted a claim or they were part of a class to which payments were to be made automatically. In these settlements, 34 million class members were guaranteed recovery as of the time of the last document available for review, having made claims or participated in an automatic distribution.<sup>305</sup> Of 382 settlements that offered cash relief, the Bureau determined that 36.6 percent included automatic cash distribution that did not require individual consumers to submit a claim form or claim request.<sup>306</sup>

The Study also sought to calculate the rate at which consumers claimed relief when such a process was required to obtain relief. The Bureau was able to calculate the claims rate in 25.1 percent of the 419 settlements that contained enough data for the Bureau to calculate the value of

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<sup>304</sup> *Id.*, section 8 at 28.

<sup>305</sup> *Id.*, section 8 at 27. The value of cash payments to class members in the 251 settlements described above (\$1.1 billion), divided by the number of class members in the 236 settlements described above (34 million), yields an average recovery figure of approximately \$32 per class member. Since the publication of the Study, some stakeholders have reported on this \$32 figure. *See, e.g.*, Todd Zywicki & Jason Johnston, *A Ban that Will Only Help Class Action Lawyers*, Mercatus Ctr., Geo. Mason Univ. blog (Mar. 18, 2016), [http://mercatus.org/expert\\_commentary/ban-will-only-help-class-action-lawyers](http://mercatus.org/expert_commentary/ban-will-only-help-class-action-lawyers). The Bureau notes that this figure represents an approximation, because the set of 251 settlements for which the Bureau had payee information was not completely congruent with the set of 236 settlements for which the Bureau had payment information. However, the Bureau believes that this \$32-per-class-member recovery figure is a reasonable estimate.

<sup>306</sup> This set of 382 settlements represents the 410 settlements in which some form of cash relief was available, excluding 28 cases in which cash relief consisted solely of a *cy pres* payment or reward payment to the lead plaintiff(s), because, for class members, these cases involve neither automatic nor claims-made distributions. Study, *supra* note 2, section 8 at 19.

cash relief that had been or was scheduled to be paid to class members (105 cases). In these cases, the average claims rate was 21 percent and the median claims rate was 8 percent.<sup>307</sup> Rates for these cases should be viewed as a floor, given that the claims numbers used to calculate these rates may not have been final for many of these settlements as of the date of the last document in the docket and available for review by the Bureau. The weighted average claims rate, excluding the cases providing for automatic relief, was 4 percent including the large *TransUnion* settlement, and 11 percent excluding that settlement.<sup>308</sup>

The Study also examined attorney's fee awards. Across all settlements that reported both fees and gross cash and in-kind relief, fee rates were 21 percent of cash relief and 16 percent of cash and in-kind relief. Here, too, the Study did not include any valuation for behavioral relief, even when courts relied on such valuations to support fee awards. The Bureau was able to compare fees to cash payments in 251 cases (or 60 percent of our data set). In these cases, of the total amount paid out in cash by defendants (both to class members and in attorney's fees), 24 percent was paid in fees.<sup>309</sup>

In addition, the Study includes a case study of *In re Checking Account Overdraft Litigation*, MDL 2036 (the Overdraft MDL) – a multi-district proceeding involving class actions against a number of banks – to shed further light on the impact of arbitration agreements on the resolution of individual and class claims. As of the Study's publication, 23 cases had been resolved in the Overdraft MDL. In eleven cases, the banks' deposit agreements did not include

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<sup>307</sup> Study, *supra* note 2, section 8 at 30.

<sup>308</sup> *Id.* Compared with the "average claims rate," which is merely the average of the claims rates in the relevant class actions, the "weighted average claims rate" factors in the relative size of the classes.

<sup>309</sup> *Id.*, section 8 at 35-36. These percentages likely represent ceilings on attorney's fee awards as a percentage of class payments, as they will fall as class members may have filed additional claims in the settlements after the Bureau's Study period ended.

arbitration provisions; in those cases, 6.5 million consumers obtained \$377 million in relief. In three cases, the defendants' deposit agreements had arbitration provisions, but the defendants did not seek arbitration; in those cases, 13.7 million consumers obtained \$458 million in relief.<sup>310</sup> Another four defendants moved to seek arbitration, but ultimately settled; in those cases 8.8 million consumers obtained \$180.5 million in relief.<sup>311</sup> Five companies, in contrast, successfully invoked arbitration agreements, resulting in the dismissal of the cases against them.<sup>312</sup>

The Overdraft MDL cases also provided useful insight into the extent to which consumers were able to obtain relief via informal dispute resolution – such as telephone calls to customer service representatives. As the Study notes, in 17 of the 18 Overdraft MDL settlements, the amount of the settlement relief was finalized, and the number of class members determined, after specific calculations by an expert witness who took into account the number and amount of fees that had already been reversed based on informal consumer complaints to customer service. The expert witness used data provided by the banks to calculate the amount of consumer harm on a per-consumer basis; the data showed, and the calculations reflected, informal reversals of overdraft charges. Even after controlling for these informal reversals, nearly \$1 billion in relief was made available to more than 28 million class members in these MDL cases.<sup>313</sup>

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<sup>310</sup> *Id.*, section 8 at 44. One of these three defendants, Bank of America, had an arbitration agreement in the applicable checking account contract, but, in 2009, began to issue checking account agreements without an arbitration agreement. Prior to the transfer of the litigation to the MDL, Bank of America moved to seek individual arbitration of the dispute; but once the litigation was transferred, Bank of America did not renew its motion seeking arbitration, instead listing arbitration as an affirmative defense. *See, e.g., id.*, section 8 at 41 n.59.

<sup>311</sup> *Id.*, section 8 at 45.

<sup>312</sup> *Id.*, section 8 at 42.

<sup>313</sup> *Id.*, section 8 at 39-46. The case record does not reveal how many consumers had received informal relief of some form. It is likely that many other class action settlements account for similar set-offs for consumers that

*Consumer Financial Class Actions and Public Enforcement (Section 9 of Study)*

Section 9 of the Study explores the relationship between private consumer financial class actions and public (governmental) enforcement actions. As Section 9 notes, some industry trade association commenters (commenting on the RFI) urged the Bureau to study whether class actions are an efficient and cost-effective mechanism to ensure compliance with the law given the authority of public enforcement agencies. Specifically, these commenters suggested that the Bureau explore the percentage of class actions that are follow-on proceedings to government enforcement actions. Other stakeholders have argued that private class actions are needed to supplement public enforcement, given the limited resources of government agencies, and that private class actions may precede public enforcement and, in some cases, spur the government to action. To better understand the relationship between private class actions and public enforcement, Section 9 analyzes the extent to which private class actions overlap with government enforcement activity and, when they do overlap, which types of actions come first.

The Bureau obtained data for this analysis in two steps. First, it assembled a sample of public enforcement actions and searched for “overlapping” private class actions, meaning that the cases sought relief against the same defendants for the same conduct, regardless of the legal theory employed in the complaint at issue.<sup>314</sup> The Bureau did this by reviewing websites for all Federal regulatory agencies with jurisdiction over consumer finance matters and the websites of the State regulatory and enforcement agencies in the 10 largest and 10 smallest States and four county agencies in those States to identify reports on public enforcement activity over a period of

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received relief in informal dispute resolution, as settling defendants would have economic incentives to avoid double-compensating such plaintiffs.

<sup>314</sup> *Id.*, section 9 at 5 & Appendix U at 141.

five years.<sup>315</sup> The Bureau used this sample because it wanted to capture enforcement activity by both large and small States and because it wanted to capture enforcement activity by city attorneys, in light of the increasing work by city attorneys in this regard. The Bureau then searched an online database to identify overlapping private cases and searched the pleadings in those cases.<sup>316</sup>

Second, the Bureau essentially performed a similar search, but in reverse: the Bureau assembled a sample of private class actions and then searched for overlapping public enforcement actions. This sample of private class actions was derived from a sample of the class settlements used for Section 8 and a review of the websites of leading plaintiffs' class action law firms. To find overlapping public enforcement actions (typically posted on government agencies' websites), the Bureau searched online using keywords specific to the underlying private action.<sup>317</sup>

The Study found that, where the government brings an enforcement action, there is rarely an overlapping private class action. For 88 percent of the public enforcement actions the Bureau

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<sup>315</sup> The analysis included review of enforcement activity conducted by the Bureau, the FTC, the Department of Justice (specifically the Civil Division and the Civil Rights Division), the Department of Housing and Urban Development, the Office of the Comptroller of the Currency, the former Office of Thrift Supervision, the Federal Deposit Insurance Corporation, the Federal Reserve Board of Governors, the National Credit Union Administration. It also included review of proceedings brought by State banking regulators, to the extent that they had independent enforcement authority, from Alaska, California, the District of Columbia, Florida, Georgia, Michigan, New York, Ohio, Pennsylvania, Rhode Island, Texas, and Vermont. And the review included State attorney general actions brought by California, Texas, New York, Florida, Illinois, Pennsylvania, Ohio, Georgia, Michigan, North Carolina, New Hampshire, Rhode Island, Montana, Delaware, South Dakota, Alaska, North Dakota, the District of Columbia, Vermont, and Wyoming. Finally, the analysis included consumer enforcement activity from city attorneys from Los Angeles, San Francisco, San Diego, and Santa Clara County. Study, *supra* note 2, Appendix U at 141-42. See *supra* note 148 (noting that 41 FDIC enforcement actions were inadvertently omitted from the results published in Section 9 of the Study; that the corrected total number of enforcement actions reviewed in Section 9 was 1,191; and that other figures, including the identification of public enforcement cases with overlapping private actions, were not affected by this omission).

<sup>316</sup> Study, *supra* note 2, section 9 at 7.

<sup>317</sup> *Id.*, section 9 at 5-7.

identified, the Bureau did not find an overlapping private class action.<sup>318</sup> The Study similarly found that, where private parties bring a class action, an overlapping government enforcement action exists in only a minority of cases, and rarely exists when the class action settlement is relatively small. For 68 percent of the private class actions the Bureau identified, the Bureau did not find an overlapping public enforcement action. For class action settlements of less than \$10 million, the Bureau did not identify an overlapping public enforcement action 82 percent of the time.<sup>319</sup>

Finally, the Study found that, when public enforcement actions and class actions overlapped, private class actions tended to precede public enforcement actions instead of the reverse. When the Study began with government enforcement activity and identified overlapping private class actions, public enforcement activity was preceded by private activity 71 percent of the time. Likewise, when the Bureau began with private class actions and identified overlapping public enforcement activity, private class action complaints were preceded by public enforcement activity 36 percent of the time.<sup>320</sup>

#### *Arbitration Agreements and Pricing (Section 10 of Study)*

Section 10 of the Study contains the results of a quantitative analysis exploring whether arbitration agreements affect the price and availability of credit to consumers. Commenters on the Bureau's RFI suggested that the Bureau explore whether arbitration agreements lower the prices of financial services to consumers. In academic literature, some hypothesize that arbitration agreements reduce companies' dispute resolution costs and that companies "pass

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<sup>318</sup> *Id.*, section 9 at 14.

<sup>319</sup> *Id.*, section 9 at 4.

<sup>320</sup> *Id.*, section 9 at 4.

through” at least some cost savings to consumers in the form of lower prices, while others reject this notion.<sup>321</sup> However, as the Study notes, there is little empirical evidence to support either position.<sup>322</sup>

To address this gap in scholarship, the Study explored the effects of arbitration agreements on the price and availability of credit in the credit card marketplace following a series of settlements in *Ross v. Bank of America*, an antitrust case in which, among other things, several credit card issuers were alleged to have colluded to introduce arbitration agreements into their credit card contracts.<sup>323</sup> In these *Ross* settlements (separately negotiated from the settlements pertaining to the non-disclosure of currency conversion fees), certain credit card issuers agreed to remove arbitration agreements from their consumer credit card contracts for at least three and one-half years.<sup>324</sup> Using data from the CCDB,<sup>325</sup> the Bureau examined whether it could find statistically significant evidence, at standard confidence level (95 percent), that companies that removed their arbitration agreements raised their prices (measured by total cost of credit) in a manner that was different from that of comparable companies that did not remove

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<sup>321</sup> Compare, e.g., Amy J. Schmitz, *Building Bridges to Remedies for Consumers in International eConflicts*, 34 U. Ark. L. Rev. 779, 779 (2012) (“[C]ompanies often include arbitration clauses in their contracts to cut dispute resolution costs and produce savings that they may pass on to consumers through lower prices.”) with Jeffrey W. Stempel, *Arbitration, Unconscionability, and Equilibrium, The Return of Unconscionability Analysis as a Counterweight to Arbitration Formalism*, 19 Ohio St. J. on Disp. Resol. 757, 851 (2004) (“[T]here is nothing to suggest that vendors imposing arbitration clauses actually lower their prices in conjunction with using arbitration clauses in their contracts.”).

<sup>322</sup> Study, *supra* note 2, section 10 at 5.

<sup>323</sup> See First Amended Class Action Complaint, *In re Currency Conversion Antitrust Litig.*, MDL No. 1409 (S.D.N.Y. June 4, 2009).

<sup>324</sup> Study, *supra* note 2, section 10 at 6.

<sup>325</sup> The CCDB provides loan-level information, stripped of direct personal identifiers, regarding consumer and small business credit card portfolios for a sample of large issuers, representing 85 to 90 percent of credit card industry balances. *Id.*, section 10 at 7-11.

their agreements. The Bureau was unable to identify any such evidence from the data.<sup>326</sup>

The Bureau performed a similar inquiry into whether affected companies altered the amount of credit they offered consumers, all else being equal, in a manner that was statistically different from that of comparable companies. The Study notes that this inquiry was subject to limitations not applicable to the price inquiry, such as the lack of a single metric to define credit availability.<sup>327</sup> Using two measures of credit offered, the Study did not find any statistically significant evidence that companies that eliminated arbitration provisions reduced the credit they offered.<sup>328</sup>

#### **IV. Post-Study Outreach**

##### *A. Stakeholder Outreach Following the Study*

As noted, the Bureau released the Arbitration Study in March 2015. After doing so, the Bureau held roundtables with key stakeholders and invited them to provide feedback on the Study and how the Bureau should interpret its results.<sup>329</sup> Stakeholders also provided feedback to the Bureau or published their own articles commenting on and responding to the Study. The Bureau has reviewed all of this correspondence and many of these articles in preparing this proposal.

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<sup>326</sup> See *id.*, section 10 at 15. In the Study, the Bureau described several limitations of its model. For example, it is theoretically possible that the *Ross* settlers had characteristics that would make their pricing different after removal of the arbitration agreement, as compared to non-settlers. See *id.*, section 10 at 15-17.

<sup>327</sup> *Id.*

<sup>328</sup> *Id.*, section 10 at 15.

<sup>329</sup> As noted above, the Bureau similarly invited feedback from stakeholders on the Preliminary Report published in December 2013. In early 2014, the Bureau also held roundtables with stakeholders to discuss the Preliminary Report. See *supra* Parts III.A-III.C (summarizing the Bureau's outreach efforts in connection with the Study).



## *B. Small Business Review Panel*

In October 2015, the Bureau convened a Small Business Review Panel (SBREFA Panel) with the Chief Counsel for Advocacy of the Small Business Administration (SBA) and the Administrator of the Office of Information and Regulatory Affairs with the Office of Management and Budget (OMB).<sup>330</sup> As part of this process, the Bureau prepared an outline of proposals under consideration and the alternatives considered (SBREFA Outline), which the Bureau posted on its website for review by the small financial institutions participating in the panel process, as well as the general public.<sup>331</sup> Working with stakeholders and the agencies, the Bureau identified 18 Small Entity Representatives (SERs) to provide input to the SBREFA Panel on the proposals under consideration. With respect to some markets, the relevant industry trade associations reported significant difficulty in identifying any small financial services companies that would be impacted by the approach described in the Bureau's SBREFA Outline.

Prior to formally meeting with the SERs, the Bureau held conference calls to introduce the SERs to the materials and to answer their questions. The SBREFA Panel then conducted a full-day outreach meeting with the small entity representatives in October 2015 in Washington, D.C. The SBREFA Panel gathered information from the SERs at the meeting. Following the

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<sup>330</sup> The Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA), as amended by section 1100G(a) of the Dodd-Frank Act, requires the Bureau to convene a Small Business Review Panel before proposing a rule that may have a substantial economic impact on a significant number of small entities. *See* 5 U.S.C. 609(d).

<sup>331</sup> Bur. Of Consumer Fin. Prot., Outline of Proposals under Consideration for the SBREFA process (Oct. 7, 2015), available at [http://files.consumerfinance.gov/f/201510\\_cfpb\\_small-business-review-panel-packet-explaining-the-proposal-under-consideration.pdf](http://files.consumerfinance.gov/f/201510_cfpb_small-business-review-panel-packet-explaining-the-proposal-under-consideration.pdf); Bur. Of Consumer Fin. Prot., Press Release, *CFPB Considers Proposal to Ban Arbitration Clauses that Allow Companies to Avoid Accountability to Their Customers* (Oct. 7, 2015), available at <http://www.consumerfinance.gov/newsroom/cfpb-considers-proposal-to-ban-arbitration-clauses-that-allow-companies-to-avoid-accountability-to-their-customers/>. The Bureau also gathered feedback on the SBREFA Outline from other stakeholders and members of the public, and from the Bureau's Consumer Advisory Board (CAB). *See* <http://www.consumerfinance.gov/advisory-groups/advisory-groups-meeting-details/> Video of the Bureau's October 2015 presentation to the CAB is available at <https://www.youtube.com/watch?v=V11Xbp9z2KQ>.

meeting, nine SERs submitted written comments to the Bureau. The SBREFA Panel then made findings and recommendations regarding the potential compliance costs and other impacts of the proposed rule on those entities. Those findings and recommendations are set forth in the Small Business Review Panel Report, which is being made part of the administrative record in this rulemaking.<sup>332</sup> The Bureau has carefully considered these findings and recommendations in preparing this proposal and addresses certain specific issues that concerned the Panel below.

### *C. Additional Stakeholder Outreach*

At the same time that the Bureau conducted the SBREFA Panel, it met with other stakeholders to discuss the SBREFA Outline and the impacts analysis discussed in that outline. The Bureau convened several roundtable meetings with a variety of industry representatives – including national trade associations for depository banks and non-bank providers – and consumer advocates. Bureau staff also presented an overview at a public meeting of the Bureau’s Consumer Advisory Board (CAB) and solicited feedback from the CAB on the proposals under consideration. The Bureau expects to meet with Indian tribes and engage in consultation pursuant to its Policy for Consultation with Tribal Governments after the release of this notice of proposed rulemaking. The Bureau specifically solicits comment on this proposal from Tribal governments.

## **V. Legal Authority**

As discussed more fully below, there are two components to this proposal: a proposal to prohibit providers from the use of arbitration agreements to block class actions (as set forth in

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<sup>332</sup> Bur. Of Consumer Fin. Prot., U.S. Small Bus. Admin. & Office of Mgmt. & Budget, *Final Report of the Small Business Review Panel on CFPB’s Potential Rulemaking on Pre-Dispute Arbitration Agreements* (2015), available at [http://files.consumerfinance.gov/f/documents/CFPB\\_SBREFA\\_Panel\\_Report\\_on\\_Pre-Dispute\\_Arbitration\\_Agreements\\_FINAL.pdf](http://files.consumerfinance.gov/f/documents/CFPB_SBREFA_Panel_Report_on_Pre-Dispute_Arbitration_Agreements_FINAL.pdf) (hereinafter SBREFA Panel Report).

proposed § 1040.4(a)) and a proposal to require the submission to the Bureau of certain arbitral records (as set forth in proposed § 1040.4(b)). The Bureau is issuing the first component of its proposal pursuant to its authority under section 1028(b) of the Dodd-Frank Act and is issuing the second component of its pursuant to its authority under that section and under sections 1022(b) and (c).

*A. Section 1028*

Section 1028(b) of the Dodd-Frank Act authorizes the Bureau to issue regulations that would “prohibit or impose conditions or limitations on the use of an agreement between a covered person and a consumer for a consumer financial product or service providing for arbitration of any future dispute between the parties,” if doing so is “in the public interest and for the protection of consumers.” Section 1028(b) also requires that “[t]he findings in such rule shall be consistent with the Study.”

Section 1028(c) further instructs that the Bureau’s authority under section 1028(b) may not be construed to prohibit or restrict a consumer from entering into a voluntary arbitration agreement with a covered person after a dispute has arisen. Finally, Section 1028(d) provides that, notwithstanding any other provision of law, any regulation prescribed by the Bureau under section 1028(b) shall apply, consistent with the terms of the regulation, to any agreement between a consumer and a covered person entered into after the end of the 180-day period beginning on the effective date of the regulation, as established by the Bureau. As is discussed below in Part VI, the Bureau finds that its proposals relating to pre-dispute arbitration

agreements fulfill all these statutory requirements and are in the public interest, for the protection of consumers, and consistent with the Bureau’s Study.<sup>333</sup>

*B. Sections 1022(b) and (c)*

Section 1022(b)(1) of the Dodd-Frank Act authorizes the Bureau to prescribe rules “as may be necessary or appropriate to enable the Bureau to administer and carry out the purposes and objectives of the Federal consumer financial laws, and to prevent evasions thereof.” Among other statutes, Title X of the Dodd-Frank Act is a Federal consumer financial law.<sup>334</sup>

Accordingly, in proposing this rule, the Bureau is proposing to exercise its authority under Dodd-Frank Act section 1022(b) to prescribe rules under Title X that carry out the purposes and objectives and prevent evasion of those laws. Section 1022(b)(2) of the Dodd-Frank Act prescribes certain standards for rulemaking that the Bureau must follow in exercising its authority under section 1022(b)(1).<sup>335</sup>

Dodd-Frank section 1022(c)(1) provides that, to support its rulemaking and other functions, the Bureau shall monitor for risks to consumers in the offering or provision of consumer financial products or services, including developments in markets for such products or services. The Bureau may make public such information obtained by the Bureau under this section as is in the public interest.<sup>336</sup> Moreover, section 1022(c)(4) of the Act provides that, in conducting such monitoring or assessments, the Bureau shall have the authority to gather information from time to time regarding the organization, business conduct, markets, and

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<sup>333</sup> See *infra* Part VI.

<sup>334</sup> See Dodd-Frank section 1002(14) (defining “Federal consumer financial law” to include the provisions of Title X of the Dodd-Frank Act).

<sup>335</sup> See Section 1022(b)(2) Analysis, *infra* Part V.B. (discussing the Bureau’s standards for rulemaking under section 1022(b)(2) of the Dodd-Frank Act).

<sup>336</sup> Dodd-Frank section 1022(c)(3)(B).

activities of covered persons and service providers. The Bureau proposes § 1040.4(b) pursuant to the Bureau’s authority under Dodd-Frank section 1022(c), as well as its authority under Dodd-Frank section 1028(b).

## **VI. The Bureau’s Preliminary Findings That the Proposal is in the Public Interest and for the Protection of Consumers**

In this section, the Bureau sets forth how it interprets the requirements of Dodd-Frank section 1028(b) and why it preliminarily finds that the proposed rule (as set out more fully in proposed § 1040.4 and the Section-by-Section Analysis thereto) would be in the public interest and for the protection of consumers. The Bureau also identifies below why it believes that its proposal would be consistent with the Study. This section first explains the Bureau’s interpretation of the legal standard, then discusses its application to the class proposal (proposed § 1040.4(a)) and the monitoring proposal (proposed § 1040.4(b)).

### *A. Relevant Legal Standard*

As discussed above in Part V, Dodd-Frank section 1028(b) authorizes the Bureau to “prohibit or impose conditions or limitations on the use of” a pre-dispute arbitration agreement between covered persons and consumers if the Bureau finds that doing so “is in the public interest and for the protection of consumers.” This requirement can be read as either a single integrated standard or as two separate tests (that a rule be both “in the public interest” and “for the protection of consumers”), and the Bureau must exercise its expertise to determine which reading best effectuates the purposes of the statute. As explained below, the Bureau is proposing to interpret the two phrases as related but conceptually distinct. The Bureau invites comment on this proposed interpretation, and specifically on whether “in the public interest” and “for the

protection of consumers” should be interpreted as having independent meanings or as a single integrated standard.

The Dodd-Frank section 1028(b) statutory standard parallels the standard set forth in Dodd-Frank section 921(b), which authorizes the SEC to “prohibit or impose conditions or limitations on the use of” a pre-dispute arbitration agreement between investment advisers and their customers or clients if the SEC finds that doing so “is in the public interest and for the protection of investors.” That language in turn parallels language in the Securities Act and the Exchange Act, which, for over 80 years, have authorized the SEC to adopt certain regulations or take certain actions if doing so is “in the public interest and for the protection of investors.”<sup>337</sup> The SEC has routinely applied the Exchange Act language without delineating separate tests or definitions for the two phrases.<sup>338</sup> There is an underlying logic to such an approach since investors make up a substantial portion of “the public” whose interests the SEC is charged with advancing. This is even more true for section 1028, since nearly every member of the public is a consumer. Furthermore, in exercising its roles and responsibilities as the Consumer Financial Protection Bureau, the Bureau ordinarily approaches the idea of consumer protection holistically in accordance with the broad range of factors it generally considers under Title X of Dodd-Frank, which as discussed further below include systemic impacts and other public concerns.

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<sup>337</sup> See, e.g., Securities Act of 1933, Public Law 73 22, section 3(b)(1) (1933) 15 U.S.C 77c(b)(1); Securities Exchange Act of 1934, Public Law 73 291, section 12(k)(1) (1934) 15 U.S.C. 78(k)(1).

<sup>338</sup> Under the Exchange Act, the SEC has often found that its actions are “for the protection of investors and in the public interest” without delineating separate standards or definitions for the two phrases. See, e.g., *In re: Bravo Enterprises Ltd.*, S.E.C. Release No. 75775, Admin. Proc. No. 3-16292 at 6 (Aug. 27, 2015) (applying “the ‘public interest’ and ‘protection of investors’ standards” in light “of their breadth [and] supported by the structure of the Exchange Act and Section 12(k)(1)’s legislative history”). See also SEC Release No. 5627 (Oct. 14, 1975) (“Whether particular disclosure requirements are necessary to permit the Commission to discharge its obligations under the Securities Act and the Securities Exchange Act or are necessary or appropriate in the public interest or for the protection of investors involves a balancing of competing factors.”).

Therefore, if the Bureau were to treat the standard as a single, unitary test, the Bureau’s analysis would encompass the public interest, as defined by the purposes and objectives of the Bureau and informed by the Bureau’s particular expertise in the protection of consumers.

The Bureau believes, however, that treating the two phrases as separate tests may ensure a fuller consideration of all relevant factors. This approach would also be consistent with canons of construction that counsel in favor of giving the two statutory phrases discrete meaning notwithstanding the fact that the two phrases in section 1028(b) – “in the public interest” and “for the protection of consumers” – are inherently interrelated for the reasons discussed above.<sup>339</sup> Under this framework, the Bureau would be required to exercise its expertise to determine what each standard requires because both terms are ambiguous. In doing so, and as described in more detail below, the Bureau would look, using its expertise, to the purposes and objectives of Title X to inform the “public interest” prong,<sup>340</sup> while relying on its expertise in consumer protection to define the “consumer protection” prong.

Under this approach the Bureau believes that “for the protection of consumers” in the context of section 1028 should be read to focus specifically on the effects of a regulation in promoting compliance with laws applicable to consumer financial products and services and avoiding or preventing harm to the consumers who use or seek to use those products. In contrast, under this approach the Bureau would read section 1028(b)’s “in the public interest” prong, consistent with the purposes and objectives of Title X, to require consideration of the entire range of impacts on consumers and impacts on other elements of the public. These interests

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<sup>339</sup> See *Hibbs v. Winn*, 542 U.S. 88, 101 (2004); *Bailey v. United States*, 516 U.S. 137, 146 (1995).

<sup>340</sup> This approach is also consistent with precedent holding that the statutory criterion of “public interest” should be interpreted in light of the purposes of the statute in which the standard is embedded. See *Nat’l Ass’n for Advancement of Colored People v. FPC*, 425 U.S. 662, 669 (1976).

encompass not just the elements of consumer protection described above, but also secondary impacts on consumers such as effects on pricing, accessibility, and the availability of innovative products, as well as impacts on providers, markets, the rule of law and accountability, and other general systemic considerations.<sup>341</sup> The Bureau is proposing to adopt this interpretation, giving the two phrases independent meaning.<sup>342</sup>

The Bureau’s interpretations of each phrase standing alone are informed by several considerations. As noted above, for instance, the Bureau would look to the purposes and objectives of Title X to inform the “public interest” prong. The Bureau’s starting point in defining the public interest is therefore section 1021(a) of the Act, which describes the Bureau’s purpose as follows: “The Bureau shall seek to implement and, where applicable, enforce Federal consumer financial law consistently for the purpose of ensuring that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive.”<sup>343</sup> Similarly, section 1022 of the Act authorizes the Bureau to prescribe rules to “carry out the purposes and objectives of the

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<sup>341</sup> Treating consumer protection and public interest as two separate but overlapping criteria is consistent with the FCC’s approach to a similar statutory requirement. *See Verizon v. FCC*, 770 F.3d 961, 964 (D.C. Cir. 2014).

<sup>342</sup> The Bureau believes that findings sufficient to meet the two tests explained here would also be sufficient to meet a unitary interpretation of the phrase “in the public interest and for the protection of consumers,” because any set of findings that meets each of two independent criteria would necessarily meet a single test combining them.

<sup>343</sup> Section 1021(b) goes on to authorize the Bureau to exercise its authorities:

for the purposes of ensuring that, with respect to consumer financial products and services,—

- (1) consumers are provided with timely and understandable information to make responsible decisions about financial transactions;
- (2) consumers are protected from unfair, deceptive, or abusive acts and practices and from discrimination;
- (3) outdated, unnecessary, or unduly burdensome regulations are regularly identified and addressed in order to reduce unwarranted regulatory burdens;
- (4) Federal consumer financial law is enforced consistently, without regard to the status of a person as a depository institution, in order to promote fair competition; and
- (5) markets for consumer financial products and services operate transparently and efficiently to facilitate access and innovation.



Federal consumer financial laws and to prevent evasions thereof” and provides that in doing so the Bureau shall consider “the potential benefits and costs” of a rule both “to consumers and covered persons, including the potential reduction of access by consumers to consumer financial products or services.” Section 1022 also directs the Bureau to consult with the appropriate Federal prudential regulators or other Federal agencies “regarding consistency with prudential, market, or systemic objectives administered by such agencies,” and to respond in the course of rulemaking to any written objections filed by such agencies.<sup>344</sup> The Bureau interprets these purposes and requirements to reflect a recognition and expectation that the administration of consumer financial protection laws is integrated with the advancement of a range of other public goals such as fair competition, innovation, financial stability, the rule of law, and transparency.

Accordingly, the Bureau proposes to interpret the phrase “in the public interest” to condition any regulation on a finding that such regulation serves the public good based on an inquiry into the regulation’s implications for the Bureau’s purposes and objectives. This inquiry would require the Bureau to consider benefits and costs to consumers and firms, including the more direct consumer protection factors noted above, and general or systemic concerns with respect to the functioning of markets for consumer financial products or services, the broader economy, and the promotion of the rule of law and accountability.<sup>345</sup>

With respect to “the protection of consumers,” as explained above, the Bureau ordinarily considers its roles and responsibilities as the Consumer [Financial] Protection Bureau to encompass attention to the full range of considerations relevant under Title X without separately

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<sup>344</sup> Dodd-Frank sections 1022(b)(2)(B) and (C).

<sup>345</sup> The Bureau uses its expertise to balance competing interests, including how much weight to assign each policy factor or outcome.

delineating some as “in the public interest” and others as “for the protection of consumers.” However, given that section 1028(b) pairs “the protection of consumers” with the “public interest,” the latter of which the Bureau interprets to include the full range of considerations encompassed in Title X, the Bureau believes, based on its expertise, that “for the protection of consumers” should be read more narrowly. Specifically the Bureau believes “for the protection of consumers” should be read to focus on the effects of a regulation in promoting compliance with laws applicable to consumer financial products and services, and avoiding or preventing harm to consumers that may result from violations of those laws or other consumer rights.

The Bureau therefore proposes to interpret the phrase “for the protection of consumers” in section 1028 – which relates specifically to arbitration agreements – to condition any regulation on a finding that such regulation would serve to deter and redress violations of the rights of consumers who are using or seek to use a consumer financial product or service. The focus under this prong of the test, as the Bureau is proposing to interpret it, would be exclusively on impacts on the level of compliance with relevant laws, including deterring violations of those laws, and on consumers’ ability to obtain redress or relief. This would not include consideration of other benefits or costs or more general or systemic concerns with respect to the functioning of markets for consumer financial products or services or the broader economy. For instance, a regulation would be “for the protection of consumers” if it adopted direct requirements or augmented the impact of existing requirements to ensure that consumers receive “timely and understandable information” in the course of financial decision making, or to guard them from

“unfair, deceptive, or abusive acts and practices and from discrimination.”<sup>346</sup> The Bureau proposes to interpret the phrase “for the protection of consumers” as it is used in section 1028 as not in and of itself requiring the Bureau to consider more general or systemic concerns with respect to the functioning of the markets for consumer financial products or services or the broader economy,<sup>347</sup> which the Bureau will consider under the public interest prong.

As discussed above, the Bureau provisionally believes that giving separate consideration to the two prongs best ensures that the purpose of the statute is effectuated. This proposed interpretation would prevent the Bureau from acting solely based on more diffuse public interest benefits, absent a meaningful direct impact on consumer protection as described above. Likewise, the proposed interpretation would prevent the Bureau from issuing arbitration regulations that would undermine the public interest as defined by the full range of factors discussed above, despite some advancement of the protection of consumers.

The Bureau invites comment on its proposed interpretation of section 1028(b). The Bureau specifically invites comment on whether “in the public interest” and “for the protection of consumers” should be interpreted as having independent meaning and, if so, whether the Bureau’s proposed interpretation of each effectuates the purpose of this provision. The Bureau also invites comments on whether a single, unitary standard would lead to a substantially different interpretation or application.<sup>348</sup>

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<sup>346</sup> Dodd-Frank section 1021(b)(1) and (2).

<sup>347</sup> See *Whitman v. Am. Trucking Ass’ns, Inc.*, 531 U.S. 457, 465 (2001).

<sup>348</sup> As noted above, if the Bureau were to treat the standard as a single, unitary test, it would involve the same considerations as described above, while allowing for a more flexible balancing of the various considerations. The Bureau accordingly believes that findings sufficient to meet the two tests explained here would also be sufficient to meet a unitary test, because any set of findings that meets each of two independent criteria would necessarily meet a more flexible single test combining them.

### *B. Preliminary Factual Findings from the Study and the Bureau's Further Analysis*

The Study provides a factual predicate for assessing whether particular proposals would be in the public interest and for the protection of consumers. This Part sets forth the preliminary factual findings that the Bureau has drawn from the Study and from the Bureau's additional analysis of arbitration agreements and their role in the resolution of disputes involving consumer financial products and services. The Bureau emphasizes that each of these findings is preliminary and subject to further consideration in light of the comments received and the Bureau's ongoing analysis. The Bureau invites comments on all aspects of the discussion of the factual findings that follows.

The Bureau preliminarily concludes, consistent with the Study and based on its experience and expertise, that: (1) the evidence is inconclusive on whether individual arbitration conducted during the Study period is superior or inferior to individual litigation in terms of remediating consumer harm; (2) individual dispute resolution is insufficient as the sole mechanism available to consumers to enforce contracts and the laws applicable to consumer financial products and services; (3) class actions provide a more effective means of securing relief for large numbers of consumers affected by common legally questionable practices and for changing companies' potentially harmful behaviors; (4) arbitration agreements block many class action claims that are filed and discourage the filing of others; and (5) public enforcement does not obviate the need for a private class action mechanism.

### *A Comparison of the Relative Fairness and Efficiency of Individual Arbitration and Individual Litigation Is Inconclusive*

The benefits and drawbacks of arbitration as a means of resolving consumer disputes have long been contested. The Bureau does not believe that, based on the evidence currently

available to the Bureau, it can determine whether the mechanisms for the arbitration of individual disputes between consumers and providers of consumer financial products and services that existed during the Study period are more or less fair or efficient in resolving these disputes than leaving these disputes to the courts.<sup>349</sup>

The Bureau believes that the predominant administrator of consumer arbitration agreements is the AAA, which has adopted standards of conduct that govern the handling of disputes involving consumer financial products and services. The Study further showed that these disputes proceed relatively expeditiously, the cost to consumers of this mechanism is modest, and at least some consumers proceed without an attorney. The Study also showed that those consumers who do prevail in arbitration may obtain substantial individual awards – the average recovery by the 32 consumers who won judgments on their affirmative claims was nearly \$5,400.<sup>350</sup>

At the same time, the Study showed that a large percentage of the relatively small number of AAA individual arbitration cases are initiated by the consumer financial product or service companies or jointly by companies and consumers in an effort to resolve debt disputes. The Study also showed that companies prevail more frequently on their claims than consumers<sup>351</sup> and that companies are almost always represented by attorneys. Finally, the Study showed that consumers prevailed and were awarded payment of their attorney’s fees by companies in 14.4

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<sup>349</sup> See Study, *supra* note 2, section 6 at 2-5 (explaining why “[c]omparing frequency, processes, or outcomes across litigation and arbitration is especially treacherous”). The Bureau did not study and is not evaluating post-dispute agreements to arbitrate between consumers and companies.

<sup>350</sup> See *id.*, section 5 at 41.

<sup>351</sup> *Id.*, section 5 at 39, 43. The Study did not suggest why companies prevail more often than consumers. While some stakeholders have suggested that arbitrators are biased – citing, for example, that companies are repeat players or often the party effectively chooses the arbitrator – other stakeholders and research suggests that companies prevail more often than consumers because of a difference in the relative merits of such cases.

percent of the 146 disputes resolved by arbitrators in which attorneys represented consumers, while companies prevailed and were awarded payment of their attorney's fees by consumers in 14.1 percent of 341 disputes resolved by arbitrators.<sup>352</sup>

Arbitration procedures are privately determined and can pose risks to consumers. For example, until it was effectively shut down by the Minnesota Attorney General, NAF was the predominant administrator for certain types of arbitrations. As set out in Part II.C above, NAF stopped conducting consumer arbitrations in response to allegations that its ownership structure gave rise to an institutional conflict of interest. The Study showed isolated instances of arbitration agreements containing provisions that, on their face, raise significant concerns about fairness to consumers similar to those raised by NAF, such as an agreement designating a tribal administrator that does not appear to exist and agreements specifying NAF as a provider even though NAF no longer handles consumer finance arbitration, making it difficult for consumers to resolve their claims.<sup>353</sup>

*Individual Dispute Resolution Is Insufficient In Enforcing Laws Applicable to Consumer Financial Products and Services and Contracts*

Whatever the relative merits of individual proceedings pursuant to an arbitration agreement compared to individual litigation, the Bureau preliminarily concludes, based upon the

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<sup>352</sup> Study, *supra* note 2, section 5 at 79-80. Note that the number of attorney's fee requests was not recorded.

<sup>353</sup> *Id.*, section 2 at 35. On the issue of NAF, *see Wert v. ManorCare of Carlisle PA, LLC*, 124 A.2d 1248, 1250 (Pa. 2015) (affirming denial of motion to compel arbitration after finding arbitration agreement provision that named NAF as administrator as "integral and non-severable"); *but see Wright v. GGNSC Holdings LLC*, 808 N.W.2d 114, 123 (S.D. 2011) (designation of NAF as administrator was ancillary and arbitration could proceed before a substitute). On the issue of tribal administrators, *see Jackson v. Payday Financial, LLC*, 764 F.3d 765 (7th Cir. 2014) (refusing to compel arbitration because tribal arbitration procedure was "illusory").

results of the Study, that individual dispute resolution mechanisms are an insufficient means of ensuring that consumer financial protection laws and consumer financial contracts are enforced.

The Study showed that consumers rarely pursue individual claims against their companies, based on its survey of the frequency of consumer claims, collectively across venues, in Federal courts, small claims courts, and arbitration. First, the Study showed that consumer-filed Federal court lawsuits are quite rare compared to the total number of consumers of financial products and services. As noted above, from 2010 to 2012, the Study showed that only 3,462 individual cases were filed in Federal court concerning the five product markets studied during the period, or 1,154 per year.<sup>354</sup> Second, the Study showed that relatively few consumers file claims against companies in small claims courts even though most arbitration agreements contain carve-outs permitting such court claims. In particular, as noted above, the Study estimated that, in the jurisdictions that the Bureau studied, which cover approximately 85 million people, there were only 870 small claims disputes in 2012 filed by an individual against any of the 10 largest credit card issuers, several of which are also among the largest banks in the United States.<sup>355</sup>

Extrapolating those results to the population of the United States suggests that, at most, a few

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<sup>354</sup> Study, *supra* note 2, section 6 at 27. As noted above, the Study did not include data on individual cases in State courts due to database limitations. One industry publication reports that litigation in court involving three consumer protection statutes occurs at a rate on the order of about 1,000 cases per month. WebRecon, LLC, “Out Like a Lion... Debt Collection Litigation & CFPB Complaint Statistics, Dec 2015 & Year in Review,” *available at* <http://webrecon.com/out-like-a-lion-debt-collection-litigation-cfpb-complaint-statistics-dec-2015-year-in-review/> (some cases included in this analysis would not be covered by the class proposal). Relatedly, some critics of the Study contend that the number of Federal court individual cases is low because Federal court litigation is complex and consumers need an attorney to proceed. Whatever the reason, even fewer consumers pursue claims in arbitration. *See* Study, *supra* note 2, section 5 at 19.

<sup>355</sup> The figure of 870 claims includes all cases in which an individual sued a credit card issuer, without regard to whether the claim itself was consumer financial in nature. As the Study noted, the number of claims brought by consumers that were consumer financial in nature was likely much lower. Additionally, the Study cross-referenced its sample of small claims court filings with estimated annual volume for credit card direct mail using data from a commercial provider. The volume numbers showed that issuers collectively had a significant presence in each jurisdiction, at least from a marketing perspective. *See* Study, *supra* note 2, Appendix Q at 113-14.

thousand cases at most are filed per year in small claims court by consumers concerning consumer financial products or services.

A similarly small number of consumers file consumer financial claims in arbitration. The Study shows that from the beginning of 2010 to the end of 2012 consumers filed 1,234 individual arbitrations with the AAA, or about 400 per year across the six markets studied.<sup>356</sup> Given that the AAA was the predominant administrator identified in the arbitration agreements studied, the Bureau believes that this represents substantially all consumer finance arbitration disputes that were filed during the Study period. Similarly, JAMS (the second largest provider of consumer finance arbitration<sup>357</sup>) has reported to Bureau staff that it handled about 115 consumer finance arbitrations in 2015.

Collectively, as set out in the Study, the number of all individual claims filed by consumers in individual arbitration, individual litigation in Federal court, or small claims court is relatively low in the markets analyzed in the Study compared to the hundreds of millions of consumers of various types of financial products and services.<sup>358</sup> The Bureau believes that the relatively low numbers of formal individual claims may be explained, at least in part, by the fact

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<sup>356</sup> See *id.* & section 5 at 19. Of the 1,234 consumer-initiated arbitrations, 565 involved affirmative claims only by the consumer with no dispute of alleged debt; another 539 consumer filings involved a combination of an affirmative consumer claim and disputed debt. *Id.*, section 5 at 31. This equates to 1,104 filings (out of 1,234), or 368 per year, in which the consumer asserted an affirmative claim at all. *Id.* In 737 claims filed by either party (or just 124 consumer filings), the only action taken by the consumer was to dispute the alleged debt. *Id.* Another 175 were mutually filed by consumers and companies. *Id.*, section 5 at 19.

<sup>357</sup> *Id.*, section 4 at 2.

<sup>358</sup> For instance, at the end of 2015, there were 600 million consumer credit card accounts, based on the total number of loans outstanding from Experian & Oliver Wyman Market Intelligence Reports. Experian & Oliver Wyman, *2015 Q4 Experian – Oliver Wyman Market Intelligence Report: Bank Cards Report*, at 1-2 (2015) and Experian & Oliver Wyman, *2015 Q4 Experian – Oliver Wyman Market Intelligence Report: Retail Lines*, at 1-2 (2015). In the market for consumer deposits, one of the top checking account issuers serviced 30 million customer accounts (JPMorgan Chase Co., Inc., 2010 Annual Report, at 36) and in the Overdraft MDL settlements, 29 million consumers with checking accounts were eligible for relief. Study, *supra* note 2, section 8 at 40.



that legal harms are often difficult for consumers to detect without the assistance of an attorney. For example, some harms, by their nature, such as discrimination or non-disclosure of fees, can only be discovered and proved by reference to how a company treats many individuals or by reference to information possessed only by the company, not the consumer.<sup>359</sup> Individual dispute resolution requires a consumer to recognize his or her own right to seek redress for any harm the consumer has suffered or otherwise to seek a dispensation from the company.

The Bureau also believes that the relatively low number of formally filed individual claims may be explained by the low monetary value of the claims that are often at issue.<sup>360</sup> Claims involving products and services that would be covered by the proposed rule often involve small amounts. When claims are for small amounts, there may not be significant incentives to pursue them on an individual basis. As one prominent jurist has noted, “Only a lunatic or a

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<sup>359</sup> For example, proving a claim of lending discrimination in violation of ECOA typically requires a showing of disparate treatment or disparate impact, which require comparative proof that members of a protected group were treated or impacted worse than members of another group. U.S. Dep’t of Housing & Urban Dev., Policy Statement on Discrimination in Lending, 59 FR 18266, 18268 (Apr. 15, 1994). Evidence of overt discrimination can also prove a claim of discrimination under ECOA but such proof is very rare and thus such claims are typically proven through showing disparate treatment or impact. See *Cherry v. Amoco Oil Co.*, 490 F. Supp. 1026, 1030 (N.D. Ga. 1980). Systemic overcharges may also be difficult to resolve on an individual basis. See, e.g., Stipulation and Agreement of Settlement at 30, *In re Currency Conversion Fee Multidistrict Litigation*, MDL 1409 (S.D.N.Y. July 20, 2006) (noting that the plaintiffs class allegations that the network and bank defendants “inter alia . . . have conspired, have market power, and/or have engaged in Embedding, otherwise concealed and/or not adequately disclosed the pricing and nature of their Foreign Transaction procedures; and, as a result, holders of Credit Cards and Debit Cards have been overcharged and are threatened with future harm.”).

<sup>360</sup> One indicator of the relative size of consumer injuries in consumer finance cases is the amount of relief provided by financial institutions in connection with complaints submitted through the Bureau’s complaint process. In 2015, approximately 6 percent of company responses to complaints for which the company reported providing monetary relief (approximately 9,730 complaints) were closed “with monetary relief” for a median amount of \$134 provided per consumer complaint. See Bureau of Consumer Fin. Prot., *Consumer Response Annual Report (2016) available at [http://files.consumerfinance.gov/f/201604\\_cfpb\\_consumer-response-annual-report-2015.pdf](http://files.consumerfinance.gov/f/201604_cfpb_consumer-response-annual-report-2015.pdf)*. The Bureau’s complaint process and informal dispute resolution mechanisms at other agencies do not adjudicate claims; instead, they provide an avenue through which a consumer can complain to a provider. Complaints submitted to the Bureau benefit the public and the financial marketplace by informing the Bureau’s work; however, the Bureau’s complaint system is not a substitute for consumers’ rights to bring formal disputes and relief is not guaranteed.

fanatic sues for \$30.”<sup>361</sup> In other words, it is impractical for the typical consumer to incur the time and expense of bringing a formal claim over a relatively small amount of money, even without a lawyer. Congress and the Federal courts developed procedures for class litigation in part because “the amounts at stake for individuals may be so small that separate suits would be impracticable.”<sup>362</sup> Indeed, the Supreme Court has explained that:

[t]he policy at the very core of the class action mechanism is to overcome the problem that small recoveries do not provide the incentive for any individual to bring a solo action prosecuting his or her own rights. A class action solves this problem by aggregating the relatively paltry potential recoveries into something worth someone’s (usually an attorney’s) labor.<sup>363</sup>

The Study’s survey of consumers in the credit card market reflects this dynamic. Very few consumers said they would pursue a legal claim if they could not get what they believed were unjustified or unexplained fees reversed by contacting a company’s customer service department.<sup>364</sup>

Even when consumers are inclined to pursue individual claims, finding attorneys to represent them can be challenging. Attorney’s fees for an individual claim can easily exceed expected individual recovery.<sup>365</sup> A consumer must pay his or her attorney in advance or as the

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<sup>361</sup> *Carnegie v. Household Int’l, Inc.*, 376 F.3d 656, 661 (7th Cir. 2004).

<sup>362</sup> 1966 Adv. Comm. Notes, 28 U.S.C. App. 161.

<sup>363</sup> *Amchem Prod.*, 521 U.S. at 617 (citing *Mace v. Van Ru Credit Corp.*, 109 F.3d 338, 344 (7th Cir. 1997)).

<sup>364</sup> Just 2.1 percent of respondents said that they would have sought legal advice or would have sued with or without an attorney for unrecognized fees on a credit card statement. Study, *supra* note 2, section 3 at 17-18. Similarly, many financial services companies opt not to pursue small claims against consumers; for example, these providers do not actively collect on small debts because it is not worth their time and expense given the small amounts at issue and their low likelihood of recovery.

<sup>365</sup> For instance, in the Study’s analysis of individual arbitrations, the average and median recoveries by consumers winning awards on their affirmative claims were \$5,505 and \$2,578, respectively. Study, *supra* note 2, section 5 at 39. By way of comparison (attorney’s fees data limited to successful affirmative consumer claims was not reported in the Study), the average and median consumer attorney’s fees awards were \$8,148 and \$4,800, respectively, across cases involving judgments favoring consumers involving affirmative relief or disputed debt relief. *Id.*, section 5 at 79. Note that the Study did not address the number of cases in which attorney’s fees were requested by the consumer. *Id.*

work is performed unless the attorney is willing to take a case on contingency – a fee arrangement where an attorney is paid as a percentage of recovery, if any – or rely on an award of defendant-paid attorney’s fees, which are available under many consumer financial statutes. Attorneys for consumers often are unwilling to rely on either contingency-based fees or statutory attorney’s fees because in each instance the attorney’s fee is only available if the consumer prevails on his or her claim (which always is at least somewhat uncertain). Consumers may receive free or reduced-fee legal services from legal services organizations, but these organizations frequently are unable to provide assistance to many consumers because of the high demand for their services and limited resources.<sup>366</sup>

For all of these reasons, the Bureau preliminarily finds that the relatively small number of arbitration, small claims, and Federal court cases reflects the insufficiency of individual dispute resolution mechanisms alone to enforce effectively the law for all consumers of a particular provider, including Federal consumer protection laws and consumer finance contracts.

Some stakeholders claim that the low total volume of individual claims, in litigation or arbitration, found by the Study is attributable not to inherent deficiencies in the individual dispute resolution systems but rather to the success of informal dispute resolution mechanisms in resolving consumers’ complaints. On this theory, the cases that actually are litigated or arbitrated are outliers – consumer disputes in which the consumer either bypassed the informal

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<sup>366</sup> There is a large unmet need for legal services for low-income individuals who want legal help in consumer cases. By one estimate, roughly 130,000 consumers (for all goods, not just financial products or services) were turned away because the legal aid service providers serving low-income individuals did not have enough staff or capacity to help. See Legal Services Corp., *Documenting the Justice Gap In America*, at 7 (2007), available at <http://www.lsc.gov/sites/default/files/LSC/images/justicegap.pdf>. See also Helynn Stephens, *Price of Pro Bono Representations: Examining Lawyers’ Duties and Responsibilities*, 71 Def. Counsel J. 71 (2004) (“Legal services programs are able to assist less than a fifth of those in need.”).

dispute resolution system or the system somehow failed to produce a resolution. The Bureau does not find this argument persuasive.

The Bureau understands that when an individual consumer complains about a particular charge or other practice, it is often in the financial institution's interest to provide the individual with a response explaining that charge and, in some cases, a full or partial refund or reversal of the practice, in order to preserve the customer relationship.<sup>367</sup> But, as already noted, many consumers may not be aware that a company is behaving in a particular way, let alone that the company's conduct is unlawful. Thus, an informal dispute resolution system is unlikely to provide relief to all consumers who are adversely affected by a particular practice. Indeed, the Bureau has observed that most of its enforcement actions deliver relief to consumers who have not received it already through informal dispute resolution.

Moreover, even where consumers do make complaints informally, the outcome of these disputes may be unrelated to the underlying merits of the claim.<sup>368</sup> Nothing requires a company to resolve a dispute in a particular consumer's favor, to award complete relief to that consumer, to decide the same dispute in the same way for all consumers, or to reimburse consumers who

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<sup>367</sup> This is true, of course, only to the extent that consumers have a choice of financial service providers. The Bureau notes that consumers do not have such a choice in some important consumer financial markets, including in markets where servicing or debt collection is outsourced by a creditor and the consumer typically does not have the ability to choose a different servicer or debt collector.

<sup>368</sup> Commentators have advised that concerns other than whether a violation occurred should be considered when resolving complaints. See, e.g., Claes Fornell & Birger Wernerfelt, *Defensive Marketing Strategy by Customer Complaint Management: A Theoretical Analysis*, 24 J. of Marketing Res. 337, 339 (1987) (“[W]e show that by attracting and resolving complaints, the firm can defend against competitive advertising and lower the cost of offensive marketing without losing market share.”); Mike George, Cosmo Graham & Linda Lennard, *Complaint Handling: Principles and Best Practice* at 6 (2007) (discussing research that shows that customers who complain are more likely to re-purchase the good or service than those who do not and noting that additional research that shows that good complaints culture and processes may well lead to improved financial performance), available at [https://www2.le.ac.uk/departments/law/research/cces/documents/Complainhandling-PrinciplesandBestPractice-April2007\\_000.pdf](https://www2.le.ac.uk/departments/law/research/cces/documents/Complainhandling-PrinciplesandBestPractice-April2007_000.pdf).

had not raised their dispute to a company. Regardless of the merits of or similarities between the complaints, the company retains discretion to decide how to resolve them. For example, if two consumers bring the same dispute to a company, the company might resolve the dispute in favor of a consumer who is a source of significant profit while it might reach a different resolution for a less profitable consumer.<sup>369</sup> Indeed, in the Bureau’s experience it is quite common for financial institutions (especially the larger ones that interact with the greatest number of consumers) to maintain profitability scores on each customer and to cabin the discretion of customer service representatives to make adjustments on behalf of complaining consumers based on such scores.<sup>370</sup>

The example of overdraft reordering, which was included in the Study’s discussion of the Overdraft MDL, provides an example of the limitations of informal dispute resolution and the important role of class litigation in more effectively resolving consumers’ disputes.<sup>371</sup> In the cases included in the MDL, certain customers lodged informal complaints with banks about the overdraft fees. The subsequent litigation revealed that banks had been reordering transactions from chronological order to an order based on highest to lowest amount to maximize the number

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<sup>369</sup> One study showed that one bank refunded the same fee at varying rates depending on the branch location that a consumer visited. Jason S. Johnston & Todd Zywicki, *The Consumer Financial Protection Bureau’s Arbitration Study: A Summary And Critique* (Mercatus Center 2015), <http://mercatus.org/publication/consumer-financial-protection-bureau-arbitration-study-summary-critique> (explaining that the process undertaken by one bank in 2014 “resulted in its refunding 94 percent of wire transfer fees that customers complained about at its San Antonio office and 75 percent of wire transfer fees that customers complained about at its Brownsville office. During that same period, the bank responded to complaints about inactive account fees by making refunds 74 percent of the time in San Antonio but only 56 percent of the time in Houston.”). The study does not provide information on how many of the bank’s customers complained or why some customers were successful in receiving refunds while others were not.

<sup>370</sup> See, e.g., Rick Brooks, *Banks and Others Base Their Service On Their Most-Profitable Customers*, Wall St. J. (Jan. 7, 1999), available at <http://www.wsj.com/articles/SB915601737138299000> (explaining how some banks will treat profitable customers differently from unprofitable ones and citing examples of banks using systems to routinely allow customer service representatives to deny fee refund and other requests from unprofitable customers while granting those from profitable customers).

<sup>371</sup> Study, *supra* note 2, section 8 at 39-46.

of overdraft fees. As far as the Bureau is aware, these informal complaints, while resulting in some refunds to the relatively small number of consumers who complained, produced no changes in the bank practices in dispute. Ultimately, after taking into account the relief that consumers had obtained informally, 29 million bank customers received cash relief in court settlements because they did not receive relief through internal dispute resolution processes.<sup>372</sup>

Thus, while informal dispute resolution systems may provide some relief to some consumers – and while some stakeholders have argued that arbitration agreements may even enhance the incentives that companies have to resolve those informal disputes that do arise on a case-by-case basis – the Bureau preliminarily finds that these systems alone are inadequate mechanisms to resolve potential violations of the law that broadly apply to many or all customers of a particular company for a given product or service.

The Bureau’s experience and expertise includes fielding consumer complaints, supervising a vast array of markets for consumer financial products and services, and enforcing Federal consumer financial laws. Based on this experience and expertise, the Bureau believes that even though systemic factors may discourage individual consumers from filing small claims, the ability of consumers to pursue these claims is important. Based on its experience and expertise, the Bureau preliminarily finds that small claims can reflect significant aggregate harms when the potentially illegal practices affect many consumers, and, more generally, the market for consumer financial products and services. For example, a single improper overdraft fee may

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<sup>372</sup> In total, 18 banks paid \$1 billion in settlement relief to over 29 million consumers. Study, *supra* note 2, section 8 at 43-46 (explaining how the settlements were distributed). These settlement figures were net of any payments made to consumers via informal dispute resolution; an expert witness calculated the sum of fees attributable to the overdraft reordering practice and subtracted all refunds paid to complaining consumers. The net amount was the baseline from which settlement payments were negotiated. *See id.*, section 8 at 45-46 nn.61 & 63.

only “cost” a consumer \$35, but if that fee is charged to tens of thousands of consumers, it can have a substantial impact on both the consumers on whom such fees are imposed and the profits of the company retaining the fees.<sup>373</sup> When all or most providers engage in a similar practice, the market for that product or service is significantly impacted.

*Class Actions Provide a More Effective Means of Securing Significant Consumer Relief and Changing Companies’ Potentially Illegal Behavior*

The Bureau preliminarily finds, based on the results of the Study and its further analysis, that the class action procedure provides an important mechanism to remedy consumer harm. The Study showed that class action settlements are a more effective means through which large numbers of consumers are able to obtain monetary and injunctive relief in a single case.

In the five-year period studied, 419 Federal consumer finance class actions reached final class settlements. These settlements involved, conservatively, about 160 million consumers and about \$2.7 billion in gross relief of which, after subtracting fees and costs, \$2.2 billion was available to be paid to consumers in cash relief or in-kind relief.<sup>374</sup> Further, as set out in the Study, nearly 24 million class members in 137 settlements received automatic distributions of

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<sup>373</sup> For example, in *Gutierrez v. Wells Fargo Bank, N.A.*, the court explained that the defendant bank’s own documents established that it stood to make \$40 million more per year from overdraft fees by reordering transaction high-to-low rather than chronologically. See *Gutierrez v. Wells Fargo Bank, N.A.*, 730 F. Supp. 2d 1080, 1097 (N.D. Cal. 2010). For further procedural history for *Gutierrez*, see *infra* note 377.

<sup>374</sup> The number of consumers (160 million) obtaining relief in class settlements excludes a single settlement that involved a class of 190 million consumers. Study, *supra* note 2, section 8 at 15. Section 8 of the Study, on Federal class action settlements, covered a wider range of products than the analysis of individual arbitrations in Section 5 of the Study, which was limited to credit cards, checking/debit cards, payday and similar loans, general purpose reloadable prepaid cards, private student loans, and auto purchase loans. *Id.*, section 5 at 17-18. If the class settlement results were narrowed to the six product markets covered in Section 5, the Study would have identified \$1.8 billion in total relief (\$1.79 billion in cash and \$9.4 million of in-kind relief), or \$360 million per year, covering 78.8 million total class members, or 15.8 million members per year.

class settlements, meaning they received payments without having to file claims.<sup>375</sup> In the five years studied, at least 34 million consumers received \$1.1 billion in actual or guaranteed payments.<sup>376</sup> In addition to the monetary relief awarded in class settlements, consumers also received non-monetary relief from those settlements. Specifically, the Study showed that there were 53 settlements covering 106 million class members that mandated behavioral relief that required changes in the settling companies' business practices. The Bureau preliminarily finds, based on its experience and expertise – including its review and monitoring of these settlements and its enforcement of Federal consumer financial law through both litigation and supervisory actions – that behavioral relief could be, when provided, at least as important for consumers as monetary relief. Indeed, prospective relief can provide more relief to affected consumers, and for a longer period, than retrospective relief because a settlement period is limited (and provides a fixed amount of cash relief), whereas injunctive relief lasts for years or may be permanent.

The Bureau further preliminarily finds that, based on its experience and expertise, class action settlements also benefit consumers not included in a particular class settlement because, as a result of a class settlement, companies frequently change their practices in ways that benefit consumers who are not members of the class. In resolving a class action, many companies stop potentially illegal practices either as part of the settlement or because the class action itself informed them of a potential violation of law and of the risk of future liability if they continued

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<sup>375</sup> *Id.*, section 8 at 27.

<sup>376</sup> As noted above, *see supra* note 369 **Error! Bookmark not defined.** and accompanying text, researchers have calculated that, on average, each consumer that received monetary relief during the period studied received \$32. Because the settlements providing data on payments (a figure defined in the Study, *supra* note 2, section 8 at 4-5 n.9, to include relief provided by automatic distributions or actually claimed by class members in claims made processes) to class members did not overlap completely with the settlements providing data on the number of class members receiving payments, this calculation is incorrect. Nonetheless, the Bureau believes that it is a roughly accurate approximation.



the conduct in question. Any consumer impacted by that practice – whether or not the consumer is in a particular class – would benefit from an enterprise-wide change. For example, if a class settlement only involved consumers who had previously purchased a product, a change in conduct by the company might benefit consumers who were not included in the class settlement but who purchase the product or service in the future.

One example of this appears to have occurred with respect to overdraft practices. In *Gutierrez v. Wells Fargo*, the court ruled that certain Wells Fargo overdraft practices were illegal.<sup>377</sup> Although that judgment was limited to a California class of Wells consumers, Wells thereafter appears to have also changed its overdraft practices in other jurisdictions in the United States.<sup>378</sup> Similarly, the Bureau bases this preliminary finding on its understanding of the important benefits gained by consumers through behavioral changes companies agree to make that benefit both existing customers and future customers. This is, for example, why the Bureau frequently tries to secure such behavioral relief from companies through its own enforcement actions. Although the value of these behavioral changes (and those, not considered behavioral relief in the Study, where companies simply agree to comply with the law going forward) are

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<sup>377</sup> The original bench trial awarded “a certified class of California depositors” both cash and injunctive relief based on violations of California law. *Gutierrez v. Wells Fargo Bank, N.A.*, 730 F. Supp. 2d 1080, 1082 (N.D. Cal. 2010). The Ninth Circuit reversed part of the judgment on the basis that the some parts of California law – as applied to overdraft reordering practices – were preempted by the National Bank Act, and remanded to the district court for it to determine if relief could still be granted under the parts of California law that were not preempted. 704 F.3d 712, 730 (9th Cir. 2012). Upon remand, the district court reinstated the judgment, including restitution and injunctive relief. 944 F. Supp. 2d 819 (N.D. Cal. 2013). The Ninth Circuit upheld parts of the reinstated judgment, permitting a judgment against Wells and upholding the award of restitution, but vacating for the grant of injunctive relief as overly broad. 589 Fed. Appx. 824 (9th Cir. Oct. 29, 2014), *cert. denied*, --- S.Ct. ---, 2016 WL 1278632 (Apr. 4, 2016).

<sup>378</sup> See Danielle Douglas-Gabriel, *Big banks have been gaming your overdraft fees to charge you more money*, Wash. Post Wonkblog (July 17, 2014), <https://www.washingtonpost.com/news/wonk/wp/2014/07/17/wells-fargo-to-make-changes-to-protect-customers-from-overdraft-fees/> (“Half of the country’s big banks play this game, but one has decided to stop: Wells Fargo. Starting in August, the bank will process customers’ checks in the order in which they are received, as it already does with debit card purchases and ATM withdrawals.”).

typically not quantified in case records, the Bureau believes their value to consumers are significant.<sup>379</sup>

The Bureau has considered stakeholder arguments that class actions are not effective at securing relief and behavior changes for large numbers of consumers because the Study showed that about three-fifths of cases filed as seeking class treatment are resolved through voluntary individual settlements (or an outcome consistent with a voluntary individual settlement).<sup>380</sup> The Bureau believes, however, that the best measure of the effectiveness of class actions for all consumers is the absolute relief they provide, and not the proportion of putative class cases that result in individual settlements or potential individual settlements. The fact that many cases filed as putative class cases do not result in class relief does not change the significance of that relief in the cases that do provide it. Moreover, when a named plaintiff agrees in a putative class action to an individual settlement, by rule it occurs before certification of a class, and thus does not prevent other consumers from resolving similar claims, including by filing their own class actions. The Bureau believes that, beyond the named plaintiff, an individual settlement of a class case does not bind other consumers or affect their right to pursue their claims ; in this sense they are no worse off than if the individually settled case had never been filed at all. Accordingly, the Bureau believes it more appropriate to evaluate class actions based on the magnitude of relief that these cases, collectively (including the many that do result in class settlements) deliver to

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<sup>379</sup> As is discussed below in the Section 1022(b)(2) Analysis, the Study uses “behavioral relief” to refer to class settlements which contained a commitment by a defendant to alter its behavior prospectively, for example by promising to change business practices in the future or implementing new compliance programs. The Bureau did not include a defendant’s agreement to just comply with the law, without more, as behavioral relief (Study, *supra* note 2, Appendix S at 135).

<sup>380</sup> Study, *supra* note 2, section 6 at 37.

consumers.<sup>381</sup> Thus, the Bureau preliminarily finds that the concerns raised by stakeholders regarding the predominance of individual outcomes in cases filed as putative class cases are not substantial enough for the Bureau to find that the class proposal would be ineffective in providing consumer relief.

For these reasons, the Bureau preliminarily finds that the class action mechanism is a more effective means of providing relief to consumers for violations of law or contract affecting groups of consumers than other mechanisms available to consumers, such as individual formal adjudication (either through judicial or arbitral fora) or informal efforts to resolve disputes.

*Arbitration Agreements Block Some Class Action Claims and Suppress the Filing of Others*

The Bureau preliminarily finds, based upon the results of the Study, that arbitration agreements have the effect of blocking a significant portion of class action claims that are filed and of suppressing the filing of others.

As noted above in Part III, the Study showed that arbitration agreements are widespread in consumer financial markets and hundreds of millions of consumers use consumer financial products or services that are subject to arbitration agreements. Arbitration agreements give companies that offer or provide consumer financial products and services the contractual right to block the filing of class actions in both court and arbitration. When a plaintiff files a class action in court regarding a claim that is subject to a valid and applicable arbitration agreement, a defendant has the ability to request that the court dismiss or stay the litigation in favor of arbitration. If the court grants such a dismissal or stay in favor of arbitration, the class case

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<sup>381</sup> Stakeholders similarly assert that class actions are ineffective because the fact most are resolved on an individual basis indicates that they were unlikely to result in class certification. The Bureau is not aware of evidence to support this assertion. Cases settle on an individual basis for a variety of reasons and, as noted, whether and why they are resolved does not alter the value of aggregate relief awarded in cases that settle on a classwide basis.

could, in principle, be refiled as a class arbitration.<sup>382</sup> However, the Study showed that, depending on the market, between 85 to 100 percent of the contracts with arbitration agreements the Bureau reviewed expressly precluded an arbitration proceeding on a class basis. The Study did not identify any contracts with arbitration agreements that explicitly permitted class arbitration. The combined effect of these provisions is to enable companies that adopt arbitration agreements effectively to bar *all* class proceedings, whether in litigation or arbitration, to which the agreement applies.

As set out above in Part II.C, the public filings of some companies confirm that the effect – indeed, often the purpose – of such provisions is to allow companies to shield themselves from class liability.<sup>383</sup> Some have stated, both to the Bureau and in public statements (such as those made by small entity representatives in the SBREFA Panel hearing on arbitration), that companies adopt arbitration agreements for the purpose of blocking private class action filings. Some trade association stakeholders have further argued that the class action waiver is integral to offering individual arbitration: they see little point in permitting individuals to bring arbitrations if other similarly situated consumers will simply join a class action in any case.

The Study showed that defendants are not reluctant to invoke arbitration agreements to block putative class actions and were successful in many cases. The Study recorded nearly 100 Federal and State class action filings that were dismissed or stayed because companies invoked arbitration agreements by filing a motion to compel arbitration and citing an arbitration

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<sup>382</sup> In class arbitration, a class representative brings an arbitration on behalf of many individual, similarly-situated plaintiffs. The Study identified only two class arbitrations filed before the AAA from 2010 to 2012. Study, *supra* note 2, section 5 at 86.

<sup>383</sup> See *supra* note 90.

agreement in support.<sup>384</sup> The Study further indicates that companies were at least 10 times more likely to move to stay or dismiss a case filed as a class action on the basis of an arbitration agreement than non-class cases.<sup>385</sup> In other words, companies used arbitration agreements far more frequently to block class actions than to move individual court cases to arbitration. The Bureau preliminarily finds that the above data combined indicate that the primary reason many companies include arbitration agreements in their contracts is to discourage the filing of class actions and block those that are filed. While companies might perceive other benefits of maintaining arbitration agreements for individual disputes, for many, those benefits seem ancillary to their ability to limit class actions.

The analysis of cases in the Study further supports the Bureau's preliminary finding that arbitration agreements are frequently used to prevent class actions from proceeding. While the Study reports that motions to compel arbitration were filed in only 16.7 percent of class actions filed from 2010 to 2012, the Bureau was unable to determine in what percentage of class action cases analyzed defendants had arbitration agreements and were in a position to invoke an arbitration agreement.<sup>386</sup> However, in a sample of class action cases against credit card companies known to have arbitration agreements, motions to compel arbitration were filed 65 percent of the time and, when filed, they were successful 61.5 percent of the time.<sup>387</sup>

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<sup>384</sup> Section 6 of the Study identified two sources of data on motions to compel arbitration. First, the Study identified 562 Federal and State putative class action filings in six products markets from 2010 to 2012, and in 94 of these cases, defendants filed motions to compel arbitration; 46 of these motions were granted, and the rest were denied or still pending at the time the Study was published. See Study, *supra* note 2, section 6 at 58. Further, the Study identified at least 50 more putative class cases pertaining to consumer financial products or services (including more than the initial six markets studied) that were dismissed pursuant to a motion to compel arbitration that cited the *Concepcion* case. *Id.*, section 6 at 58-59.

<sup>385</sup> *Id.*, section 6 at 57-58.

<sup>386</sup> *Id.*, section 6 at 56.

<sup>387</sup> *Id.*, section 6 at 61.

The Bureau further preliminarily finds that when courts grant a motion to dismiss class claims based on arbitration agreements, the large number of consumers who would have constituted the putative class are unlikely to pursue the claims on an individual basis and are even less likely to pursue them in class arbitration. For instance, for the 46 class cases identified in the Study in which a motion to compel arbitration was granted, there was only an indication of 12 subsequent arbitration filings in the court dockets or the AAA Case Data, only two of which the Study determined were filed as putative class arbitrations.<sup>388</sup> More broadly, the overall volume of AAA consumer-filed claims – just over 400 individual cases per year – suggests that individual arbitration is not the destination for any significant number of putative class members. The case study of opt-outs from settlements in the Preliminary Results of the Study further demonstrates this.<sup>389</sup> It reviewed Federal and State class action settlements that involved 13 million class members eligible for \$350 million in relief from defendants that used arbitration agreements in their consumer contracts, all naming the AAA as the arbitration administrator. In these settlements, 3,605 of the 13 million class members chose to opt out of receiving cash relief.<sup>390</sup> Nevertheless, just three out of these 3,605 individuals appear to have taken the opportunity to file arbitrations before the AAA against the same settling defendants.<sup>391</sup> Although the case study is just one example, the Bureau has little reason to believe consumers in similar cases would refile in arbitration.

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<sup>388</sup> *See id.*, section 6 at 57-58.

<sup>389</sup> *See* Preliminary Results, *supra* note 2, Appendix A at 102-04.

<sup>390</sup> *See id.* at 104.

<sup>391</sup> As the Preliminary Results make clear, *at most* three out of 3,605 individuals filed claims before the AAA against the same defendants. It is not clear from the records provided to the Bureau whether these three consumers pressed the same claims in arbitration that formed the basis of the class settlement. Preliminary Results, *supra* note 2, at 104 n.225.

In addition to blocking class actions that are actually filed, the Bureau preliminarily finds that arbitration agreements inhibit a number of putative class action claims from being filed at all for several reasons. Plaintiffs and their attorneys may choose not to file such claims because arbitration agreements substantially lower the possibility of classwide relief. Given that and the fact that attorneys incur costs in preparing and litigating a case (and consumers rarely pay these costs up front in a class action) attorneys may decline to take such cases at all if they calculate that they will incur costs with little chance of recouping them. Not surprisingly, when a consumer or a lawyer considers whether to file a class action, the existence of an arbitration agreement that, if invoked, would effectively eliminate the possibility for a successful class claim likely discourages many of these suits from being filed at all. While it is difficult to measure the full scope of claims that are never filed because of arbitration agreements, stakeholders that surveyed attorneys found that they frequently turn away cases – both individual and class – when arbitration agreements were present.<sup>392</sup> In some markets, consumers could not file class action cases after market participants included arbitration agreements in their consumer contracts.<sup>393</sup>

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<sup>392</sup> In response to the Bureau’s Request for Information in connection with the Study, one consumer group commenter submitted a 2012 survey conducted of 350 consumer attorneys. *See* Nat’l Ass’n of Consumer Advocates, *Consumer Attorneys Report: Arbitration clauses are everywhere, consequently causing consumer claims to disappear*, at 5 (2012), available at <http://www.consumeradvocates.org/sites/default/files/NACA2012BMASurveyFinalRedacted.pdf> (hereinafter NACA Survey). Over 80 percent of those attorneys reported turning down at least one case they believed to be meritorious because the presence of an arbitration agreement would make filing the case futile and of those, the median number of cases each attorney turned away was  $t=10$ . *Id.* at 5. The NACA survey indicates that consumer attorneys believe that the presence of arbitration agreements often inhibit them from filing complaints, including class actions, on behalf of consumers. The Bureau notes that this survey has methodological limits. The survey does not purport to indicate the total number of cases turned away in aggregate. And the survey does not examine whether a case that was turned down by a single attorney was subsequently filed by another attorney.

<sup>393</sup> *See, e.g., Ross v. American Express Co.*, 35 F.Supp.3d 407, 433 (S.D.N.Y. 2014) (reviewing standing of credit card holders claiming injury from inclusion of pre-dispute arbitration agreements and noting that “loss of the

*Public Enforcement Is Not a Sufficient Means to Enforce Consumer Protection Laws and Consumer Finance Contracts*

The Bureau preliminarily concludes, based upon the results of the Study and its own experience and expertise, that public enforcement is not itself a sufficient means to enforce consumer protection laws and consumer finance contracts.

Most consumer protection statutes provide explicitly for private as well as public enforcement mechanisms. For some laws, only public enforcement is available because lawmakers sometimes decide that certain factors favor allowing only government enforcement. For other laws, lawmakers decide there should be both types of enforcement – public and private. On several occasions, Congress expressly recognized the role class actions can have in effectuating Federal consumer financial protection statutes. As described in Part II, for instance, Congress amended TILA in 1974 to limit damages in class cases to the lesser of \$100,000 or 1 percent of the creditor’s net worth. In reports and floor debates concerning the 1974 TILA amendments, the Senate reasoned that the damages cap it imposed would balance the objectives of providing adequate deterrence while appropriately limiting awards (because it viewed potential TILA class damages as too high).<sup>394</sup> Two years later, when the 1976 TILA

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services of class action lawyers to monitor and challenge Issuing Bank behavior and the loss of the opportunity to go to court” were a prospective injury for standing purposes).

<sup>394</sup> *Class Actions Under the Truth in Lending Act*, 83 Yale L.J. 1410, 1429 (1974) (“Two major concerns were expressed by the Senate in its report and floor debates on this amendment. First, the Senate took note of the trend away from class actions after [*Ratner v. Chemical Bank New York Trust Co.*, 329 F. Supp. 270 (S.D.N.Y. 1971)] and the need for potential class action liability to encourage voluntary creditor compliance. The Senate considered individual actions an insufficient deterrent to large creditors, and so imposed a \$100,000 or one percent of net worth ceiling to provide sufficient deterrence without financially destroying the creditor.”).



amendments increased the cap to the lesser of \$500,000 or 1 percent of the creditor's net worth, the primary basis for the increase was the need to adequately deter large creditors.<sup>395</sup>

The market for consumer finance products and services is vast, encompassing trillions of dollars of assets and revenue and tens if not hundreds of thousands of companies. As discussed further in the Section 1022(b)(2) Analysis, this proposal alone would cover about 50,000 firms. And this proposal would leave unaffected the single largest consumer financial market – the mortgage market – because Congress expressly prohibited most arbitration agreements in that market in the Dodd-Frank Act.<sup>396</sup>

In contrast, the resources of public enforcement agencies are limited. For example, the Bureau enforces over 20 separate Federal consumer financial protection laws with respect to every depository institution with assets of more than \$10 billion and all non-depository institutions. Yet the Bureau has about 1,500 employees, only some of whom work in its Division of Supervision, Enforcement, and Fair Lending, which supervises for compliance and enforces violations of these laws.<sup>397</sup> Furthermore, the Bureau is the only federal agency exclusively focused on enforcing these laws. Other financial regulators, including Federal prudential regulators and State agencies, have authority to supervise and enforce other laws with respect to the entities within their jurisdictions, but they face resource constraints as well.

Further, those other regulators often have many different mandates, only part of which is

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<sup>395</sup> S. Rept. 94-590, Consumer Leasing Act of 1976, at 8 (“The recommended \$500,000 limit, coupled with the 1 percent formula, provides, we believe, a workable structure for private enforcement. Small businesses are protected by the 1 percent measure, while a potential half million dollar recovery ought to act as a significant deterrent to even the largest creditor.”); *see also* H. Rep. 95-1315, Electronic Fund Transfer Act (1978) at 15.

<sup>396</sup> Dodd-Frank section 1414.

<sup>397</sup> Bureau of Consumer Fin. Prot., *Semi-Annual Report of the CFPB*, at 131 (2015), available at [http://files.consumerfinance.gov/f/201511\\_cfpb\\_semi-annual-report-fall-2015.pdf](http://files.consumerfinance.gov/f/201511_cfpb_semi-annual-report-fall-2015.pdf) (noting that CFPB had 1,529 staff as of September 30, 2015).

consumer protection. By authorizing private enforcement of the consumer financial statutes, Congress and the states have allowed for more comprehensive enforcement of these statutory schemes.

The Study showed private class actions complement public enforcement rather than duplicate it. In 88 percent of the public enforcement actions the Bureau identified, the Bureau did not find an overlapping private class action.<sup>398</sup> Similarly, in 68 percent of the private class actions the Bureau identified, the Bureau did not find an overlapping public enforcement action. Moreover, in a sample of class action settlements of less than \$10 million, there was no overlapping public enforcement action 82 percent of the time.<sup>399</sup> Even where there was overlap, private class actions tended to precede public enforcement actions, roughly two-thirds of the time.

Finally, the Bureau notes that as a general matter public authorities cannot enforce private contracts or violations of the common law affecting consumers. For those types of claims, private class actions are not just complementary but often the only likely means by which consumers can enforce their rights.

*C. The Bureau Preliminarily Finds That the Class Proposal Is in the Public Interest and for the Protection of Consumers*

The prior section articulated the Bureau's preliminary findings that individual dispute resolution mechanisms are an insufficient means of enforcing consumer financial laws and contracts; public enforcement cannot be relied upon to fully and effectively enforce all of these

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<sup>398</sup> Study, *supra* note 2, section 9 at 4.

<sup>399</sup> *Id.*

laws and private contracts; and class actions, when not blocked by arbitration agreements, provide a valuable complement to public enforcement and a means of providing substantial relief to consumers. In light of the Study, the Bureau's experience and expertise, and the Bureau's analysis and findings as discussed above, the Bureau preliminarily finds that precluding providers from blocking consumer class actions through the use of arbitration agreements would better enable consumers to enforce their rights under Federal and State consumer protection laws and the common law and obtain redress when their rights are violated. Allowing consumers to seek relief in class actions, in turn, would strengthen the incentives for companies to avoid potentially illegal activities and reduce the likelihood that consumers would be subject to such practices in the first instance. The Bureau preliminarily finds that both of these outcomes resulting from allowing consumers to seek class action relief would be in the public interest and for the protection of consumers.

The analysis below discusses the bases for these findings in the reverse order, beginning with a discussion of the protection of consumers and then addressing the public interest. As discussed further below, the Bureau recognizes that creating these incentives and causing companies to choose between increased risk mitigation and enhanced exposure to liability would impose certain burdens on providers. These burdens would be chiefly in the form of increased compliance costs to prevent violations of consumer financial laws enforceable by class actions, including the costs of forgoing potentially profitable (but also potentially illegal) business practices that may increase class action exposure, and in the increased costs to litigate class actions themselves, including, in some cases, providing relief to a class. The Bureau also recognizes that providers may pass through some of those costs to consumers, thereby increasing prices. Those impacts are delineated and, where possible, quantified in the Bureau's Section

1022(b)(2) Analysis below and, with regard in particular to burdens on small financial services providers, discussed further below in the Section-by-Section Analysis to proposed § 1040.4(a) and in the initial Regulatory Flexibility Analysis (IRFA).

After reviewing the considerations that would support a potential finding that the class proposal would be for the protection of consumers and in the public interest, this section considers, under the legal standard established by section 1028, costs to providers as well as other potentially countervailing considerations, such as the potential impacts on innovation in the market for consumer financial products and services. In light of all these considerations, the Bureau preliminarily finds that that standard is satisfied.

The Bureau seeks comments on its preliminary finding set forth below – that the class proposal would be in the public interest and for the protection of consumers.

*Enhancing Compliance with the Law and Improving Consumer Remuneration and Company Accountability Is for the Protection of Consumers*

Under the status quo, arbitration agreements obstruct effective enforcement of the law through class proceedings. This harms consumers in two ways: it makes consumers *both* more likely to be subject to potentially illegal conduct because of underinvestment in compliance activities and deliberate risk-taking by companies *and* makes consumers less likely to be able to obtain meaningful relief when violations do occur. The Bureau preliminarily finds that the class proposal, by changing the status quo, creating incentives for greater compliance, and restoring an important means of relief and accountability, would be for the protection of consumers.

To the extent that laws cannot be effectively enforced, the Bureau believes that companies may be more likely to take legal risks, *i.e.*, to engage in potentially unlawful business practices, because they know that any potential costs from exposure to putative class action

filings have been reduced if not effectively eliminated. Due to this reduction in legal exposure (and thus a reduction in risk), companies have less of an incentive to invest in compliance management in general, such as by investing in employee training with respect to compliance matters or by carefully monitoring changes in the law and making appropriate changes in their conduct.

As discussed in the Section 1022(b)(2) Analysis, economic theory supports the Bureau's belief that the availability of class actions affects compliance incentives. The standard economic model of deterrence holds that individuals who benefit from engaging in particular actions that violate the law will instead comply with the law when the expected cost from violation, *i.e.*, the expected amount of the cost discounted by the probability of being subject to that cost, exceeds the expected benefit. Consistent with that model, Congress<sup>400</sup> and the courts<sup>401</sup> have long recognized that deterrence is one of the primary objectives of class actions.

The preliminary finding that class action liability deters potentially illegal conduct and encourages investments in compliance is confirmed by the Bureau's own experience and its observations about the behavior of firms and the effects of class actions in markets for consumer

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<sup>400</sup> See, *e.g.*, *supra* note 394; H. Rept. 94-589, Equal Credit Opportunity Act Amendments of 1976, at 14 (Jan. 21, 1976).

<sup>401</sup> See, *e.g.*, *Reiter v. Sonotone Corp.*, 442 U.S. 330, 344 (1979) (noting that antitrust class actions “provide a significant supplement to the limited resources available to the Department of Justice for enforcing the antitrust laws and deterring violations”); *Hughes v. Kore of Indiana Enter.*, 731 F.3d 672, 677-78 (7th Cir. 2013) (Posner, J.) (“A class action, like litigation in general, has a deterrent as well as a compensatory objective. . . . The compensatory function of the class action has no significance in this case. But if [defendant’s] net worth is indeed only \$1 million . . . the damages sought by the class, and, probably more important, the attorney’s fee that the court will award if the class prevails, will make the suit a wake-up call for [defendant] and so have a deterrent effect on future violations of the Electronic Fund Transfer Act by [the defendant] and others.”); *deHaas v. Empire Petroleum Co.*, 435 F.2d 1223, 1231 (10th Cir. 1970) (“Since [class action rules] allow many small claims to be litigated in the same action, the overall size of compensatory damages alone may constitute a significant deterrent.”); *Globus v. Law Research Service, Inc.*, 418 F.2d 1276, 1285 (2d Cir. 1969) (“Compensatory damages, especially when multiplied in a class action, have a potent deterrent effect.”).

financial products and services. The Bureau has analyzed a variety of evidence that, in its view, indicates that companies invest in compliance to avoid activities that could increase their exposure to class actions.

First, the Bureau is aware that companies monitor class litigation relevant to the products and services that they offer so that they can mitigate their liability by changing their conduct before being sued themselves. This effect is evident from the proliferation of public materials – such as compliance bulletins, law firm alerts, and conferences – where legal and compliance experts routinely and systematically advise companies about relevant developments in class action litigation,<sup>402</sup> for instance claims pertaining to EFTA,<sup>403</sup> the Fair and Accurate Credit Transactions Act (FACTA),<sup>404</sup> FCRA,<sup>405</sup> FDCPA,<sup>406</sup> and the TCPA.<sup>407</sup>

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<sup>402</sup> A brief search by the Bureau has uncovered dozens of alerts advising companies to halt conduct or review practices in light of a class action filed in their industry that may impact their businesses. A selection of these alerts is set forth in the next several footnotes and all are on file with the Bureau. *See, e.g.,* Jones Day, *The Future of Mandatory Consumer Arbitration Clauses* (Nov. 13, 2015) (“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 [on arbitration]. These steps could help to diminish . . . risks that would result from the CFPB’s anticipated placement of substantial limitations on the use of arbitration clauses”); Ballard Spahr LLP, *Seventh Circuit Green Lights Data Breach Class Action Against Neiman Marcus* (July 28, 2015) (noting in response to a recent data breach class action that its attorneys “regularly advise financial institutions on compliance with data security and privacy issues”); Bryan Cave LLP, *Plaintiffs Seek Class Status for Alleged Card Processing “Junk Fee” Scheme* (Nov. 5, 2015) (“[P]rocessors and merchant acquirers should revisit their form agreements and billing practices to ensure they are free of provisions that a court might consider against public policy, and that all fees payable by a merchant are clearly identified in the application, the main agreement, or a schedule to the agreement.”); Jenner & Block LLP, *Civil Litigation Outlook for 2016* (Feb. 1, 2016) (“Given such developments, 2016 will bring a strong and continued focus on privacy protections and data breach prevention both in the class action context and otherwise.”); Bryan E. Hopkins, *Legal Risk Management for In-House Counsel & Managers* 49-52 (2013) (noting a variety of compliance activities companies should consider in product design in order to mitigate class action exposure).

<sup>403</sup> *See, e.g.,* Bracewell LLP, *Bankers Beware: ATM Fee Class Action Suits on the Rise* (Oct. 5, 2010) (noting dozens of class action cases regarding ATM machines and advising ATM operators “to make sure that their ATMs provide notice to consumers on both the machine and on the screen (with the opportunity for the customer to opt-out before a fee is charged) if a fee will be charged for providing the ATM service.”).

<sup>404</sup> *See, e.g.,* Arent Fox LLP, *Unlucky Numbers: Ensuring Compliance with the Fair and Accurate Credit Transactions Act* (Nov. 18, 2011) (explaining allegations in one class action and noting that “ensuring proactive compliance with FACTA is crucial because a large number of non-compliant receipts may be printed before the problem is brought to a company’s attention.”); Jones Day, *If Your Business Accepts Credit Cards, You Need to Read This* (Sept. 2007) (“If your company has not been sued for a FACTA violation, you still need to act. . . . If any

Relatedly, where there is class action exposure, companies and their representatives will seek to focus more attention and resources on general proactive compliance monitoring and management. The Bureau has seen evidence of this motivation in various law and compliance firm alerts. For example, one such alert, posted shortly after the Bureau released its SBREFA Outline, noted that the Bureau was considering proposals to prevent arbitration agreements from being used to block class actions. In light of these proposals, the firm recommended several “Steps to Consider Taking Now,” including, “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

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potential violation is noted, correct it immediately. Also, to avoid future unknown liability, monitor the decisions related to FACTA to determine whether there are any changes regarding the statute’s interpretation. With that, your company will be able to immediately correct any ‘new’ violations found to exist under the law. If your company has been sued, act immediately to come into compliance with FACTA.”).

<sup>405</sup> See, e.g., K&L Gates LLP, *Beyond Credit Reporting: the Extension of Potential Class Action Liability to Employers under the Fair Credit Reporting Act* (Apr. 7, 2014) (“In light of FCRA’s damages provisions and the recent initiation of putative class actions against large national companies, business entities which collect background information for prospective or current employees should stay abreast of the requirements of FCRA and related state law, and should be proactive in developing sound and logical practices to comply with FCRA’s provisions.”).

<sup>406</sup> See, e.g., K&L Gates LLP, *You Had Me at “Hello” Letter: Second Circuit Concludes That a RESPA Transfer-of-Servicing Letter Can Be a Communication in Connection with Collection of a Debt* (Sept. 22, 2015) (“[M]ortgage servicers would do well to ensure they are paying close attention when reviewing such letters for FDICPA compliance” in order to avoid class action liability).

<sup>407</sup> See, e.g., DLA Piper, *Ninth Circuit Approves Provisional Class Action Certification in TCPA Class Action, Defines “Prior Express Consent”* (Nov. 19, 2012) (“*Meyer* [a class action] seems to make clear that creditors and debt collectors must verify that debtors provided their cell phone numbers and that the numbers were provided *at the time of the transactions related to the debts* before contact is made using an automated or predictive dialer. For cell phone numbers provided *later* by debtors, it is imperative that creditors and debt collectors make clear to the owners of those numbers that they may be contacted at these numbers for purposes of debt collection.”); Mayer Brown LLP, *Seventh Circuit Holds That Companies Are Liable Under Telephone Consumer Protection Act for Placing Automated Calls to Reassigned Numbers* (May 16, 2012) (“[C]ompanies must ensure that the actual recipients of automated calls have consented to receiving them, and take steps to update their records when telephone numbers have been reassigned to new subscribers. For example, the Seventh Circuit [in a class action] noted that callers could avoid liability by doing a ‘reverse lookup to identify the current subscriber’ or by ‘hav[ing] a person make the first call’ to verify that the number is ‘still assigned’ to the customer.”).

result in groups of consumers taking action.”<sup>408</sup> Another recent alert relating to electronic payments litigation noted that firms could either improve their compliance efforts or adopt arbitration agreements to limit their class action exposure.<sup>409</sup> Similarly, trade associations routinely update their members about class litigation and encourage them to examine their practices so as to minimize their class action exposure. For example, a 2015 alert from a credit union trade association describes “a new potential wave of overdraft-related suits. . . . target[ing] institutions that base fees on ‘available’ instead of ‘actual’ balance” and advises credit unions to take five compliance-related steps to mitigate potential class action liability.<sup>410</sup>

While the Bureau believes that such monitoring and attempts to anticipate litigation affect the practices of companies that are exposed to class action liability, the impacts can be hard to document and quantify because companies rarely publicize changes in their behavior, let alone publicly attribute those changes to risk-mitigation decisions. The Bureau has, however, identified instances where it believes that class actions filed against one or more firms in an industry led to others changing their practices, presumably in an effort to avoid being sued themselves. For example, between 2003 and 2006, 11 auto lenders settled class action lawsuits alleging that the lenders’ credit pricing policies had a disparate impact on minority borrowers

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<sup>408</sup> See, e.g., Jones Day, *The Future of Mandatory Consumer Arbitration Clauses*, JonesDay.com (Nov. 2015), available at <http://www.jonesday.com/the-future-of-mandatory-consumer-arbitration-clauses-11-13-2015/>.

<sup>409</sup> Ballard Spahr LLP, *The Next EFTA Class Action Wave Has Started* (Sept. 1, 2015), <http://www.ballardspahr.com/alertspublications/legalalerts/2015-09-01-the-next-efta-class-action-wave-has-started.aspx> (“We have counseled financial institutions and consumer businesses . . . on taking steps to mitigate the risk of claims by consumers (such as by adding an enforceable arbitration provision to the relevant agreement).”); see also Wiley Rein LLP, *E-Commerce—The Next Target of ‘Big Data’ Class Actions?* (Jan. 5, 2016), <http://www.wileyrein.com/newsroom-articles-E-Commerce-The-Next-Target-of-Big-Data-Class-Actions.html> (noting that arbitration agreements can help to avoid class litigation and advising that “it would also be advisable for e-commerce vendors to include in their privacy policy an arbitration clause establishing that any dispute would be adjudicated in individual arbitration (as opposed to class litigation or arbitration).”).

<sup>410</sup> Credit Union Magazine, *Minimize the Risk of Overdraft Fee Lawsuits*, Credit Union Nat’l Ass’n (June 26, 2015), available at <http://news.cuna.org/articles/106373-minimize-the-risk-of-overdraft-fee-lawsuits>.



under ECOA. In the settlements, the lenders agreed to restrict interest rate markups to no more than 2.5 percentage points. Following these settlements, a markup cap of 2.5 percent became standard across the industry even with respect to companies outside the direct scope of the settlements.<sup>411</sup> Use of caps has continued even after the consent decrees that triggered them have expired.<sup>412</sup>

As another example, since 2012, 18 banks have entered into class action settlements as part of the Overdraft MDL,<sup>413</sup> in which plaintiffs challenged the adoption of a particular method of ordering the processing of payment transactions that increases substantially the number of overdraft fees incurred by consumers compared with alternative methods. Specifically, the litigation challenged banks that commingled debit card transactions with checks and automated clearinghouse transactions that come in over the course of a day and reordered the transactions to process them in descending order based on amount. Relative to chronological or a lowest-to-highest ordering, this practice typically produces more overdraft fees by exhausting funds in the account before the last several small debits can be processed. In the years since the litigation, the industry has largely abandoned this practice. According to a 2015 study, from 2013 to 2015, the

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<sup>411</sup> See F&I and Showroom, *2.5 Percent Markups Becoming the Trend* (Aug. 9, 2005), <http://www.fi-magazine.com/news/story/2005/08/2-5-markups-becoming-the-trend.aspx>; Chicago Automobile Trade Ass'n, *Automotive News: 2.5 Percent Becoming Standard Dealer Finance Markup* (Nov. 22, 2010), [http://www.cata.info/automotive\\_news\\_25\\_becoming\\_standard\\_dealer\\_finance\\_markup/](http://www.cata.info/automotive_news_25_becoming_standard_dealer_finance_markup/). The Bureau notes that California's adoption in 2006 of the Car Buyer's Bill of Rights, which mandated a maximum 2.5 percent markup for loan terms of 60 months or less, may also have influenced the adoption of this markup limit. Cal. Dep't of Motor Vehicles, *Car Buyer's Bill of Rights*, available at [https://www.dmv.ca.gov/portal/dmv/?1dmy&urile=wcm:path:/dmv\\_content\\_en/dmv/pubs/brochures/fast\\_facts/ffvr35](https://www.dmv.ca.gov/portal/dmv/?1dmy&urile=wcm:path:/dmv_content_en/dmv/pubs/brochures/fast_facts/ffvr35).

<sup>412</sup> See e.g., Automotive News, *Feds Eye Finance Reserve* (Feb. 25, 2013), available at <http://www.autonews.com/article/20130225/RETAIL07/302259964/feds-eye-finance-reserve> ("Most were settled by 2003, with the lenders agreeing to cap the finance reserve at two or three percentage points. That cap became the industry standard.").

<sup>413</sup> See *supra* notes 311-313 & 371-372 and accompanying text.

percentage of large banks that used commingled high-to-low-reordering decreased from 37 percent to 9 percent.<sup>414</sup>

A third example of companies responding to class actions by changing their practices to improve their compliance with the law relates to foreign transaction fees and debit cards. *In re Currency Conversion Fee Antitrust Litigation* (MDL 1409) is a class action proceeding in which plaintiffs alleged, in part, that banks that issued credit cards and debit cards violated the law by not adequately disclosing foreign transaction fees to consumers when they opened accounts.<sup>415</sup> In the settlement, two large banks agreed to list the rate applicable to foreign transaction fees in their initial disclosures for personal checking accounts with debit cards.<sup>416</sup> A review of the market subsequent to the 2006 settlement indicates that this type of disclosure is now standard practice for debit card issuers across the market, not merely by the two large banks bound by the settlement.<sup>417</sup>

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<sup>414</sup> See Pew Charitable Trusts, *Checks and Balances: 2015 Update*, at 12, Figure 11 (May 2015), available at [http://www.pewtrusts.org/~media/assets/2015/05/checks\\_and\\_balances\\_report\\_final.pdf](http://www.pewtrusts.org/~media/assets/2015/05/checks_and_balances_report_final.pdf). According to a different 2012 study, community banks predominantly posted items in an order intended to minimize overdrafts, such as low-to-high or check or transaction order. The Independent Community Banks of America (ICBA) Overdraft Payment Services Study at 40 (June 2012), available at <https://www.icba.org/files/ICBASites/PDFs/2012OverdraftStudyFinalReport.pdf>. Only 8.8 percent of community banks reordered transactions from high to low dollar amount. *Id.* at 42 & fig. 57. Most of the community banks studied did not change their posting order in the two year period their overdraft practices were reviewed. *See id.* at 42 (noting that 82 percent of community banks had not changed the order in which they posted transactions during the two years before the ICBA's study). To the extent that community banks changed their practices, in the two years preceding the 2012 study, 70.7 percent of those that changed their practices stopped high-to-low reordering. *Id.*

<sup>415</sup> Third Consol. Am. Class Action Compl., *In Re Currency Conversion Fee Antitrust Litig.*, MDL Docket No. 1409 (S.D.N.Y., July 18, 2006) (alleging that general purpose and debit cardholders were “charged hidden and embedded collusively set prices, including a hidden, embedded and collusively set base currency conversion fee equal to 1% of the amount of the foreign currency transaction,” that “most member banks tack[ed] on a currency conversion fee of their own,” and that all of this was done in violation of “TILA, EFTA and the state consumer protection laws require[ing] disclosure of such fees in, inter alia, cardholder solicitations and account statements”).

<sup>416</sup> Stip. & Agmt of Settlement, *In re Currency Conversion Fee Antitrust Litig.*, MDL 1409, 27-30 (S.D.N.Y. July 20, 2006).

<sup>417</sup> In some instances, the dynamics of deterrence may be different. In another example from the *In re Currency Conversion Fee* class action litigation, the defendants voluntarily halted the conduct at issue upon being sued.

These are a few examples of industry-wide change in response to class actions that the Bureau believes support its preliminary finding that exposure to consumer financial class actions creates incentives that encourage companies to change potentially illegal practices and to invest more resources in compliance in order to avoid being sued.<sup>418</sup> The cases help to illustrate the mechanisms, among others, by which the proposed class rule would deter potentially illegal practices by many companies. The Bureau believes that the result would be more legally compliant consumer financial products and services that would advance the protection of consumers.

As discussed in more detail in the Section 1022(b)(2) Analysis, the Bureau does not believe it is possible to quantify the benefits to consumers from the increased compliance incentives attributable to the class proposal due in part to obstacles to measuring the value of deterrence directly in a systematic way. Nonetheless, the Bureau preliminarily finds that increasing compliance incentives would be for the protection of consumers.

The Bureau recognizes that some companies may decide to assume the resulting increased legal risk rather than investing more in ensuring compliance with the law and foregoing practices that are potentially illegal or even blatantly unlawful. Other companies may seek to mitigate their risk but miscalibrate and underinvest or under comply. To the extent that

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Karen Bruno, *Foreign transaction fees: Hidden credit card 'currency conversion fees' may be returned – if you file soon*, CreditCards.com (May 23, 2007), <http://www.creditcards.com/credit-card-news/foreign-transaction-fee-1282.php> (“[I]n most cases the companies voluntarily began disclosing fees once the suit was filed.”).

<sup>418</sup> Some stakeholders have suggested that even absent class action exposure there already are sufficient incentives for compliance and that class actions are too unpredictable to increase compliance incentives. The Bureau is not, at this point, persuaded by these arguments. The Bureau recognizes, of course, as discussed further in the Section 1022(b)(2) Analysis, that exposure to private liability is not the only incentive that companies have to comply with the law. However, based on its experience and expertise and for the reasons discussed herein, the Bureau believes that companies can (and in many cases should) do more to ensure that their conduct is compliant and that the presence of class action exposure will affect companies’ incentives to comply.

this happens, the Bureau preliminarily finds that the class proposal would enable many more consumers to obtain redress for violations than do so today, when companies can use arbitration agreements to block class actions. As set out in the Bureau’s Section 1022(b)(2) Analysis, the amount of additional compensation consumers would be expected to receive from class action settlements in the Federal courts varies by product and service – specifically, by the prevalence of arbitration agreements in those individual markets – but is substantial nonetheless and in most markets represents a considerable increase.<sup>419</sup>

Furthermore, the Bureau preliminarily finds that through such litigation consumers would be better able to cause providers to cease engaging in unlawful or questionable conduct prospectively than under a system in which companies can use arbitration agreements to block class actions. Class actions brought against particular providers can, by providing behavioral relief into the future to consumers, force more compliance where the general increase in incentives due to litigation risk are insufficient to achieve that outcome.

The Overdraft MDL also helps illustrate the potential ongoing value of such prospective relief. A recent study by an academic researcher based on the Overdraft MDL settlements offered rare data on the relationship between the settlement relief offered to class members compared to the sum total of injury suffered by class members that has important implications

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<sup>419</sup> As is explained in the Section 1022(b)(2) Analysis below, the Bureau calculates the future number of class actions by estimating that, in any given market, the providers that currently use arbitration agreements would face class litigation at the same rate and same magnitude as the providers that currently do not use arbitration agreements faced during the five-year period covered by the Study. For all but one of the markets for which the Bureau makes an estimate, only one market – pawn shops – was there no Federal class settlement in the period studied, and the Bureau projects that consumers in these markets would receive no additional compensation from Federal class settlements if the class proposal were adopted. Because it did not have the relevant data, the Bureau did not separate State class settlements by markets or project additional compensation attributable to future State class settlements. Where litigation actually occurs, there would also be increased costs to providers in the form of attorney’s fees and related expenses. The Bureau addresses these costs below.

for the value of prospective relief. The analysis calculated that in the various settlements, the value of cash settlement relief offered to the class constituted between 7 and 70 percent (or an average of 38 percent and a median of 40 percent) of the total value of harm suffered by class members from overdraft reordering during the class period.<sup>420</sup> The total value of injuries suffered by class members can be estimated using these settlement relief-to-total consumer harm ratios and the sum of cash settlement relief. Using the average settlement-to-harm rate of 38 percent, and the total cash relief figure of about \$1 billion in the Overdraft MDL settlements, an estimate of the total value of harm suffered by consumers in the settlements identified by the Bureau would be approximately \$2.6 billion.<sup>421</sup> More concretely, this figure estimates the total amount of additional or excess overdraft fees class members paid to the settling banks during the class periods because of the banks' use of the high-to-low reordering method to calculate overdraft fees.

This sum – \$2.6 billion – can also be used as a basis for determining the potential *future* value of the cessation of the high-to-low reordering practice. If \$2.6 billion is the total amount of excess overdraft fees class members paid during their respective class periods because of the high-to-low reordering practice, the same figure (converted to an annualized figure using the

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<sup>420</sup> Brian T. Fitzpatrick & Robert C. Gilbert, *An Empirical Look at Compensation in Consumer Class Actions*, 11 N.Y.U. J. L. & Bus. 767, 785 (2015) (“[N]ot only can we report the average payout for class members who participated in the settlements, but also what the plaintiffs thought these payouts recovered relative to the damage done to class members.”). Fitzpatrick worked with Gilbert, an attorney involved in the Overdraft MDL settlements, to identify the total quantum of overdraft fees attributable to the practice of reordering in settlements identified by the Study. *Id.*

<sup>421</sup> *See id.* at 786 & tbl. 3. The calculation is the total amount of relief the Study identified with the Overdraft MDL settlements (\$1 billion), divided by .38 (the average “recovery rate” of the 15 Overdraft settlements identified by Fitzpatrick and Gilbert, which ranged from approximately 14 percent to 69 percent). While Fitzpatrick and Gilbert’s analysis separately identified the settlement to harm ratio for each individual bank, the banks were anonymized for purposes of their analysis and, therefore, cannot be matched to the specific class settlements set out in the Study.

class period)<sup>422</sup> may be used to estimate how much the same class members save *every year* in the future by no longer being subject to high-to-low reordering practice for purposes of calculating overdraft fees. The prospective benefits to consumers as a whole are often even larger because companies frequently change their practices not just with regard to class members, but to their customer base as a whole, and other companies that were not sued may also preemptively change their practices. As this one example shows, prospective relief – because it can continue in perpetuity – can have wide-ranging benefits for consumers over and above the value of retrospective relief, and can, through changing the behavior of providers subject to a suit, benefit other customers of these providers who are not class members.

For all of these reasons, the Bureau believes that the class proposal would increase compliance and increase redress for non-compliant behavior and thus would be for the protection of consumers. To the extent that the class proposal would affect incentives (or lead to more prospective relief) and enhance compliance, consumers seeking to use particular consumer financial products or services would more frequently receive the benefits of the statutory and common law regimes that legislatures and courts have implemented and developed to protect them. Consumers would, for example, be more likely to receive the disclosures required by and compliant with TILA, to benefit from the error-resolution procedures required by TILA and EFTA, and to avoid the unfair and abusive debt collection practices proscribed by the FDCPA

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<sup>422</sup> Assuming the average class period was the 10-year class period of the largest settlement, the 18 Overdraft MDL settlements collectively provide \$260 million in prospective relief per year to those class members identified in our case studies. This estimate assumes that future overdraft fees generated from the high-to-low practice would have been comparable to the fees generated in the past. This estimate does not take into account the ongoing benefit to other consumers who were not class members (those who, for instance, were not in the jurisdiction covered by the settlement, or those who acquired accounts after the settlement), nor is the benefit to those consumers who bank with institutions that were not sued but voluntarily stopped the overdraft reordering practice. Nor does this figure include any of the other settlements identified by the Bureau in Section 8 of the Study, which did not contain the kind of information on the proportion of calculable harm to settlement relief.

and the discriminatory practices proscribed by ECOA.<sup>423</sup> In those States that provide for private enforcement of their fair competition law, consumers similarly would be less likely to be exposed to unfair or deceptive acts or practices. Consumers also would be more likely to receive the benefits of their contract terms and less likely to be exposed to tortious conduct.

*Enhancing Compliance with the Law and Improving Consumer Remuneration and Company Accountability Is in the Public Interest*

The Bureau also preliminarily finds that the class proposal would be in the public interest. This preliminary finding is based upon several considerations, which are discussed below and include the beneficial aspects for consumers (who, as previously discussed, are part of the public whose interests are to be furthered), leveling the playing field for providers, and enhancing the rule of law. Consistent with the legal standard, the Bureau also considers concerns, which have been raised by stakeholders as well, including the class proposal's impacts on costs and financial access, innovation, the potential of class actions to provide windfalls to plaintiffs, and the availability of individual dispute resolution, and preliminarily finds that the class proposal would be for the protection of consumers and in the public interest in light of full consideration of these and other relevant factors.

First, as discussed extensively above, the Bureau believes that its preliminary finding that the class proposal would protect consumers also contributes to a finding that the class proposal would be in the public interest.

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<sup>423</sup> See generally Study, *supra* note 2, section 8 at 13 & fig. 1 (noting the number of class settlements by frequency of claim type).

Second, the Bureau considers the impact the class proposal would have on leveling the playing field in markets for consumer financial products and services in its public interest analysis. The Bureau preliminarily finds that the class proposal would create a more level playing field between providers that concentrate on compliance and providers that choose to adopt arbitration agreements to insulate themselves from being held to account by the vast majority of their customers and, as the Study showed, from virtually any private liability. The Bureau believes this also supports a determination that the class proposal would be in the public interest.

Specifically, the Bureau believes that companies that adopt arbitration agreements to manage their liability may possess certain advantages over companies that instead make greater investments in compliance to manage their liability, both in their ability to minimize costs and to profit from the provision of potentially illegal consumer financial products and services. The Bureau does not expect that eliminating the advantages enjoyed by companies with arbitration agreements would necessarily shift market share to companies that eschew arbitration agreements and instead focus on up front compliance because the future competitive balance between companies would also depend on many additional factors. It has thus not counted the effects of this factor as a major element of the Section 1022(b)(2) Analysis. However, the Bureau believes that eliminating this type of arbitrage as a potential source of competition would be in the public interest.<sup>424</sup>

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<sup>424</sup> The Bureau recognizes, of course, that under the current system companies without arbitration agreements can level the playing field by adopting such agreements. But the Bureau believes that the public interest would be served by a system in which a level playing field is achieved by bringing all companies' compliance incentives up to the level of those that face class action liability for non-compliance. The public interest would not be served by a system in which the level playing field is achieved by bringing compliance incentives down to the level of those



Finally, the Bureau believes that its preliminary finding that the class proposal would have the effect of achieving greater compliance with the law implicates additional benefits beyond those noted above with respect to the protection of individual consumers and impacts on responsible providers. Federal and State laws that protect consumers were developed and adopted because many companies, unrestrained by a need to comply with such laws, would engage in conduct that is profit-maximizing but that lawmakers have determined disservices the public good by distorting the efficient functioning of these markets. These Federal and State laws, among other things, allow consumer financial markets to operate more transparently and to operate with less invidious discrimination, and for consumers to make more informed choices in their selection of financial products and services.

Thus, the Bureau believes that by creating enhanced incentives and remedial mechanisms to enforce compliance, the class proposal could improve the functioning of consumer financial markets as a whole. First, enhanced compliance would, over the long term, create a more predictable, efficient, and robust regime. Second, the Bureau also believes enhanced compliance and more effective remedies could also reduce the risk that consumer confidence in these markets would erode over time as individuals, faced with the non-uniform application of the law and left without effective remedies for unlawful conduct, may be less willing to participate in certain sections of the consumer financial markets. For all of these reasons, the Bureau believes

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companies that are effectively immune from such liability. Indeed, “races to the bottom” within the consumer financial services markets were a significant concern prompting Congress to enact the Dodd-Frank Act because of their potential impacts on consumers, responsible providers, and broader systemic stability. S. Rept. 111-176, The Restoring American Financial Stability Act of 2010, at 10 (Apr. 30, 2010) (“This fragmentation led to regulatory arbitrage between federal regulators and the states, while the lack of any effective supervision on nondepositories led to a ‘race to the bottom’ in which the institutions with the least effective consumer regulation and enforcement attracted more business, putting pressure on regulated institutions to lower standards to compete effectively, ‘and on their regulators to let them.’”).

that promoting the rule of law – in the form of accountability under and transparent application of the law to providers of consumer financial products or services – would be in the public interest as well as for the protection of consumers.

During both the SBREFA process and ongoing outreach with various stakeholders, some participants have suggested that the class proposal would not be in the public interest because it would: (1) impose costs on providers that would be passed through to consumers; (2) reduce incentives for innovation in markets for consumer financial products and services; (3) deliver windfalls to named plaintiffs and class members; or (4) negatively affect the means available to consumers to resolve individual disputes formally and informally. Participants in the SBREFA process also asserted that the class proposal would have disproportionate impacts on small entities. After carefully considering these points and factoring them into its analysis as discussed further below and in the discussion of small business impact in the Section-by-Section Analysis to proposed § 1040.4(a), the Bureau preliminarily finds that the class proposal would on balance be in the public interest.<sup>425</sup>

*Costs to Providers and Pass-Through to Consumers.* As discussed in the Section 1022(b)(2) Analysis, the Bureau recognizes that the class proposal would impose three types of costs on providers: (1) costs associated with increased compliance, including compliance management costs and costs of eschewing potentially illegal but profitable practices; (2) costs for legal defense and retrospective and prospective remediation; and (3) costs associated with changing contracts. As further discussed in that section, the Bureau also recognizes that some

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<sup>425</sup> In the Section-by-Section Analysis to proposed § 1040.4(a), the Bureau specifically addresses certain concerns related to the class proposal and its costs. That discussion is incorporated in this section 1028(b) analysis by reference. The Bureau also in that discussion seeks comment whether it should exempt small entities from the proposed rule. The Bureau discusses further potential alternatives below in the Bureau's IRFA.

portion of those costs could be passed through to consumers. The Bureau believes, however, that the fact that these costs would, at least in the first instance, be incurred by providers or that some of the costs could be passed through to consumers does not alter its finding that the class proposal would be in the public interest.

The Bureau believes that compliance, litigation, and remediation costs generally are a necessary component of the broader private enforcement scheme, and that certain costs are vital to uphold a system that vindicates actions brought through the class mechanism. The specific marginal costs that would be attributable to the class proposal are similarly justified. These costs are justified to protect consumers and produce the benefits discussed above. The fact that some of these costs, described below, may be passed through does not alter the Bureau's belief that it would be in the public interest (and for the protection of consumers) for the class proposal to cause providers to incur these costs.<sup>426</sup>

Further, as noted in the Section 1022(b)(2) Analysis below, the Bureau believes that it is important given the size of the markets at issue to evaluate cost predictions relative to the number of accounts and consumers so as to properly assess the scale of the predictions. Given hundreds of millions of accounts across affected providers, the hundreds or thousands of competitors in most markets, and the numerical estimates of costs as specified below, the Bureau does not believe that the expenses due to the additional class settlements that would result from

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<sup>426</sup> Some stakeholders have suggested that providers would incur costs that produce no benefits by engaging in compliance management activities that would not result in any changes in the providers' behaviors. According to this view, providers would sustain an increase in compliance costs without any actual change in behavior or added compliance by, for example, double or triple checking previous compliance efforts. However, the Bureau would not expect a firm to waste money confirming that it already complies when it receives no benefit in exchange for that investment. In addition, as the examples cited above suggest, class actions can assist firms in locating areas where their compliance efforts may be insufficient and allow them to focus their increased compliance efforts in areas where private actions are most likely.

this proposed rule would result in a noticeable impact on access to consumer financial products or services.<sup>427</sup> Similarly, the Bureau also believes that the potential cost impacts on small providers, and individual providers more generally, are not as large as some stakeholders have suggested based on the detailed analysis provided below that factors in likelihood of litigation, recovery rates, and other considerations.

*Innovation.* Some stakeholders have suggested that the proposal would disserve the public interest because it would discourage innovation. According to this argument, providers would refrain from developing or offering products and services that benefit consumers and are lawful – or may withdraw existing, beneficial products from the market – due to concerns that the products may pose legal risk, for instance because they are novel. The Bureau is not currently persuaded that this would occur for several reasons.

First, the Bureau notes that some innovation in consumer financial markets can disserve the interest of consumers and the public and that deterring such innovation actually would advance the public interest. For example, a major cause of the financial crisis was “innovation” in the mortgage market – innovation that led to the introduction of a set of high-risk products and underwriting practices.<sup>428</sup> Similarly, Congress enacted the CARD Act in response to “innovation” in the credit card marketplace – such as the practice of triggering interest rate hikes based on “universal default” – that made the pricing of credit cards more opaque and

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<sup>427</sup> As is noted below, the impacts might be higher for some markets.

<sup>428</sup> See Fin. Crisis Inquiry Comm’n, *The Financial Crisis Inquiry Report*, at 104-05 (2011), available at <https://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf> (discussing creation of a larger, new, subprime mortgage market, expanded use of high-risk products such as certain adjustable rate mortgages, and looser underwriting practices).

unpredictable for consumers and distorted what was then the second largest consumer credit market.<sup>429</sup>

Conversely, the Bureau notes that some innovation is designed to mitigate risk. For example, many banks and credit unions are experimenting with “safe” checking accounts (accounts that do not allow consumers to overdraw) these products are designed to reduce overdraft risks to consumers. Similarly, some credit card issuers have experimented with products with fewer or no penalty fees as a means of reducing risk to consumers. The Bureau believes that to extent that the class proposal would affect positive innovations of this type, it would tend to facilitate them.

The Bureau recognizes that there may be some innovation that is designed to serve the needs of consumers but that leverages new technologies or approaches to consumer finance in ways that raise novel legal questions and, in that sense, carry legal risk. The Bureau believes that these innovators, in general, consider a variety of concerns when bringing their ideas to market. But, even if at the margin, the effect of the proposed rule would be to deter certain innovations from being launched, the Bureau believes that, on balance, that would be a price worth paying in order to achieve the benefits of the rule for the public and consumers. The Bureau believes that, in general, it is a mark of a well-functioning regulatory regime when entities must balance their desire to profit from innovation with the need to comply with laws designed to protect consumers.<sup>430</sup> The Bureau thus preliminarily finds that the impact of the class proposal on

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<sup>429</sup> See Bureau of Consumer Fin Prot., *CARD Act Report*, at 27, 74 (2013), available at [http://files.consumerfinance.gov/f/201309\\_cfpb\\_card-act-report.pdf](http://files.consumerfinance.gov/f/201309_cfpb_card-act-report.pdf); 15 U.S.C. 1666i-i.

<sup>430</sup> See Dan Quan, *Project Catalyst: We're open to innovative approaches to benefit consumers* (Oct. 10, 2014), <http://www.consumerfinance.gov/blog/category/project-catalyst/> (“Consumer-friendly innovation can drive down

innovation supports rather than refutes a finding that the class proposal would be in the public interest because it would incentivize providers to reach the right balance between innovation in the marketplace and consumer protection.

*Windfalls.* Some stakeholders have suggested that the class proposal would allow named plaintiffs in putative class actions to leverage the threat of a class action to obtain a windfall individual recovery. Others go further and suggest that the class proposal would result in windfall recoveries to entire classes on the grounds that the certification of a class would induce providers to settle claims with little or no merit because of the litigation expenses and risk of massive recoveries. Relatedly, some stakeholders have expressed concern that small businesses are particularly vulnerable to this scenario and that they feel even greater pressure to settle cases upon class certification because the value of the claim may constitute a substantial portion of the small business's net worth.

The Bureau recognizes that there is some risk that the class proposal would enable some plaintiffs to file putative class actions and leverage the threat of class liability to obtain a more favorable settlement than could have been obtained in an action filed on an individual basis in the first instance. However, the Study finds that for most consumers the value of their individual claim is too small to be worth pursuing individually, and the Bureau does not believe that the ability to file a putative class action would materially change consumers' interest in pursuing

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costs, improve transparency, and make people's lives better. On the other hand, new products can also pose unexpected risks to consumers through dangers such as hidden costs or confusing terms.”).

individual relief. The Section 1022(b)(2) Analysis quantifies the potential costs from putative class actions not settled on a class basis and finds those costs to be relatively low.<sup>431</sup>

With respect to the suggestion that the class proposal would result in windfalls to entire classes, the Study showed that certification almost invariably occurs coincident with a settlement and thus is not typically the force that drives settlement. The Study further found that not infrequently, settlements follow a decision by a court rejecting a dispositive motion (*e.g.*, a motion to dismiss) filed by the defendants. Moreover, the Bureau is not aware of any evidence to suggest that companies routinely settle cases on a class basis for more than their expected value, *i.e.*, more than the exposure to the class discounted by an assessment of the likelihood of success.<sup>432</sup> As discussed in the IRFA, the Bureau believes that the impacts on small providers are less severe than some stakeholders have argued, given that small providers are to class actions and other considerations.

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<sup>431</sup> The Study demonstrated that the number of putative class cases resulting in individual outcomes is itself quite low, showing each year an average of 100 putative class actions filed in Federal courts and a sample of State courts relating to six significant markets were resolved in a manner that included an individual settlement or a potential individual settlement. Study, *supra* note 2, section 6 at 42, fig. 12; *id.*, app. O at 106 tbl. 19 (covering settlements that represent nearly a fifth of the population). As a matter of absolute impact, individual settlements in 100 cases per year (even when extrapolated to other markets and all State courts) are not significant enough to pose a substantial per-account cost to providers and thus are unlikely to result in a significant price increase to consumers, as discussed in Section 1022(b)(2) Analysis below.

<sup>432</sup> See, *e.g.*, *In re Citigroup Inc. Sec. Litig.*, 965 F. Supp. 2d 369, 383 (S.D.N.Y. 2013) (noting that securities settlement was relatively low due to “the risk that the plaintiffs might not prevail was significant”); see also Wright, Miller & Kane, 7A Fed. Prac. & Proc. Civ. 1797.1, at 82-88 (3d ed.) (identifying factors for district court’s determination of the fairness of proposed relief for a class settlement, including “the likelihood of the class being successful in the litigation” and “the amount proposed as compared to the amount that might be recovered, less litigation costs, if the action went forward”); *Reynolds v. Beneficial Nat’l Bank*, 288 F.3d 277, 285 (7th Cir. 2002) (Posner, J.) (reversing order approving settlement agreement where the “judge made no effort to translate his intuitions about the strength of the plaintiffs’ case, the range of possible damages, and the likely duration of the litigation if it was not settled now into numbers that would permit a responsible evaluation of the reasonableness of the settlement”).

In addition, Congress and the courts also continue to calibrate class action procedures to discourage frivolous litigation.<sup>433</sup> The Supreme Court, for example, has rendered a series of decisions making clear that Rule 23 “does not set forth a mere pleading standard” and establishing a number of requirements to subject putative class claims to close scrutiny before proceeding on a class basis.<sup>434</sup> Further, Congress has acted to limit frivolous litigation through various steps including enactment of CAFA. Similarly, stakeholders successfully lobbied Congress to remove an EFTA provision that led to a spike in class action litigation.<sup>435</sup>

*Individual Dispute Resolution.* Some companies and industry trade associations have argued that, if the class proposal were adopted, providers would likely remove their arbitration agreements entirely and this would impair consumers’ ability to resolve their individual disputes. Other companies have told the Bureau that they would keep their arbitration agreements or that they remain undecided on what they would do. To the extent that providers would remove their arbitration agreements, the Bureau has heard two reasons. First, that if providers can no longer block class actions some stakeholders have stated that the arbitration agreement serves no purpose. Second, some stakeholders have suggested that establishing and maintaining a system to resolve disputes in arbitration is costly and that providers might have no incentive to provide consumers with the benefits of arbitration if they are also required to incur increased costs in defending class actions.

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<sup>433</sup> *Reiter*, 442 U.S. at 345 (“District courts must be especially alert to identify frivolous claims brought to extort nuisance settlements; they have broad power and discretion vested in them by Fed. Rule Civ. Proc. 23 with respect to matters involving the certification and management of potentially cumbersome or frivolous class actions.”).

<sup>434</sup> *Wal-Mart Stores, Inc. v. Dukes*, 564 U.S. 338, 350 (2011).

<sup>435</sup> See, e.g., Kevin Bogardus, *Banks lobby to repeal ATM fee signs*, The Hill (June 19, 2012), available at <http://thehill.com/business-a-lobbying/233393-bank-lobby-says-congress-should-repeal-atm-signs>. Stakeholders are now undertaking similar efforts with respect to other substantive statutes.



As for those asserting the first reason, the Bureau believes that, to the extent these providers find that the arbitration agreement provides no benefit to themselves or their consumers in individual disputes, then it is possible the agreement would not be maintained under the class proposal. For such providers, however, the Bureau believes the arbitration agreement has thus effectively been serving no function other than a class action waiver and would have no impact on their individual dispute resolution processes.

As for those asserting this second reason, the Bureau is not persuaded for the reasons discussed here and in the Section 1022(b)(2) Analysis. These firms must already maintain two systems to the extent that most arbitration agreements allow for litigation in small claims courts, and companies almost never seek to compel other cases to arbitration when first filed in court. The Bureau does not believe that, to the extent there is a burden of maintaining arbitration agreements to resolve individual disputes, the availability of class actions would impact that burden which exists regardless. Companies will always have to defend and resolve individual disputes that their customers bring – whether in court or in arbitration. In these individual disputes, companies will always incur defense costs and oftentimes settlement costs. While some companies may have to pay fees to the arbitration administrators that they would not have to pay in court, the empirical evidence indicates that the absolute number of cases in which these fees are incurred is low (and that the total fees in any one case are also low).<sup>436</sup> Moreover, the costs of the up front fees would be offset against potential savings from arbitration’s streamlined discovery and other processes, which some stakeholders have argued are a substantial benefit to all parties. Thus, the Bureau does not see why the costs of resolving a few cases in arbitration,

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<sup>436</sup> See Study, *supra* note 2, section 5 at 75-76.

even if somewhat greater than resolving these cases in litigation, would alone cause companies to withdraw an option that they often assert benefits both themselves and consumers.

Nor is the Bureau persuaded that if providers eliminated their arbitration agreements that doing so would affect their incentives to resolve disputes informally. As previously noted, the Bureau recognizes that when an individual consumer complains about a particular charge or other action, it is often in the financial institution's interest to preserve the customer relationship by providing the individual with a response explaining that charge and, in some cases, a full or partial refund or reversal of the charge or action. That incentive would not be affected by the elimination of arbitration agreements. The Bureau is skeptical that the risk of individual litigation is a significant driver of companies' decisions to resolve disputes informally given how infrequently individual cases are filed either in court or arbitration, and the Bureau is also skeptical that if providers were subject to court litigation but not arbitration that would substantially change their assessment of the risk and hence their willingness to provide an informal resolution.

Thus, the Bureau does not preliminarily find that individual dispute resolution (whether formal or informal) is an adequate substitute for group litigation that can provide many consumers relief in a single proceeding.

The Bureau seeks comments on its preliminary findings discussed above that the class proposal would be in the public interest and for the protection of consumers.

*D. The Bureau Finds That the Monitoring Proposal Is in the Public Interest and for the Protection of Consumers*

The class proposal would not prohibit covered entities from continuing to include arbitration agreements in consumer financial contracts generally; providers would still be able to

include them in consumer contracts and invoke them to compel arbitration in court cases not filed in court as class actions. In addition, the class proposal would not foreclose the possibility of class arbitration so long as the consumer chooses arbitration as the forum in which he or she pursues the class claims and the applicable arbitration agreement does not prohibit class arbitration. Thus, the Bureau separately considers whether the other requirement of its proposal – that providers submit certain arbitral records to the Bureau (proposed § 1040.4(b)), the monitoring proposal) – would be in the public interest and for the protection of consumers.

As explained in Part VI.A, the evidence before the Bureau is inconclusive as to the relative efficacy and fairness of individual arbitration compared to individual litigation. Thus, the Bureau is not proposing to prohibit arbitration agreements entirely. The Bureau remains concerned, however, that the potential for consumer harm in the use of arbitration agreements in the resolution of individual disputes remains. Among these concerns is that arbitrations could be administered by biased administrators (as was alleged in the case of NAF), that harmful arbitration provisions could be enforced, or that individual arbitrations could otherwise be conducted in an unfair manner.

The Study showed that, in the markets covered by the Study, an overwhelming majority of arbitration agreements specify AAA or JAMS as an administrator (or both) and both administrators have created consumer arbitration protocols that contain procedural and substantive safeguards designed to ensure a fair process.<sup>437</sup> While the Bureau believes that these safeguards currently apply to the vast majority of consumer finance arbitrations that do occur, this could change. Administrators may change the safeguards in ways that could harm

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<sup>437</sup> *Id.*, section 2 at 34-40; *see generally id.*, section 4.

consumers, companies may (and currently do) select other arbitrators or arbitration administrators that adopt different standards of conduct or operate with no standards at all (*e.g.*, a company may choose an individual as an arbitrator who conducts the arbitration according to his or her own rules), arbitration agreements may contain provisions that could harm consumers, or the use of arbitration to resolve consumer disputes may evolve in other ways that the Bureau cannot foresee, particularly were the class proposal to be adopted. For these reasons, the Bureau preliminarily finds that the proposed rule requiring submission of arbitral documents would be in the public interest and for the protection of consumers.

#### *Overview of the Monitoring Proposal*

The Bureau is neither proposing to restrict the use of arbitration agreements with respect to individual arbitrations nor proposing to prescribe specific methods or standards for adjudicating individual arbitrations. The Bureau is instead proposing a system that would allow it and, potentially the public, to review certain arbitration materials. The Bureau expects that its proposed requirements would bring greater transparency to the arbitration process and allow for the Bureau and, potentially, the public to monitor how arbitration evolves.

Specifically, the Bureau is proposing a regime that would require providers to submit five types of documents with respect to any individual arbitration case (see proposed § 1040.4(b)(1)):

- (1) the initial claim (whether filed by a consumer or by the provider) and any counterclaim;
- (2) the pre-dispute arbitration agreement filed with the arbitrator or arbitration administrator;
- (3) the award, if any, issued by the arbitrator or arbitration administrator;
- (4) any communications from the arbitrator or arbitration administrator with whom the claim was filed relating to a refusal to administer or dismissal of a claim due to the provider's failure to pay required fees; and
- (5) any

communications related to a determination that an arbitration agreement does not comply with the administrator's fairness principles.

Under the monitoring proposal, the Bureau would publish on its website the materials it receives in some form, with appropriate redaction or aggregation as warranted.

*The Bureau Believes That the Monitoring Proposal Would Have Several Positive Outcomes for Consumers and the Public*

The Bureau preliminarily finds that the monitoring proposal would have several positive outcomes that, taken into consideration with other relevant factors including costs, would be in the public interest and for the protection of consumers.

First, the monitoring proposal would be for the protection of consumers because it would allow the Bureau (and if submissions are published, the public) to better understand arbitrations that occur now and in the future and to ensure that consumers' rights are being protected. The materials the Bureau proposes to collect – similar to the AAA materials the Bureau reviewed in the Study – would allow the Bureau to continue to monitor how arbitrations and arbitration agreements evolve, and allow it to see whether they evolve in ways that harm consumers.

The documents the Bureau proposes to collect would provide the Bureau with different insights. For example, collection of arbitration claims would provide transparency regarding the types of claims consumers and providers are bringing to arbitration. Collecting claims would allow the Bureau to monitor the raw number of arbitrations, which has fluctuated over time, from at least tens of thousands of provider-filed arbitration claims per year before mid-2009, to just

hundreds per year in the AAA set reviewed by the Bureau.<sup>438</sup> Rapid changes in the number of claims might signal a return to large-scale debt collection arbitrations by companies and potential consumer protection issues, as had occurred in the past with NAF (discussed above in Part II.C).

The proposed collection of awards would provide insights into the types of claims that reach the point of adjudication and the way in which arbitrators resolve these claims. Collection of arbitration agreements in conjunction with the claims (and awards) would allow the Bureau to monitor the impact that particular clauses in arbitration agreements have on consumers and providers, the resolution of those claims, and how arbitration agreements evolve. Finally, collection of correspondence regarding non-payment of fees and non-compliance with due process principles would allow the Bureau insight into whether and to what extent providers fail to meet the arbitral administrators' standards. Those consumers that may be harmed by these providers' non-payment of fees or failure to adhere to fairness principles would also benefit by having those instances reported to the Bureau for potential further action. The Bureau believes that it is possible that the increased transparency arising from the monitoring proposal and the Bureau's publication of materials it receives may deter some unfair individual arbitrations because providers would have an interest in protecting their reputations and they themselves may be wary to retain an arbitrator or arbitration administrator that proceeds in an unfair manner.

Beyond shedding light on the operation of the arbitration system writ large, the proposed collection of documents also would enhance the Bureau's ability to monitor consumer finance markets for risks to consumers. For example, the collection of claims and awards would provide the Bureau with additional information about the types of potential violations of consumer

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<sup>438</sup> See, e.g., Preliminary Results, *supra* note 2 at 60-62.

finance or other laws alleged in arbitration and whether any particular providers are facing repeat claims or have engaged in potentially illegal practices. At the same time, the collection of arbitration agreements and correspondence regarding non-payment of fees or non-compliance with fairness standards would enable the Bureau to identify providers that may have adopted one-sided agreements in an attempt to avoid liability altogether by discouraging a consumer from seeking resolution of a claim in arbitration.

Second, the monitoring proposal would be for the protection of consumers because it would allow the Bureau to take action against providers that are engaging in potentially illegal actions that impede consumers' ability to bring claims against their providers. For example, if the Bureau became aware that a particular company was routinely not paying arbitration fees, it could take action against that company or refer its conduct to another regulator. The Bureau intends to draw upon all of its statutorily authorized tools to address conduct that harms consumers that may occur in the future in connection with providers' use of arbitration agreements.

The Bureau also preliminarily finds that the monitoring proposal would be in the public interest for all of the reasons set forth above as to why it would be for the protection of consumers and for the following additional reasons.

First, it would allow the Bureau to better evaluate whether the Federal consumer finance laws are being enforced consistently. The public interest analysis is informed by one of the purposes of the Bureau, which is to “enforce Federal consumer financial law consistently.”<sup>439</sup> Through the window into arbitrations provided by the monitoring proposal, the Bureau would be

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<sup>439</sup> See generally Dodd-Frank section 1021(b) (setting forth the Bureau's purposes).

better able to know whether arbitral decisions are applying the laws consistently on an ongoing basis and whether any consumer protection issues arise in those cases that warrant further action by the Bureau.

Second, by allowing the Bureau access to documents about the conduct of arbitrations, the Bureau would be able to learn of and assess consumer allegations that providers have violated the law and, more generally, determine whether arbitrations proceed in a fair and efficient manner. The Bureau believes that creating a system of accountability is an important part of any dispute resolution system. By creating a mechanism through which the Bureau can monitor whether the system is being abused, the Bureau can further the public interest in maintaining a functioning, fair, and efficient arbitration system.

Third, the Bureau preliminarily finds that the monitoring proposal would be in the public interest to the extent that the Bureau publishes the materials it collects because publication would further the Bureau's goal of transparency in the financial markets. The Bureau believes that publishing claims would provide transparency by revealing to the public the types of claims filed in arbitration and whether consumers or providers are filing the claims. Publishing awards would provide transparency by revealing how different arbitrators decide cases and signaling to attorneys for consumers and providers which sorts of cases favor and do not favor consumers, thereby potentially facilitating better pre-arbitration case assessment and resolution of more disputes by informal means.<sup>440</sup> Publication may also help develop a more general understanding among consumers of the facts and law at issue in consumer financial arbitrations.

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<sup>440</sup> The Bureau already publishes certain narratives and outcomes data concerning consumer complaints submitted with the Bureau. The Bureau has explained that it publishes this material because it "believes that greater transparency of information does tend to improve customer service and identify patterns in the treatment of



Further, consumers, public enforcement agencies, and attorneys for consumers and providers would be able to review the records and identify trends that warrant further action including, for example, when firms do not pay fees or violate administrators' fairness rules. These groups routinely use public databases, such as online court records, decision databases, and government complaint databases (*e.g.*, the Bureau's complaint database, various states' arbitration disclosure requirements, and the FTC's Sentinel database) today in conducting their work. Making awards public may also generate public confidence in the arbitrators selected for a specific case as well as the arbitration system, at least for administrators whose awards tend to demonstrate fairness and impartiality.

In these ways, the monitoring proposal would improve the ability of a broad range of stakeholders to understand whether markets for consumer financial products and services are operating in a fair and transparent manner.

The Bureau believes that the compliance burden on providers of the monitoring proposal would be sufficiently low that, especially given the benefits of the proposal, it would not be a significant factor weighing against the proposal being in the public interest.<sup>441</sup> As discussed in greater detail in the Section 1022(b)(2) Analysis below, the Bureau expects that, unless the use of arbitration changes dramatically, the number of arbitrations subject to this part of the monitoring proposal would remain low. Most providers would have no obligations under the

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consumers, leading to stronger compliance mechanisms and customer service. . . . In addition, disclosure of consumer narratives will provide companies with greater insight into issues and challenges occurring across their markets, which can supplement their own company-specific perspectives and lend more insight into appropriate practices." Bureau of Consumer Fin. Prot., Disclosure of Consumer Complaint Narrative Data, 80 FR 15572, 15576 (Mar. 24, 2015).

<sup>441</sup> The Bureau preliminarily finds that none of the remaining factors that it previously identified as being relevant to the public interest analysis under section 1028 is relevant to the analysis whether the monitoring proposal would be in the public interest but seeks comment on whether it should consider additional or different criteria.

monitoring proposal in any given year because most providers do not face even one consumer arbitration in a year. In any event, the burden of redacting and submitting materials would be relatively minimal.

The Bureau has also considered whether the monitoring proposal, in making claims submitted in arbitration and decisions resolving those claims transparent, would somehow adversely impact the arbitration process. While there conceivably could be other negative impacts on consumers' engagement in the arbitration process arising from adoption of the monitoring proposal, the key potential concern thus far identified by the Bureau would be the concern that consumers would be less likely to engage in arbitration because they feared that submission and possible publication would cause information about them to be divulged. However, the Bureau does not believe that this concern would materialize because the proposal would require the redaction of information that identifies consumers.

With respect to providers, the Bureau does not believe that they should be able to maintain secrecy around their disputes with customers (insofar as the Bureau's Consumer Response function publishes the names of providers). Furthermore, the Bureau notes that expectations of privacy are reduced to the extent arbitration awards and other documents containing parties' names and other information are filed with a court, such as in an effort to enforce an award. Relatedly, the Bureau notes that AAA, which is the largest administrator of consumer arbitrations, maintains consumer rules that permit it to publish consumer awards, and

thus providers are already on notice that arbitrations they are involved in might become public.<sup>442</sup>

The Bureau seeks comment on all aspects of its determination that the monitoring proposal would be in the public interest and for the protection of consumers. The Bureau also seeks comment on whether consumers should be able to opt-out of the Bureau's publication of documents related to the arbitrations in which they participate.

## **VII. Section-by-Section Analysis**

The Bureau is proposing to create 12 CFR Part 1040, which would set forth regulations regarding arbitration agreements. Below, the Bureau explains each of the proposed subsections and commentary thereto for proposed Part 1040.

### *Section 1040.1 Authority, Purpose, and Enforcement*

The first section of proposed Part 1040 would set forth the Bureau's authority for issuing the regulation and the regulation's purpose.

#### *I(a) Authority*

Proposed § 1040.1(a) would state that the Bureau is issuing this proposed rule pursuant to the authority granted to it by Dodd-Frank sections 1022(b)(1), 1022(c), and 1028(b). As described in Part V, Dodd-Frank section 1022(b)(1) authorizes the Bureau to prescribe rules and issue orders and guidance, as may be necessary or appropriate to enable the Bureau to administer and carry out the purposes and objectives of the Federal consumer financial laws, and to prevent

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<sup>442</sup> AAA, Consumer Arbitration Rules (amended effective Sept. 1, 2014), R-43(c) ("The AAA may choose to publish an award rendered under these Rules; however, the names of the parties and witnesses will be removed from awards that are published, unless a party agrees in writing to have its name included in the award."). The AAA also provides public access to arbitration demands and awards for all class arbitrations (including party names). *See* AAA, Class Arbitration Case Docket (last visited May 1, 2016) <https://www.adr.org/aaa/faces/services/disputeresolutionservices/casedocket>.

evasions thereof. Section 1022(c)(4) authorizes the Bureau to monitor for risks to consumers in the offering or provision of consumer financial products or services, including developments in markets for such products or services. Dodd-Frank section 1028(b) states that the Bureau, by regulation, may prohibit or impose conditions or limitations on the use of an agreement between a covered person and a consumer for a consumer financial product or service providing for arbitration of any future dispute between the parties, if the Bureau finds that such a prohibition or imposition of conditions or limitations is in the public interest and for the protection of consumers. Section 1028(b) further states that the findings in such rule shall be consistent with the study conducted under Dodd-Frank section 1028(a).

#### *1(b) Purpose*

As part of its authority under Dodd-Frank section 1028(b), the Bureau may prohibit or impose conditions or limitations on the use of pre-dispute arbitration agreements if the Bureau finds that they are “in the public interest and for the protection of consumers.” Proposed § 1040.1(b) would state that the proposed rule’s purpose is to further these objectives. Dodd-Frank section 1028(b) also requires the findings in any rule issued under section 1028(b) to be consistent with the Study conducted under section 1028(a), which directs the Bureau to study the use of pre-dispute arbitration agreements in connection with the offering or providing of consumer financial products or services. For the reasons described above in Part VI the Bureau believes the preliminary findings in this proposed rule are consistent with the Study.

#### *Section 1040.2 Definitions*

In proposed § 1040.2, the Bureau proposes to set forth certain terms used in the regulation that the Bureau believes it is appropriate to define.

## *2(a) Class action*

The substantive provisions of proposed § 1040.4(a)(1), discussed below, concern class actions; thus, the Bureau is proposing to define “class action.” The Bureau believes that the term class action is broadly understood to mean a lawsuit in which one or more parties seek to proceed as a representative of other similarly situated class members pursuant to Rule 23 of the Federal Rules of Civil Procedure or any State process analogous to Rule 23. This term refers to cases in which one or more parties seek class treatment regardless of when class treatment is sought; it should not be limited to cases filed initially as class actions. The Bureau intends “State process analogous to Rule 23” to refer to any State process substantially similar to the various iterations of Rule 23 since its adoption. Proposed § 1040.2(a) would adopt this definition of class action and also clarify that this rule would apply to class actions filed in State court. The Bureau seeks comment on whether the proposed definition of class action would be appropriate. The Bureau further seeks comment on whether the Bureau should use “State process analogous to Rule 23” or an alternative formulation that may be broader or narrower, and what types of cases would be captured or excluded by such an alternative formulation.

## *2(b) Consumer*

Dodd-Frank section 1028(b) authorizes the Bureau to issue regulations concerning pre-dispute arbitration agreements between a covered person and a “consumer.” Dodd-Frank section 1002(4) defines the term consumer as an individual or an agent, trustee, or representative acting on behalf of an individual. Proposed § 1040.2(b) would borrow the definition of consumer from the Dodd-Frank Act and state that a consumer is an individual or an agent, trustee, or representative acting on behalf of an individual. The Bureau seeks comment on whether the

proposed definition would be appropriate and whether it should consider other definitions of the term consumer.

*2(c) Provider*

Dodd-Frank section 1028(b) authorizes the Bureau to issue regulations concerning pre-dispute arbitration agreements between a “covered person” and a consumer. Dodd-Frank section 1002(6) defines the term “covered person” as any person that engages in offering or providing a consumer financial product or service and any affiliate of such a person if such affiliate acts as a service provider to that person. Section 1002(19) further defines person to mean an individual, partnership, company, corporation, association (incorporated or unincorporated), trust, estate, cooperative organization, or other entity.

Throughout the proposed rule, the Bureau uses the term “provider” to refer to the entity to which the requirements in the proposed rule would apply. For example, proposed § 1040.4(a)(1), discussed below, would prohibit providers from seeking to rely in any way on a pre-dispute arbitration agreement entered into after the compliance date set forth in proposed § 1040.5(a) (“compliance date”) with respect to any aspect of a class action that is related to any of the consumer financial products or services covered by proposed § 1040.3.

Proposed § 1040.2(c) would define provider as a subset of the term covered person. In doing so, proposed § 1040.2(c) would clarify that the proposed rule’s intended coverage would be within the parameters of the Bureau’s authority under Dodd-Frank section 1028(b). Specifically, proposed § 1040.2(c) would define the term provider to mean (1) a person as defined by Dodd-Frank section 1002(19) that engages in offering or providing any of the consumer financial products or services covered by proposed § 1040.3(a) to the extent that the person is not excluded under proposed § 1040.3(b); or (2) an affiliate of a provider as defined in

proposed § 1040.2(c)(1) when that affiliate would be acting as a service provider to the provider with which the service provider is affiliated consistent with the meaning set forth in 12 U.S.C. 5481(6)(B). The Bureau derives this formulation from the definition of covered person in Dodd-Frank section 1002(6), 12 U.S.C. 5481(6)(B).

The definition of the term “person” includes the phrase “or other entity.” That term readily encompasses governments and government entities. Even if the term were ambiguous, the Bureau believes – based on its expertise and experience with respect to consumer financial markets – that interpreting it to encompass governments and government entities would promote the consumer protection, fair competition, and other objectives of the Dodd-Frank Act. The Bureau also believes that the terms “companies ” or “corporations” under the definition of “person,” on their face, cover all companies and corporations, including government-owned or -affiliated companies and corporations. And even if those terms were ambiguous, the Bureau believes – based on its expertise and experience with respect to consumer financial markets – that interpreting them to cover government-owned or -affiliated companies and corporations would promote the objectives of the Dodd-Frank Act.

The Bureau notes that proposed § 1040.4(a)(1), discussed below, would apply to providers with respect to pre-dispute arbitration agreements entered into by *other persons* after the compliance date, even if that other person is excluded for coverage by proposed § 1040.3(b). For further discussion of this issue, see the discussion of proposed comment 4-2, below.

The Bureau intends the phrase “that engages in offering or providing any of the consumer financial products or services covered by § 1040.3(a)” to clarify that the proposed rule would apply to providers that use a pre-dispute arbitration agreement entered into with a consumer for the products and services enumerated in proposed § 1040.3(a). The Bureau also intends this

phrase to convey that, even if an entity would be a provider under proposed § 1040.2(c) because it offers or provides consumer financial products or services covered by proposed § 1040.3(a), it would not be a provider with respect to products and services that it may provide that are not covered by proposed § 1040.3(a).

Proposed comment 2(c)-1 would further clarify this issue and explain that a provider as defined in proposed § 1040.2(c) that also engages in offering or providing products or services not covered by proposed § 1040.3(a) must comply with this part only for the products or services that it offers or provides that are covered by proposed § 1040.3(a). The proposed comment would clarify that, where an entity would be a provider because it offers or provides at least one covered product or service, it need not comply with this part with respect to all its products and services; it need comply only with respect to those that are covered by proposed § 1040.3(a).

The Bureau seeks comment on the proposed definition of provider, including whether proposed comment 2(c)-1 clarifies the scope of the term.

#### *2(d) Pre-Dispute Arbitration Agreement*

Proposed § 1040.2(d) would define the term pre-dispute arbitration agreement as an agreement between a provider and a consumer providing for arbitration of any future dispute between the parties. The Bureau's proposed definition of pre-dispute arbitration agreement is based on Dodd-Frank section 1028(b), which authorizes the Bureau to regulate the use of such agreements.

The Bureau believes that the meaning of the term arbitration is widely understood. As such, the Bureau is not proposing to define it. The Bureau seeks comment, however, on whether the term arbitration should be defined, and, if so, how and why. The Bureau further notes that, in the proposed definition of "pre-dispute arbitration agreement," the phrase "providing for



arbitration of any future dispute between the parties” would include agreements between providers and consumers under which, if one sues the other in court, either party can invoke the arbitration agreement to require that the dispute proceed, if at all, in arbitration instead.

Proposed comment 2(d)-1 would state that a pre-dispute arbitration agreement for a consumer financial product or service includes any agreement between a provider and a consumer providing for arbitration of any future disputes between the parties, regardless of its form or structure. The proposed comment would provide two illustrative examples: (1) a standalone pre-dispute arbitration agreement that applies to a product or service; and (2) a pre-dispute arbitration agreement that is included within, annexed to, incorporated into, or otherwise made a part of a larger agreement that governs the terms of the provision of a product or service. This comment would help clarify that “pre-dispute arbitration agreement” would not be limited to a standalone “agreement” but could be a provision within an agreement for a consumer financial product or service.

The Bureau is not aware of any Federal regulation that defines the term pre-dispute arbitration agreement but seeks comment on whether the proposed text – which restates the relevant statutory provision – would provide sufficient guidance as to when an arbitration agreement is “pre-dispute.” This proposed definition of pre-dispute arbitration agreement would not include a voluntary arbitration agreement between a consumer and a covered person after a dispute has arisen. The Bureau seeks comment on whether the Bureau should define or provide additional clarification regarding when an arbitration agreement is “pre-dispute.”

#### *Section 1040.3 Coverage*

As discussed above, Dodd-Frank section 1028(b) authorizes the Bureau to issue regulations concerning agreements between a covered person and a consumer “for a consumer

financial product or service” providing for arbitration of any future disputes that may arise. Accordingly, proposed § 1040.3 would set forth the products and services to which proposed Part 1040 applies. Proposed § 1040.3(a) generally would provide a list of products and services that would be covered by the proposed rule, while proposed § 1040.3(b) would provide limited exclusions.

The Bureau is proposing to cover a variety of consumer financial products and services that the Bureau believes are in or tied to the core consumer financial markets of lending money, storing money, and moving or exchanging money – all markets covered in significant part in the Study. These include, for example: (1) most types of consumer lending (such as making secured loans or unsecured loans or issuing credit cards), activities related to that consumer lending (such as providing referrals, servicing, credit monitoring, debt relief, and debt collection services, among others, as well as the purchasing or acquiring of such consumer loans), and extending and brokering those automobile leases that are consumer financial products or services; (2) storing funds or other monetary value for consumers (such as providing deposit accounts); and (3) providing consumer services related to the movement or conversion of money (such as certain types of payment processing activities, transmitting and exchanging funds, and cashing checks).

Proposed § 1040.3(a) would describe the products and services in these core consumer financial markets that would be covered by Part 1040. Each component is discussed separately below in the discussion of each subsection of proposed § 1040.3(a).<sup>443</sup> The Bureau notes that both banks and nonbanks may provide these products and services. As discussed above in

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<sup>443</sup> Following that discussion, an illustrative set of examples of persons providing these products and services is included in the introduction of the Section-by-Section Analysis to proposed § 1040.3(b).

connection with the definition of “provider” in proposed § 1040.2(c) and below in this section and in the Bureau’s analysis under Dodd-Frank section 1022(b)(2), a covered person under the Dodd-Frank Act who engages in offering or providing a product or service described in proposed § 1040.3(a) generally would be subject to the proposed rule, except to the extent an exclusion in proposed § 1040.3(b) applies to that person.

*1040.3(a) Covered Products and Services*

As set forth above, the Bureau’s rulemaking authority under Dodd-Frank section 1028(b) generally extends to the use of an agreement between a covered person and a consumer for a “consumer financial product or service” (as defined in Dodd-Frank section 1002(5)). However, as discussed in the Section-by-Section Analysis of proposed § 1040.3(b)(5), Dodd-Frank sections 1027 and 1029 (codified at 12 U.S.C. 5517 and 5519) exclude certain activities by certain covered persons, such as the sale of nonfinancial goods or services, including automobiles, from the Bureau’s rulemaking authority in certain circumstances.<sup>444</sup>

In exercising its authority under section 1028, the Bureau is proposing to cover consumer financial products and services in what it believes are core markets of lending money, storing money, and moving or exchanging money. Accordingly, the Bureau is not, at this time, proposing to cover every type of consumer financial product or service as defined in Dodd-Frank section 1002(5), particularly those outside these three core areas, though the Bureau would continue to monitor markets for consumer financial products and services both those that would

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<sup>444</sup> However, as also discussed in greater detail in proposed § 1040.3(b)(5), even where the person offering or providing a consumer financial product or service may be excluded from coverage under the regulation, for instance because that party is an automobile dealer extending a loan in circumstances that exempt the automobile dealer from the rulemaking authority of the Bureau under Dodd-Frank section 1029, the rule would still apply to providers of other consumer financial products or services (such as servicers or debt collectors) in connection with the same loan.

and would not be within the proposed scope and may at a later time revisit the scope of this proposed rule.

In addition, the Bureau is proposing coverage of core product markets in a way that the Bureau believes would facilitate compliance because several terms in the proposed scope provisions are derived from existing, enumerated consumer financial protection statutes implemented by the Bureau. In so doing, the Bureau expects that the coverage of proposed Part 1040 would incorporate relevant future changes, if any, to the enumerated consumer financial protection statutes and their implementing regulations and to provisions of Title X of Dodd-Frank referenced in proposed § 1040.3(a). For example, changes that the Bureau has proposed regarding the definition of an account under Regulation E would, if adopted, affect the scope of proposed § 1040.3(a)(6).

Specifically, the Bureau is proposing in § 1040.3(a) that proposed Part 1040 generally would apply to pre-dispute arbitration agreements for the products or services listed in proposed § 1040.3(a) to the extent they are consumer financial products or services as defined by 12 U.S.C. 5481(5). As proposed comment 3(a)-1 would explain, that provision generally defines two types of consumer financial products and services. The first type is any financial product or service that is “offered or provided for use by consumers primarily for personal, family, or household purposes.” The second type is a financial product or service that is delivered, offered, or provided in connection with the first type of consumer financial product or service.

The Bureau seeks comment on all aspects of its proposed approach to coverage in this proposed rulemaking. Specifically, the Bureau seeks comment on whether any products or services that the Bureau has proposed to cover should not be covered, and whether any types of consumer financial products or services that it has not proposed to cover should be covered. The

Bureau further seeks comment on its approach to referencing terms in enumerated consumer financial protection statutes and Dodd-Frank sections (and their respective implementing regulations) as set forth in proposed § 1040.3, and the fact that future changes to these terms may affect the scope of the proposed rule.

*1040.3(a)(1)*

The Bureau believes that the proposed rule should apply to consumer credit and related activities including collecting on consumer credit. Specifically, proposed § 1040.3(a)(1) would include in the coverage of proposed Part 1040 consumer lending under ECOA, 15 U.S.C. 1691 *et seq.*, as implemented by Regulation B, 12 CFR part 1002, and activities related to that lending.<sup>445</sup>

In particular, proposed § 1040.3(a)(1) would cover specific consumer lending activities engaged in by persons acting as “creditors” as defined by Regulation B, along with the related activities of acquiring, purchasing, selling, or servicing such consumer credit. Proposed § 1040.3(a)(1) breaks these covered consumer financial products or services into the following five types: (i) providing an “extension of credit” that is “consumer credit” as defined in Regulation B, 12 CFR 1002.2; (ii) acting as a “creditor” as defined by 12 CFR 1002.2(*l*) by “regularly participat[ing] in a credit decision” consistent with its meaning in 12 CFR 1002.2(*l*) concerning “consumer credit” as defined by 12 CFR 1002.2(h); (iii) acting, as a person’s primary business activity, as a “creditor” as defined by 12 CFR 1002.2(*l*) by “refer[ring] applicants or prospective applicants to creditors, or select[ing] or offer[ing] to select creditors to whom requests for credit may be made” consistent with its meaning in 12 CFR 1002.2(*l*); (iv) acquiring, purchasing, or selling an extension of consumer credit covered by proposed

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<sup>445</sup> The related activity of debt collection would be covered by proposed § 1040.3(a)(10).

§ 1040.3(a)(1)(i); or (v) servicing an extension of consumer credit covered by proposed § 1040.3(a)(1)(i).

*1040.3(a)(1)(i) and (ii)*

Proposed § 1040.3(a)(1)(i) would cover providing any “extension of credit” that is “consumer credit” as defined by Regulation B, 12 CFR 1002.2.<sup>446</sup> In addition, proposed § 1040.3(a)(1)(ii) would cover acting as a “creditor” as defined by 12 CFR 1002.2(l) by “regularly participat[ing] in a credit decision” consistent with its meaning in 12 CFR 1002.2(l) concerning “consumer credit” as defined by 12 CFR 1002.2(h). Collectively, the coverage proposed in §§ 1040.3(a)(1)(i) and (ii) would reach creditors both when they approve consumer credit transactions and extend credit, as well as when they participate in decisions leading to the denial of applications for consumer credit. ECOA has applied to these activities since its enactment in the 1970s, and the Bureau believes that entities are familiar with the application of ECOA to their products and services. Regulation B, which implements ECOA, defines credit as “the right granted by a creditor to an applicant to defer payment of a debt, incur debt and defer its payment, or purchase property or services and defer payment therefor.” 12 CFR 1002.2(j).<sup>447</sup> By proposing to cover extensions of consumer credit and participation in consumer credit decisions already covered by ECOA as implemented by Regulation B, the Bureau expects that

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<sup>446</sup> As noted in proposed comment 3(a)(1)(i)-1, Regulation B defines “credit” by reference to persons who meet the definition of “creditor” in Regulation B. 12 CFR 1002.2(l). Persons who do not regularly participate in credit decisions in the ordinary course of business, for example, are not creditors as defined by Regulation B. *Id.* In addition, by proposing to cover only credit that is “consumer credit” under Regulation B, the Bureau is making clear that the proposed rule would not apply to business loans.

<sup>447</sup> *See also* 12 CFR 1002.2(q) (Regulation B provision defining the terms “extend credit” and “extension of credit” as “the granting of credit in any form (including, but not limited to, credit granted in addition to any existing credit or credit limit; credit granted pursuant to an open-end credit plan; the refinancing or other renewal of credit, including the issuance of a new credit card in place of an expiring credit card or in substitution for an existing credit card; the consolidation of two or more obligations; or the continuance of existing credit without any special effort to collect at or after maturity”).

participants in the consumer credit market would have a significant body of experience and law to draw upon to understand how the proposed rule would apply to them, which would facilitate compliance with proposed Part 1040.

As indicated in its SBREFA Outline, the Bureau had originally considered covering consumer credit under either of two statutory schemes: TILA or ECOA and their implementing regulations.<sup>448</sup> Upon further consideration, however, the Bureau believes that using a single definition would be simpler and thus it proposes to use the Regulation B definitions under ECOA because they are more inclusive. For example, unlike TILA and its implementation regulation (Regulation Z, 12 CFR 1026.2(17)(i)), ECOA and Regulation B do not include a blanket exclusion for credit with four or fewer installments and no finance charge. Regulation B also explicitly addresses participating in credit decisions, and as discussed below in the Section-by-Section Analysis to proposed § 1040.3(a)(1)(iii), loan brokering.

The Bureau further notes that in many circumstances, merchants, retailers, and other sellers of nonfinancial goods or services (hereafter, merchants) may act as creditors under ECOA in extending credit to consumers. While such extensions of consumer credit would be covered by proposed § 1040.3(a)(1), exemptions proposed in § 1040.3(b) may exclude the merchant itself from coverage. Those exemptions are discussed in detail in the corresponding part of the Section-by-Section Analysis further below. On the other hand, if a merchant creditor were not eligible for any of these proposed exemptions with respect to a particular extension of consumer credit, then proposed Part 1040 generally would apply to the merchant with respect to such transactions. For example, the Bureau believes merchant creditors significantly engaged in

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<sup>448</sup> SBREFA Outline at 22.

extending consumer credit with a finance charge often would be ineligible for these exemptions.<sup>449</sup>

*1040.3(a)(1)(iii)*

Proposed § 1040.3(a)(1)(iii) would cover persons who, as their primary business activity, act as “creditors” as defined by Regulation B, 12 CFR 1002.2(l), by engaging in any one or more of the following activities covered by Regulation B: referring consumers to other ECOA creditors, or selecting or offering to select such other creditors from whom the consumer may obtain ECOA credit. Regulation B comment 2(l)-2 describes examples of persons engaged in such activities.<sup>450</sup> Regularly engaging in these activities generally makes a person a creditor under Regulation B, 12 CFR 1002.2(l). Thus proposed § 1040.3(a)(1)(iii) would only apply to persons who are regularly engaging in these activities.<sup>451</sup>

In addition, in this proposed rule, the Bureau does not generally propose to cover activities of merchants to facilitate payment for the merchants’ own nonfinancial goods or services.<sup>452</sup> Accordingly, proposed § 1040.3(a)(1)(iii) would only apply to persons providing

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<sup>449</sup> Certain automobile dealers may still be exempt, however, under proposed § 1040.3(b)(5) when they are extending credit with a finance charge in circumstances that exclude the automobile dealer from the Bureau’s rulemaking authority under Dodd-Frank section 1029. In addition, certain small entities may still be exempt under proposed § 1040.3(b)(5) in certain other circumstances, such as those specified in Dodd-Frank section 1027(a)(2)(D). A merchant that is a government or government affiliate also could be exempt under proposed § 1040.3(b)(2).

<sup>450</sup> Regulation B comment 2(l)-2 states: “*Referrals to creditors.* For certain purposes, the term creditor includes such persons as real estate brokers, automobile dealers, home builders, and home-improvement contractors who do not participate in credit decisions but who only accept applications and refer applicants to creditors, or select or offer to select creditors to whom credit requests can be made.”

<sup>451</sup> The Bureau also has proposed a more specific exemption for activities that are provided only occasionally. See proposed § 1040.3(b)(3) and the Section-by-Section Analysis thereto.

<sup>452</sup> As noted above, however, the proposed rule often would apply to merchant creditors engaged significantly in extending consumer credit with a finance charge.



these types of referral or selection services as their primary business.<sup>453</sup> Thus, as proposed comment 3(a)(1)(iii)-1 would clarify, a merchant whose primary business activity consists of the sale of nonfinancial goods or services generally would not fall into this category. Proposed § 1040.3(a)(1)(iii) would not apply, for example, to a merchant that refers the consumer to a creditor to help the consumer purchase the merchant's own nonfinancial goods and services.<sup>454</sup>

*1040.3(a)(1)(iv) and (v)*

Proposed §§ 1040.3(a)(1)(iv) and (v) would cover certain specified types of consumer financial products or services when offered or provided with respect to consumer credit covered by proposed § 1040.3(a)(1)(i). First, proposed § 1040.3(a)(1)(iv) would cover acquiring, purchasing, or selling an extension of consumer credit covered by proposed § 1040.3(a)(1)(i). In addition, proposed § 1040.3(a)(1)(v) would cover servicing of an extension of consumer credit covered by proposed § 1040.3(a)(1)(i). With regard to servicing, the Bureau is not proposing a specific definition but, proposed comment 3(a)(1)(v)-1 would note other examples where the Bureau has defined servicing: for the postsecondary student loan market in 12 CFR 1090.106 and the mortgage market in Regulation X, 12 CFR 1024.2(b).<sup>455</sup>

The Bureau invites comment on proposed § 1040.3(a)(1) and related proposed commentary. In particular, the Bureau requests comment on defining coverage in proposed

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<sup>453</sup> Transmitting or payment processing in similar circumstances also generally would not be covered by paragraphs (7) and (8) of proposed § 1040.3(a), as discussed in the Section-by-Section Analysis of those provisions below.

<sup>454</sup> Of course, if the merchant regularly participates in a consumer credit decision as a creditor under Regulation B, proposed § 1040.3(a)(1)(ii) could still apply to the merchant, particularly in circumstances where no exemptions in proposed § 1040.4(b) apply to the merchant.

<sup>455</sup> 12 CFR 1090.106 is the Bureau's larger participant rule for the postsecondary student loan servicing market. As noted in the rule, "servicing loans" is a "consumer financial product or service" pursuant to the Dodd-Frank Act. See 78 FR 73,383, 73,385 n.25 (Dec. 6, 2013) (citing 12 U.S.C. 5481(15)(A)(i) (defining "financial product or service," including "extending credit and servicing loans") and 12 U.S.C. 5481(5) (defining "consumer financial product or service").

§ 1040.3(a)(1) by reference to consumer lending activities carried out by “creditors” as defined by Regulation B, and the activities of acquiring, purchasing, selling, and servicing extensions of consumer credit as defined by Regulation B. The Bureau also seeks comment on whether this proposed coverage should be expanded or reduced or whether there are any alternative definitions the Bureau should consider in its proposed coverage of consumer credit transactions and related activities. For example, the Bureau requests comment on the “primary business” limitation in proposed § 1040.3(a)(1)(iii), including whether the term “primary business” should be defined and if so, how, or whether a different limitation should be used, such as an exclusion for referral or selection activities that are incidental to the sale of a nonfinancial good or service. In addition, the Bureau notes that a common activity performed by creditors and consumer credit servicers is furnishing information to a consumer reporting agency, an activity that is covered by the Fair Credit Reporting Act (FCRA), 15 U.S.C. 1681s-2. The Bureau therefore requests comment on whether such furnishing, by any person covered by proposed § 1040.3(a)(1), should also be separately identified as a covered product or service.

*1040.3(a)(2)*

The Bureau believes the proposed rule should cover brokering or extending consumer automobile leases, consistent with the definition of that activity in the Bureau’s larger participant rulemaking for the automobile finance market codified at 12 CFR 1090.108. As the Bureau explained in that rulemaking, from the perspective of the consumer, many automobile leases function similarly to financing for automobile purchase transactions and have a similar impact on

the consumer and his or her well-being.<sup>456</sup> Accordingly, proposed § 1040.3(a)(2) would extend coverage to brokering or extending consumer automobile leases in either of two circumstances identified in 12 CFR 1090.108, each of which applies only if the initial term of the lease is at least 90 days: (1) the lease is the “functional equivalent” of an automobile purchase finance arrangement and is on a “non-operating basis” within the meaning of Dodd-Frank section 1002(15)(A)(ii); or (2) the lease qualifies as a “full-payout lease and a net lease” within the meaning of the Bureau’s Larger Participant rulemaking for the auto finance market, codified at 12 CFR 1001.2(a).<sup>457</sup> The Bureau seeks comment on the coverage of consumer automobile leasing in proposed § 1040.3(a)(2).

#### *1040.3(a)(3)*

The Bureau believes that the proposed rule should cover debt relief services, such as services that offer to renegotiate, settle, or modify the terms of a consumer’s debt. Proposed § 1040.3(a)(3) would include in the coverage of proposed Part 1040 providing services to assist a consumer with debt management or debt settlement, modifying the terms of any extension of consumer credit covered by proposed § 1040.3(a)(3)(i), or avoiding foreclosure. With the exception of the reference to an extension of consumer credit covered by proposed § 1040.3(a)(3)(i), these terms derive directly from the definition of this consumer financial

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<sup>456</sup> An automobile pursuant to that regulation means any self-propelled vehicle primarily used for personal, family, or household purposes for on-road transportation and does not include motor homes, recreational vehicles, golf carts, and motor scooters. 12 CFR 1090.108(a).

<sup>457</sup> The Bureau finalized a larger participant rule for auto financing in 2015. *Defining Larger Participants of the Automobile Financing Market and Defining Certain Automobile Leasing Activity as a Financial Product or Service*, 80 FR 37495 (Jun. 30, 2015). That rule provides greater detail on the Bureau’s approach to defining extending or brokering automobile leasing in accordance with the Bureau’s authority under the Dodd-Frank Act. *Id.* The provision at 12 CFR 1001.2(a)(1) covers leases of an automobile where the lease “[q]ualifies as a full-payout lease and a net lease, as provided by 12 CFR 23.3(a), and has an initial term of not less than 90 days, as provided by 12 CFR 23.11 . . . .”.

product or service in Dodd-Frank section 1002(15)(A)(viii)(II).<sup>458</sup> The Bureau notes that the term debt is broader than the credit the Bureau proposes to cover in proposed § 1040.3(a)(1)(i). As a result, as explained in proposed comment 3(a)(3)-1, this proposed coverage would reach debt relief services for all types of consumer debts, whether arising from secured or unsecured consumer credit transactions, or consumer debts that do not arise from credit transactions.

In its SBREFA Outline, the Bureau considered defining debt relief coverage more narrowly by reference to the definition of “debt relief services” under the FTC’s Telemarketing Sales Rule, 16 CFR part 310.<sup>459</sup> However, in further considering this approach, the Bureau has determined that definition may be too narrow, as it does not expressly cover debt relief services for secured credit products, such as mortgages, or for debts that do not arise from credit transactions, such as tax debts, or debts in other contexts (ranging from the health to the utilities sectors) which may or may not arise from credit transactions, depending on the facts or circumstances.<sup>460</sup> The Bureau believes the scope of coverage in proposed § 1040.3(a)(3) would be appropriate because, as noted, debt relief services are not only focused on credit transactions. Moreover, debt relief services provided for other types of debts can affect a consumer’s credit report because the person to whom the debt is owed may furnish information to a consumer reporting agency,<sup>461</sup> and by extension, the consumer’s access to credit can be affected. The

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<sup>458</sup> 12 U.S.C. 5481(15)(A)(viii)(II). For examples of the types of services that fall within this proposed coverage, see the following Bureau enforcement actions: Complaint ¶ 4, CFPB v. Meracord, LLC, No. 3:13-cv-05871 (W.D. Wash. Oct. 3, 2013); Complaint ¶ 4, CFPB v. Global Client Solutions, No. 2:14-cv-06643 (C.D. Cal. Aug. 25, 2014); Complaint ¶¶ 8-14, CFPB v. Orion Processing, LLC, No. 1:15-cv-23070-MGC (S.D. Cal. Aug. 17, 2015).

<sup>459</sup> SBREFA Outline *supra* note 331, at 22. See 16 CFR 310.2(o) (covering services seeking debt relief for consumers from “unsecured creditors or debt collectors”).

<sup>460</sup> In addition, the Bureau is concerned that incorporating a term from a regulation that applies in the telemarketing context only may create confusion, and could reduce protection for consumers obtaining debt relief services from providers not engaged in telemarketing.

<sup>461</sup> See 15 U.S.C. 1681s-2.

Bureau seeks comment on proposed § 1040.3(a)(3), including whether the Bureau should consider alternatives, and if so, which alternatives.

Another consumer financial product or service, which is listed in Dodd-Frank section 1002(15)(A)(viii)(I), is providing credit counseling to a consumer. Credit counseling can include counseling on consumer credit that would be covered by the proposed rule, including but not limited to credit repair services that may also be subject to the Credit Repair Organizations Act, 15 U.S.C. 1679, *et seq.* The Bureau seeks comment on whether proposed Part 1040 also should apply to credit counseling services, and if so, what types of services should be covered.

#### *1040.3(a)(4)*

The Bureau believes that the proposed rule should apply to providing consumers with consumer reports and information specific to a consumer from consumer reports, such as by providing credit scores and credit monitoring. Specifically, proposed § 1040.3(a)(4) would include in the scope of proposed Part 1040 providing directly to a consumer a consumer report as defined by the FCRA, 15 U.S.C. 1681a(d), a credit score, or other information specific to a consumer from such a consumer report, except when such consumer report is provided by a user covered by 15 U.S.C. 1681m solely in connection with an adverse action as defined in 15 U.S.C. 1681a(k) with respect to a product or service not covered by any of paragraphs (1) through (3) or paragraphs (5) through (1) of proposed § 1040.3(a).<sup>462</sup>

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<sup>462</sup> In its SBREFA Outline (*supra* note 331, at 23), the Bureau indicated it was considering a proposal to cover credit monitoring services. The Bureau believes that it is appropriate to propose covering not only services that provide “monitoring” of consumer credit report information, but also that provide such information on a one-off basis. That is, the nature and source of the underlying information is what should define this scope of coverage, and not the frequency with which the information is provided to the consumer.

The FCRA, enacted in 1970, defines which types of businesses are consumer reporting agencies. 15 U.S.C. 1681a(f). Consumer reporting agencies are the original sources of consumer reports as defined by the FCRA.<sup>463</sup> In general, the consumer reporting agencies provide consumer reports to “users” of these reports within the meaning of the FCRA who may in turn provide the consumer reports or information from them to consumers.<sup>464</sup> The consumer reporting agencies also provide consumer reports directly to consumers. The Bureau believes that defining this scope of coverage by reference to a statutorily-defined type of underlying information, a consumer report, would help providers better understand which types of products and services are covered, which would facilitate compliance with Part 1040 as proposed.<sup>465</sup>

Proposed § 1040.3(a)(4) therefore would apply to consumer reporting agencies when providing such products or services directly to consumers, as well as to other types of entities that deliver consumer reports or information from consumer reports directly to consumers. For example, proposed § 1040.3(a)(4) would cover not only credit monitoring services that monitor entries on a consumer’s consumer credit report on an ongoing basis, but also a discrete service that transmits a consumer report as defined by the FCRA, a credit score, or other information from a consumer report directly to a consumer. Such discrete services may be provided at the consumer’s request or as required by law, such as via a notice of adverse action on a consumer

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<sup>463</sup> 15 U.S.C. 1681a(d).

<sup>464</sup> 15 U.S.C. 1681m.

<sup>465</sup> To the extent a future Bureau regulation were to further interpret the definition of consumer report under 15 U.S.C. 1681a(d), or other terms incorporated into that definition such as a consumer reporting agency, 15 U.S.C. 1681a(f), the definition in the implementing regulation would be used, in conjunction with the statute, to define this component of coverage of this proposed rule.

credit application,<sup>466</sup> in connection with a risk-based pricing notice generally required under Regulation V, 12 CFR 1022.72, when a consumer receives materially less favorable material terms for consumer credit based on the creditor's use of a consumer report, or in connection with transmission of results of reinvestigation of a dispute from a consumer reporting agency to a consumer pursuant to the FCRA.<sup>467</sup>

Proposed § 1040.3(a)(4) would not, however, cover users of consumer reports who provide those reports or information from them to consumers solely in connection with adverse action notices with respect to a product or service that is not otherwise covered by proposed § 1040.3(a). For example, a user of a consumer report providing a consumer with a copy of their credit report solely in connection with an adverse action notice taken on an application for employment would not be covered by proposed § 1040.3(a)(4).

The Bureau invites comment on proposed § 1040.3(a)(4), including whether the reference to a consumer report as defined in the FCRA is appropriate and whether the coverage of proposed § 1040.3(a)(4) should be expanded or narrowed, and, if so, how. In particular, the Bureau requests comment on whether the proposed rule also should cover products and services that provide or monitor information obtained from sources other than a consumer report under the FCRA, for example as part of a broader suite of identity theft prevention services, and if so, which such products or services should be covered and why. In addition, the Bureau requests

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<sup>466</sup> See, e.g., 15 U.S.C. 1681j(a) (FCRA provision granting consumer right to free annual disclosure from consumer credit report file); 15 U.S.C. 1681g(a) (mandating consumer reporting agency provide information from the consumer's file to the consumer upon request); 15 U.S.C. 1681g(f) (mandating consumer reporting agency provide consumer credit score to the consumer upon request); and 15 U.S.C. 1681m(a) (FCRA provision mandating that user of consumer report to provide adverse action notice that includes credit score, among other information).

<sup>467</sup> See, e.g., 15 U.S.C. 1681i(a)(6) (FCRA provision mandating consumer reporting agency to provide the consumer with notice of results of reinvestigation of disputed information in the consumer's credit report file).

comment on whether proposed § 1040.3(a)(4) should apply to a broader range of services undertaken by consumer reporting agencies as defined by the FCRA that may have a bearing on the ability of consumers to participate in the credit market and the manner in which they do so. Such activities could include conducting investigations of information in consumer reports that is disputed by consumers, opting consumers out of information sharing, placing a fraud alert on a consumer's credit report, or placing a security freeze on a consumer's credit report.

Finally, the Bureau requests comment on whether the use of arbitration agreements by consumer reporting agencies in the provision of the products and services described above may have an impact on the ability of consumers to pursue or participate in class actions asserting claims under FCRA against the consumer reporting agencies more generally, and if so, whether the proposed rule should mitigate those impacts, and if so, how.

*1040.3(a)(5)*

The Bureau believes the proposed rule should apply to deposit and share accounts. Proposed § 1040.3(a)(5) would include in the coverage of proposed Part 1040 accounts subject to the Truth in Savings Act (TISA), 12 U.S.C. 4301 *et seq.*, and its implementing regulations, 12 CFR part 707, which applies to credit unions, and Regulation DD, 12 CFR part 1030, which applies to depository institutions.

TISA created uniform disclosure requirements for deposit and share accounts.<sup>468</sup> For banks, the Bureau's Regulation DD implements TISA. For credit unions, the National Credit Union Administration implements TISA in its own regulations codified at 12 CFR part 707. TISA has existed since 1991 and the Bureau believes that banks and credit unions are familiar

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<sup>468</sup> 12 U.S.C. 4301(b).



with when TISA applies to accounts that they may offer. Accordingly, the Bureau believes that defining the accounts the Bureau proposes cover by reference to terms in TISA, and its implementing regulations, Regulation DD and 12 CFR part 707 would facilitate compliance with proposed Part 1040. The Bureau invites comment on proposed § 1040.3(a)(5), including its reference to TISA, whether the Bureau should reference other definitions of deposit or share accounts beyond those also included in proposed § 1040.3(a)(6) discussed below, and whether this portion of the proposed coverage should be expanded or narrowed, and if so, how.

#### *1040.3(a)(6)*

In addition to coverage of deposit and share accounts as defined by (or within the meaning set forth in) TISA in proposed § 1040.3(a)(5), the Bureau believes the proposed rule should cover other accounts as well as remittance transfers subject to EFTA, 15 U.S.C. 1693 *et seq.* EFTA applies, for example, to nonbank providers of accounts and to many, but not necessarily all, of the deposit and share accounts provided by depository institutions. Thus, proposed § 1040.3(a)(6) would include in the coverage for proposed Part 1040 accounts and remittance transfers subject to EFTA, including its implementing regulation, Regulation E, 12 CFR part 1005. EFTA, first adopted in 1978, provides a basic framework establishing the rights, liabilities, and responsibilities of participants in electronic fund and remittance transfer systems and creates rules specific to consumer asset accounts and remittance transfers.<sup>469</sup> The Bureau implements EFTA in Regulation E. The Bureau believes that defining this coverage by

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<sup>469</sup> See 15 U.S.C. 1693(b); 12 CFR 1005.2(b) (defining “account”) and 12 CFR 1005.30(e) (defining “remittance transfer”).

reference to accounts and remittance transfers subject to EFTA as implemented by Regulation E would facilitate compliance with proposed Part 1040.

The Bureau notes that it has separately proposed a rule to extend the definition of “account” to include “prepaid accounts.”<sup>470</sup> As noted above, where this proposed rule references terms from another statute or its implementing regulations, to the extent that term is redefined or the subject of a new interpretation in the future, that new definition or interpretation would apply to the use of that term in proposed § 1040.3. Here, for example, any new definition of account that would include prepaid products would be incorporated into proposed § 1040.3(a)(6).

The Bureau notes that EFTA also regulates preauthorized electronic fund transfers (PEFTs) and store gifts cards and gift certificates. The Bureau has not proposed to include those activities as covered products or services under proposed § 1040.3(a)(6). The Bureau notes that certain gift cards and gift certificates redeemable only at a single store or affiliated group of merchants, while subject to Regulation E,<sup>471</sup> are payment devices that merchants use to help consumers pay for their own goods or services, which as noted above, the Bureau is not proposing to cover except in limited circumstances. In addition, PEFTs, while not described as a separate category of coverage, generally would be covered when offered as part of a covered product or service. For example, the Bureau understands that PEFTs may be offered by creditors and servicers of consumer credit under proposed §§ 1040.3(a)(1), providers of TISA or EFTA accounts or remittance transfers under paragraphs (5) or (6) of proposed § 1040.3(a), funds

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<sup>470</sup> Prepaid Accounts Under the Electronic Fund Transfer Act (Regulation E) and the Truth in Lending Act (Regulation Z), 79 FR 77101 (Dec. 23, 2014) (hereinafter Prepaid NPRM). The Bureau seeks comment on whether the products that would be included in Regulation E by that proposed rule should be included in proposed § 1040.3(a)(6).

<sup>471</sup> See 12 CFR 1005.20(a).

transmitting services under proposed § 1040.3(a)(7), payment processing under proposed § 1040.3(a)(8), or debt collection under proposed § 1040.3(a)(10).

The Bureau invites comment on proposed § 1040.3(a)(6), including the reference to accounts or remittance transfers subject to EFTA, as implemented by Regulation E, and whether it should be expanded or narrowed. The Bureau also seeks comment on whether the proposed rule should cover other types of stored value products and services within the meaning of Dodd-Frank Act section 1002(15)(A)(v), and if so, what these products and services are, why they should be covered, and how they should be defined.

#### *1040.3(a)(7)*

The Bureau believes that the proposed rule should apply to transmitting or exchanging funds. Proposed § 1040.3(a)(7) would include in the coverage of proposed Part 1040 transmitting or exchanging funds, except when integral to another product or service that is not covered by proposed § 1040.3. Dodd-Frank section 1002(29) defines transmitting or exchanging funds to mean:

receiving currency, monetary value, or payment instruments from a consumer for the purpose of exchanging or transmitting the same by any means, including transmission by wire, facsimile, electronic transfer, courier, the Internet, or through bill payment services or through other businesses that facilitate third-party transfers within the United States or to or from the United States.

For example, a business that provides consumers with domestic money transfers generally would be covered by proposed § 1040.3(a)(7). As noted above, however, proposed § 1040.3(a)(7) would not apply to transmitting or exchanging funds where that activity is integral to a non-covered product or service. Thus, proposed § 1040.3(a)(7) generally would not apply, for example, to a real estate settlement agent, an attorney, or a trust company or other custodian transmitting funds from an escrow or trust account that are an integral part of real estate

settlement services or legal services. By contrast, a merchant who offers a domestic money transfer service as a stand-alone product to consumers would be covered by proposed § 1040.3(a)(7). In addition, the Bureau believes that mobile wireless third-party billing services that engage in transmitting funds would be covered by proposed § 1040.3(a)(7), as the Bureau understands that such services would not typically be integral to the provision of wireless telecommunications services.

The Bureau seeks comment on proposed § 1040.3(a)(7), including whether the Bureau should consider alternatives in defining these terms, and if so, particular definitions or changes the Bureau should consider and why. For example, the Bureau seeks comment on whether the Bureau should define the limitation on this coverage by reference to funds transmitting or exchanging that is necessary or essential to a non-covered product or service, rather than by reference to such activities that are integral to the non-covered product or service.

#### *1040.3(a)(8)*

The Bureau believes that the proposed rule should cover certain types of payment and financial data processing. Proposed § 1040.3(a)(8) therefore would include in the coverage of proposed Part 1040 any product or service in which the provider or the provider's product or service accepts financial or banking data directly from a consumer for the purpose of initiating a payment by a consumer via a payment instrument as defined 15 U.S.C. 5481(18)<sup>472</sup> or initiating a credit card or charge card transaction for a consumer, except when the person accepting the data or providing the product or service accepting the data is selling or marketing the

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<sup>472</sup> Dodd-Frank section 1002(18) defines a "payment instrument" as "a check, draft, warrant, money order, traveler's check, electronic instrument, or other instrument, payment of funds, or monetary value (other than currency)."

nonfinancial good or service for which the payment, credit card, or charge card transaction is being made. Proposed comment 3(a)(8)-1 would clarify that the definitions of the terms credit card and charge card in Regulation Z, 12 CFR 1026.2(a)(15), apply to the use of these terms in proposed § 1040.3(a)(8).

The coverage of proposed § 1040.3(a)(8) would not include all types of payment and financial data processing, but rather only those types that involve accepting financial or banking data directly from the consumer for initiating a payment, credit card, or charge card transaction. An entity would be covered, for example, by providing the consumer with a mobile phone application (or app, for short) that accepts this data from the consumer and transmits it to a merchant, a creditor, or others. An entity also would be covered by itself accepting the data from the consumer at a storefront or kiosk, by electronic means on the Internet or by email, or by telephone. For example, a wireless, wireline, or cable provider that allows consumers to initiate payments to third parties through its billing platform would be covered by proposed § 1040.3(a)(8).

The Bureau notes that the breadth of proposed § 1040.3(a)(8) would be limited in several ways. First, the coverage of proposed § 1040.3(a)(8) would not include merchants, retailers, or sellers of nonfinancial goods or services when they are providing payment processing services directly and exclusively for purpose of initiating payments instructions by the consumer to pay such persons for the purchase of, or to complete a commercial transaction for, such nonfinancial goods or services. Those types of payment processing services are excluded from the type of financial product or service identified in Dodd-Frank section 1002(15)(A)(vii)(I). As a result, they would not be a consumer financial product or service pursuant to 12 U.S.C. 5481(5), which is a statutory limitation on the coverage of proposed § 1040.3(a). For the sake of clarity,

proposed § 1040.3(a)(8) would state that it would not apply to accepting instructions directly from a consumer to pay for a nonfinancial good or service sold by the person who is accepting the instructions. In addition, proposed § 1040.3(a)(8) would not apply to accepting instructions directly from a consumer to pay for a nonfinancial good or service marketed by the person who is accepting the instructions. As a result of this proposed exception, proposed § 1040.3(a)(8) would not reach, for example, a sales agent, such as a travel agent, who accepts an instruction from a consumer to pay for a nonfinancial good or service that is marketed by the agent on behalf of a third party that provides the nonfinancial good or service.

The Bureau further notes that certain forms of payment processing also would be covered by other provisions of proposed § 1040.3(a). For example, proposed § 1040.3(a)(1)(v) (servicing of consumer credit), § 1040.3(a)(3) (debt relief services), § 1040.3(a)(5) (deposit and share accounts), § 1040.3(a)(6) (consumer asset accounts and remittance transfers), § 1040.3(a)(7) (transmitting or exchanging funds), or § 1040.3(a)(10) (debt collection) could involve certain forms of payment processing, whether or not those forms also would be covered by proposed § 1040.3(a)(8).

The Bureau seeks comment on proposed § 1040.3(a)(8), including on whether it should adopt a broader, narrower, or different definition of covered payment and financial data processing and, if so, why and how it should do so. For example, the Bureau seeks comment on whether proposed § 1040.3(a)(8) should include an exclusion like the exclusion in proposed § 1040.3(a)(7) for products or services that are integral to another product or service not covered by proposed § 1040.3, and if so, what examples of such products or services should be excluded and why.

*1040.3(a)(9)*

The Bureau believes that the proposed rule should apply to cashing checks for consumers as well as to associated consumer check collection and consumer check guaranty services. Proposed § 1040.3(a)(9) would include in the coverage of proposed Part 1040 check cashing, check collection, or check guaranty services, which are types of consumer financial product or service identified in Dodd-Frank section 1002(15)(A)(vi). The Bureau seeks comment on proposed § 1040.3(a)(9), including on whether the Bureau should consider alternatives in defining this scope of coverage, and if so, particular definitions or changes the Bureau should consider and why.

*1040.3(a)(10)*

The Bureau believes that the proposed rule should apply to debt collection activities arising from products covered by paragraphs (1) through (9) of proposed § 1040.3(a). Dodd-Frank section 1002(15)(A)(x) identifies debt collection as a type of consumer financial product or service that is separate from, but related to, other types of consumer financial products or services. In the proposed rule, the Bureau is similarly proposing to include a separate provision specifying the coverage of activities relating to debt collection in proposed § 1040.3(a)(10). In addition to collections on consumer credit as defined under ECOA, other products and services covered by proposed § 1040.3(a) may lead to collections; if any of these collection activities were not separately covered, collectors in these cases could seek to invoke arbitration agreements. Yet the Study showed that FDCPA class actions were the most common type of class actions filed across six significant markets and that debt collection class settlements were

by far the most common type of class action settlement in all of consumer finance,<sup>473</sup> which in turn suggests that debt collection is an activity in which it is especially important to allow for private enforcement, including class actions, to guarantee the consumer protections afforded by the FDCPA, among other applicable laws. Moreover, particularly in light of the fact that collectors often bring suit against consumers and the history discussed above in Part II of numerous claims being filed by debt collectors against consumers in an arbitral forum where there were serious fairness concerns, the Bureau believes that application of the proposed rule to collection activities may be one of the most important components of the rule.

Specifically, proposed § 1040.3(a)(10) would apply the requirements of proposed Part 1040 to collecting debt that arises from any of the consumer financial products or services covered by any of paragraphs (1) through (9) of proposed § 1040.3(a). For clarity, proposed § 1040.3(a)(10) would identify the specific types of entities that the Bureau understands typically are engaged in collecting these debts: (i) a person offering or providing the product or service giving rise to the debt being collected, an affiliate of such person, or a person acting on behalf of such person or affiliate; (ii) a purchaser or acquirer of an extension of consumer credit covered by proposed § 1040.3(a)(1)(i), an affiliate of such person, or a person acting on behalf of such person or affiliate; and (iii) a debt collector as defined by the FDCPA, 15 U.S.C. 1692a(6). The coverage of each of these types of entities engaged in debt collection is discussed separately below.

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<sup>473</sup> Study, *supra* note 2, section 6 at 19 and section 8 at 12.



*1040.3(a)(10)(i) and (ii)*

Proposed § 1040.3(a)(10)(i) would apply to collection by a person offering or providing the covered product or service giving rise to the debt being collected, an affiliate of such person,<sup>474</sup> or a person acting on behalf of such person or affiliate. This coverage would include, for example, collection by a creditor extending consumer credit. The Bureau notes, however, that as with proposed § 1040.3(a)(1) discussed above, proposed § 1040.3(a)(10)(i) would not extend coverage to collection directly by a merchant of debt arising from credit it extends for the purchase of its nonfinancial goods or services in circumstances where the merchant is exempt under proposed § 1040.3(b). Similarly, collection directly by governments or government affiliates on credit they extend would be exempt in the circumstances described in proposed § 1040.3(b).

In addition, proposed § 1040.3(a)(10)(ii) would cover collection activities by an acquirer or purchaser of an extension of consumer credit covered by proposed § 1040.3(a)(1), an affiliate of such person, or a person acting on behalf of such person or affiliate. This coverage would reach such persons even when proposed § 1040.3(b) would exclude the original creditor from coverage. For example, such collection activities by acquirers or purchasers would be covered even when the original creditor, such as a government or merchant, would be excluded from coverage in circumstances described in proposed § 1040.3(b). As a result, collection by an acquirer or purchaser of an extension of merchant consumer credit covered by Regulation B, such as medical credit, would be covered by proposed § 1040.3(a)(10)(ii), even in circumstances

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<sup>474</sup> As proposed comment 3(a)(10)-2 would clarify, Dodd-Frank section 1002(1) defines the term affiliate as “any person that controls, is controlled by, or is under common control with another person.” 12 U.S.C. 5481(1).

where proposed § 1040.3(b)(5) would exclude the medical creditor from coverage.<sup>475</sup> In other words, although hospitals, doctors, and other service providers extending incidental ECOA consumer credit would not be subject to the requirements of § 1040.4 to the extent proposed § 1040.3(b)(5) would exclude them from coverage because the Bureau lacks authority over them under Dodd-Frank section 1027 or they would be excluded under another provision of proposed § 1040.3(b), an acquirer or purchaser of such consumer credit generally would be subject to proposed § 1040.4.<sup>476</sup>

The Bureau believes that many activities involved in collection of debts arising from extensions of consumer credit would also constitute servicing under proposed § 1040.3(a)(1)(v). However, the Bureau is proposing the coverage of collection activities by any other person acting on behalf of the provider or affiliate in §§ 1040.3(a)(10)(i) and (ii) to confirm that collection activity by a such other persons would be covered even when such other persons do not meet the definition of a debt collector under the FDCPA (*see* proposed § 1040.3(a)(10)(iii))

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<sup>475</sup> ECOA credit includes incidental credit pursuant to Regulation B and the commentary specifically notes that hospitals and doctors can provide such incidental credit. *See* 12 CFR 1002.3(c), comment 1 (“If a service provider (such as a hospital, doctor, lawyer, or merchant) allows the client or customer to defer the payment of a bill, this deferral of debt is credit for purposes of the regulation, even though there is no finance charge and no agreement for payment in installments.”).

<sup>476</sup> The Bureau also explained in its Debt Collection Larger Participant Rulemaking, in analyzing what type of transactions are “credit” under the Dodd-Frank Act, that “[i]n some situations, a medical provider may grant the right to defer payment after the medical service is rendered. In those circumstances, the transaction might involve an extension of credit.” *Defining Larger Participants of the Consumer Debt Collection Market*, 77 FR 65775, 65779 (Oct. 31, 2012). Other regulatory guidance in the past has indicated that “a health care provider is a creditor [under ECOA] if it regularly bills patients after the completion of services, including for the remainder of medical fees not reimbursed by insurance. Similarly, health care providers who regularly allow patients to set up payment plans after services have been rendered are creditors.” *See* Steven Toporoff, *The “Red Flags” Rule: What Health Care Providers Need to Know*, Modern Medicine Network (Jan. 11, 2010) (commentary by attorney at FTC), *available at* <http://www.modernmedicine.com/modern-medicine/news/modernmedicine/modern-medicine-feature-articles/red-flags-rule-what-healthcare-> (last visited May 1, 2016). The Bureau is not interpreting ECOA or Regulation B here.

discussed below) because they are not collecting on an account obtained in default.<sup>477</sup> By proposing coverage of debt collection by such other persons, the Bureau also seeks to confirm that collection activity would be covered even in contexts in which industry may sometimes differentiate between the terms servicing and debt collection. For example, in some contexts “servicing” may be used in the industry to refer to activities involving seeking and processing payments on a debt from a consumer who is not in default, while “collections” may sometimes be used by industry to refer to post-default activities.<sup>478</sup> Both types of collection activity would be covered under the proposed rule.

*1040.3(a)(10)(iii)*

As discussed above, some debt collection activities are carried out by persons hired by the owner of a debt to collect the debt. The FDCPA generally considers such persons to be debt collectors subject to its statutory requirements and prohibitions designed to deter abusive practices. Allegations of violation of the FDCPA by debt collectors also were among the most common type of consumer claim identified in the Study, whether in class actions, individual arbitration, or individual litigation. Proposed § 1040.3(a)(10)(iii) therefore would include in the coverage of proposed Part 1040 collecting debt by a debt collector as defined by the FDCPA, 15

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<sup>477</sup> See 15 U.S.C. 1692a(6)(F)(iii) (defining a debt collector to exclude a person collecting on an account “not in default at the time it was obtained”).

<sup>478</sup> See FTC, *The Structure and Practices of the Debt Buying Industry*, at n.57 (2013) (“Creditors consider consumers who are late in paying as being ‘delinquent’ on their debts. Creditors may continue to collect on delinquent debts, but after a period of time creditors consider consumers to be in ‘default’ on their debts.”).

U.S.C. 1692a(6),<sup>479</sup> when the debt arises from any consumer financial products and services described in proposed §§ 1040.3(a)(1) through (9).

As discussed above, the Bureau believes it is important to cover collection on all of the consumer financial products and services covered by the rule, since all of these products can generate fees that, if not paid, that lead to collection activities by debt collectors as defined in the FDCPA. Of course, one of the most common types of debt collected by FDCPA debt collectors arises from consumer credit transactions. Accordingly, proposed § 1040.3(a)(10)(iii) would extend coverage, for example, to collection by a third-party FDCPA debt collector acting on behalf of the persons extending credit who are ECOA creditors and thus subject to proposed § 1040.3(a)(1)(i) or their successors and assigns who are subject to proposed § 1040.3(a)(1)(iv). The Bureau believes that proposed § 1040.3(a)(10)'s references to these existing regulatory regimes would facilitate compliance, since the Bureau expects that industry has substantial experience with existing contours of coverage under the FDCPA and ECOA. As discussed above, proposed § 1040.3(a)(10)(iv) would apply proposed Part 1040 to purchasers of consumer credit extended by persons over whom the Bureau lacks authority under Dodd-Frank section 1027 or 1029 or who are otherwise exempt under proposed § 1040.3(b). Similarly, proposed § 1040.3(a)(10)(iii) would apply to FDCPA debt collectors when collecting on this type of credit as well as other debts arising from products or services covered by proposed §§ 1040.3(a)(1) through (9) provided by persons over whom the Bureau lacks authority under Dodd-Frank section 1027 or 1029 or who are otherwise exempt under proposed § 1040.3(b) .

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<sup>479</sup> To the extent a future Bureau regulation were to implement the definition of debt collector under 15 U.S.C. 1692a(6), the definition in the implementing regulation would be used, in conjunction with the statute, to define this component of coverage of this proposed rule.

The Bureau recognizes that FDCPA debt collectors do not typically become party to agreements with consumers for the provision of debt collection services; they instead collect on debt incurred pursuant to contracts between consumers and creditors or other providers. There are, however, a number of ways in which the proposed rule would regulate or otherwise affect the conduct of debt collectors. First, to the extent that the debt collector is collecting on a debt arising from an extension of consumer credit covered by proposed § 1040.3(a)(1), any pre-dispute arbitration agreement for that product or service that is entered into after the date set forth in proposed § 1040.5(a) already would be required under proposed § 1040.4(a)(2) to contain a provision that expressly prohibits anyone, including the debt collector, from invoking it in response to a class action. Second, independent of the above-described contractual restriction, under proposed § 1040.4(a)(1), discussed below, the debt collector would be prohibited from invoking a pre-dispute arbitration agreement in a class action dispute concerning such collection activities. If a pre-dispute arbitration agreement is the basis for an individual arbitration filed by or against the debt collector related to its collection activities that are covered by the proposal, then the debt collector also would be required to submit to the Bureau the records specified in proposed § 1040.4(b). Finally, to the extent that a collector becomes party to a contract with individual consumers in the course of settling debts, such as a payment plan agreement, and that contract includes a pre-dispute arbitration agreement, then proposed § 1040.4(a)(2) would require the collector to include the prescribed language in that pre-dispute arbitration agreement.<sup>480</sup>

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<sup>480</sup> See proposed comment 4-1.

Proposed comment 3(a)(10)-1 would further clarify that collecting debt by persons listed in § 1040.3(a)(1) would be covered with respect to the consumer financial products or services identified in those provisions, but not for other types of credit or debt they may collect, such as business credit.

The Bureau seeks comment on its proposed debt collection coverage. For example, the Bureau requests comment on whether furnishing information to a consumer reporting agency covered by the FCRA, 15 U.S.C. 1681s-2, by any person covered by proposed § 1040.3(a)(10) should also be separately identified as a covered product or service. The Bureau also seeks comment on whether there are any persons who neither provide a product or service covered by any of paragraphs (1) through (9) of proposed § 1040.3(a) nor are an FDCPA debt collector nonetheless engage in debt collection on such products or services, and if so, whether proposed § 1040.3(a)(10) should be expanded to cover such persons, and if so, why and how. Similarly, the Bureau requests comment on whether debt collectors as defined in the FDCPA would include anyone not already covered by §§ 1040.3(a)(i) and (ii), and if not, whether the proposed rule should simply clarify that debt collectors as defined in the FDCPA are covered under proposed §§ 1040.3(a)(i) and (ii), as applicable, rather than separately stating their coverage under proposed § 1040.3(a)(10)(iii).

*1040.3(b) Exclusions from coverage*

Proposed § 1040.3(b) would identify the set of conditions under which certain persons would be excluded from the coverage of proposed Part 1040 when providing a specified product or service covered by proposed § 1040.3(a).

The Bureau further notes that certain additional limitations are inherent in proposed § 1040.3(a). These limitations arise not only from the terms chosen for proposed § 1040.3(a) in

general, but also from the fact that in a number of places proposed § 1040.3(a) references terms from other enumerated consumer financial protection statutes and their implementing regulations. For example, a transaction is “credit” as defined by Regulation B implementing ECOA only if there is a “right” to defer payment.<sup>481</sup> These limitations would be incorporated into the coverage of proposed Part 1040, regardless of whether they are explicitly mentioned in the text of the regulation or the commentary of the proposed rule.

As discussed above, if an exclusion in proposed § 1040.3(b) does not apply to a person that offers or provides a product or service described in proposed § 1040.3(a), that person would meet the definition of a provider in proposed § 1040.2(c) and would be subject to the proposed rule. Even if an exclusion in proposed § 1040.3(b) applies person offering or providing a product or service, however, that person may still be covered by Part 1040 when providing a different product or service described in proposed § 1040.3(a) if an exemption in proposed § 1040.3(b) does not apply to that product or service.

For illustrative purposes, the Bureau notes that persons offering or providing consumer financial products or services covered by proposed § 1040.3(a) described above may include, without limitation, banks, credit unions, credit card issuers, certain automobile lenders, auto title lenders, small-dollar or payday lenders, private student lenders, payment advance companies, other installment and open-end lenders, loan originators and other entities that arrange for consumer loans, providers of certain automobile leases, loan servicers, debt settlement firms, foreclosure rescue firms, certain credit service/repair organizations, providers of consumer credit

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<sup>481</sup> See Regulation B comment 2(j)-1 (“Under Regulation B, a transaction is credit if there is a right to defer payment of a debt . . .”).

reports and credit scores, credit monitoring service providers, debt collectors, debt buyers, check cashing providers, remittance transfer providers, domestic money transfer or currency exchange service providers, and certain payment processors.<sup>482</sup>

The Bureau requests comment on the exclusions proposed in § 1040.4(b), and also on whether the proposed rule should include other exclusions. For example, as discussed below in the Section-by-Section Analysis to proposed § 1040.4(b), the Bureau requests comment on whether the proposed rule should include an exclusion for certain small entities. In addition, the Bureau requests comment on how the proposed rule should interact with potential regulations, discussed above, that may be promulgated by the U.S. Department of Education. The Bureau notes, for example, that such a regulation, if adopted, could overlap with the Bureau's proposed rule here, which would apply to postsecondary education institutions that are significantly engaged in provide financing directly to consumers with a finance charge.<sup>483</sup>

#### *1040.3(b)(1)*

Proposed § 1040.3(b)(1) would exclude from the coverage of proposed Part 1040 broker-dealers to the extent they are providing any products and services covered by proposed § 1040.3(a) that are also subject to specified rules promulgated or authorized by the SEC prohibiting the use of pre-dispute arbitration agreements in class litigation and providing for making arbitral awards public. The term broker-dealer generally refers to persons engaged in the

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<sup>482</sup> The Bureau discusses the examples as well as other types of entities that may be covered in certain circumstances above in the Section-by-Section Analysis to proposed § 1040.3. In addition, as part of its broader administration of the enumerated consumer financial protection statutes and Title X of the Dodd-Frank Act, the Bureau continues to analyze the nature of products or services tied to virtual currencies.

<sup>483</sup> See Press Release, U.S. Dept. of Ed., *U.S. Department of Education Takes Further Steps to Protect Students from Predatory Higher Education Institutions* (Mar. 11, 2016) (describing negotiated rulemaking agenda for 2015-16 as including a potential regulation addressing mandatory arbitration agreements used by higher education institutions), available at <http://www.ed.gov/news/press-releases/us-department-education-takes-further-steps-protect-students-predatory-higher-education-institutions> (last visited May 1, 2016).



business of effecting securities transactions for the account of others or buying and selling securities for their own account.<sup>484</sup> Broker-dealers may provide products that are described in proposed § 1040(a). For example, broker-dealers may extend credit to allow customers to purchase securities. Securities credit is subject to ECOA as recognized in Regulation B, 12 CFR 1002.3(b). The Bureau proposes to exclude such persons from coverage to the extent providing products and services described in proposed § 1040.3(a) because they are already covered by existing regulations that limit the application of pre-dispute arbitration agreements to class litigation and provide for making arbitral awards public.

As discussed above, since 1992, FINRA, a self-regulatory organization overseen by the SEC, has required pre-dispute arbitration agreements adopted by broker-dealers to include language disclaiming the application of the arbitration agreement to class actions filed in court.<sup>485</sup> The SEC, which must authorize FINRA rules, authorized the original version of this rule in 1992.<sup>486</sup> The Bureau also notes that claims in FINRA arbitration between customers and broker-dealers are filed with FINRA,<sup>487</sup> which is overseen by the SEC, and all awards between customers and broker-dealers under FINRA rules must be made public.<sup>488</sup> Proposed comment 3(b)(1)-1 would clarify that § 1040.3(b)(1)'s reference to rules authorized by the SEC would include those promulgated by FINRA and approved by the SEC, as described above, in order

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<sup>484</sup> See 15 U.S.C. 78c(4)-(5) (defining the terms broker and dealer under the Securities Exchange Act).

<sup>485</sup> FINRA Rule 2268(f). FINRA, formerly the National Association of Securities Dealers, also serves as an arbitral administrator for disputes concerning broker-dealers and its rules further prohibit broker-dealers from enforcing an arbitration agreement against a member of a certified or putative class case. FINRA Rule 12204(d).

<sup>486</sup> SEC approving release for amendments to NASD Code of Arbitration Procedure and Rules of Fair Practice, Exchange Act Rel. No. 31371, 1992 WL 324491 (Oct. 28, 1992).

<sup>487</sup> FINRA Rule 12302(a) (providing that claimant must file an initial claim with the Director of the FINRA Office of Dispute Resolution).

<sup>488</sup> FINRA Rule 12904(h) (“All awards shall be made publicly available.”).

that products and services covered by those FINRA rules would be excluded from the coverage of proposed Part 1040.

The Bureau invites comment on proposed § 1040.3(b)(1) and comment 3(b)(1)-1, including whether such an exclusion from proposed Part 1040 is appropriate and whether it should be expanded or narrowed, and if so, how. In particular, the Bureau seeks comment on the extent to which any other person who is acting in an SEC-regulated capacity, such as an investment adviser, may also be providing a consumer financial product or service that would be subject to proposed § 1040.3.<sup>489</sup> For example, the Bureau seeks comment on whether the proposed rule should include an exclusion for such persons to the extent they are subject to any SEC rule (which does not currently exist, but which the SEC could adopt in the future, for example, under Dodd-Frank section 921) that is functionally equivalent to the proposed rule.

The CFTC has a regulation requiring that pre-dispute arbitration agreements in customer agreements for products and services regulated by the CFTC be voluntary, such that the

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<sup>489</sup> See Dodd-Frank section 1002(21) (defining “person regulated by the [Securities and Exchange] Commission” as “a person who is—(A) a broker or dealer that is required to be registered under the Securities Exchange Act of 1934; (B) an investment adviser that is registered under the Investment Advisers Act of 1940; (C) an investment company that is required to be registered under the Investment Company Act of 1940, and any company that has elected to be regulated as a business development company under that Act; (D) a national securities exchange that is required to be registered under the Securities Exchange Act of 1934; (E) a transfer agent that is required to be registered under the Securities Exchange Act of 1934; (F) a clearing corporation that is required to be registered under the Securities Exchange Act of 1934; (G) any self-regulatory organization that is required to be registered with the Commission; (H) any nationally recognized statistical rating organization that is required to be registered with the Commission; (I) any securities information processor that is required to be registered with the Commission; (J) any municipal securities dealer that is required to be registered with the Commission; (K) any other person that is required to be registered with the Commission under the Securities Exchange Act of 1934; and (L) any employee, agent, or contractor acting on behalf of, registered with, or providing services to, any person described in any of subparagraphs (A) through (K), but only to the extent that any person described in any of subparagraphs (A) through (K), or the employee, agent, or contractor of such person, acts in a regulated capacity.”); see also Dodd-Frank section 1027(i)(1) (providing that Dodd-Frank Act Title X provisions may not be “construed as altering, amending, or affecting the authority of the [Securities and Exchange] Commission to adopt rules, initiate enforcement proceedings, or take any other action with respect to a person regulated by the [Securities and Exchange] Commission. The Bureau shall have no authority to exercise any power to enforce this title with respect to a person regulated by the [Securities and Exchange] Commission.”).

customer receives a specified disclosure before being asked to sign the pre-dispute arbitration agreement, is not required to sign the pre-dispute arbitration agreement as a condition of receiving the product or service, and is only subject to the pre-dispute arbitration agreement if he or she separately signs it, among other requirements.<sup>490</sup> The Bureau has considered whether to propose excluding from coverage any consumer financial products and services covered by proposed § 1040.3(a) that are subject to the CFTC regulation.<sup>491</sup> That regulation, however, does not ensure consumers have access to private remedies in class actions and does not provide for transparency of arbitral awards. The Bureau believes that this proposed rule can provide important consumer protections for providers that might also be subject to the CFTC’s regulation. The Bureau also believes that complying with both rules would not be unduly burdensome for any affected providers, given the limited nature of the CFTC rule. The Bureau therefore is not proposing an exemption for those persons.

Under the proposed rule, any product or service that is subject to both the Bureau’s proposed rule and the CFTC rule<sup>492</sup> would therefore need to meet the requirements of both rules. For example, any pre-dispute arbitration agreement would need to be both satisfy the CFTC requirements to ensure the contract is voluntary and contain the provision mandated by proposed

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<sup>490</sup> 17 CFR 166.5.

<sup>491</sup> See SBREFA Outline *supra* note 331, at 23.

<sup>492</sup> The Bureau understands that foreign currency spot transactions are not covered by the CFTC rule. See 17 CFR 166.5(a)(ii) (applying CFTC rule to “retail fore[ign] ex[change]”); *but see* 7 U.S.C. 2(c)(2)(B)(i)(I) (Commodity Exchange Act covering retail foreign exchange contracts that provide for “future delivery”) & CFTC and SEC, Further Definition of “Swap,” “Security-Based Swap,” and “Security-Based Swap Agreement”; Mixed Swaps; Security-Based Swap Agreement Recordkeeping; Final Rule, 77 FR 48208, 48256 (Aug. 13, 2012) (“The CEA generally does not confer regulatory jurisdiction on the CFTC with respect to spot transactions.”).

§ 1040.4(a)(2).<sup>493</sup> The Bureau seeks comment on which types of products and services might be subject to both its proposed rule and the existing CFTC rule, on the incidence of potentially-classable disputes over these products or services, on the compatibility of its proposed rule with the existing CFTC rule, and on whether the Bureau should exempt consumer financial products and services that are subject to the CFTC rule or more broadly activities that are subject to the jurisdiction of the CFTC under the Commodity Exchange Act.<sup>494</sup>

*1040.3(b)(2)*

Proposed § 1040.3(b)(2) would exclude from the coverage of proposed Part 1040 governments and their affiliates, as defined by 12 U.S.C. 5481(1), to the extent providing products and services directly to consumers in circumstances specified in proposed § 1040.3(b)(2)(i) or (ii). This proposed exclusion would not apply to an entity that is neither a government nor an affiliate of a government but provides services to a government or an affiliate of a government.<sup>495</sup>

The Bureau believes that private enforcement of consumer protection laws, when provided for by statute, is an important companion to regulation, supervision over, and enforcement against private providers by governments at the local, State, and Federal levels. The Bureau believes, however, that financial products and services provided by governments and

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<sup>493</sup> If a provider offers products or services that are covered by the proposed rule, such as consumer credit, and others that are not, the provider would be permitted to use contract language that is tailored to this circumstance. See proposed § 1040.4(a)(2)(ii).

<sup>494</sup> See Dodd-Frank section 1002(20) (defining “person regulated by the [CFTC]” as “any person that is registered, or required by statute or regulation to be registered, with the [CFTC], but only to the extent that the activities of such person are subject to the jurisdiction of the [CFTC] under the Commodity Exchange Act.”); see also *Dodd-Frank* section 1027(j)(1) (providing that the Bureau shall have no authority to exercise any power to enforce this title with respect to a person regulated by the CFTC).

<sup>495</sup> Dodd-Frank section 1002(1) defines the term affiliate as “any person that controls, is controlled by, or is under common control with another person.” 12 U.S.C. 5481(1).

their affiliates directly to consumers who reside within territorial jurisdiction of the governments should generally not be covered by proposed Part 1040 given the unique position that governments are in with respect to products and services the governments and their affiliates themselves provide directly to their own constituents.

Specifically, proposed § 1040.3(b)(2)(i) would exclude from coverage any products and services covered by proposed § 1040.3(a) when provided directly by the Federal government and its affiliates. In circumstances where proposed § 1040.3(b)(2)(i) would apply, the Bureau believes that the Federal government and its affiliates are uniquely accountable through the democratic process to consumers to whom the Federal government and its affiliates directly provide products and services. The Bureau additionally believes that the democratic process may compel the Federal government and its affiliates to treat consumers fairly with respect to dispute resolution over the products and services they provide directly to consumers. For these reasons, the Bureau proposes to exempt from coverage of Part 1040 products and services provided directly by the Federal government and its affiliates to consumers. By limiting this exemption to products and services provided directly by the Federal government and its affiliates, proposed § 1040.3(b)(2)(i) would not exempt nongovernmental entities that provide covered products or services on behalf of the Federal government or its affiliates, such as a student loan servicer. Proposed comment 3(b)(2)-1 would reiterate this point, with respect to the exclusions in proposed § 1040.3(b)(2), and also would note that the definition of affiliate in Dodd-Frank section 1002(1) would apply to the use of the term in proposed § 1040.3(b)(2).

Proposed § 1040.3(b)(2)(ii) would exclude from coverage any State, local, or tribal government, and any affiliate of a State, local, or tribal government, to the extent it is providing consumer financial products and services covered by § 1040.3(a) directly to consumers who

reside in the government’s territorial jurisdiction. The Bureau believes that such governments and their affiliates are persons pursuant to Dodd-Frank section 1002(19) and that a number of such governments and their affiliates may provide financial products and services that could otherwise be covered by proposed § 1040.3(a). In circumstances where proposed § 1040.3(b)(2)(ii) would apply, the Bureau believes that governments and their affiliates are uniquely accountable through the democratic process to consumers for products and services the governments and their affiliates provide directly to consumers who reside within their territorial jurisdiction. The Bureau additionally believes that the democratic process may compel governments and their affiliates to treat consumers who reside within the government’s territorial jurisdictions fairly with respect to dispute resolution over the products and services the governments and affiliates provide directly to those consumers. For these reasons, the Bureau proposes to exempt from coverage of Part 1040 products and services provided directly by governments and their affiliates to consumers who reside within the territorial jurisdiction of these governments.

By limiting this exclusion to services provided “directly” by these governments and their affiliates, the proposal would make clear that proposed § 1040.3(b)(2)(ii) would not exclude from the coverage of Part 1040 nongovernmental entities that provide covered products or services on behalf of State, local, or tribal governments or their affiliates, such as a bank that issues a payroll card account for State, local, or tribal government employees or a private debt collector that collects on consumer credit extended by a State, local, or tribal government. This proposed exemption also would not extend to State, local, or tribal governments or their affiliates providing products or services to consumers who reside outside the territorial jurisdiction of the government. The Bureau believes that the democratic process and its accountability mechanisms

are not generally as strong in protecting consumers who do not reside in the territory of the government that is itself, or via a government affiliate, providing products or services directly to them. For example, because such consumers do not reside in the government's territorial jurisdiction, they are not likely to be eligible to vote in elections to select representatives in that government or on ballot initiatives or other matters that would bind that government or its affiliates.<sup>496</sup>

Accordingly, proposed comment 1040.3(b)(2)-2 would provide examples of consumer financial products and services that are offered or provided by State, local, or tribal governments or their affiliates directly to consumers who reside in the government's territorial jurisdiction. These would include the following: (A) a bank that is an affiliate of a State government providing a student loan or deposit account directly to a resident of the State; and (B) a utility that is an affiliate of a State or municipal government providing credit or payment processing services directly to a consumer who resides in the State or municipality to allow a consumer to purchase energy from an energy supplier that is not an affiliate of the same State or municipal government. Proposed comment 3(b)(2)-2 would provide examples of consumer financial products and services that are offered or provided by State, local, or tribal governments or their affiliates directly to consumers who do not reside in the government's territorial jurisdiction. These would include the following: (A) a bank that is an affiliate of a State government providing a student loan to a student who resides in another State; and (B) a tribal government affiliate providing a short-term loan to a consumer who does not reside in the tribal

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<sup>496</sup> In its SBREFA Outline (*supra* note 331, at 23), the Bureau indicated it was considering a proposal to exempt governments providing certain services to consumers outside their jurisdiction. As noted here, the Bureau is concerned that democratic accountability is not sufficient to ensure consumer protections in those circumstances, and therefore is not proposing such an exemption.

government's territorial jurisdiction and completes the transaction via Internet. These examples are illustrative, and non-exhaustive. The use of the term "affiliated" in these examples also indicates that this exemption would not apply to services provided by persons who are not affiliates of governments. For example, so-called "public utilities" would not be exempt unless they control, are controlled by, or are under common control with a government or its affiliates. The Bureau requests comment on these proposed examples, and on whether other examples should be included.

The Bureau further notes that the proposed rule would not cover any government utility, or other affiliates of governments such as schools, when eligible for other exemptions in proposed § 1040.3(b). For example, a government would be exempt when providing consumer credit for its own services if the government does this below the frequency specified in proposed § 1040.3(b)(3), or if the credit does not include a finance charge, in which case the exemption in proposed § 1040.3(b)(5) may apply.

The Bureau seeks comment on the exclusions in proposed § 1040.3(b)(2), including on the use of the terms "government," "affiliate," "resides," and "territorial jurisdiction" in proposed § 1040.3(b)(2)(i) and (ii), and, if clarifications are needed in general or for specific types of governments or governmental affiliates, what those should be. The Bureau specifically solicits comment on the exclusions in proposed § 1040.3(b)(2) from tribal governments under its Policy for Consultation with Tribal Governments.<sup>497</sup> The Bureau also requests comment on whether a government affiliate created by a government but which does not qualify as an "arm"

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<sup>497</sup> Bureau of Consumer Fin. Prot., *Policy for Consultation with Tribal Governments*, (Apr. 22, 2013), available at [http://files.consumerfinance.gov/f/201304\\_cfpb\\_consultations.pdf](http://files.consumerfinance.gov/f/201304_cfpb_consultations.pdf).



of the government should be covered by this proposed exemption.<sup>498</sup> In particular, the Bureau requests comment on whether the proposed exemption should be narrowed so that it does not apply to a government affiliate that is not an “arm” of the government. Finally, the Bureau requests comment on whether the governments or government affiliates described in proposed § 1040.3(b)(2) should be excluded from coverage entirely, and on whether the exclusions as proposed should be expanded to cover additional actors or narrowed to cover only certain consumer financial products and services, and if so, which products and services.

#### *1040.3(b)(3)*

The Bureau proposes in § 1040.3(b)(3) an exemption for a person in relation to any product or service listed in a paragraph under proposed § 1040.3(a) that the person and any affiliates collectively offer or provide to no more than 25 consumers in the current calendar year and that it and any affiliates have not provided to more than 25 consumers in the preceding calendar year.<sup>499</sup> For example, a person who, together with its affiliates, provides a covered product or service to 26 or more consumers in the current calendar year or in the previous calendar year would not be eligible for this proposed exemption and generally would be required to comply with all applicable provisions of the proposed rule starting with the 26th consumer to whom the product or service is offered or provided in the calendar year.

The Bureau believes that a threshold of the type described above (based upon provision of a product or service to only 25 or fewer persons annually) may be appropriate to exclude

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<sup>498</sup> See, e.g., *Pele v. Pennsylvania Higher Educ. Assistance Authority*, 628 Fed. Appx. 870, 873 (4th Cir. 2015) (holding that student loan servicing agency created by the state of Pennsylvania was not an arm of the state and thus was not exempt from the coverage of the Fair Credit Reporting Act) (petition for *certiorari pending*).

<sup>499</sup> As proposed comment 3(b)(3)-1 would make clarify, Dodd-Frank section 1002(1) defines the term affiliate as “any person that controls, is controlled by, or is under common control with another person.” 12 U.S.C. 5481(1).

covered products and services from coverage when they are not offered or provided on a regular basis for several reasons. First, the Bureau believes that services and products offered or provided to only 25 or fewer consumers per year are unlikely to cause harms that are eligible for redress in class actions under the “numerosity” requirement of Federal Rule 23 governing class actions or State analogues, as discussed above in Part II. Second, when covered products or services are offered or provided so infrequently, the likelihood of an individual claim in arbitration also is especially low. Therefore, the Bureau believes that applying the proposed rule to persons who engage in so little activity involving a covered product or service is unlikely to have a significant impact on consumers. Third, the Bureau believes that excluding covered products and services that entities offer or provide so infrequently would relieve these entities of the burden of complying with the proposed rule for those products and services.

The Bureau is aware that some of the terms in statutes or their implementing regulations referenced in proposed § 1040.3(a) have their own exclusions for persons who do not regularly engage in covered activity. Except for the definition of remittance transfer in Regulation E subpart B, which is incorporated into proposed § 1040.3(a)(6),<sup>500</sup> the terms referenced do not specify a particular numeric threshold.<sup>501</sup>

For purposes of this rule, the Bureau believes that a single uniform numerical threshold may facilitate compliance and reduce complexity, particularly given that application of the

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<sup>500</sup> The definition of remittance transfer in Regulation E is limited to transactions conducted by a remittance transfer provider in the normal course of its business. 12 CFR 1005.30(f)(1); *see also* Regulation E comment 30(f)-2 (“[w]hether a person provides remittance transfers in the normal course of business depends on the facts and circumstances”). Regulation E further provides a safe harbor whereby persons providing 100 or fewer transfers in the current and prior calendar years are deemed not to be remittance transfer providers. 12 CFR 1005.30(f)(2). Thus, the proposed rule would not apply to transfers provided by persons who are not remittance transfer providers, because such transfers are not “remittance transfers” as defined by Regulation E.

<sup>501</sup> For example, the definition of creditor in ECOA and Regulation B and debt collector in the FDCPA refer to regular activity but do not specify a numeric threshold.

proposed rule would not just affect consumers' ability to bring class claims under specific Federal consumer financial laws, but also other types of State and Federal law claims. The proposed 25-consumer threshold also would be generally consistent with the threshold for "regularly extend[ing] consumer credit" under 12 CFR 1026.2(a)(17)(v), which applies certain TILA disclosure requirements to persons making more than 25 non-mortgage credit transactions in a year. The Bureau emphasizes that it is proposing this uniform standard in the unique context of this proposed rule, and that it expects to continue to interpret thresholds under the enumerated consumer financial protection statutes and their implementing regulations according to their specific language, contexts, and purposes. The Bureau further notes that basing an exemption on the level of activity in the current and preceding calendar year is consistent with the threshold under 12 CFR 1026.2(a)(17)(v).

The Bureau seeks comment on this proposed exclusion from coverage, including whether the proposed uniform numerical threshold for excluding persons who do not regularly engage in providing a covered product or service is warranted and if not, what alternatives should be considered. For example, the Bureau seeks comment on whether the threshold should be higher or lower, determined by aggregating the number of times all covered products are offered or provided, or incorporate other elements. The Bureau also seeks comment on the proposal to base the exclusion on total activities in the current and preceding calendar years. Finally, the Bureau seeks comment on whether to adopt a grace period or other transition mechanism for entities when they first cross the 25-consumer threshold.

*1040.3(b)(4)*

Merchants, retailers, and other sellers of nonfinancial goods and services generally may be subject to the proposed rule when acting as creditors as defined by Regulation B when they

extend consumer credit or participate in consumer credit decisions, or when they engage in collection on or sale of these consumer credit accounts, unless they are excluded from the Bureau's rulemaking authority under Dodd-Frank section 1027(a)(2). Section 1027(a)(2)(A) generally excludes these activities by a merchant, retailer, or other seller of nonfinancial goods or services to the extent that person extends credit directly to a consumer exclusively for the purchase of a nonfinancial good or service directly from that person. Section 1027(a)(2) also states, however, that the general exclusion in section 1027(a)(2)(A) is limited by subparagraphs (B) and (C) of section 1027(a)(2).<sup>502</sup> As a result, in several circumstances described in subparagraphs (B) and (C) of section 1027(a)(2) (outlined below), the proposed rule generally would apply to merchants, retailers, and other sellers of nonfinancial goods or services providing extensions of consumer credit covered by proposed § 1040.3(a) that is of the type described in section 1027(a)(2)(A) (described above). In proposed § 1040.3(b)(4), the Bureau proposes one exception to this general rule, for engaging in assignment, sale, or other conveyance of a certain type of consumer credit as described below.

To explain this proposed exemption, it is necessary to describe further the limitations on the merchant creditor exclusion in Dodd-Frank section 1027(a)(2). As noted above, there are a number of circumstances when merchants engaged in these activities are not excluded by Dodd-Frank section 1027(a)(2). Section 1027(a)(2)(B) confers authority upon the Bureau generally over such extensions of consumer credit and associated debt collection activities by the merchants in three circumstances, set forth in subparagraphs (i), (ii), and (iii) of section

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<sup>502</sup> When the general exclusion in section 1027(a)(2)(A) does apply, the merchant would be excluded by proposed § 1040.3(b)(5). As discussed below, that proposed provision would clarify that the proposal would not apply to persons when they are excluded from the rulemaking authority of the Bureau by Dodd-Frank section 1027 or 1029.

1027(a)(2)(B) respectively. Subparagraph (i) relates to certain circumstances where the merchant, retailer, or other seller “assigns, sells, or otherwise conveys” a debt to a third party. Subparagraph (ii) relates to certain circumstances where the amount of credit extended significantly exceeds the value of a good or service. Subparagraph (iii), as clarified by Dodd-Frank section 1027(a)(2)(C), relates to certain circumstances where a merchant creditor is engaged significantly in providing consumer financial products and services and imposes a finance charge.

Proposed § 1040.3(b)(4) would provide an exemption from coverage under Part 1040 to merchants, retailers, and other sellers of nonfinancial goods or services extending consumer credit as described in section 1027(a)(2)(A)(i) when only the first of these three circumstances described above is present and the second and third of these circumstances is not present. If the Bureau did not adopt this proposed exemption, then merchants extending credit subject to ECOA by allowing consumers to defer payment for goods or services – even without imposing a finance charge – would themselves be covered by the proposed rule to the extent they were to sell, assign, or otherwise convey that credit account, when not in delinquency or default, to a third party consistent with Dodd-Frank section 1027(a)(2)(B)(i). Such sale, assignment, or conveyance could occur, for example, in certain types of commercial borrowing engaged in by merchants, such as factoring, or collateralized lines of credit under which the merchant assigns its interest in its receivables. However, under the proposed exemption, such merchants would not be covered by Part 1040 in this context unless the amount of credit they extended significantly exceeds the value of the good or service or they engage significantly in extending

credit with a finance charge.<sup>503</sup> Thus, unless either of those circumstances is present, the proposal would not affect the cost of credit of such merchants when they are engaged in such business borrowing activities. By contrast, for example, when the merchants are significantly engaged in extending consumer credit with a finance charge (generally covered by TILA and Regulation Z), however, the proposed rule generally would apply.

Proposed § 1040.3(b)(4)(i) would thus exclude from the coverage of proposed Part 1040 merchants, retailers, or other sellers of nonfinancial goods or services to the extent providing an extension of consumer credit covered by proposed § 1040.3(a)(1)(i) and described by Dodd-Frank section 1027(a)(2)(A)(i) in connection with a credit transaction pursuant to Dodd-Frank section 1027(a)(2)(B)(i) unless the same credit transactions are also credit transactions pursuant to Dodd-Frank section 1027(a)(2)(B)(ii) or (iii). Thus, a merchant who is a creditor under Regulation B that is extending consumer credit as described in Dodd-Frank section 1027(a)(2)(A)(i) would be eligible for this exemption with respect to such consumer credit transactions when they are sold, assigned, or otherwise conveyed to a third party, if the consumer credit was not extended in an amount that significantly exceeded the value of the good or service under section 1027(a)(2)(B)(ii) and did not have a finance charge under section 1027(a)(2)(B)(iii) (or it did have a finance charge but the creditor was not engaged significantly in that type of lending under section 1027(a)(2)(C)(i)). Proposed § 1040.3(b)(4) would only exempt a merchant, retailer, or seller of the nonfinancial good or service and therefore would not affect coverage of other persons who may conduct servicing, debt collection activities, or provide covered products and services pursuant to proposed § 1040.3(a) in connection with the

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<sup>503</sup> See Dodd-Frank sections 1027(a)(2)(B)(ii) and (iii); 12 U.S.C. 5517(a)(2)(B)(ii) and (iii).

same extension of consumer credit. As discussed below in the Section-by-Section Analysis to proposed comments 4-1 and 4-2, those providers would be subject to the proposed rule.

Further, the exclusion in proposed § 1040.3(b)(4)(ii) would apply to a merchant who purchases or acquires credit extended by another merchant in a sale, assignment, or other conveyance that is subject to Dodd-Frank section 1027(a)(2)(B)(i). As a result, the proposed rule would not apply, for example, to a merchant who, in a merger or acquisition transaction, acquires customer accounts of another merchant who had extended credit with no finance charge and not in an amount that significantly exceeded the value of the goods or services (*i.e.*, credit not subject to Dodd-Frank section 1027(a)(2)(B)(ii) or (iii)).

The Bureau invites comment on the exception in proposed § 1040.3(b)(4) including on whether the Bureau should consider alternatives in defining this exception, and if so, particular definitions or changes the Bureau should consider and why.

#### *1040.3(b)(5)*

The proposed rule would not apply to persons to the extent they are excluded from the rulemaking authority of the Bureau under Dodd-Frank sections 1027 and 1029. For the sake of clarity, the Bureau proposes to make this limitation an explicit exemption in proposed § 1040.3(b)(5). Proposed § 1040.3(b)(5) thus would clarify that Part 1040 would not apply to a person to the extent the Bureau lacks rulemaking authority over that person or a product or service offered or provided by the person under Dodd-Frank sections 1027 and 1029 (12 U.S.C. 5517 and 5519).

However, the application of proposed § 1040.4 would be limited under proposed § 1040.3(b)(5) only to the extent that sections 1027 and 1029 constrain the Bureau's authority. Consistent with these restraints in sections 1027 and 1029, the Bureau may have section 1028

rulemaking authority in certain circumstances over a person that assumes or seeks to use an arbitration agreement entered into by another person over whom the Bureau lacked such authority. Notably, entities excluded from Bureau rulemaking authority under sections 1027 and 1029 may still be covered persons as defined by Dodd-Frank section 1002(6). Thus, proposed § 1040.4 may apply to a provider that assumes or seeks to use an arbitration agreement entered into by a covered person over whom the Bureau lacks rulemaking authority under Dodd-Frank sections 1027 and 1029 with respect to the activity at issue.

For example, proposed § 1040.4 may apply to a provider that is a debt collector as defined in the FDCPA collecting on debt arising from a consumer credit transaction originated by a merchant, even if the merchant would be exempt under proposed § 1040.3(b)(5) because the merchant is excluded from Bureau rulemaking authority under Dodd-Frank section 1027 for the particular extension of consumer credit at issue. As noted in the discussion of proposed § 1040.3(a)(10) above, for example, hospitals, doctors, and other service providers extending incidental ECOA credit would not be subject to the requirements of § 1040.4 to the extent the Bureau lacks rulemaking authority over them under Dodd-Frank section 1027. Similarly, proposed § 1040.4 may apply to a provider that is acquiring an automobile loan originated by an automobile dealer in circumstances where the automobile dealer is exempt by proposed § 1040.3(b)(5) because the auto dealer is excluded from Bureau rulemaking authority under Dodd-Frank section 1029.

#### *Section 1040.4 Limitations on the Use of Pre-Dispute Arbitration Agreements*

Dodd-Frank section 1028(b) authorizes the Bureau to prohibit or impose conditions or limitations on the use of an agreement between a covered person and a consumer for a consumer financial product or service providing for arbitration of any future dispute between the parties, if



the Bureau finds that doing so is in the public interest and for the protection of consumers. Section 1028(b) also requires that the findings in such rule be consistent with the Study conducted under Dodd-Frank section 1028(a). Section 1028(d) further states that any regulation prescribed by the Bureau under section 1028(b) shall apply to any agreement between a consumer and a covered person entered into after the end of the 180-day period beginning on the effective date of the regulation.<sup>504</sup> Pursuant to this authority and the findings set forth in greater detail in Part VI above, the Bureau proposes § 1040.4, which would set forth the conditions or limitations that the Bureau would impose on providers that use pre-dispute arbitration agreements entered into after the compliance date.

Specifically, proposed § 1040.4 would contain three provisions. Proposed § 1040.4(a)(1) would generally prohibit providers from seeking to rely in any way on a pre-dispute arbitration agreement entered into after the compliance date with respect to any aspect of a class action that is related to any of the consumer financial products or services covered by proposed § 1040.3. Proposed § 1040.4(a)(2) would require providers, upon entering into a pre-dispute arbitration agreement for a product or service covered by proposed § 1040.3 after the compliance date, to include a specified plain-language provision in their pre-dispute arbitration agreements disclaiming the agreement's applicability to class actions. And proposed § 1040.4(b) would require a provider that includes a pre-dispute arbitration agreement in its consumer contracts to submit specified arbitral records to the Bureau for any pre-dispute arbitration agreement entered into after the compliance date.

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<sup>504</sup> For further discussion of the compliance date, see the Section-by-Section Analysis to proposed § 1040.5(a), below.

Each of these three proposed provisions contains the phrase “entered into.” To aid interpretation of proposed § 1040.4, the Bureau proposes to add in the official interpretations a series of examples of what would and would not constitute “entering into” a pre-dispute arbitration agreement. As noted above, the term “entering into” appears in Dodd-Frank section 1028(d), which states that any rule prescribed by the Bureau under section 1028(b) shall apply to any pre-dispute arbitration agreement “entered into” after the end of the 180-day period beginning on the rule’s effective date. The phrase “entered into” is not defined in section 1028 or anywhere else in the Dodd-Frank Act. The Bureau interprets the phrase “entered into” generally to include any circumstance in which a person agrees to undertake obligations or gains rights in an agreement. The Bureau believes that this interpretation best effectuates the purposes of section 1028, is practical and clear in its meaning, and is reasonable.

Proposed comment 4-1.i would provide illustrative examples of when a provider enters into a pre-dispute arbitration agreement for purposes of § 1040.4 and proposed comment 4-1.ii would provide illustrative examples of when a provider does not enter into a pre-dispute arbitration agreement for purposes of § 1040.4. Proposed comments 4-1.i.A through C would state that examples of when a provider enters into a pre-dispute arbitration agreement include, but are not limited to, the following three scenarios. First, proposed comment 4-1.i.A would explain that a provider enters into a pre-dispute arbitration agreement where it provides to a consumer a new product or service that is subject to a pre-dispute arbitration agreement, and the provider is a party to the pre-dispute arbitration agreement. The Bureau does not interpret this example to include new charges on a credit card covered by a pre-dispute arbitration entered into before the compliance date. Second, proposed comment 4-1.i.B would explain that a provider enters into a pre-dispute arbitration agreement where it acquires or purchases a product covered

by proposed § 1040.3 that is subject to a pre-dispute arbitration agreement and becomes a party to that agreement, even if the person selling the product is excluded from coverage under proposed § 1040.3(b). Third, proposed comment 4-1.i.C would explain that a provider enters into a pre-dispute arbitration agreement where it adds a pre-dispute arbitration agreement to an existing product or service. The Bureau interprets Dodd-Frank section 1028(b) to include authority that would allow the Bureau to require that providers comply with proposed § 1040.4 to the extent they choose to add pre-dispute arbitration agreements to existing consumer agreements after the compliance date.

Proposed comments 4-1.ii would then state that examples of when a provider *does not* enter into a pre-dispute arbitration agreement include, but are not limited to, two scenarios. Proposed comment 4-1.ii.A would state the first scenario – that a provider does not enter into a pre-dispute arbitration agreement where it modifies, amends, or implements the terms of a product or service that is subject to a pre-dispute arbitration agreement that was entered into before the compliance date. However, a provider would be considered to enter into a pre-dispute arbitration agreement where the modification, amendment, or implementation constitutes providing a new covered product or service. Proposed comment 4-1.ii.A would also address the scenario in which a provider modifies, amends, or implements the terms of a pre-dispute arbitration agreement itself. Proposed comment 4-1.ii.B would address the second scenario and would state that a provider does not enter into a pre-dispute arbitration agreement where it acquires or purchases a product that is subject to a pre-dispute arbitration but does not become a party to that agreement. The Bureau believes that the phrase entered into an agreement as used in Dodd Frank section 1028 can be interpreted to permit application of a Bureau regulation issued under the provision to agreements modified or amended after the compliance date, in

certain circumstances. However, for the purposes of this proposal, the Bureau is proposing to interpret the phrase more narrowly, as reflected by, for example, proposed comment 4-1.ii.B. The Bureau solicits comment on whether, for the purposes of the proposal, it should instead interpret the phrase more broadly to encompass certain modifications or amendments of an agreement after the compliance date and what the impacts of such an interpretation would be.

Proposed § 1040.4, in general, would apply to a provider regardless of whether the provider itself entered into a pre-dispute arbitration agreement, as long as the agreement was entered into after the compliance date.<sup>505</sup> Proposed comment 4-2 would clarify this by explaining how proposed § 1040.4 applies to a provider that does not itself enter into a pre-dispute arbitration agreement.

Proposed comment 4-2 would explain that pursuant to proposed § 1040.4(a)(1), a provider cannot rely on any pre-dispute arbitration agreement entered into by another person after the effective date with respect to any aspect of a class action concerning a product or service covered by § 1040.3 and pursuant to § 1040.4(b). That comment would further clarify that a provider may be required to submit certain specified records related to claims filed in arbitration pursuant to such pre-dispute arbitration agreements and cross-reference comment 4(a)(2)-1 which is discussed below. The comment would go on to provide an example of a debt collector collecting on covered consumer credit that is prohibited by § 1040.4(a)(1) from relying on a pre-dispute arbitration agreement entered into by the creditor with respect to a class action even when the debt collector does not itself enter a pre-dispute arbitration agreement. The

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<sup>505</sup> The Bureau believes this is consistent with Dodd-Frank sections 1028(b) and 1028(d), which authorize the Bureau to prohibit or impose conditions or limitations on the use of a pre-dispute arbitration agreement between a covered person and a consumer (section 1028(b)) and state that shall apply to any agreement between a consumer and a covered person entered into after the compliance date (section 1028(d)).

Bureau seeks comment whether proposed comments 4-1 and -2 are helpful in facilitating compliance, and whether the Bureau should provide additional or different examples.

*4(a) Use of Pre-Dispute Arbitration Agreements in Class Actions*

For the reasons discussed more fully in Part VI and pursuant to its authority under Dodd-Frank section 1028(b), the Bureau proposes § 1040.4(a). Proposed § 1040.4(a)(1) would require that a provider shall not seek to rely on a pre-dispute arbitration agreement entered into after the compliance date with respect to any aspect of a class action that is related to any of the consumer financial products or services covered by proposed § 1040.3, unless the court has ruled that the class action may not proceed and any appellate review of that ruling has been resolved.

Proposed § 1040.4(a)(2) would generally require providers to ensure that any pre-dispute arbitration agreements entered into after the compliance date contain a specified provision disclaiming the applicability of those agreements to class action cases concerning a consumer financial product or service covered by the proposed rule.

The Bureau notes that proposed § 1040.4(a) would permit an arbitration agreement that allows for class arbitration, provided that a consumer could not be required to participate in class arbitration instead of class litigation. In other words, a pre-dispute arbitration agreement that allows a consumer to choose whether to file a class claim in court or in arbitration would be permissible under proposed § 1040.4(a), although an arbitration agreement that permits the claim to only be filed in class arbitration would not be permissible.<sup>506</sup>

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<sup>506</sup> In its SBREFA Outline, the Bureau noted that it was considering an alternative that would have given consumer financial services providers discretion to use arbitration agreements that required that class proceedings be conducted in arbitration instead of court, provided those arbitration proceedings satisfied minimum standards of fairness. The Bureau has not heard from any stakeholders that this option is preferable to the class proposal. Nonetheless, the Bureau will continue to consider feedback regarding this alternative.

### *Small Business Review Panel Recommendations*

As discussed above, the Bureau preliminarily finds that the proposed rule would be in the public interest and for the protection of consumers and would be consistent with the Study. Those findings are subject to further revision in light of comments received, however. In addition, the Bureau continues to consider recommendations made to it by the SBREFA Panel Report as part of the SBREFA process.<sup>507</sup> Some of the broader concerns from SERs regarding whether to adopt the class proposal are addressed above in Part VI, as well as below in Part VIII (the Section 1022(b)(2) Analysis) and Part IX (the Regulatory Flexibility Analysis). In the discussion that follows, the Bureau considers other recommendations contained in the Panel Report.

As the Panel Report indicates, many of the SERs expressed concern about the impacts of limiting the use of pre-dispute arbitration agreements in class action litigation. Specifically, the SERs expressed concern that defending even one class action litigation – including defense counsel fees and any settlements ultimately paid out – could put a small entity out of business. In response to these concerns, the SBREFA Panel recommended that the Bureau continue to evaluate the costs to small entities of defending class actions and how such costs may differ from the costs to larger entities.

This proposed rule's impacts analyses pursuant to section 1022(b)(2) of the Dodd-Frank Act (Part VIII below) and section 603 of the Regulatory Flexibility Act<sup>508</sup> (Part IX below) examines several aspects of costs related to small entities. The Bureau believes that small

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<sup>507</sup> See *supra* Part IV (Post-Study Outreach).

<sup>508</sup> 5 U.S.C. 601, *et seq.*

consumer finance entities face class litigation at a lower rate than entities that are not small. Depository institutions with less than \$600 million in assets, for example, make up the vast majority of depositories overall; however, only about one Federal class settlement per year with depository institutions analyzed in the Study involved institutions below that threshold. Further, the magnitude of the settlements, measured by payments to class members, is also considerably smaller. The documented payments to class members from all cases that involve smaller depository institutions added together is under \$2 million over the five years analyzed in the Study. The Bureau's Section 1022(b)(2) Analysis also notes several factors that affect how small entities in consumer financial markets may respond to the proposed rule in a different manner than larger entities.

Further, despite the fact that the Bureau is not certifying, at this time, that the proposed rule would not have a significant economic impact on a substantial number of small entities, the Bureau believes that the arguments and calculations outlined both in Section 1022(b)(2) Analysis, as well as the arguments and calculations that follow, strongly suggest that the proposed rule would indeed not have a significant economic impact on a substantial number of small entities in any of the covered markets. As discussed in greater detail in the Section 1022(b)(2) Analysis, while the expected cost per provider from the Bureau's rule is about \$200 per year from Federal class cases, these costs would not be evenly distributed across small providers. In particular, the Bureau estimates that about 25 providers per year would be involved in an additional Federal class settlement – a considerably higher expense than \$200 per year. In addition, the additional Federal cases filed as class litigation that would end up not settling on class basis (121 per year according to the Bureau's estimates) are also likely to result in a considerably higher expense than \$200. However, as noted in the Regulatory Flexibility

Analysis, the vast majority of the providers covered by the proposal would not experience any of these effects.

The Bureau also notes that, under proposed § 1040.3(b)(4), its proposed rule would not apply to any person when providing a product or service covered by § 1040.3(a) that the person and any of its affiliates collectively provide to no more than 25 consumers in the current calendar year and to no more than 25 consumers in the preceding calendar year. Consistent with the Panel's recommendation, however, the Bureau solicits further feedback on the costs of defending class actions and whether those costs may differ or be disproportionate for small entities as compared to larger ones.

The Panel Report reflects a concern expressed by several SERs that preventing providers from relying on pre-dispute arbitration agreements in class litigation would affect the small entities' ability to obtain insurance coverage for class action litigation defense costs, which the SERs noted was already expensive. The Panel recommended that the Bureau further assess the availability and costs of insurance for small entities including impacts on insurance premiums and deductibles and any costs related to pursuing unpaid claims against an insurer, particularly whether and how insurance covers class action defense costs and whether exposure to class actions would impact the cost and availability of this insurance.

As discussed in the Bureau's Section 1022(b)(2) Analysis, the Bureau recognizes that, in response to the Bureau's proposal, providers may make various investments to reduce the potential financial impacts of class litigation. For example, providers might opt for more comprehensive insurance coverage that would presumably cover more class litigation exposure or would have a higher reimbursement limit. However, during the Small Business Review Panel, the SERs noted that it often is not clear to them which type of class litigation exposure a



policy covers nor was it clear that providers typically ask insurers about this sort of coverage. The SERs explained that their coverage is often determined on a more specialized case-by-case basis that limits at least small providers' ability to plan ahead. Larger firms may have more sophisticated policies and more systematic understanding of their coverage, however, or they may self-insure. Finally, the insurance providers might require at least some of the changes to compliance discussed above as a prerequisite for coverage or for a discounted premium. Consistent with the Panel's recommendation, the Bureau seeks comment on whether and, if so, how the rule would affect class action litigation defense insurance costs for covered entities.

Some SERs rejected the Bureau's reasoning, discussed in Part VI, that the potential for class action litigation encourages companies to comply with relevant consumer finance laws and deters companies from practices that may harm consumers. The Panel recommended that the Bureau seek comment on whether small entities engage in different compliance practices than large entities and that the Bureau further analyze the impact of class actions on small entities' conduct. As discussed more fully above, the Bureau continues to believe that, with respect to both small entities and larger entities, the availability of class actions encourages compliance with relevant consumer finance laws and deters practices that may harm consumers. Consistent with the Panel's recommendation, the Bureau seeks comment on the impact of class action exposure on providers' compliance and specifically on whether those compliance efforts might differ for smaller entities as compared to larger ones.

A few of the SERs further expressed concern that the Bureau's class proposal would expose their businesses to more class litigation which could, in turn, increase their companies' litigation defense costs and therefore increase the cost of business credit that the entities rely on to facilitate their operations. These SERs stated that they believed that their lenders would

increase the cost of business credit for their companies if their companies could no longer rely on arbitration agreements in class actions. The Panel recommended that the Bureau consider whether there are alternative actions that the Bureau could take that would still accomplish the Bureau's goals of encouraging increased compliance with relevant consumer financial laws and providing relief to harmed consumers while not increasing small entities' exposure to class action lawsuits that could increase their cost of credit.

The Bureau has analyzed the potential impacts on small providers' own costs of credit and the availability of other alternatives, as discussed further in Part IX (the Regulatory Flexibility Analysis). Consistent with that more extended discussion and the Panel's recommendation, the Bureau seeks comment on whether proposed § 1040.4(a) would increase the cost of credit for small entities and whether there are alternatives to proposed § 1040.4(a) that would accomplish the Bureau's objectives while mitigating any potential increases to the cost of credit for small entities. The Bureau also seeks comment on whether and to what extent commercial lenders inquire in the course of underwriting a loan about a potential borrower's exposure to class actions or ability to rely on pre-dispute arbitration agreements to reduce exposure to class actions.

The SERs suggested alternatives to the Bureau's class proposal that, in their view, would protect small entities from the costs of class litigation. One such alternative would be exempting small entities from some, or all, of the proposed rule's requirements. Accordingly, the Panel recommended that the Bureau evaluate the impact of its class proposals on small entities and consider exempting small entities from some requirements of the class proposal or consider delaying implementation of the rule for small entities.

At this time, the Bureau is not proposing an exemption for small entities because it believes that the availability of class actions protects consumers who do business with small entities. While the Study shows that small entities are less likely to have arbitration agreements than larger entities,<sup>509</sup> the Bureau is aware that both large and small entities commit violations of consumer financial laws in ways that harm consumers. The Bureau believes that the availability of meaningful relief is important in such cases. Further, it has considered the impact of its class proposals on small entities, including the concerns expressed by SERs about the cost of litigating class actions, and as discussed in Part IX and above believes that they would be relatively modest. Consequently, the Bureau seeks comment on whether the Bureau should exempt small entities from some or all requirements of the proposed rule. The Bureau seeks comment on whether adopting a small entity exemption would advance the purposes of the proposed rule, namely, the furtherance of the public interest and the protection of consumers regarding the use of pre-dispute arbitration agreements in agreements for consumer financial products or services.

In the event the Bureau were to adopt a small entity exemption, the Bureau seeks comment on how to formulate such an exemption for all small providers or for small providers in particular industries. One approach could be to use the Small Business Administration (SBA) size standards to determine whether an entity is small, although that could involve complexity particularly as to entities that might qualify in more than one category.<sup>510</sup> The Bureau could also use some other standard that would apply to all providers based on, for example, the volume of

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<sup>509</sup> See Study, *supra* note 2, section 2, at 16-17.

<sup>510</sup> SBA has established numerical definitions, or “size standards,” for all for-profit industries. Size standards represent the largest size that a business (including its subsidiaries and affiliates) may be to remain classified as a small business concern for purposes of qualifying for SBA and other Federal programs. See Small Bus. Admin., Table of Small Business Size Standards (updated Feb. 26, 2016), available at <https://www.sba.gov/content/small-business-size-standards>.

covered products or services provided to consumers or revenue derived from such products or services. The Bureau could also adopt varying standards based on other criteria for each covered market, but that could involve the same complexity as using the SBA size standards. Apart from what standard the Bureau might adopt, the Bureau also seeks comment on whether the Bureau would need to monitor which entities would avail themselves of such an exemption and, if so, how the Bureau should do so. Finally, the Bureau seeks comment on whether, if it were to adopt an exemption, it should monitor exempt entities' reliance on arbitration agreements in class actions, such as by requesting that such entities submit copies of motions to compel arbitration that they file in class action cases.

Some of the SERs also suggested that, rather than prohibit providers from relying on pre-dispute arbitration agreements in class actions, the Bureau instead mandate improved disclosures regarding arbitration and educate consumers regarding their dispute resolution rights. These SERs stated that consumer education could encourage consumers to pursue individual claims in small claims court or arbitration that they might otherwise abandon or be discouraged from pursuing, thereby reducing the need for class action litigation to address consumer harms. The SERs thus echoed what some other industry participants have told the Bureau – that, rather than limit the use of arbitration in any way, the Bureau should advocate for arbitration and encourage consumers to take their individual claims before an arbitrator. The Panel recommended that the Bureau consider whether, through improved disclosure requirements and consumer education initiatives, the Bureau could increase consumers' awareness and understanding of their available dispute resolution mechanisms and use of these mechanisms to resolve disputes and redress consumer harms.

The Bureau has considered the issue carefully and preliminarily concludes that better consumer understanding through either disclosure or consumer education would not lead to a material increase in the filing of individual claims to the level necessary that would alleviate the need for class action litigation to remedy large-scale consumer harms. This analysis is described further below in Part IX (the Regulatory Flexibility Analysis). As described above in Part VI, consumer financial claims often involve claims for such small amounts that they are impractical for consumers to pursue on an individual basis in any forum – litigation or arbitration. Unlike class actions, which permit consumers to pursue their claims as a group and share the costs of bringing the claim, increased disclosure and consumer education alone would not address this underlying economic obstacle that prevents most consumers from obtaining relief for violations of law.

Further, where a provider has violated the law, many consumers may be unaware that they have been harmed. Class actions address this problem, because, typically, all consumers harmed by a course of conduct become part of the class. In contrast, improved disclosures do not, because improved awareness of dispute resolution options is not likely to affect a consumer's behavior where the consumer does not know that the consumer has suffered a legally actionable harm. Thus, the Bureau believes that making class actions available to consumers would result in consumers being able to pursue their claims on a much greater scale than would improving disclosures and increasing consumer education.

Consistent with the Panel's recommendation, and to gather additional views about this issue, the Bureau solicits comment on whether improved disclosure or consumer education could increase consumers' understanding of dispute resolution and use of individual arbitration to resolve disputes and redress consumer harms sufficient to obviate the need for the class proposal.

The Bureau also continues to evaluate whether it should provide additional consumer education materials regarding dispute resolution rights, in addition to rather than in lieu of the proposed interventions.

Finally, the SERs expressed concern about exposure to class action litigation based on certain statutory causes of action that have no limit on statutory damages in a class action, such as the TCPA.<sup>511</sup> The SERs stated that a small entity may be unable to absorb a class action award or settlement of claims brought under a statute, like the TCPA, where damages are uncapped. The Panel recommended that the Bureau evaluate and seek comment on whether specific features of particular causes of action affect the availability of consumer relief, the deterrent effect of class actions, and consequences to small entities arising from settlement or recovery for those causes of action.

The Bureau has considered, but is not at this time proposing, an exemption to this part for particular causes of action. The Bureau believes that Congress and State legislatures, as applicable, are better positioned than the Bureau to establish the appropriate level of damages for particular harms under established statutory schemes. While the Bureau recognizes the concern, expressed by SERs, among others, that particular statutes may create the possibility of disproportionate damages awards, the Bureau believes that Congress and the courts are the appropriate institutions to address such issues. For example, industry groups have lobbied, and

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<sup>511</sup> The TCPA is a statute implemented by the Federal Communications Commission that affords consumers certain rights and protections related to telephone solicitations and the use of automated telephone equipment, such as automatic dialing systems. 47 U.S.C. 227. TCPA allows for actual damages (which are awarded rarely) or statutory damages (authorized by the statute without regard to the degree of harm to the plaintiff) ranging from \$500 to \$1,500 per violation, with each unsolicited call or text message considered a separate violation. 47 U.S.C. 227(b)(3). The TCPA does not place an aggregate cap on statutory damages in class actions. Consequently, statutory damages may be substantial if the same conduct applies to a large class of consumers.

may continue to lobby Congress and the FCC to amend the TCPA, including its statutory damages scheme.<sup>512</sup> The Bureau believes it is particularly appropriate to defer to Congress and the courts on the TCPA, which the Bureau does not administer.<sup>513</sup> The Bureau nevertheless seeks comment on its approach to this issue, including whether there are compelling reasons to exclude particular causes of action from the proposed rule, bearing in mind that legislatures are ultimately charged with setting that balance.

#### *4(a)(1) General Rule*

In furtherance of the Bureau's goal to ensure that class actions are available to consumers who are harmed by providers of consumer financial products and services, for the reasons discussed above in Part VI and in accordance with the Bureau's authority under Dodd-Frank section 1028(b), the Bureau proposes § 1040.4(a)(1). Proposed § 1040.4(a)(1) would require that a provider shall not rely in any way on a pre-dispute arbitration agreement entered into after the compliance date with respect to any aspect of a class action that is related to any of the consumer financial products or services covered by proposed § 1040.3 including to seek a stay or dismissal of particular claims or the entire action, unless and until the presiding court has ruled that the case may not proceed as a class action and, if that ruling may be subject to appellate

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<sup>512</sup> See, e.g., Letter from U.S. Chamber of Com., et al., to FTC, In the Matter of Rules and Regulations Implementing the Telephone Consumer Protection Act of 1991, CG Docket No. 02-278 (Feb. 2, 2015), available at [https://www.uschamber.com/sites/default/files/2.2.15-multi-association letter to fcc on tcpa.pdf](https://www.uschamber.com/sites/default/files/2.2.15-multi-association%20letter%20to%20fcc%20on%20tcpa.pdf); Credit Union Nat'l Ass'n, *CUNA Sends Letter to Energy and Commerce Subcommittee about TCPA Order Concerns*, CUNA.org (Nov. 17, 2015), available at <http://www.cuna.org/Legislative-And-Regulatory-Advocacy/Removing-Barriers-Blog/Removing-Barriers-Blog/CUNA-Sends-Letter-to-Energy-and-Commerce-Subcommittee-about-TCPA-Order-Concerns/>.

<sup>513</sup> The Bureau further notes that the Supreme Court this term is considering a challenge that would limit the scope of statutory damage claims in class actions. See *Spokeo, Inc. v. Robins, cert. granted*, 135 S.Ct. 1892 (2015).

review on an interlocutory basis, the time to seek such review has elapsed or the review has been resolved.<sup>514</sup>

Proposed § 1040.4(a)(1) would bar providers from relying on a pre-dispute arbitration agreement entered into after the compliance date of the rule, as described above, even if the pre-dispute arbitration agreement does not include the provision required by § 1040.4(a)(2). Examples of this scenario include where a provider uses preprinted agreements that would be temporarily excepted from proposed § 1040.4(a)(2) (*see* proposed § 1040.5(b)); a debt collector with respect to a pre-dispute arbitration agreement entered into after the compliance date by a creditor that was excluded from coverage under proposed § 1040.3(b); and where a provider has violated proposed § 1040.4(a)(2) by failing to amend its agreement to include the required provision. The Section-by-Section Analysis to proposed § 1040.3(a)(10), above, contains additional examples, pertaining to debt collection by merchants, of scenarios where proposed § 1040.4(a)(1) would apply even where the pre-dispute arbitration agreements itself is not required to contain the provision outlined in proposed § 1040.4(a)(2).

Proposed § 1040.4(a)(1) would prevent providers from relying on a pre-dispute arbitration agreement in a class action unless and until the presiding court has ruled that the case may not proceed as a class action, and, if the ruling may be subject to interlocutory appellate review, the time to seek such review has elapsed or the review has been resolved. For example, when a case is filed as a putative class action and a court has not yet ruled on a motion to certify the class, proposed § 1040.4(a)(1) would prohibit a motion to compel arbitration that relied on a

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<sup>514</sup> The Bureau notes that the prohibition in proposed § 1040.4(a)(1) would apply to providers' relying on provisions in pre-dispute arbitration agreements, as well as on the overall agreement.



pre-dispute arbitration agreement. If the court denies a motion for class certification and orders the case to proceed on an individual basis, and the ruling may be subject to interlocutory appellate review – pursuant to Rule 23(f) of the Federal Rules of Civil Procedure or an analogous State procedural rule – proposed § 1040.4(a)(1) would prohibit a motion to compel arbitration based on a pre-dispute arbitration agreement until the time to seek appellate review has elapsed or appellate review has been resolved. If the court denies a motion for class certification and the ruling is either not subject to interlocutory appellate review, the time to seek review has elapsed, or the appellate court has determined that the case may not proceed as a class action, proposed § 1040.4(a)(1) would no longer prohibit a provider from relying on a pre-dispute arbitration agreement in the case.

Proposed comment 4(a)(1)-1 provides a non-exhaustive list of examples illustrating what it means for a provider to “rely on a pre-dispute arbitration agreement with respect to any aspect of a class action.” The proposed comment would provide six examples: seeking dismissal, deferral, or stay of any aspect of a class action (proposed comment 4(a)(1)-1.i); seeking to exclude a person or persons from a class in a class action (proposed comment 4(a)(1)-1.ii); objecting to or seeking a protective order intended to avoid responding to discovery in a class action (proposed comment 4(a)(1)-1.iii); filing a claim in arbitration against a consumer who has filed a claim on the same issue in a class action (proposed comment 4(a)(1)-1.iv); filing a claim in arbitration against a consumer who has filed a claim on the same issue in a class action after the trial court has denied a motion to certify the class but before an appellate court has ruled on an interlocutory appeal of that motion, if the time to seek such an appeal has not elapsed and the appeal has not been resolved (proposed comment 4(a)(1)-1.v); and filing a claim in arbitration against a consumer who has filed a claim on the same issue in a class action after the trial court

has granted a motion to dismiss the claim where the court has noted that the consumer has leave to refile the claim on a class basis, if the time to refile the claim has not elapsed (proposed comment 4(a)(1)-1.vi).

One purpose of proposed comments 4(a)(1)-1.iv through vi would be to prevent providers from evading proposed § 1040.4(a)(1) by filing an arbitration claim against a consumer who has already filed a claim on the same issue in a putative class action. The Bureau notes, however, that proposed § 1040.4(a)(1) would not prohibit a provider from continuing to arbitrate a claim that was filed before the consumer filed a class action claim. For example, if a provider files an arbitration claim to collect a debt from a consumer, and the consumer later files a class action claim, the arbitration of that claim would still be permitted to go forward, although, under proposed § 1040.4(a)(1) the provider could not use the pre-dispute arbitration agreement to block the class action.

The Bureau seeks comment on these examples and whether further clarification regarding when this provision would apply in the course of litigation would be helpful to providers. Specifically, the Bureau seeks comment on whether the language “claim on the same issue,” which appears in proposed comment 4(a)(1)-1.v and vi, is sufficiently limiting and would not prevent, for example, arbitrations involving unrelated claims to go forward even if they involve the same consumer. The Bureau also seeks comment on whether entities may seek to circumvent or evade proposed § 1040.4(a)(1) and whether additional clarification would be needed to prevent such circumvention or evasion.<sup>515</sup>

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<sup>515</sup> The Bureau notes that it has the authority under Dodd-Frank section 1022(b)(1) to, among other things, issue orders or guidance after a rule to prevent evasions of Federal consumer financial law.

Proposed comment 4(a)(1)-2 would state that, in a class action concerning multiple products or services only some of which are covered by proposed § 1040.3, the prohibition in proposed § 1040.4(a)(1) applies only to claims that concern the covered products or services. The Bureau seeks comment on this comment and whether providers need additional clarification regarding the application of proposed § 1040.4(a)(1) in class actions for multiple products and services, only some of which are covered by proposed § 1040.3.

*4(a)(2) Provision Required in Covered Pre-dispute Arbitration Agreements*

In furtherance of the Bureau's goal to ensure that class actions are available to consumers who are harmed by consumer financial service providers, for the reasons discussed above in Part VI and in accordance with the Bureau's authority under Dodd-Frank section 1028(b), proposed § 1040.4(a)(2) would generally require providers to ensure that pre-dispute arbitration agreements contain specified provisions explaining that the agreements cannot be invoked in class proceedings. These proposed requirements are discussed in greater detail below.

*4(a)(2)(i)*

Proposed § 1040.4(a)(2)(i) would state that, except as permitted by proposed § 1040.4(a)(2)(ii) and (iii) and proposed § 1040.5(b), providers shall, upon entering into a pre-dispute arbitration agreement for a product or service covered by proposed § 1040.3 after the compliance date, ensure that any such agreement contains the following provision:

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.

Requiring a provider's arbitration agreement to contain such a provision would ensure that consumers, courts, and other relevant third parties, including potential purchasers, are made aware when reading the agreement that it may not be used to prevent consumers from pursuing

class actions concerning consumer financial products or services covered by the proposed rule. Moreover, to the extent a provider attempts to invoke a pre-dispute arbitration agreement, consumers could invoke this contractual provision to enforce their right to proceed in court for class claims. The Bureau intends this provision to be limited to class action cases that concern a consumer financial product or service that would be covered by proposed § 1040.3. In addition, the Bureau intends the phrase “neither we nor anyone else shall use this agreement” – rather than merely “we shall not use this agreement” – to make clear to consumers that the proposed rule would bind both the provider that initially enters into the agreement and any third party that might later be assigned the agreement or otherwise seek to rely on it.

The Bureau has attempted to draft the proposed contractual provision – as well as the contractual provisions in proposed § 1040.4(a)(2)(ii) and (iii) – to be in plain language. While the Bureau does not believe that disclosure requirements or consumer education could lead to a material increase in the filing of individual claims, the Bureau does believe that consumers who consult their contracts should be able to access an understandable explanation of their dispute resolution rights.

The Bureau intends the phrase “contains the following provision” in proposed § 1040.4(a)(2)(i) to clarify that the text specified by proposed § 1040.4(a)(2)(i) shall be included as a provision of the pre-dispute arbitration agreement, as for example, the FTC’s Holder in Due Course Rule also requires.<sup>516</sup> Thus, providers may not – for example – include the required language as a separate notice or consumer advisory, except in certain circumstances that would

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<sup>516</sup> This rule prohibits a person who, in the ordinary course of business, sells or leases goods or services to consumers from taking or receiving a consumer credit contract that fails to contain a provision specified in the regulation stating that any holder of the contract is subject to all claims and defenses that the debtor could assert against the seller. 16 CFR 433.2.

be governed by proposed § 1040.4(a)(2)(iii). Further, similar to how the Bureau understands the provision required by the Holder in Due Course Rule, the Bureau intends the provision to create a binding legal obligation. As a result, if a consumer or attorney were unaware of proposed § 1040.4(a)(1), the Bureau expects that the provision required by proposed § 1040.4(a)(2)(i) would have a substantially similar legal effect through the operation of applicable contract law.

The Bureau seeks comment on proposed § 1040.4(a)(2)(i) generally. The Bureau also seeks comment on whether the rule should mandate that covered entities insert the provision into their pre-dispute arbitration agreements. In addition, the Bureau seeks comment on whether the provision, as drafted, is in plain language and would be understandable to consumers. The Bureau further seeks comment on whether the proposed provision would accomplish its purpose of binding both the provider that forms an initial agreement with the consumer and any future acquirers of it, as well as third parties that may seek to rely on it, such as debt collectors.

*4(a)(2)(ii)*

Proposed § 1040.4(a)(2)(ii) would permit providers to include in a pre-dispute arbitration agreement covering multiple products or services – only some of which are covered by proposed § 1040.3 – an alternative provision in place of the one required by proposed § 1040.4(a)(2)(i).

Proposed § 1040.4(a)(2)(ii) would require this alternative provision to contain the following text:

We are providing you with more than one product or service, only some of which are covered by the Arbitration Agreements Rule issued by the Consumer Financial Protection Bureau. We agree that neither we nor anyone else will use this agreement to stop you 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. This provision applies only to class action claims concerning the products or services covered by that Rule.

Under proposed § 1040.4(a)(2)(ii), providers using one contract for transactions involving both products and services covered by proposed § 1040.3 and products and services not covered by

proposed § 1040.3 would have the option to – but would not be required to – use the alternative provision. Where contracts cover products and services covered by proposed § 1040.3 and products and services not covered by proposed § 1040.3, the Bureau believes that the alternative provision would improve consumer understanding because the alternative provision would more accurately describe consumers’ dispute resolution rights. As with proposed § 1040.4(a)(2)(i), discussed above, the Bureau intends for the text to be included as a provision in the pre-dispute arbitration agreement and for the text to have binding legal effect.

The Bureau seeks comment on proposed § 1040.4(a)(2)(ii) generally. The Bureau also seeks comment on whether it would be appropriate to permit the use of an alternative provision; whether the text of the proposed provision would be understandable to consumers; whether providers should be permitted to specify which products being provided are covered by the Rule; and whether the Bureau should consider making the alternative provision mandatory, rather than optional, in contracts for multiple products and services, only some of which would be covered by the proposed rule.

*4(a)(2)(iii)(A) and (B)*

Proposed § 1040.4(a)(2)(iii) would set forth how to comply with proposed § 1040.4(a)(2) in circumstances where a provider enters into a pre-existing pre-dispute arbitration agreement that does not contain either the provision required by proposed § 1040.4(a)(2)(i) or the alternative permitted by proposed § 1040.4(a)(2)(ii). Under proposed § 1040.4(a)(2)(iii), within 60 days of entering into the pre-dispute arbitration agreement, providers would be required either to ensure that the agreement is amended to contain the provision specified in proposed § 1040.4(a)(2)(iii)(A) or provide any consumer to whom the agreement applies with the written notice specified in proposed § 1040.4(a)(2)(iii)(B). For providers that choose to ensure that the

agreement is amended, the provision specified by proposed § 1040.4(a)(2)(iii)(A) would be as follows:

We agree that neither we nor anyone else that later becomes a party to this pre-dispute arbitration agreement will use it 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.

For providers that choose to provide consumers with a written notice, the required notice provision specified by § 1040.4(a)(2)(iii)(B) would be as follows:

We agree not to use any pre-dispute arbitration 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.

The Bureau believes that by permitting providers to furnish a notice to consumers, in lieu of amending their agreements, the notice option afforded by proposed § 1040.4(a)(2)(iii)(B) would yield consumer awareness benefits while reducing the burden to providers for whom amendment may be challenging or costly. Further, the Bureau intends the notice option to ensure that consumers are adequately informed even if the provider that enters into a pre-existing agreement lacks a legally permissible means for amending the agreement to add the required provision. The Bureau notes that, whether the provider elects to ensure that the agreement is amended, chooses to provide the required notice, or violates proposed § 1040.4(a)(2)(iii) by failing to do either of the above, the provider would still be required to comply with proposed § 1040.4(a)(1).

The Bureau seeks comment on proposed § 1040.4(a)(2)(iii). The Bureau also seeks comment on whether the text of proposed § 1040.4(a)(2)(iii)(A) and (B) would be understandable to consumers. The Bureau further seeks comment on whether 60 days would be an appropriate timeframe for requiring providers to ensure that agreements are amended or

provide notice, taking into consideration situations where, for example, providers are acquiring accounts.

As discussed in the Bureau's Section 1022(b)(2) Analysis below, buyers of medical debt would, in some cases, need to perform due diligence to determine how this proposed rule would apply to the debts they buy. For example, proposed § 1040.4(a)(2) would require buyers of consumer credit, including medical credit, when they enter into a pre-dispute arbitration agreement to amend the agreement to contain a provision – or send the consumer a notice – stating that the debt buyer would not invoke that pre-dispute arbitration agreement in a class action. In cases that may involve incidental credit under ECOA, debt buyers might face additional impacts from the rule from additional due diligence to determine which acquired debts arise from credit transactions,<sup>517</sup> or alternatively from the additional class action exposure created from sending consumer notices on debts that did not arise from credit transactions (*i.e.*, from potential over-compliance). The Bureau seeks comment on the extent of these impacts, and whether an exemption from the notice requirement in proposed § 1040.4(a)(2) would be warranted for buyers of medical debt, or whether the proposed rule should allow a medical debt buyer to send a tailored notice to the consumer that does not specify whether the underlying debt is covered credit in the first instance.

Proposed comment 4(a)(2)-1 would highlight an important difference in the application of proposed § 1040.4(a)(2), as compared with proposed § 1040.4(a)(1). Proposed § 1040.4, in

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<sup>517</sup> The Bureau has previously recognized that requiring such determinations across an entire portfolio of collection accounts may be burdensome for buyers of medical debt because whether such debts constitute credit will turn on facts and circumstances that are unique to the health care context and of which the debt buyer may not be aware. As a result, the Bureau exempted medical debt from revenue that must be counted toward larger participant status of a debt collector. *See* Debt Collection Larger Participant Final Rule, 77 FR 65775, 65780 (Oct. 31, 2012).



general, would apply to a provider regardless of whether the provider itself entered into a pre-dispute arbitration agreement, as long as the agreement was entered into after the compliance date. For example, proposed § 1040.4(a)(1) would prohibit a debt collector that does not enter into a pre-dispute arbitration agreement from moving to compel a class action case to arbitration on the basis of that agreement, so long as the original creditor entered into the pre-dispute arbitration agreement after the compliance date. Proposed § 1040.4(a)(2), in comparison, would apply to providers only when they enter into a pre-dispute arbitration agreement for a product or service.<sup>518</sup> Thus, proposed § 1040.4(a)(2) would not apply to the debt collector in the example cited previously; but it would apply to a debt buyer that acquires or purchases a product covered by proposed § 1040.3 and becomes a party to the pre-dispute arbitration agreement.<sup>519</sup> Proposed comment 4(a)(2)-1 would clarify this distinction by stating that the requirements of proposed § 1040.4(a)(2) would not apply to a provider that does not enter into a pre-dispute arbitration agreement with a consumer.

Proposed comment 4(a)(2)-2 would provide an illustrative example clarifying what proposed § 1040.4(a)(2)(iii) requires when a provider enters into a pre-dispute arbitration agreement that the consumer had previously entered into with another entity and does not contain the provision required by proposed § 1040.4(a)(2)(i) or the alternative permitted by proposed § 1040.4(a)(2)(ii). The proposed comment would explain that such a situation could arise where Bank A is acquiring Bank B after the compliance date, and Bank B had entered into pre-dispute arbitration agreements before the compliance date. The proposed comment would state that if, as

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<sup>518</sup> See proposed § 1040.4(a)(2) (“Upon *entering into* a pre-dispute arbitration agreement for a product or service covered by proposed § 1040.3 after the date set forth in § 1040.5(a)...” (emphasis added)).

<sup>519</sup> See proposed comment 4-1.i (providing examples of entering into a pre-dispute arbitration agreement).

part of the acquisition, Bank A acquires products of Bank B's that are subject to pre-dispute arbitration agreements (and thereby enters into such agreements), proposed § 1040.4(a)(2)(iii) would require Bank A to either (1) ensure the account agreements are amended to contain the provision required by proposed § 1040.4(a)(2)(iii)(A) or (2) deliver the notice in accordance with proposed § 1040.4(a)(2)(iii)(B).

Proposed comment 4(a)(2)-3 would state that providers that elect to deliver a notice in accordance with proposed § 1040.4(a)(2)(iii) may provide the notice in any way the provider communicates with the consumer, including electronically. The proposed comment would further explain that the notice may be provided either as a standalone document or included in another notice that the customer receives, such as a periodic statement to the extent permitted by other laws and regulations. The Bureau believes that permitting providers a wide range of options for furnishing the notice would accomplish the goal of consumer understanding while affording providers flexibility, thereby reducing the burden on providers.

The Bureau seeks comment on proposed comments 4(a)(2)-1, -2, and -3. The Bureau also seeks comment on whether proposed comment 4(a)(2)-3's explanation that the notice permitted by proposed § 1040.4(a)(3) may be provided in any way the provider typically communicates with the consumer, including electronically, provides adequate clarification to providers while helping ensure that consumers receive the notice.

#### *4(b) Submission of Arbitral Records*

While proposed § 1040.4(a) would prevent providers from relying on pre-dispute arbitration agreements in class actions, it would not prohibit covered entities from maintaining pre-dispute arbitration agreements in consumer contracts generally. Providers could still invoke such agreements to compel arbitration in cases not filed as class actions. Thus, the Bureau has

separately considered whether regulatory interventions pertaining to these “individual” arbitrations would be in the public interest and for the protection of consumers, as well as whether the findings for such interventions are consistent with the Bureau’s Study.

For reasons discussed more fully in Part VI and pursuant to its authority under section 1028(b), the Bureau proposes § 1040.4(b), which would mandate the submission of certain arbitral records to the Bureau. Proposed § 1040.4(b)(1) would require, for any pre-dispute arbitration agreement entered into after the compliance date, providers to submit copies of specified arbitration records enumerated in proposed § 1040.4(b)(1) to the Bureau, in the form and manner specified by the Bureau. As with all the requirements in this proposed rule, compliance with this provision would be required beginning on the compliance date. The Bureau would develop, implement, and publicize an electronic submission process that would be operational before this date, were proposed § 1040.4(b) to be adopted.

Proposed § 1040.4(b)(2) would require that providers submit any record required pursuant to proposed § 1040.4(b)(1) within 60 days of filing by the provider of any such record with the arbitration administrator and within 60 days of receipt by the provider of any such record filed or sent by someone other than the provider, such as the arbitration administrator or the consumer. Proposed § 1040.4(b)(3) would set forth the information that providers shall redact before submitting records to the Bureau. Proposed § 1040.4(b)(1) through (3) are discussed in greater detail below.

The Bureau notes that proposed § 1040.4(b) would require submission only of records arising from arbitrations pursuant to pre-dispute arbitration agreements entered into after the compliance date where one or more of the parties is a provider and the dispute concerns a product covered by the rule. The Bureau further notes that the provision would apply to both

individual arbitration proceedings and class arbitration proceedings. If providers participate in arbitrations as the result of agreements with consumers to arbitrate that are not made until after a dispute has arisen, proposed § 1040.4(b) would not require submission of such records.

Proposed § 1040.4(b) further would provide that copies of records should be submitted, to ensure that providers do not submit original documents.

As noted above, the Bureau proposes § 1040.4(b) pursuant to its authority under Dodd-Frank sections 1028(b) and 1022(c)(4). Section 1022(c)(4) authorizes the Bureau to “gather information from time to time regarding the organization, business conduct, markets, and activities of covered persons and service providers.” The Bureau notes that it is not proposing to obtain information in this rule for the purpose of gathering or analyzing the personally identifiable financial information of consumers. Proposed § 1040.4(b)(3) would require providers to redact information that could directly identify consumers.<sup>520</sup>

As discussed above, the Bureau is not now proposing to ban pre-dispute arbitration agreements entirely, nor is it proposing to prohibit specific practices in individual arbitration other than the use of pre-dispute arbitration agreements to block class actions. Nevertheless, the Bureau will continue to evaluate the impacts on consumers of arbitration and arbitration agreements. To the extent necessary and appropriate, the Bureau intends to draw upon all of its statutorily authorized tools to address conduct that harms consumers. Specifically, the Bureau will continually analyze all available sources of information, including, if the proposed rule is finalized, information submitted to the Bureau pursuant to proposed § 1040.4(b) as well as other

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<sup>520</sup> Pursuant to Dodd-Frank section 1022(c)(4)(C), the Bureau may not obtain information under its section 1022(c)(4) authority “for the purpose of gathering or analyzing the personally identifiable financial information of consumers.”

information garnered through its supervisory, enforcement, and market monitoring activities. The Bureau will draw upon these sources to assess trends pertinent to its statutory mission, including trends in the use of arbitration agreements; the terms of such agreements; and the procedures, conduct, and results of arbitrations.

Among other regulatory tools, the Bureau may consider conducting additional studies on consumer arbitration pursuant to Dodd-Frank section 1028(a) for the purpose of evaluating whether further rulemaking would be in the public interest and for the protection of consumers; improving its consumer education tools; or, where appropriate, undertaking enforcement or supervisory actions.<sup>521</sup>

The Bureau notes that the question of whether the use of individual arbitration in consumer finance cases is in the public interest and for the protection of consumers is discrete from the question of whether some covered persons are engaged in unfair, deceptive, or abusive acts or practices in connection with their individual arbitration agreements. The Bureau intends to use its supervisory and enforcement authority as appropriate to evaluate whether specific practices in relation to arbitration – such as the use of particular provisions in agreements or particular arbitral procedures – constitute unfair, deceptive, or abusive acts and practices pursuant to Dodd-Frank section 1031. The Bureau will pay particular attention to any provisions in arbitration agreements that might function in such a way as to deprive consumers of their ability to pursue their claims in arbitration. For example, in certain circumstances, an agreement that requires consumers to resolve disputes, in arbitration or otherwise, in person in a particular

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<sup>521</sup> The Bureau interprets section 1028 to allow it, as appropriate, to further study the use of pre-dispute arbitration agreements and, if appropriate, to promulgate rules that would prohibit or impose conditions or limitations on the use of a pre-dispute arbitration agreement or to amend any rule that it would finalize pursuant to this proposal.

location regardless of the consumer's location could violate Dodd-Frank section 1031. In certain circumstances, requiring consumers to resolve claims in a systematically biased forum or before a biased decision-maker, in a forum that does not exist, or in a forum that does not have a procedure to allow a consumer to bring a claim could similarly violate Dodd-Frank section 1031. The Bureau is actively monitoring the use of such practices that may function in such a way as to deprive consumers of their ability to pursue their claims in arbitration and will continue to evaluate them in accordance with all applicable law and the full extent of the Bureau's authorities.

Consumer advocates and some other stakeholders have expressed concern that a proposal under consideration similar to proposed § 1040.4(b) that the Bureau described in its SBREFA Outline would allow the Bureau to monitor certain arbitration trends, but not to monitor or quantify the claims that consumers may have been deterred from filing because of the existence of a pre-dispute arbitration agreement. In particular, consumer advocates and some other stakeholders have expressed concern that pre-dispute arbitration agreements discourage consumers from filing claims in court or in arbitration and discourage attorneys from representing consumers in such proceedings. Consumer attorneys have noted, for example, that arbitration does not allow them to file cases that can develop the law (because the outcomes are usually private and do not have precedential effect) and, thus, they are wary of expending limited resources.<sup>522</sup> The Bureau acknowledges that its proposal would provide limited insight into how and whether arbitration agreements discourage filing of claims, but it nonetheless seeks comment

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<sup>522</sup> See, e.g., *Arbitration: Is It Fair When Forced?* Hearing before the S. Comm. on the Judiciary, 112<sup>th</sup> Cong. 177 (2011) (Prepared Statement of F. Paul Bland, Senior Attorney, Public Justice), at 81-82.

on whether the proposed collection of the arbitral records specified in proposed § 1040.4(b) would permit the Bureau – and the public, to the extent the Bureau publishes the records (discussed below) – to monitor arbitration and detect practices that harm consumers.

Proposed comment 4(b)-1 would clarify that, to comply with the submission requirement in proposed § 1040.4(b), providers would not be required to submit the records themselves if they arranged for another person, such as an arbitration administrator or an agent of the provider, to submit the records on the providers' behalf. Proposed comment 4(b)-1 would also make clear, however, that the obligation to comply with proposed § 1040.4(b) nevertheless remains on the provider and, thus, the provider must ensure that such person submits the records in accordance with proposed § 1040.4(b). This proposed comment anticipates that arbitration administrators may choose to provide this service to providers.

The Bureau seeks comment on its approach to arbitration agreements generally and all aspects of its proposal to collect certain arbitral records. The Bureau further seeks comment on known and potential consumer harms in individual arbitration. In particular, it seeks comment on whether it should consider fewer, more, or different restrictions on individual arbitration, whether it should prohibit individual arbitration altogether and whether it has accurately assessed the harm to consumers that occurs when covered entities include pre-dispute arbitration agreements. As for its proposal to collecting arbitral records, the Bureau seeks comment on whether doing so will further the Bureau's stated goal of monitoring potential harms in providers' use of arbitration agreements as well as the underlying legal claims. Further, the Bureau seeks comment on whether proposed comment 4(b)-1 provides adequate clarification regarding the fact that the proposed rule would allow third parties to fulfill companies' obligations under proposed § 1040.4(b). In addition, the Bureau seeks comment on its plan to

make an electronic submission process operational before the compliance date, including what features of such a system would be useful to providers, their agents, or the general public.

#### *Publication of Arbitral Records*

The Bureau intends to publish arbitral records collected pursuant to proposed § 1040.4(b)(1). The Bureau is considering whether to publish such records individually or in the form of aggregated data. Prior to publishing such records, the Bureau would ensure that they are redacted, or that the data is aggregated, in accordance with applicable law, including Dodd-Frank section 1022(c)(8), which requires the Bureau to “take steps to ensure that proprietary, personal, or confidential consumer information that is protected from public disclosure under [the Freedom of Information Act or the Privacy Act] . . . is not made public under this title.”

The Bureau seeks comment on the publication of the records that would be required to be submitted by proposed § 1040.4(b)(1), including whether it should limit any publication based on consumer privacy concerns arising out of the publication of such records after their redaction pursuant to proposed § 1040.4(b)(3) or if providers would have other confidentiality concerns. In addition, the Bureau seeks comment on whether it should publish arbitral records individually or in the form of aggregated data. The Bureau also seeks comment on whether there are alternatives to publication by the Bureau – such as publication by other entities – that would further the purposes of publication described above.

#### *Small Business Review Panel*

During the Small Business Review Panel process, the SERs expressed some concern about the indirect costs of requiring submission of arbitral claims and awards to the Bureau, such as whether the requirement might cause the cost of arbitration administration to increase and whether it might require companies to devote employee resources to redacting consumers’



confidential information before submission. The SERs also expressed concern about the possibility of the Bureau publishing arbitral claims and awards (as was set forth in the SBREFA Outline) due to perceived risks to consumer privacy, impacts on their companies' reputation, and fear that publication of data regarding claims and awards might not present a representative picture of arbitration.

In response to these and other concerns raised by the SERs, the Panel recommended that the Bureau seek comment on whether the publication of claims and awards would present a representative picture of arbitration. The Panel also recommended that the Bureau continue to assess whether and by how much the proposal to require submission of arbitral records would increase the costs of arbitration including administrative fees or covered entities' time. In addition, the Panel recommended that the Bureau consider the privacy and reputational impacts of publishing claims and awards for both the businesses and consumers involved in the dispute. The Bureau appreciates the SERs' concern about privacy risks and has sought to mitigate these risks by proposing the redaction requirements in proposed § 1040.4(b)(3), described below. The Bureau understands the SERs' concerns that publishing certain arbitral records could affect companies' reputations or paint an unrepresentative picture of arbitration (for example, by publishing awards, but not settlements). However, the Bureau notes that published court opinions also have this effect (in that settlements are typically not public), and the Bureau is not aware of any distinctions specific to arbitration in this respect. The Bureau has considered several aspects of the costs of its proposed submission requirement in its Section 1022(b)(2) Analysis, below. However, the Bureau continues to assess each of these issues and believes public comment would assist the Bureau in its assessment. Consistent with the SERs' recommendation, the Bureau seeks comment on each of the above issues.

#### *4(b)(1) Records to be Submitted*

As stated above, proposed § 1040.4(b) would require that, for any pre-dispute arbitration agreement entered into after the compliance date, providers submit a copy of the arbitration records specified by proposed § 1040.4(b)(1) to the Bureau, in the form and manner specified by the Bureau.<sup>523</sup> Proposed § 1040.4(b)(1) would list the arbitral records that providers would be required to submit to the Bureau. As with all the requirements in this proposed rule, compliance with this provision would be required for pre-dispute arbitration agreements entered into after the compliance date.

#### *4(b)(1)(i)*

Proposed § 1040.4(b)(1)(i) would require, in connection with any claim filed by or against the provider in arbitration pursuant to a pre-dispute arbitration agreement entered into after the compliance date, that providers submit (A) the initial claim form and any counterclaim; (B) the pre-dispute arbitration agreement filed with the arbitrator or administrator; (C) the judgment or award, if any, issued by the arbitrator or arbitration administrator; and (D) if an arbitrator or arbitration administrator refuses to administer or dismisses a claim due to the provider's failure to pay required filing or administrative fees, any communication the provider receives from the arbitrator or an arbitration administrator related to such a refusal.

Proposed § 1040.4(b)(1)(i)(A) would require providers to submit any initial claims filed in arbitration pursuant to a pre-dispute arbitration agreement and any counterclaims. By "initial claim," the Bureau means the filing that initiates the arbitration, such as the initial claim form or demand for arbitration. The Bureau believes that collecting claims would permit the Bureau to

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<sup>523</sup> The Bureau anticipates that it would separately provide technical details pertaining to the submission process.

monitor arbitrations on an ongoing basis and identify trends in arbitration proceedings, such as changes in the frequency with which claims are filed, the subject matter of the claims, and who is filing the claims. Based on the Bureau's expertise in handling and monitoring consumer complaints as well as monitoring private litigation, the monitoring of claims would also help the Bureau identify business practices that harm consumers. The Bureau seeks comment on its proposal to require submission of claims. The Bureau also seeks comment on whether further clarification of the meaning of "claim," either in proposed § 1040.2 or in commentary, would be helpful to providers. In addition, the Bureau also seeks comment on whether it should collect the response by the opposing party, if any, in addition to the claim. The Bureau further seeks comment on whether providers would encounter other obstacles in complying with the proposed submission requirement and, if so, what those obstacles are

Proposed § 1040.4(b)(1)(i)(B) would require providers to submit, in connection with any claim filed in arbitration by or against the provider, the pre-dispute arbitration agreement filed with the arbitrator or arbitration administrator. The Bureau notes that, due to concerns relating to burden on providers and the Bureau itself, the Bureau is not proposing to collect all pre-dispute arbitration agreements that are provided to consumers. Instead, it is proposing only to require submission in the event an arbitration filing occurs.<sup>524</sup> By collecting the pre-dispute arbitration agreement, the Bureau would be able to monitor the impact that particular clauses in the agreement have on the conduct of an arbitration. For example, collecting pre-dispute arbitration agreements pursuant to which arbitrations were filed – combined with collecting judgments and

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<sup>524</sup> Pursuant to Regulation Z, credit card issuers are already required to submit their consumer agreements to the Bureau (although the Bureau has temporarily suspended this requirement). *See* 12 CFR 1026.58. The Bureau has also proposed to collect prepaid account agreements. Prepaid NPRM, *supra* note 474.

awards pursuant to proposed § 1040.4(b)(1)(i)(C) – may permit the Bureau to gather information about whether clauses specifying that the parties waive certain substantive rights when pursuing the claim in arbitration affect outcomes in arbitration. The Bureau seeks comment on its proposal to require submission of pre-dispute arbitration agreements when arbitration claims are filed.

Proposed § 1040.4(b)(1)(i)(C) would require providers to submit the judgment or award, if any, issued by the arbitrator or arbitration administrator in an arbitration subject to proposed § 1040.4(b). This proposed requirement would be intended to reach only awards issued by an arbitrator that resolve an arbitration and not settlement agreements where they are not incorporated into an award. The Bureau believes that the proposed submission of these awards would aid the Bureau in its ongoing review of arbitration and help the Bureau assess whether arbitrations are being conducted fairly and without bias. The Bureau seeks comment on this aspect of the proposal and on whether it should consider requiring the submission of records that are not awards but that also close arbitration files.

Proposed § 1040.4(b)(1)(i)(D) would apply where an arbitrator or arbitration administrator refuses to administer or dismisses a claim due to the provider's failure to pay required filing or administrative fees. If this occurs, proposed § 1040.4(b)(1)(i)(D) would require the provider to submit any communication the provider receives from the arbitration administrator related to such a refusal or dismissal. With regard to communications relating to nonpayment of fees, the Bureau understands that arbitrators or administrators, as the case may be, typically refuse to administer an arbitration proceeding if filing or administrative fees are not

paid. The Bureau understands that arbitrators or administrators will typically send a letter to the parties indicating that the arbitration has been suspended due to nonpayment of fees.<sup>525</sup> Pre-dispute arbitration agreements often mandate that the provider, rather than the consumer, pay some of the consumer's arbitration fees.<sup>526</sup>

Where providers successfully move to compel a case to arbitration (and obtain its dismissal in court), but then fail to pay the arbitration fees, consumers may be left unable to pursue their claims. The Study identified at least 50 instances of such non-payment of fees by companies in cases filed by consumers.<sup>527</sup> The Bureau is proposing § 1040.4(b)(1)(i)(D) to permit it to monitor non-payment of fees by providers whose consumer contracts include pre-dispute arbitration agreements and whether particular entities appear to be not paying fees as part of a tactical effort to avoid arbitration, which essentially forecloses a consumer's ability to bring a claim if the claim is governed by a pre-dispute arbitration agreement. The Bureau further expects that requiring submission of communications related to non-payment of fees would discourage providers from engaging in such activity.

Proposed § 1040.4(b)(1)(i)(D) would require providers to submit communications from arbitration administrators related to the dismissal or refusal to administer a claim for nonpayment of fees even when such nonpayment is the result of a settlement between the provider and the consumer. The Bureau believes this requirement would prevent providers who are engaging in strategic non-payment of arbitration fees to claim, in bad faith, ongoing settlement talks to avoid

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<sup>525</sup> See AAA, *Consumer Arbitration Rules*, *supra* note 130 at 32; JAMS, *Streamlined Arbitration Rules and Procedures*, *supra* note 132 at 9 (effective July 1, 2014).

<sup>526</sup> Study, *supra* note 2, section 5 at 58.

<sup>527</sup> Study, *supra* note 2, section 5 at 66 n.110. The Bureau has similarly received consumer complaints involving entities' alleged failure to pay arbitral fees.

the disclosure to the Bureau of communications regarding their non-payment. The Bureau anticipates that companies submitting communications pursuant to proposed § 1040.4(b)(1)(i)(D) could indicate in their submission that nonpayment resulted from settlement and not from a tactical maneuver to prevent a consumer from pursuing the consumer's claim. Further, as stated above in the discussion of proposed § 1040.4(b)(1)(i)(C), the Bureau would not be requiring submission of the underlying settlement agreement or notification that a settlement has occurred.

The Bureau seeks comment on proposed § 1040.4(b)(1)(D). In addition, the Bureau seeks comment on the submission of communications from arbitration administrators related to the dismissal or refusal to administer a claim for nonpayment of fees even when such nonpayment is the result of a settlement between the provider and the consumer, including whether doing so would serve the policy goal of discouraging non-payment of arbitral fees by providers. The Bureau also seeks comment on the impact such a requirement would have on providers.

*4(b)(1)(ii)*

Proposed § 1040.4(b)(1)(ii) would require providers to submit to the Bureau any communication the provider receives from an arbitrator or arbitration administrator related to a determination that a provider's pre-dispute arbitration agreement that is entered into after the compliance date for a consumer financial product or service covered by proposed § 1040.3 does not comply with the administrator's fairness principles, rules, or similar requirements, if such a determination occurs. The Bureau is concerned about providers' use of arbitration agreements that may violate arbitration administrators' fairness principles or rules. Several of the leading

arbitration administrators maintain fairness principles or rules, which the administrators use to assess the fairness of the company's pre-dispute arbitration agreement.<sup>528</sup> These administrators may refuse to hear an arbitration if the company's arbitration agreement does not comply with the relevant principles or rules.<sup>529</sup> Some administrators will also review a company's agreement preemptively – before an arbitration claim has been filed – to determine if the agreement complies with the relevant principles or rules.<sup>530</sup>

The Bureau believes that requiring submission of communications from administrators concerning agreements that do not comply with arbitration administrators' fairness principles or rules would allow the Bureau to monitor which providers could be attempting to harm consumers or discourage the filing of claims in arbitration by mandating that disputes be resolved through unfair pre-dispute arbitration agreements. The Bureau also believes that requiring submission of such communications could further discourage covered entities from inserting pre-dispute arbitration agreements in consumer contracts that do not meet arbitrator fairness principles. The Bureau notes that, pursuant to proposed § 1040.4(b)(1)(ii), communications that the provider receives would include communications sent directly to the provider as well as those sent to a consumer or a third party where the provider receives a copy.

Proposed comment 4(b)(1)(ii)-1 would clarify that, in contrast to the other records the Bureau proposes to collect under proposed § 1040.4(b)(1), proposed § 1040.4(b)(1)(ii) would

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<sup>528</sup> See AAA Consumer Due Process Protocol, *supra* note 131; JAMS, *Policy on Consumer Arbitrations Pursuant to Pre-Dispute Clauses Minimum Standards of Procedural Fairness* (effective July 15, 2009), available at [http://www.jamsadr.com/files/Uploads/Documents/JAMS-Rules/JAMS\\_Consumer\\_Min\\_Std-2009.pdf](http://www.jamsadr.com/files/Uploads/Documents/JAMS-Rules/JAMS_Consumer_Min_Std-2009.pdf) (hereinafter JAMS Minimum Standards of Procedural Fairness).

<sup>529</sup> See AAA Consumer Arbitration Rules, *supra* note 130, at 10; JAMS Streamlined Arbitration Rules and Procedures, *supra* note 132, at 6.

<sup>530</sup> See AAA Consumer Arbitration Rules, *supra* note 130, at 16.

require the submission of communications both when the determination occurs in connection with the filing of a claim in arbitration as well as when it occurs if no claim has been filed. Proposed comment 4(b)(1)(ii)-1 would state further that, if such a determination occurs with respect to a pre-dispute arbitration agreement that the provider does not enter into with a consumer, submission of any communication related to that determination is not required. The Bureau understands that providers may submit pre-dispute arbitration agreements to administrators, which review such agreements for compliance with rules even where an arbitral claim has not been filed.<sup>531</sup> The proposed comment would state that, if the provider submits a prototype pre-dispute arbitration agreement for review by the arbitration administrator and never actually includes it in any consumer agreements, the pre-dispute arbitration agreement would not be entered into and thus submission to the Bureau of communication related to a determination made by the administrator concerning the pre-dispute arbitration agreement would not be required. The Bureau believes that this clarification is needed to avoid discouraging providers from submitting prototype pre-dispute arbitration agreements to administrators for their review.

Proposed comment 4(b)(1)(ii)-2 would clarify that what constitutes an administrator's fairness principles or rules pursuant to proposed § 1040.4(b)(ii)(B) should be interpreted broadly. That comment would further provide current examples of such principles or rules, including the AAA's Consumer Due Process Protocol and the JAMS Policy on Consumer Arbitrations Pursuant to Pre-Dispute Clauses Minimum Standards of Procedural Fairness.<sup>532</sup>

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<sup>531</sup> Beginning September 1, 2014, a business that intends to provide the AAA as a potential arbitrator in a consumer contract must notify the AAA at least 30 days before the planned effective date of the contract and provide a copy of the arbitration agreement to the AAA. AAA Consumer Arbitration Rules, *supra* note 130 at 16.

<sup>532</sup> AAA Consumer Due Process Protocol, *supra* note 131; JAMS Minimum Standards for Procedural Fairness, *supra* note 528. The Bureau notes that it would be offering these specific principles or rules merely to assist



The Bureau seeks comment on proposed § 1040.4(b)(1)(ii)(B) and proposed comments 4(b)(1)(ii)(B)-1 and -2. The Bureau also seeks comment on whether these provisions would encourage providers to comply with their arbitration administrators' fairness principles or rules. In addition, the Bureau seeks comment on whether there are other examples of fairness principles the Bureau should list or concerns regarding the principles that the Bureau has proposed to list as examples.

*4(b)(2) Deadline for Submission*

Proposed § 1040.4(b)(2) would state that a provider shall submit any record required by proposed § 1040.4(b)(1) within 60 days of filing by the provider of any such record with the arbitration administrator and within 60 days of receipt by the provider of any such record filed or sent by someone other than the provider, such as the arbitration administrator or the consumer. The Bureau proposes a 60-day period for submitting records to the Bureau to allow providers a sufficient amount of time to comply with these requirements. The Bureau proposes what it believes is a relatively lengthy deadline because it expects that providers will continue to face arbitrations infrequently,<sup>533</sup> and, as a result, may be relatively unfamiliar with the requirements of proposed § 1040.4(b).

The Bureau also notes that, as proposed comment 4(b)-1 indicates, providers would comply with proposed § 1040.4(b) if another person, such as an arbitration administrator, submits the specified records directly to the Bureau on the provider's behalf, although the

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providers with compliance; this comment does not represent an endorsement by the Bureau of these specific principles or rules.

<sup>533</sup> See Study, supra note 2, section 5 at 20 (stating that, from 2010 to 2012, 1,847 individual AAA cases, or about 616 per year, were filed for six consumer financial product markets).

provider would be responsible for ensuring that the person submits the records in accordance with proposed § 1040.4(b).

This proposed 60-day period is consistent with feedback the Bureau received from the SERs during the Small Business Review panel process who expressed concern that a short deadline might burden companies given the relative infrequency of arbitration and, thus, their potential unfamiliarity with this particular requirement. The Bureau seeks comment on whether 60 days would be a sufficient period for providers to comply with the requirements of proposed § 1040.4(b).

#### *4(b)(3) Redaction*

Proposed § 1040.4(b)(3) would require providers to redact certain specific types of information that can be used to directly identify consumers before submitting arbitral records to the Bureau pursuant to proposed § 1040.4(b)(1). The Bureau endeavors to protect the privacy of consumer information. Additionally, as discussed more fully above, the Bureau proposes § 1040.4(b), in part, pursuant to its authority under Dodd-Frank section 1022(c)(4), which provides that the Bureau may not obtain information “for the purpose of gathering or analyzing the personally identifiable financial information of consumers.” The Bureau has no intention of gathering or analyzing information that directly identifies consumers. At the same time, the Bureau seeks to minimize the burden on providers by providing clear instructions for redaction.

Accordingly, the Bureau proposes § 1040.4(b)(3), which would require that providers, before submitting arbitral records to the Bureau pursuant to proposed § 1040.4(b), redact nine specific types of information that directly identify consumers. The Bureau believes that these nine items would be easy for providers to identify and, therefore, that redacting them would impose minimal burden on providers. Proposed comment 4(b)(3)-1 would clarify that providers

are not required to perform the redactions themselves and may assign that responsibility to another entity, such as an arbitration administrator or an agent of the provider.

Pursuant to proposed § 1040.4(b)(3)(i) through (v), the Bureau would require providers to redact names of individuals, except for the name of the provider or arbitrator where either is an individual; addresses of individuals, excluding city, State, and zip code; email addresses of individuals; telephone numbers of individuals; and photographs of individuals from any arbitral records submitted to the Bureau. The Bureau notes that, with the exception of the names of providers or arbitrators where either are individuals, information related to *any* individuals – not merely the consumer to whom the consumer financial product is offered or provided – would be required to be redacted pursuant to proposed § 1040.4(b)(3)(i) through (v). This would include names or other items of information relating to third-party individuals, such as individual employees of the provider.

Proposed § 1040.4(b)(3)(ii) would require redaction of street addresses of individuals, but not city, State, and zip code. The Bureau believes that collecting such high-level location information for arbitral records could, among other things, help the Bureau match the consumer's location to the arbitral forum's location in order to monitor issues such as whether consumers are being required to arbitrate in remote fora, and assist the Bureau in identifying any local or regional patterns in consumer harm as well as arbitration activity. The Bureau believes that collecting city, State, and zip code would pose limited privacy risk and that any residual risk would be balanced by the benefit derived from collecting this information.

Proposed § 1040.4(b)(3)(vi) through (ix) would require redaction from any arbitral records submitted to the Bureau, of account numbers; social security and tax identification numbers; driver's license and other government identification numbers; and passport numbers.

These redaction requirements would not be limited to information for individual persons because the Bureau believes that the privacy of any account numbers, social security, or tax identification numbers should be maintained, to the extent they may be included in arbitral records.

The Bureau notes that it is not broadly proposing to require providers to redact all types of information that could be deemed to be personally identifiable financial information (PIFI). Because Federal law prescribes an open-ended definition of PIFI,<sup>534</sup> the Bureau believes that broadly requiring redaction of all PIFI could impose a significant burden on providers while affording few, if any, additional protections for consumers relative to the redactions the Bureau is proposing to require. As such, the list of items in proposed § 1040.4(b)(3)(i) through (ix) identifies the examples of PIFI that the Bureau anticipates are likely to exist in the arbitral records that would be submitted under § 1040.4(b)(1). The Bureau's preliminary view is that the list of items strikes the appropriate balance between protecting consumer privacy and imposing a reasonable redaction burden on providers.

The Bureau seeks comment on its approach of requiring these redactions and on the burden to providers of this redaction requirement. The Bureau also seeks comment on whether it should require redaction of a consumer's city, State, and zip code, in addition to the consumer's street address. In addition, the Bureau seeks comment on whether it should require redaction of any additional types of consumer information, including other types of information that may be considered PIFI and that are likely to be present in the arbitral records. The Bureau further seeks comment on whether any of the items described in proposed § 1040.4(b)(3)(i) through (ix), such

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<sup>534</sup> Federal regulations define "personally identifiable financial information" as "any information: (i) A consumer provides to you to obtain a financial product or service from you; (ii) About a consumer resulting from any transaction involving a financial product or service between you and a consumer; or (iii) You otherwise obtain about a consumer in connection with providing a financial product or service to that consumer." 12 CFR 1016.3(q)(1).

as “account number,” should be further defined or clarified. Finally, the Bureau also seeks comment on whether the scope of any of the items should be expanded; for example, whether “passport number” should be expanded to include the entire passport.

#### *Section 1040.5 Compliance Date and Temporary Exception*

Proposed § 1040.5 would set forth the compliance date for Part 1040 as well as a limited and temporary exception to compliance with proposed § 1040.4(a)(2) for certain consumer financial products and services.

##### *5(a) Compliance Date*

Dodd-Frank section 1028(d) provides that any regulation prescribed by the Bureau under section 1028(b) shall apply to any agreement between a consumer and a covered person entered into after the end of the 180-day period beginning on the effective date of the regulation, as established by the Bureau. The Bureau interprets the statutory language “shall apply to any agreement . . . entered into after the end of the 180-day period beginning on the effective date” to mean that the proposed rule may apply beginning on the 181<sup>st</sup> day after the effective date, as this day would be the first day “after the end of the 180-day period beginning on the effective date of the regulation.” The Bureau proposes that the proposed rule establish an effective date of 30 days after publication of a final rule in the *Federal Register*. Were this 30-day period finalized, the requirements of the proposed rule would apply beginning on the 211<sup>th</sup> day after publication of the rule in the *Federal Register*.

The Bureau believes that stating in the regulatory text the specific date on which the rule would begin to apply and adopting a user-friendly term such as “compliance date” for this date would improve understanding among providers of their obligations, and consumers of their rights, under the rule. As such, proposed § 1040.5(a) would state that compliance with this part

is required for any pre-dispute arbitration agreement entered into after the date that is 211 days after publication of the rule in the *Federal Register*; the Bureau would instruct the Office of the Federal Register to insert a specific date upon publication in the *Federal Register*. Proposed § 1040.5(a) would also adopt the term “compliance date” to refer to this date. As discussed above, the Bureau is proposing commentary to proposed § 1040.4. Specifically, proposed comment 4-1 which would provide examples of when a provider does and does not “enter into” an agreement after the compliance date.

The Bureau expects that most providers, with the exception of providers that would be covered by proposed § 1040.5(b), discussed below, would be able to comply with proposed § 1040.4(a)(2) by the 211<sup>th</sup> day after publication of a final rule. Typically, contracts that contain pre-dispute arbitration agreements are standalone documents provided in hard copy or electronic form. These contracts are provided to the consumer at the time of contracting by either the provider or a third party (for example, a grocery store where a consumer can send remittances through a remittance transfer provider). The Bureau believes that, for all providers – except those that would be covered by the temporary exception in proposed § 1040.5(b) – a 211-day period would give providers sufficient time to revise their agreements to comply with proposed § 1040.4(a)(2) (and to make any other changes required by the rule) and would give providers using hard-copy agreements sufficient time to print new copies and, to the extent necessary, deliver them to the needed locations. The Bureau anticipates that providers could continue to provide non-compliant hard-copy agreements as long as they simultaneously gave consumers a notice or amendment including the required provision as part of the agreement.

As noted above, the Bureau proposes a 30-day effective date. The Bureau has chosen 30 days based on the Administrative Procedure Act, which requires that, with certain enumerated

exceptions, a substantive rule be published in the *Federal Register* not less than 30 days before its effective date.<sup>535</sup> In the Bureau's view, a longer period before the effective date would not be needed to facilitate compliance, given that Dodd-Frank section 1028(d) mandates an additional 180-day period between the effective date and the compliance date. For the reasons discussed above, the Bureau believes that a 211-day period between *Federal Register* publication and the compliance date would afford most providers – with the exception of providers that would be covered by proposed § 1040.5(b) – sufficient time to comply. The Bureau reiterates that this 211-day period includes the effective date; thus, by virtue of setting this effective date, no additional time would be added to this 211-day period.

The Bureau seeks comment on whether a different formulation would provide greater clarity to providers and consumers as to when the rule's requirements would begin to apply. In addition, the Bureau seeks comment on whether a period of 211 days between publication of a final rule in the *Federal Register* and the rule's compliance date constitutes sufficient time for providers to comply with proposed § 1040.4(a)(2) and, if not, what an appropriate effective date should be.<sup>536</sup>

#### *5(b) Exception for Pre-Packaged General-Purpose Reloadable Prepaid Card Agreements*

As described above in the Section-by-Section Analysis to proposed § 1040.5(a), that provision would specify the rule's compliance date – the date on which the rule's requirements would begin to apply – and that such date would be 211 days after publication of a final rule in the *Federal Register*. Starting on this date, providers would, among other things, be required to

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<sup>535</sup> 5 U.S.C. 553(d).

<sup>536</sup> The Bureau notes that if an electronic submission system is not ready by the effective date, the Bureau may consider delaying the effective date of proposed § 1040.4(b).

ensure that the pre-dispute arbitration agreement contains the provision required by proposed § 1040.4(a)(2)(i) or an alternative provision permitted by proposed § 1040.4(a)(2)(ii). As described above, the Bureau expects that most providers would be able to comply with proposed § 1040.4(a)(2)(i) or (ii) by the 211<sup>th</sup> day after publication of a final rule.

However, for certain products, there may be additional factors that would make compliance by the 211<sup>th</sup> day challenging. The Bureau has concerns about whether providers of certain types of prepaid cards would be able to ensure that only compliant products are offered for sale or provided to consumers after the compliance date. Prepaid cards are typically sold in an enclosed package that contains a card and a cardholder agreement. These packages are typically printed well in advance of sale and are distributed to consumers through third-party retailers such as drugstores, check cashing stores, and convenience stores.<sup>537</sup> As a result, to comply with the rule by the compliance date, providers would need to search each retail location at which their products are sold for any non-compliant packages; remove them from the shelves; and print new packages, which could likely incur considerable expense. The Bureau believes that this represents a unique situation not present with other products and services that would be covered by proposed Part 1040.

For these reasons, proposed § 1040.5(b) would establish a limited exception from proposed § 1040.4(a)(2)'s requirement that the provider's pre-dispute arbitration agreement contain the specified provision by the compliance date. Proposed § 1040.5(b) would state that proposed § 1040.4(a)(2) shall not apply to a provider that enters into a pre-dispute arbitration agreement for a general-purpose reloadable prepaid card if certain conditions are met. For a

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<sup>537</sup> See Prepaid NPRM, *supra* note 474, at 77106–07.



provider that cannot contact the consumer in writing, proposed § 1040.5(b)(1) would set forth the following requirements: (1) the consumer acquires the card in person at a retail store; (2) the agreement was inside of packaging material when it was acquired; and (3) the agreement was packaged prior to the compliance date of the rule. For a provider that has the ability to contact the consumer in writing, proposed § 1040.5(b)(2) would require that the provider meet all of the requirements specified in proposed § 1040.5(b)(1) as well as one additional requirement; within 30 days of obtaining the consumer's contact information, the provider notifies the consumer in writing that the pre-dispute arbitration agreement complies with the requirements of proposed § 1040(a)(2) by providing an amended pre-dispute arbitration agreement to the consumer.

In the Bureau's view, this exception would permit prepaid card providers to avoid the considerable expense of pulling and replacing packages at retail stores while adequately informing consumers of their dispute resolution rights, where feasible, due to the notification requirement in proposed § 1040.5(b)(2). The Bureau notes that proposed § 1040.5(b)(2) would not impose on providers an obligation to obtain a consumer's contact information. Where providers *are* able to contact the consumer in writing, the Bureau expects that they could satisfy proposed § 1040.5(b)(2) by, for example, sending the compliant agreement to the consumer when the consumer calls to register the account and provides a mailing address or e-mail address; sending the revised terms when the provider sends a personally-embossed card to the consumer; or communicating the new terms on the provider's website.

Proposed comment 5(b)(2)-1 would clarify that the 30-day period would not begin to elapse until the provider is able to contact the consumer. Proposed comment 5(b)(4)-1 would also provide illustrative examples of situations where the provider has the ability to contact the consumer, including when the provider obtains the consumer's mailing address or email address.

Importantly, providers who avail themselves of the exception in proposed § 1040.5(b) would still be required to comply with proposed § 1040.4(a)(1) and proposed § 1040.4(b) as of the compliance date. As such, providers who avail themselves of this exception would still be prohibited, as of the compliance date, from relying on a pre-dispute arbitration agreement entered into after the compliance date with respect to any aspect of a class action concerning any of the consumer financial products or services covered by proposed § 1040.3, pursuant to proposed § 1040.4(a)(1). The amended pre-dispute arbitration agreement submitted by providers in accordance with proposed § 1040.5(b)(4) would be required to include the provision required by proposed § 1040.4(a)(2)(i) or the alternative permitted by proposed § 1040.4(a)(2)(ii). And providers would also still be required to submit certain arbitral records to the Bureau, pursuant to proposed § 1040.4(b), in connection with pre-dispute arbitration agreements entered into after the compliance date. Further, the Bureau does not anticipate that permitting prepaid providers to sell existing card stock containing non-compliant agreements would affect consumers' shopping behavior, as, currently, consumers are typically unable to review the enclosed terms and conditions before purchasing a prepaid product in any event (although the Bureau would expect that corresponding product websites would contain an accurate arbitration agreement).

The Bureau seeks comment on whether the temporary exception in proposed § 1040.5(b) is needed, and, if so, on the exception as proposed. While the Bureau believes that the term “general-purpose-reloadable prepaid card” has an accepted meaning, the Bureau seeks comment on whether a definition of this term or additional clarification regarding its meaning would be helpful to providers. Additionally, the Bureau seeks comment on whether the exception should use a different term describing prepaid products. The Bureau also seeks comment on whether the proposed exception should be available to providers of other products – instead of, or in

addition to, prepaid products – or whether the exception’s coverage should not be limited based on product type, but based on other criteria.

The Bureau also seeks comment on whether requiring providers who take advantage of the exception in proposed § 1040.5(b) to make available a compliant pre-dispute arbitration agreement within 30 days after the provider becomes aware that the agreement has been provided to the consumer would be a feasible process for providers while also adequately protecting consumers. Further, the Bureau seeks comment on whether alternatives to the proposed exception would better accomplish the objectives of furthering consumer awareness of their dispute resolution rights and ensuring consumers receive accurate disclosures without imposing excessive costs on providers. One alternative, for example, could be for the Bureau to prohibit providers from selling non-compliant agreements after the compliance date, except for agreements that were printed prior to a specified number of days (such as 90 or 120 days) before the compliance date.

### **VIII. Dodd-Frank Act Section 1022(b)(2) Analysis**

#### *A. Overview*

In developing this proposed rule, the Bureau has considered the potential benefits, costs, and impacts required by section 1022(b)(2) of the Dodd-Frank Act. Specifically, section 1022(b)(2) calls for the Bureau to consider the potential benefits and costs of a regulation to consumers and covered persons (which in this case would be the providers subject to the proposed rule), including the potential reduction of access by consumers to consumer financial products or services, the impact on depository institutions and credit unions with \$10 billion or less in total assets as described in section 1026 of the Dodd-Frank Act, and the impact on consumers in rural areas.

The Bureau requests comment on the preliminary analysis presented below as well as submissions of additional data that could inform the Bureau’s analysis of the benefits, costs, and impacts of the proposed rule. The Bureau has consulted, or offered to consult with, the prudential regulators, the Federal Housing Finance Agency, the Federal Trade Commission, the U.S. Department of Agriculture, the U.S. Department of Housing and Urban Development, the U.S. Department of the Treasury, the U.S. Department of Veterans Affairs, the U.S. Commodities Futures Trading Commission, the U.S. Securities and Exchange Commission, and the Federal Communications Commission including consultation regarding consistency with any prudential, market, or systemic objectives administered by such agencies.

The Bureau has chosen to consider the benefits, costs, and impacts of the proposed provisions as compared to the status quo in which some, but not all, consumer financial products or services providers in the affected markets (see proposed § 1040.2(c), defining the entities covered by this rule as “providers”) use arbitration agreements.<sup>538</sup> The baseline considers

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<sup>538</sup> The Bureau has discretion in each rulemaking to choose the relevant provisions to discuss and to choose the most appropriate baseline for that particular rulemaking. A potential alternative baseline for this rulemaking is the baseline of a hypothetical future state of the world where “class actions against businesses would be all but eliminated.” See Brian Fitzpatrick, *The End of Class Actions?*, 57 Ariz. L. Rev. 161 (2015). Such a baseline could be justified because the use of class-eliminating arbitration agreements may continue to grow over time. See also Myriam Gilles, *Opting Out of Liability: The Forthcoming, Near-Total Demise of the Modern Class Action*, 104 Mich. L. Rev. 373 (2005); Jean Sternlight, *As Mandatory Binding Arbitration Meets the Class Action, Will the Class Action Survive?*, 42 Wm. & Mary L. Rev. 1 (2000-2001). Indeed, in Section 2 of the Study, the Bureau documents a slight but gradual increase in the adoption of arbitration agreements by industry in particular markets. See generally Study, *supra* note 2, section 2. See also Peter Rutledge & Christopher Drahozal, *Sticky Arbitration Clauses – the Use of Arbitration Clauses after Concepcion and Amex*, 67 Vand. L. Rev. 955 (2014).

The Bureau believes that this trend is likely to continue, but for simplicity and transparency, the Bureau assumes that, if the proposed rule is not finalized, the future prevalence of arbitration agreements would remain the same as the current prevalence. The estimated impact, both of benefits and costs, would be significantly larger if the Bureau had instead used the hypothetical future state of universal adoption of arbitration agreements as the baseline, because the baseline that the Bureau actually uses assumes that a significant amount of class litigation remains regardless of whether the proposed rule is finalized.

economic attributes of the relevant markets and the existing legal and regulatory structures applicable to providers. The Bureau seeks comment on this baseline.

The Bureau invites comment on all aspects of the data that it has used to analyze the potential benefits, costs, and impacts of the proposed provisions.<sup>539</sup> However, the Bureau notes that in some instances, the requisite data are not available or are quite limited. In particular, with the exception of estimating consumer recoveries from Federal class settlements, data with which to quantify the benefits of the proposed rule are especially limited. As a result, portions of this analysis rely in part on general economic principles and the Bureau's expertise in consumer financial markets to provide a qualitative discussion of the benefits, costs, and impacts of the proposed rule. The Bureau discusses and seeks comment on several alternatives, including ones that would be applicable to larger entities as well, in the Regulatory Flexibility Analysis below.

In this analysis, the Bureau focuses on the benefits, costs, and impacts of the main aspects of the proposed rule: (1) the requirement that providers with arbitration agreements include a provision in the arbitration agreements they enter into in the future stating that the arbitration agreement cannot be invoked in class litigation; and (2) the related prohibition that would forbid providers from invoking such an agreement in a case filed as a class action. Thus, given the baseline of the status quo, the analysis below focuses on providers that currently have arbitration agreements.

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<sup>539</sup> The estimates in this analysis are based upon data obtained and statistical analyses performed by the Bureau. This includes much of the data underlying the Study and some of the Study's results. The collection of the data underlying the Study is described in the relevant sections and appendices of the Study. Some of the data was collected from easily accessible sources, such as the data underlying the Bureau's analysis of Federal class settlements. Other data is confidential, such as the data underlying the Bureau's analysis of the pass-through of costs of arbitration onto interest rates for large credit card issuers. The Bureau also collected additional information from trade groups on the prevalence of arbitration agreements used in markets that were not analyzed in Section 2 of the Study. The collection of data from trade groups is discussed further below in Part VIII and in Part IX.

The effect of the proposal on arbitration of individual disputes, both the indirect effect of the class provision discussed above and the direct effect of provisions that would require the reporting of certain arbitral records to the Bureau for monitoring purposes, is relatively minor. The Bureau is aware of only several hundred consumers participating in such disputes each year and the Bureau does not expect a sizable increase, regardless of whether the proposed rule is finalized.<sup>540</sup> If anything, the number of such disputes might decrease if the proposed rule results in some providers removing arbitration agreements altogether. As discussed below, there is no reliable evidence on whether this would occur.

Providers that currently use arbitration agreements can be divided into two categories. The first category is comprised of providers that currently include arbitration agreements in contracts they make with consumers. For these providers, which constitute the vast majority of providers using arbitration agreements, the Bureau believes that the proposed class rule would result in the change from virtually no exposure to class litigation to at least as much exposure as is currently faced by those providers with similar products or services that do not use arbitration agreements.

The second category includes providers that invoke arbitration agreements contained in consumers' contracts with another person. This category includes, for example, debt collectors and servicers who, when sued by a consumer, invoke an arbitration agreement contained in the original contract formed between the original provider and the consumer. For these providers, the additional class litigation exposure caused by the proposed rule would be somewhat less than

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<sup>540</sup> These numbers come from a single arbitration provider, the AAA, for several consumer finance markets. *See generally* Study, *supra* note 2, section 5. Based on the analysis of consumer financial contracts in Section 2 of the Study, it is likely that the AAA accounts for the majority of arbitrations in several large consumer financial markets (checking and credit cards, for example).

the increase in exposure for providers of the first type because the providers in this second category are not currently uniformly able to rely on arbitration agreements in their current operations. For example, debt collectors typically collect both from consumers whose contracts with their original creditor contain arbitration agreements and from consumers whose contracts with their original creditor do not contain arbitration agreements. Thus, these debt collectors already face class litigation risk, but if the proposal were adopted, this risk would be increased, at most, in proportion to the fraction of the providers' consumers whose contracts contain arbitration agreements.<sup>541</sup> The actual magnitude by which debt collectors' risk would be increased would likely be lower because even when a consumer's contract contains an arbitration agreement today, the ability of the debt collector to rely upon it varies across arbitration agreements and depends on the applicable contract and background law.<sup>542</sup>

The analysis below applies to both types of providers. For additional clarity and to avoid unnecessary duplication, the discussion is generally framed in terms of the first type of provider (which faces virtually no exposure to class claims today), unless otherwise noted. The Bureau estimates below the number of additional Federal class actions and putative class proceedings that are not settled on a class basis for both types of provider.

#### *Description of the Market Failure and Economic Framework*

Before considering the benefits, costs, and impacts of the proposed provisions on consumers and covered persons, as required by Section 1022(b)(2), the Bureau believes it may be useful to provide the economic framework through which it is considering those factors in

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<sup>541</sup> For example, if half of consumers on whose debts a debt collector collects have arbitration agreements in their contracts, then the debt collector's class litigation risk would at most double if the proposed rule is finalized as proposed.

<sup>542</sup> See Study, *supra* note 2, section 6 at 54 n.94.

order to more fully inform the rulemaking, and in particular to describe the market failure that is the basis for the proposed rule.<sup>543</sup> The Bureau’s economic framework assumes that when Congress and States have promulgated consumer protection laws that are applicable to consumer financial products and services (“the underlying laws”) they have done so to address a range of market failures, for example asymmetric information. The underlying laws need enforcement mechanisms to ensure providers conform their behavior to these laws. In analyzing and proposing the class proposal, the Bureau is focusing on a related market failure: reduced incentives for providers to comply with the underlying laws. The reduced incentives for providers to comply are due to an insufficient level of private enforcement.

While the Bureau assumes that the underlying laws are addressing a range of market failures, it also recognizes that compliance with these underlying laws requires some costs. There are out-of-pocket costs required to, *e.g.*, distribute required disclosures or notices, investigate alleged errors, or resolve disputes. There are opportunity costs in, for example, forgoing adjustments in interest rates, limiting penalty fees, or limiting calling hours for debt collections. And, there are costs associated with establishing a compliance management system which, *e.g.*, trains and monitors employees, reviews communications with consumers, and evaluates new products or features.

The Bureau believes, based on its knowledge and expertise, that the current incentives to comply are weaker than the economically efficient levels. It further believes that conditions are such that this implies that the economic costs of increased compliance (due to the additional

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<sup>543</sup> Although section 1022(b)(2) does not require the Bureau to provide this background, the Bureau does so as a matter of discretion to more fully inform the rulemaking.



incentives provided by the proposed rule) are justified by the economic benefits of this increased compliance. If these conditions do not hold in particular cases, the increased compliance due to the proposed rule would likely lower economic welfare. The data and methodologies available to the Bureau do not allow for an economic analysis of these premises on a law-by-law basis.<sup>544</sup> However, for purposes of this discussion, the Bureau assumes that these conditions hold.

The Study shows that class litigation is currently the most effective private enforcement mechanism for most claims in markets for consumer financial products or services in providing monetary incentives (including forgone profits due to in-kind or injunctive relief) for providers to comply with the law.<sup>545</sup> During the years covered by the Study, providers paid out hundreds of millions of dollars per year in class relief and related litigation expenses in consumer finance cases.<sup>546</sup> Class actions also resulted in substantial but difficult to quantify prospective relief. This compares to the purely retrospective relief and other expenses related to about 1,000 individual lawsuits in Federal courts filed by consumers with respect to five of the largest consumer finance markets, a similar number of individual arbitrations, and a similar number of small claims court cases filed by consumers.<sup>547</sup> Individual consumer finance lawsuits filed in state courts (other than small claims courts) add some additional modest volume, but the Bureau

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<sup>544</sup> The Bureau seeks comment and data that would allow further analysis of how to determine the point at which strengthening incentives might become inefficient.

<sup>545</sup> As discussed further below, if class litigation is generally meritless then it does not provide an incentive for providers to comply with the law.

<sup>546</sup> See generally Study, *supra* note 2, section 8. As discussed further below, with regard to providing monetary incentives to increase investment in complying with the law, both relief to consumers and litigation expenses serve to increase the strength of deterrence incentives. See Richard Posner, *Economic Analysis of Law*, 8th ed. (2011) 785-92. In particular, effectively evoking the logic of Pigouvian taxes, he notes, “what is most important from an economic standpoint is that the violator be confronted with the costs of his violation – this preserves the deterrent effect of litigation – not that he pays them to his victims.”

<sup>547</sup> See Study, *supra* note 2, section 1 at 11, 15-16. The Bureau could not quantify providers’ spending on individual adjudications for a variety of reasons, most importantly that settlement terms of these cases are most often private.

does not believe that they change the magnitude of the differential between class and individual relief. In other words, the monetary incentives for providers to comply with the law due to the threat of class actions are substantially greater than those due to the threat of consumers bringing individual disputes against providers.

The relative efficacy of class litigation – as compared to individual dispute resolution, either in courts or in front of an arbitrator – in achieving these incentives is not surprising. As discussed in Part VI, the potential legal harm per consumer arising from violations of law by providers of consumer financial products or services is frequently low in monetary terms. Moreover, consumers are often unaware that they may have suffered legal harm. For any individual, the monetary compensation a consumer could receive if successful will often not be justified by the costs (including time) of engaging in any formal dispute resolution process even when a consumer strongly suspects that a legal harm might have occurred. This is confirmed by the Study’s nationally representative survey of consumers.<sup>548</sup> In economic terms, these are negative-value legal claims (claims where costs of pursuing a remedy do not justify the potential rewards). When thousands or millions of consumers may have individual negative-value legal claims, class actions can provide a vehicle to combine these negative-value legal claims into a single lawsuit worth bringing.<sup>549</sup>

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<sup>548</sup> See generally Study, *supra* note 2, section 3. In particular, while being presented with a hypothetical situation of a clearly erroneous charge on their credit card bill that the provider is unwilling to remedy, 1.4 percent of consumers surveyed stated that they would seek legal advice or sue using an attorney, and 0.7 percent of consumers stated that they would seek legal remedies without mentioning an attorney. *Id.*, section 3 at 18.

<sup>549</sup> See, e.g., Posner, *supra* note 550 at 785-92. See also Louis Kaplow & Steven Shavell, *Fairness versus Welfare*, 114 Harv. L. Rev. 961 (2001), at 1185 n. 531 (“[C]lass actions are valuable when they allow claims that would otherwise be brought individually to proceed jointly at lower cost due to the realization of economies of scale. In addition, our analysis emphasizes that, when legal costs exceed the stakes, there may be no suits and thus no deterrence; aggregating claims also solves this problem (although it is still possible that the aggregated claim may not be socially desirable if the benefit from improved behavior is sufficiently small).”).

The Bureau's economic framework also takes into account other incentives that may cause providers to conform their conduct to the law; there are at least two other important mechanisms, which are both described here. The first incentive is the economic value for the provider to maintain a positive reputation with its customers, which will create an incentive to comply with the law to the extent such compliance is correlated with the provider's reputation. As the Study shows, many consumers might consider switching to a competitor if the consumer is not satisfied with a particular provider's performance.<sup>550</sup> In part in response to this and to other reputational incentives (including publicly accessible complaint databases), many providers have developed and administer internal dispute resolution mechanisms.<sup>551</sup> The second incentive is to avoid supervisory actions or public enforcement actions by Federal and state regulatory bodies, such as the Bureau. In response to this, many providers have developed compliance programs, particularly where they are subject to ongoing active supervision by Federal or state regulators.

However, economic theory suggests that these other incentives (including reputation and public enforcement) are insufficient to achieve optimal compliance (again, assuming that the current levels of compliance are below those that would be economically efficient),<sup>552</sup> and the Bureau's experience similarly confirms that these mechanisms do not completely solve the

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<sup>550</sup> The Study only considered the credit card market. See Study, *supra* note 2, section 3 at 18. This finding might not be generalizable to any market where consumers face a significantly higher cost of switching providers.

<sup>551</sup> The Bureau notes that an incentive to act to preserve good reputation with the consumers is not necessarily the same as an incentive to comply with the law, especially when consumers are not even aware of the legal harm.

<sup>552</sup> See, e.g., Carl Shapiro, *Consumer Information, Product Quality, and Seller Reputation*, 13 Bell J. of Econ. 20 (1982) for reputation and Posner *supra* note 550, section 13.1 for complementarity with public enforcement. Note that earlier economic literature suggested that reputation alone, coupled with competitive markets, could lead to an efficient outcome. See, e.g., Benjamin Klein & Keith B. Leffler, *The role of market forces in assuring contractual performance*, 89 J. of Polit. Econ. 4 (1981). However, formal modeling of this issue revealed that earlier intuition was incomplete. See Carl Shapiro, *Premiums for high quality products as returns to reputations*, 98 Q. J. of Econ. 4 (1983).

market failure that the class proposal would attempt to address. Given the Bureau's assumptions outlined above, economic theory suggests that any void left by weakening any one of these incentives will not be filled completely by the remaining incentives.

Reputation concerns will create the incentive for a firm to comply with the law only to the extent legally compliant or non-compliant conduct would be visible to consumers and affect the consumer's desire to keep doing business with the firm, and even then, with a lag.<sup>553</sup> Thus, there is an incentive for firms to underinvest in compliance because consumers will not notice the non-compliant conduct resulting from underinvestment for some time or may not view the non-compliant conduct as sufficient to affect the consumer's willingness to do business with the firm.<sup>554</sup>

Economic theory also suggests that regardless of whether relief is warranted under the law, the provider has a relatively strong incentive to correct issues only for the consumers who complain directly about particular practices to the provider – as those are the consumers for whom the provider's reputation is most at risk – and less of an incentive to correct the same issues for other consumers who do not raise them or who may be unaware that the practices are occurring. Accordingly, the providers' incentive to comply due to reputational concerns is, in part, driven by the fraction of consumers who could become aware of the issue. In addition, with such informal dispute resolution, correcting issues for a particular consumer could mean waiving

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<sup>553</sup> In addition, the non-compliance would have to be sufficiently egregious to cause consumers to want to switch given switching costs, and some consumers might not be able to switch ex-post at all depending on the product in question.

<sup>554</sup> See Shapiro, *supra* note 556. This underinvestment is a perpetual, rather than a temporary phenomenon: a firm underinvests today because consumers will not become aware of today's underinvestment until tomorrow, but then the firm also underinvests tomorrow because tomorrow's consumers will not become aware of tomorrow's underinvestment until the day after tomorrow, and so on. Moreover, competition is not a panacea in this model: every firm rationally underinvests in compliance.

a fee or reducing a charge, in what a provider may call a “one time courtesy,” instead of changing the provider’s procedures prospectively even with regard to the individual consumer.

Furthermore, economic theory suggests that providers will decide how to resolve informal complaints by weighing the expected profitability of the consumer who raises the complaint against the probability that the consumer will indeed stop patronizing the provider, rather than legal merit per se. In the Bureau’s experience, some companies implement this through profitability models which are used to cabin the discretion of customer service representatives in resolving individual disputes. Indeed, providers may be more willing to resolve disputes favorably for profitable consumers even in cases where the disputes do not have a legal basis, than for non-profitable consumers with serious legal claims. Thus, reputation incentives do not always coincide with complying with the law.

Public enforcement could theoretically bring some of the same cases that are not going to be brought by private enforcement absent the proposed rule. However, public enforcement resources are limited relative to the thousands of firms in consumer financial markets. Public enforcement resources also focus only on certain types of claims (for instance, violations of state and Federal consumer protection statutes but not the parties’ underlying contracts).<sup>555</sup> In addition, other factors may be at play, such as public prosecutors could be more cautious or have other, non-consumer finance priorities. For all these reasons, public enforcement can and will not entirely fill the void left by the lack of private enforcement. The Study is consistent with this prediction, suggesting that there is limited overlap between the two types of enforcement.<sup>556</sup>

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<sup>555</sup> See Part VI.

<sup>556</sup> See generally Study, *supra* note 2, section 9.

The Bureau has considered arguments that arbitration agreements provide a sufficiently strong incentive to providers to address consumers' concerns and obviate the need to strengthen private enforcement mechanisms. One reason suggested is that many such agreements contain fee-shifting provisions that require providers to pay consumers' up front filing fees.<sup>557</sup> Some stakeholders have posited that the (ostensible) ease and low up front cost of arbitration may change many negative-value individual legal claims into positive-value arbitrations that, in turn, create an additional incentive for providers to resolve matters internally.<sup>558</sup> In principle, if arbitration agreements had the effect of transforming negative-value claims into positive ones, that would affect not just providers' incentives to resolve individual cases (as stakeholders have posited) but also their incentives to comply with the law *ex ante*.

As noted above, however, there is little if any empirical support for such an argument. The Bureau has only been able to document several hundred consumers per year actually filing arbitration claims,<sup>559</sup> and the Bureau is unaware that providers have routinely concluded that considerably more consumers were likely to file.

Additionally, the Bureau believes that this argument is flawed conceptually as well. The Bureau disagrees that, even for consumers who are aware of the legal harm, the presence of arbitration agreements changes many negative-value individual legal claims into positive-value arbitrations and, in turn, creates additional incentives for providers to resolve matters internally.

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<sup>557</sup> The argument depends on arbitration being easy for consumers to engage in and costly to the providers. Thus, the providers seek to resolve all consumer disputes internally, under the threat that aggrieved consumers can (ostensibly easily) escalate the disputes to (ostensibly more expensive) arbitration.

<sup>558</sup> Note that a provider does not have to know, for example, during a consumer's call to the provider's service phone line whether this particular consumer will file for arbitration. The provider can wait until the consumer files for arbitration, and then resolve the matter with the consumer without paying any fees related to arbitration.

<sup>559</sup> See *generally* Study, *supra* note 2, section 5.

Notably, consumers weigh several other costs before engaging in any individual dispute resolution process, including arbitration. It still takes time for a consumer to learn about the process, to prepare for the process, and to go through the process. There is also still a risk of losing and, if so, of possibly having initial filing fees shifted back to the consumer.

In addition, where arbitration agreements exist, consumers are still, in practice, more likely to use formal dispute resolution mechanisms (including small claims courts) than arbitration, and this suggests that arbitration does not turn negative-value claims positive.<sup>560</sup>

In general, if the extant laws were adopted to solve some other underlying market failures, it means that, by definition, the market could not resolve these failures on its own. Therefore, given the Bureau's assumptions outlined above, a practice (arbitration agreements that can be invoked in class litigation) that lowers providers' incentive to follow these laws is a market failure since it allows the underlying market failures to reappear. The providers (and the market in general) are unable (do not find it profitable) to resolve this market failure for the same reasons (and frequently additional other reasons) that the providers could not (did not find it profitable to) solve the underlying market failures in the first place.<sup>561</sup>

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<sup>560</sup> See Study, *supra* note 2, section 1 at 15 (providers typically do not invoke arbitration agreements in individual cases). The Study showed that the presence of small claims court carve-outs in the majority of clauses. See Study, *supra* note 2, section 2 at 33.

<sup>561</sup> This argument also illustrates why form language regarding arbitration agreements is fundamentally different from standardized language regarding other contract terms, and is not necessarily efficient. The debate about the efficiency of boilerplate language, from the perspective of law and economics, is whether boilerplate language allows for more efficient contracting between the firm and the customer, thus enhancing both parties' welfares, or whether boilerplate language allows the firm to take advantage of its customer in a welfare-reducing manner, with this advantage potentially remaining even if the market is competitive. The same arguments apply to contracts of adhesion. See, e.g., Symposium, "Boilerplate": *Foundations of Market Contracts*, 104 Mich. L. Rev. No. 5 (2006).

Any law restricting two parties' freedom to contract (for example, a mandatory disclosure or a limit on some financing terms in a consumer finance statute) introduces the following friction: to comply with the law, these two parties will agree to a different contract or not contract at all. Each of these options was available to the parties before the law was adopted, but at the time the parties chose to contract more efficiently from the parties'

### *Overview of effects of the proposed rule*

The proposed rule would require providers to include language in their arbitration agreements stating that the agreement cannot be used to block a class action with respect to those consumer financial products and services that would be covered by the proposed rule and would prohibit providers from invoking such an agreement in a case filed as a class action with respect to those consumer financial products and services. The proposed rule would also prohibit third-party providers facing class litigation from relying on such arbitration agreements. The Bureau believes that the proposed rule would have three main effects on providers with arbitration agreements: (1) they would have increased incentives to comply with the law in order to avoid class litigation exposure; (2) to the extent they do not act on these incentives or acting on these incentives does not prevent class litigation filed against them, the additional class litigation exposure would ultimately result in additional litigation expenses and potentially additional class settlements; and (3) they would incur a one-time cost of changing language in consumer contracts entered into 180 days after the rule's effective date, or an ongoing cost associated with providing contract amendments or notices in the case of providers who acquire pre-existing contracts that lack the required language in their arbitration agreements. Below, the Bureau

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perspectives, at least to the extent that both parties had a choice. However, to the extent that the law was adopted to fix a market failure, this friction is exactly what is preventing that market failure from occurring: the introduction of the contracting friction is necessary for the underlying market failure to be alleviated, as opposed to being a potential source of inefficiency that could be reduced by using boilerplate contracts.

That underlying market failure could be, for example, a negative externality exerted by the firm's and its customer's contract on third parties. In a theoretical model, this would imply that the laws were endogenously chosen to correct pre-existing market failures. And this fact means that an ability to sign an efficient contract from the bilateral perspective that lowers the incentives to comply with the law is welfare-reducing since this law was supposedly passed exactly to ensure that the incentive to comply with the law is there and because this incentive alleviates another market failure.



refers to these three effects as, respectively, the deterrence effect, the additional litigation effect, and the administrative change effect.

In this Section 1022(b)(2) Analysis, the Bureau abides by standard economic practice, and omits non-economic considerations which the Bureau considers above in Part VI (the Findings). In standard economic practice, individuals' well-being results primarily from tangible impacts and is affected by direct costs or payments, changes in behavior, and so on. Conceptually, it also includes less concrete impacts on individuals, such as their "degree of aesthetic fulfillment, their feelings for others, or anything else they might value, however intangible."<sup>562</sup> However, such items can be extraordinarily difficult to discern and evaluate in practice. Moreover, economic theory does not generally recognize the value of intangible impacts to society at large apart from costs or benefits that accrue to specific individual consumers or providers.<sup>563</sup>

To take one example specific to this rulemaking, the economic conception of well-being would count any value that consumers derive from perceiving class settlements as indications that justice is being served and the rule of law is being upheld, but it would not recognize as an economic benefit any value to society at large from justice being served.<sup>564</sup> And in practice, with regard to the value that individual consumers derive from such considerations, the Bureau is

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<sup>562</sup> Kaplow & Shavell, *supra* note 553 at 968.

<sup>563</sup> "Conversely, welfare economics omits any factor that does not affect any individual's well-being." *Id.*

<sup>564</sup> *Id.* at 975 ("[P]eople might feel upset if wrongdoers escape punishment, quite apart from any view people might have about the effect of punishment on the crime rate.").

unaware of any applicable studies that would allow the Bureau to assess the strength of this value separate and apart from deterrence, relief, or other tangible benefits.<sup>565</sup>

Another example would be the impact on some consumers of lost privacy that could result when providers would be required to send redacted arbitration records about them to the Bureau. Unlike the impact on consumers when their data becomes public in a data breach, the impact of the lost privacy that the proposed rule could create is generally something that, if it exists, the Bureau does not have the ability to assess meaningfully, especially given the nature of the proposed redactions. And, as discussed above with the value that consumers may derive from the rule of law being upheld, the Bureau is unaware of any applicable studies that would allow the Bureau to assess the strength of this privacy value.

Accordingly, while as discussed in Part VI above, the Bureau believes that the proposal is in public interest due, in part, to reinforcing the rule of law, the discussion in this section considers the standard economic concept of individual well-being and focuses in particular on more tangible impacts on individual consumers and providers that are readily ascertainable in the framework under which the Bureau is assessing the costs and benefits of the proposed rule for purposes of this Section 1022(b)(2) Analysis.<sup>566</sup>

### *The Deterrence Effect*

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<sup>565</sup> See, e.g., Christopher Anderson & Louis Putterman, *Do Non-Strategic Sanctions Obey the Law of Demand? The Demand for Punishment in the Voluntary Contribution Mechanism*, 54 *Games and Econ. Beh.* 1 (2006); Jeffrey Carpenter, *The Demand for Punishment*, 62 *J. of Econ. Beh. & Org.* 522 (2007) for two examples of such studies using lab experiments with college students.

<sup>566</sup> The Bureau has discretion in any rulemaking to choose an appropriate scope of analysis with respect to potential benefits and costs. In this rulemaking, the Bureau, as a matter of discretion, has chosen to focus on the tangible, economic impacts on individual consumers and providers.

As discussed above, class litigation exposure provides a deterrence incentive to providers, above and beyond other incentives they may have to comply with the law. So long as the level of class litigation exposure is related to the level of providers' compliance with laws (that is, so long as class litigation is not brought randomly without regard to the level of compliance and thus is meritless in general), providers would want to ensure more compliance than if there was no threat of class litigation.<sup>567</sup> Given the Bureau's assumptions outlined above, economic theory suggests that providers who are immune from class litigation currently under-comply from the economic welfare perspective, and therefore this additional deterrence is beneficial.<sup>568</sup> For this purpose, both the cost of class relief and the cost of related litigation is counted as contributing to the size of the strengthened compliance incentives.<sup>569</sup>

At least two sources might inform a provider's determination of its profit-maximizing level of compliance in a regime in which there is potential class action exposure for non-compliance. First, the potential exposure can cause a provider to devote increased resources to monitoring and evaluating compliance, which can in turn lead the provider to determine that its compliance is not sufficient given the risk of litigation. Second, the potential exposure to class litigation can cause a provider to monitor and react to class litigation or enforcement actions (that could result in class litigation) against its competitors, regardless of whether the provider previously believed that its compliance was sufficient.

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<sup>567</sup> See, e.g., Kaplow & Shavell *supra* note 553 at 1166, ("In many areas of law... a primary reason to permit individuals to sue is that the prospect of suit provides an incentive for desirable behavior in the first instance.").

<sup>568</sup> See Gary Becker, *Crime and Punishment: An Economic Approach*, 76 J. Pol. Econ. 169 (1968). See also Shapiro, *supra* note 556; Posner, *supra* note 550. See discussion above on why other incentives to comply, such as public enforcement and reputation, are often insufficient or could be made more effective and efficient by introducing private enforcement as well.

<sup>569</sup> See Kaplow & Shavell, *supra* note 553.

### *The Additional Litigation Effect*

A class settlement could result in three types of relief to consumers: (1) cash relief (monetary payments to consumers); (2) in-kind relief (free or discounted access to a service); and (3) injunctive relief (a commitment by the defendant to alter its behavior prospectively, including the commitment to stop a particular practice or follow the law).

When a class action is settled, the payment from the provider to consumers is intended to compensate class members for injuries suffered as a result of actions asserted to be in violation of the law and is a benefit to those consumers. However, this benefit to consumers is also a cost to providers.<sup>570</sup> This payment from the provider to consumers in and of itself is, in economic terms, a transfer,<sup>571</sup> regardless of whether this payment is a remedy for a legal wrong or restitution of providers' previous ill-gotten gains from consumers that led to the class action in the first place. To effectuate the transfer there are also other costs involved, such as spending on attorneys (both the plaintiff's and the defendant's) and providers' management and staff time, making any such transfer payment in and of itself (*i.e.*, absent any consideration of its deterrent impact) economically inefficient.<sup>572</sup> These costs are incurred both in cases with an eventual class settlement and in cases that ultimately are dismissed by motion, abandoned, or settled on an

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<sup>570</sup> There might also be an associated increase in prices due to firms passing on the cost of these payments back to consumers. See the discussion on pass-through below.

<sup>571</sup> "Benefit and cost estimates should reflect real resource use. Transfer payments are monetary payments from one group to another that do not affect total resources available to society." Office of Mgmt. & Budget, Exec. Office of the President, Circular A-4, Regulatory Analysis, (Sept. 17, 2003) at 38, available at <https://www.whitehouse.gov/sites/default/files/omb/assets/omb/circulars/a004/a-4.pdf>. See Richard Posner, *Cost-Benefit Analysis: Definition, Justification, and Comment on Conference Papers*, 29 J. of Leg. Studies 1153, 1155 (Univ. of Chi. Press 2000) ("In the discussion at the conference John Broome offered as a counterexample to the claim that efficiency in the Kaldor-Hicks sense is a social value the forced uncompensated transfer of a table from a poor person to a rich person. I agree that allowing the transfer would not improve social welfare in any intelligible sense. But it would not be Kaldor-Hicks efficient when one considers the incentive effects.").

<sup>572</sup> As noted above, these other costs still contribute to the deterrence incentive.

individual basis, although the magnitude of the costs may vary depending upon how a case is resolved.<sup>573</sup> Thus, economic theory views class actions that result solely in cash relief as inefficient (*i.e.*, absent any consideration of its deterrent impact). More generally, under standard economic theory, any delivery system for formal or informal compensation of victims for violations of law is typically inefficient unless this system of remedies deters at least some of these violations before they occur.

Much of the discussion above also applies to in-kind and injunctive relief. In-kind relief is intended to compensate class members for injuries suffered as a result of actions asserted to be in violation of the law in ways other than by directly providing them with money. Injunctive relief is typically intended to stop or alter the defendant's practices that were asserted to be in violation of law. Both forms of relief benefit consumers. However, this benefit to consumers is also frequently a cost to providers (*e.g.*, if the practice that the provider agrees to halt was profitable, the loss of that profit is a cost to the provider). To effectuate the relief there are some similar transaction costs involved as with monetary relief, such as spending on attorneys (both the plaintiff's and the defendant's) and providers' management time.

Unlike with monetary relief, however, the benefits to consumers of in-kind and injunctive relief may not be a mirror image of the costs to providers, and the cost of providing the relief might be lower than consumer's value of receiving the relief.<sup>574</sup> In that event, litigation could be viewed as efficient from the perspective of economic theory independent of any deterrent effect.

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<sup>573</sup> Given the Bureau's assumptions outlined above, because of these costs, from the perspective of economic theory, the best outcome is the one where the possibility of class litigation results in optimal compliance, and this optimal compliance in turn results in no actual class litigation occurring.

<sup>574</sup> This is more likely to be the case where there were also pre-existing negotiation frictions that prevented a Coasian outcome. The Coase Theorem, applied to this context, postulates that a firm provides a service to its

### *The Administrative Change Effect*

The proposed class rule would mandate that providers with arbitration agreements include a provision in their future contracts stating that the provider cannot use the arbitration agreement to block a class action. This administrative change would require providers to incur expenses to change their contracts going forward, and amend contracts they acquire or provide a notice.<sup>575</sup> However, there would also be benefits related to this proposed requirement: any eventual litigation could proceed more smoothly due to the lack of need for courts or arbitrators to analyze whether the Bureau's rule indeed applies in the particular case (to the extent that the provider has complied with the proposed rule's language requirement). The new contract language could reduce legal fees and the time spent in court for both parties in class litigations. Moreover, to the extent providers adopt arbitration agreements that comply, attorneys would not need to be familiar with the Bureau's rule to know that an arbitration agreement could not be invoked in class litigation.

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customer if and only if the customer values the service more than its costs. When the Coase Theorem holds, such a delivery system of formal or informal relief will typically be inefficient, since the efficiency of the interaction between the firm and its consumer would have already been maximized before any relief occurred. As noted in Ronald Coase, *The Problem of Social Cost*, 3 J. of L. & Econ. 1 (1960), absent transaction costs, the Coase Theorem holds. However, again as Coase notes, presence of transaction costs might result in such a solution not materializing.

In general, economic theory behind optimal choices by firms in such contexts is ambiguous, at least as long as a solution consistent with the Coase Theorem is not available because of a particular pre-existing market friction (transactions costs). See, e.g., A. Michael Spence, *Monopoly, Quality & Regulation*, 6 Bell J. of Econ. 417 (1975). For a somewhat more accessible treatment (at a cost of assuming away several issues), see Richard Craswell, *Passing on the Cost of Legal Rules: Efficiency and Distribution in Buyer-Seller Relationships*, 43 Stan. L. Rev. 361 (1991).

<sup>575</sup> As discussed further below, providers like debt buyers or indirect auto lenders would need to provide notices to consumers upon purchase of consumer debt with an arbitration agreement that does not adhere to the proposed rule's mandated provision.

## *B. Potential Benefits and Costs to Covered Persons*

### *Overview*

Given that providers using arbitration agreements have chosen to do so and would be limited in their ability to continue doing so by the proposed rule, these providers are unlikely to experience many notable benefits from the Bureau's proposed rule.<sup>576</sup> Rather, the benefits of the proposed rule would flow largely to consumers, as discussed in detail in the next part of this section.

Providers' costs correspond directly to the three aforementioned effects of the proposed rule: (1) providers would experience costs to the extent they act on additional incentives for ensuring more compliance with the law; (2) providers would spend more to the extent that the exposure to additional class litigation materializes into additional litigation; and (3) providers would incur a one-time administrative change cost or ongoing amendment or notices costs. The Bureau considers each of these effects in turn. To the extent providers would pass these costs through to consumers, providers' costs would be lower. Providers' pass-through incentives are discussed further below.

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<sup>576</sup> The Bureau believes that it is possible that some providers without arbitration agreements would benefit from the proposed rulemaking. Their rivals' costs would increase, and thus providers without arbitration agreements benefit to the extent that cost increase is passed through to consumers (or to the extent rivals change their aggressive practices). See Salop and Scheffman, *Raising Rivals' Costs*, 73 Am. Econ. Rev. 267 (1983). However, the Bureau believes that the magnitude of this benefit is relatively low. In addition, the Bureau acknowledges that these providers without arbitration agreements would lose the option going forward to adopt an arbitration agreement that could be invoked in class litigation. As discussed above, economic theory treats a constraint on a party's options as imposing costs on that party, though given that these providers currently do not have arbitration agreements, the Bureau believes that the magnitude of this cost is also relatively low. Thus, for the ease of presentation and due to the low magnitude of these benefits and costs, the Bureau focuses its analysis only on providers that currently have arbitration agreements.

### *Covered Persons' Costs Due to Additional Compliance*

Persons exposed to class litigation have a significant monetary incentive to avoid class litigation. The proposed rule would prohibit providers from using arbitration agreements to limit their exposure to class litigation. As a result, providers may attempt to lower their class litigation exposure (both the probability of being sued and the magnitude of the case if sued) in a multitude of other ways. All of these ways of lowering class litigation exposure would likely require incurring expenses or forgoing profits. The investments in (or the costs of) avoiding class litigation described below, and other types of investments for the same purpose, would likely be enhanced by monitoring the market and noting class litigation settlements by the competitors, as well as actions by regulators. Providers would also likely seek to resolve any uncertainty regarding the necessary level of compliance by observing the outcomes of such litigation. These investments might also reduce providers' exposure to public enforcement.

The Bureau has previously attempted to research the costs of complying with Federal consumer financial laws as a general matter, and found that providers themselves often lack the data on compliance costs.<sup>577</sup> Even if basic data were available on how much money providers invest in legal compliance generally – as distinct from investments in customer service, general risk management, and related undertakings and functions – it is difficult to isolate the marginal compliance costs related to particular deterrence and to quantify any additional investment that would occur in the absence of arbitration agreements. Specifically, any differences in

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<sup>577</sup> See Bureau of Consumer Fin. Prot., *Understanding the Effects of Certain Deposit Regulations on Financial Institutions' Operations* (2013), available at [http://files.consumerfinance.gov/f/201311\\_cfpb\\_report\\_findings-relative-costs.pdf](http://files.consumerfinance.gov/f/201311_cfpb_report_findings-relative-costs.pdf), for challenges in general and for a description of the amount of resources spent collecting compliance information from seven banks with respect to their compliance to parts of four regulations. A significant part of the challenge is that providers typically do not track their compliance costs and it is not possible to calculate them from the standard accounting metrics.



compliance-related expenditures between firms that have and do not have arbitration agreements may be the result of other underlying factors such as a general difference in risk tolerance and management philosophy. Thus, given the data within its possession, the Bureau is unable to quantify these costs. The Bureau again requests comment and data, if available.

The Bureau believes that, as a general matter, the proposed rule would increase some providers' incentives to invest in additional compliance. The Bureau believes that the additional investment would be significant, but cannot predict precisely what proportion of firms in particular markets would undertake which specific investments (or forgo which specific activities) described below.

However, economic theory offers general predictions on the direction and determinants of this effect. Whether and how much a particular provider would invest in compliance would likely depend on the perceived marginal benefits and marginal costs of investment. For example, if the provider believes that it is highly unlikely to be subject to class litigation and that even then the amount at stake is low (or the provider is willing to file for bankruptcy if necessary to ward off a case), then the incentive to invest is low. Conversely, if the provider believes that it is highly likely to be subject to class litigation and that the amount at stake would be large if it is sued, then the incentive to invest is high.

Providers' calculus on whether and how much to invest in compliance may also be affected by the degree of uncertainty over whether a given practice is against the law, as well as the size of the stakes. Where uncertainty levels are very high and providers do not believe that they can be reduced by seeking guidance from legal counsel or regulators or by forgoing a risky practice that creates the uncertainty, providers may have less incentive to invest in lowering class litigation exposure under the logic that such actions will not make any difference in light of the

residual uncertainty about the underlying law. In the limit, if a provider believes that class litigation is completely unrelated to compliance, then the provider will rationally not invest in lowering class litigation exposure at all: the deterrence effect is going to be absent. Nonetheless, the Bureau believes that many providers know that class litigation is indeed related to their actual compliance with the law and adherence to their contracts with consumers.<sup>578</sup> Moreover, because court cases, rulemakings, and other regulatory activities address areas of legal uncertainty over time, the Bureau believes that providers at a minimum would have incentives to respond to class litigation against them and their competitors and to respond to other new legal developments as they occur.

#### *Examples of Investments in Avoiding Class Litigation*

Providers who decide to make compliance investments might take a variety of specific actions with different cost implications. First, providers might spend more on general compliance management. For example, upon the effective date of the rule, if finalized, a provider might decide to go through a one-time review of its policies and procedures and staff training materials to minimize the risks of future class litigation exposure. This review might result in revisions to policies and additional staff training. There might also be an ongoing component of costs arising from periodic review of policies and procedures and regularly updated training for employees, as well as third-party service providers, to mitigate conduct that

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<sup>578</sup> This is hard to measure empirically and the Bureau requests comments on or submissions of any empirical studies that have measured the merit of class actions involving consumer financial products or services. The Bureau is aware of some empirical literature on this question involving securities but does not believe that this literature directly applies in this context. See, e.g., Joel Seligman, *The Merits Do Matter: A Comment on Professor Grundfest's "Disimplying Private Rights of Action Under the Federal Securities Laws: The Commission's Authority,"* 108 Harv. L. Rev. 438 (1994).

could create exposure to class litigation.<sup>579</sup> Moreover, there might be additional costs to the extent that laws change, class litigation cases are publicized, or new products are developed. Both the one-time and the ongoing components could also include outside audits or legal reviews that the provider might perform.

Second, providers might incur costs due to changes in the consumer financial products or services themselves. For example, a provider might conclude that a particular feature of a product makes the provider more susceptible to class litigation, and therefore decide to remove that feature from the product or to disclose the feature more transparently, possibly resulting in additional costs or decreased revenue. Similarly, a provider might update its product features based on external information, such as actions against the provider's competitors by either regulators or private actors. The ongoing component could also include changes to the general product design process. Product design could consume more time and expense due to additional rounds of legal and compliance review. The additional exposure to class litigation could also result in some products not being developed and marketed primarily due to the risk associated with class litigation.

Some of the compliance changes that providers might make are relatively inexpensive changes in business processes that nonetheless are less likely to occur in the absence of class litigation exposure. Three examples of such investments in compliance follow. First, under the Fair Debt Collection Practices Act, debt collectors are not allowed to contact a consumer at an unusual time or place which the collector knows or should know to be inconvenient to the

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<sup>579</sup> The providers that already have a compliance management system with an audit function could, for example, increase the frequency and the breadth of audits.

consumer.<sup>580</sup> However, it is highly unlikely that even a consumer who is aware of this rule will bring an individual lawsuit or an individual arbitration over a single contact because it will require considerable time on the consumer's part, which is likely to be an even higher burden for consumers subject to debt collection than for other types of consumers. To the extent that a debt collector wants to minimize class litigation exposure, however, it could develop a procedure to avoid such contacts.

As a second example, consider a bank stopping an Automated Clearing House (ACH) payment to a third party at a consumer's request. While important to a consumer, absent the possibility of class litigation, the bank's primary incentive to ensure that the ACH payment is discontinued is to maintain a positive reputation with this particular consumer.<sup>581</sup> It is highly unlikely that a consumer would sue individually if the bank fails to take action, and it might even be unlikely that the consumer would switch to another bank because of that failure, especially given the switching costs entailed in such a move. However, a bank could invest in developing proper procedures to ensure that such payments are stopped at most three business days after a consumer's request as required under prevailing law.

The third example is a creditor sending a consumer an adverse action notice explaining the reasons for denial of a credit application.<sup>582</sup> While knowing when and why a denial has occurred may be important to an individual consumer, it is unlikely that a consumer would bring an individual suit based on the failure to provide such a notice (some consumers will not even know they are entitled to one) or on its content (consumers will not generally be in a position to

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<sup>580</sup> 15 U.S.C. 1692(a)

<sup>581</sup> A bank would have to stop such payments in at most three business days after a consumer's request. *See* 15 U.S.C. 1693e(a).

<sup>582</sup> A creditor would have to send such a notice. *See* 15 U.S.C. 1681m(a).

know whether the reason given is legally sufficient or accurate). The consumer is more likely to seek credit from another source, or simply to proceed unaware of the reasons why they are not able to access credit. However, a creditor could invest in improving its notice procedures and content.

*Covered Persons' Costs Due to Additional Class Litigation: Description of Assumptions Behind Numerical Estimates*

Additional investments in compliance are unlikely to eliminate additional class litigation completely, at least for some providers.<sup>583</sup> Thus, if the class proposal is finalized, those providers that are sued in a class action would also incur expenses associated with additional class litigation. The major expenses to providers in class litigation are payments to class members and related expenses following a class settlement, plaintiff's legal fees to the extent that the provider is responsible for paying them following a class settlement, the provider's legal fees and other litigation costs (in all cases regardless of how it is resolved), and the provider's management and staff time devoted to the litigation.

To provide an estimate of costs related to class settlements of incremental class litigation that would be permitted to proceed under the proposed rule, the Bureau developed estimates using the data underlying the Study's analysis of Federal class settlements over five years (2008-12), the Study's analysis of arbitration agreement prevalence, and additional data on arbitration agreement prevalence collected by the Bureau through outreach to trade associations in several

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<sup>583</sup> For example, as noted above, some providers might choose to forgo sufficient additional investment in compliance.

markets during the development of this proposal.<sup>584</sup> The Bureau had classified each case in the Study by the North American Industry Classification System (NAICS) code that most closely corresponded to the consumer financial product or service at issue in the case.<sup>585</sup>

To estimate the impact of the rule the Bureau used the Study data to estimate the percentage of providers in each market with an arbitration agreement today. The Bureau assumed that the class settlements that occurred involved providers without an arbitration agreement. The Bureau was then able to calculate the incidence and magnitude of class action settlements for those providers in each market and use these calculations to estimate the impact of the proposed rule going forward in each market if the providers who currently have arbitration agreements were no longer insulated from class actions.

The Bureau's estimation of additional Federal class litigation costs is based upon the set of Federal class settlements analyzed in the Study, with adjustments to align those data with the

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<sup>584</sup> See generally Study, *supra* note 2, sections 2 and 8. During the SBREFA process, the Bureau sought and obtained permission from OMB to conduct a survey of trade groups (and potentially providers) in order to assess the prevalence of arbitration agreements in the markets for which prevalence was not reported in the Study. Unless the trade groups had an exact estimate, the Bureau asked the trade group representatives to pick one of four options for the prevalence of arbitration agreements in a given market, with the percentages in the brackets also mentioned: (1) barely any providers use arbitration agreements [0 percent-20 percent]; (2) some providers but fewer than half use arbitration agreements [20 percent-50 percent]; (3) more than half but not the vast majority use arbitration agreements [50 percent-80 percent]; and (4) the vast majority use arbitration agreements [80 percent-100 percent]. The Bureau then inquired whether this number would change if the question had been asked to just small providers. For the markets for which prevalence was analyzed in the Study, the Bureau converted the estimate from the Study into one of these four ranges. Finally, the Bureau utilized the midpoint of each range for this quantification exercise (for example, assuming that 35 percent of providers use arbitration agreements if the trade group reported that some, but less than half [20 percent-50 percent] of providers use arbitration agreements). See Part IX below for further description of the data received from the trade groups.

Any inaccuracy in the prevalence numbers affects the estimates below. For example, if prevalence is actually higher in a particular market than the number used by the Bureau, then the actual costs to providers (and benefits to consumers) would be higher. In this example, the increases in across all markets costs to providers and benefits to consumers (stemming from the relief to class members) are not necessarily symmetric, since the Bureau's estimates are market-by-market.

<sup>585</sup> See U.S. Census Bureau, *North American Industry Classification System* (2012), available at <http://www.census.gov/eos/www/naics/>.

scope of the proposed rule, which is somewhat narrower.<sup>586</sup> The Study sought to identify all class action settlements involving any of the enumerated consumer financial statutes under Title X of the Dodd-Frank Act. The proposed rule is narrower in scope. Due to its narrower scope, the proposed rule would only have an impact on those entities within the proposed coverage when they offer products and services subject to the proposed rule, rather than the broader scope of the research of Federal class actions in the Study. Additionally, the proposed rule would not have an impact on cases in which arbitration agreements cannot play a role today, either because the law does not allow them to be used for the type of dispute at issue or that type of dispute does not involve a written contract with the consumer on which the defendant in the case could rely to invoke arbitration.<sup>587</sup> The set of Federal class settlements the Bureau uses to estimate impact therefore excludes 117 Federal class settlements analyzed in Section 8 of the Study.<sup>588</sup> In addition, to avoid underestimating the effects, the estimates in this section of the proposed rule also include 10 additional class settlements identified through the Section 8 search methodology which may be within the scope of the proposed rule and affected by it but which had not been counted in the data analyzed in Section 8.

The resulting set of 312 cases used to estimate impact of the proposed rule on Federal class litigation are identified in Appendix A hereto, along with a list of the 117 excluded cases described above in Appendix B. The Bureau notes that the total amount of payments and

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<sup>586</sup> The Study's Section 8 analyzed class settlements of claims under enumerated consumer laws, unless excluded as described in the methodology for Section 8. *See* Study, *supra* note 2, Appendix S at 129. In addition, class settlements of claims concerning consumer financial products or services more generally were included, even if claims were not raised under enumerated consumer laws. *Id.*

<sup>587</sup> Persons offering or providing similar products or services might be covered by the proposed rule in some circumstances; the Bureau's estimates are not a legal determination of coverage.

<sup>588</sup> *See* Appendices A and B hereto for additional details on adjustments in three other cases.

attorney's fees – the two statistics that the Bureau uses for its estimates in this Section 1022(b)(2) Analysis – for the 312 cases are not materially different than the totals for the aforementioned cases from the 419 used in the Study. That is largely a function of the fact that the additions and subtractions were for the most part relatively small class actions that did not contribute materially to the amount of aggregate gross or net relief.

With regard to the Bureau's estimations overall, the accuracy of the estimates is limited by the difficulty that often arises in data analysis of disentangling causation and correlation, namely unobserved factors that can affect multiple outcomes. As noted above, the core assumptions underlying the Bureau's estimates are that the settlements identified in the Study were all brought against providers without an arbitration agreement and that providers with arbitration agreements affected by the rule would be subject to class settlements to the same extent as providers without arbitration agreements today. The first assumption is a conservative one: it is likely that some of the settlements involved providers with arbitration agreements that they either chose not to invoke or failed to invoke successfully, in which event the Bureau's incidence estimates here are overstated. On the other hand, similar to issues discussed above with regard to estimating compliance-related expenditures, it may be that some other underlying factor (such as a general difference in risk tolerance and management philosophy) might prompt providers that use arbitration agreements today to take a different approach to underlying business practices and product structures than providers who otherwise appear similar but have never used arbitration agreements. This might make providers who use arbitration agreements today more prone to class litigation than providers who do not, and increase both the costs to providers and benefits to consumers discussed below.



The Bureau also generally assumed for purposes of the estimation that litigation data from 2008 to 2012 were representative of an average five-year period. However, the Bureau recognizes that the Bureau's own creation in 2010 may have increased incentives for some providers to increase compliance investments, although it did not begin enforcement actions until 2012. To the extent that the existence and work of the Bureau, including its supervisory activity and enforcement actions, increased compliance since 2010 in the markets the proposed rule would affect, the estimates of costs to providers and the benefits to consumers going forward would be overestimates.

To provide a more specific illustration of the Bureau's methodology, suppose for example that out of 1,000 providers in a particular market (NAICS code), 20 percent currently use arbitration agreements, and the Bureau found 40 class litigation settlements over five years. That implies that 800 providers ( $1,000 - 1,000 * 20$  percent) did not use arbitration agreements and the overall exposure for these 800 providers was 40 cases total, for a rate of 5 percent ( $40/800$ ) for five years. In turn, this implies that the 200 providers ( $1,000 * 20$  percent) that currently use arbitration agreements would be expected to face, collectively, 10 class settlements in five years ( $200 * 5$  percent), or 2 class settlements per year ( $10/5$ ).<sup>589</sup> The Bureau performs

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<sup>589</sup> These calculations were done by NAICS codes and adjusted for the composition of the debt portfolios at debt collectors. According to the comments made by SERs and other anecdotal evidence, debt collectors currently do not differentiate between debt incurred on contracts with and without arbitration agreements when deciding whether to collect on such debt. Many debts in their portfolios do not involve arbitration agreements and their ability to invoke agreements where they are present in the original credit contracts varies depending on the circumstances. See SBREFA Panel Report, *supra* note 332 at Appendix A. Thus, as discussed above, arguably all debt collectors face the risk of class litigation already. However, as discussed above, they are likely to experience an increase in risk proportional to the share of debt that they are collecting on that currently enjoys arbitration agreement protection. For purposes of this calculation, the Bureau assumed that 53 percent of debt collectors' current portfolios are subject to arbitration agreements based on the Study's estimate that 53 percent of the credit card loans outstanding are subject to arbitration agreements. Study, *supra* note 2, section 2 at 7. Thus, the Bureau assumed that the proportion of debt collectors' general portfolios that would be affected by the proposal has a prevalence of arbitration

similar calculations for the monetary exposure in terms of payments to class members and plaintiff's attorney's fees.

In the Study, the Bureau reports both the amount defendants agreed to provide as cash relief (gross cash relief) and the amount that public court filings established a defendant actually paid or was unconditionally obligated to pay to class members because of either submitted claims, an automatic distribution requirement, or a pro rata distribution with a fixed total amount (payments).<sup>590</sup> The Bureau documented about \$2 billion in gross cash relief and about \$1.09 billion in payments.<sup>591</sup> The actual (as opposed to documented by the end date of the Study) payments to consumers from the 419 Federal class settlements in the Study are somewhere between these two numbers. The Bureau uses the documented payments amount (\$1.09 billion in total) as an input in calculating payments to class members in the derivations below. However, accounting for the different scope of the proposed rule results in the aggregate payment amount changing from \$1.09 billion to \$1.07 billion.<sup>592</sup> In contrast, using gross cash relief would roughly double the calculated amount of payments to class members (thus it would double both this cost to providers and the benefit to consumers, but not any other costs to providers such as legal fees).

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agreements on par with credit card debt. The prevalence is likely to be different from 53 percent as there are other sources of debt, for example, payday and medical debt. As with other estimates of prevalence, if 53 percent is an underestimate, then debt collectors would incur more costs (and consumers would experience more benefits).

<sup>590</sup> See Study, *supra* note 2, section 8 at 3-5 and 23-29.

<sup>591</sup> The Bureau notes that the number of class cases litigated, and the corresponding numbers for both gross cash relief and payments vary year-to-year. See Study, *supra* note 2, section 8 at 12, 16, 24, and 27.

<sup>592</sup> The data presented below with respect to a given market is after adding and dropping the aforementioned cases from the 419 used in the Study. The total amount of payments, or other aggregate statistics, did not change materially due to adding and dropping these cases.

The Study documents relief provided to consumers and attorney’s fees paid to attorneys for the consumers,<sup>593</sup> but the Study does not contain data on the defense costs incurred by the providers because these data were not available to the Bureau. The Bureau therefore estimated defendant’s attorney fees based on plaintiff’s attorney’s fees with appropriate adjustments.<sup>594</sup> Specifically, the Bureau believed it was important to account for the fact that while plaintiff’s attorneys are compensated in class actions largely on a contingent basis (and thus not only lose the time value of money but, moreover, face the risk of losing the case and earning nothing), the defendant’s attorneys and the defendant’s staff are often compensated on an hourly or salary basis, and face considerably lower risk. Courts review attorney’s fees in class action settlements for reasonableness. One way courts do this is to first calculate a “lodestar” amount by multiplying the number of hours the attorneys devoted to the case by a reasonable hourly rate, and then adjust that amount by a lodestar multiplier designed to compensate the plaintiff’s attorneys for the risk they took in bringing the case with no guarantee of payment.<sup>595</sup> To the extent that lodestar multipliers incorporate a risk inapplicable to defense costs, the Bureau believes that the proper comparison for the defendant’s cost is the unadjusted plaintiff’s attorney’s fees.

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<sup>593</sup> These fees include other litigation costs such as expert report costs as well as amounts paid for settlement administrator costs. *See* Study, *supra* note 2, Appendix B at 137.

<sup>594</sup> Including other defense costs, such as discovery, and including the provider’s staff and management time (as both staff and management will spend at least some time with their attorneys in defending the case).

<sup>595</sup> For this factor, the Bureau averaged lodestar multipliers from a subset of cases from the Study where the Bureau documented a lodestar multiplier. Plaintiff’s attorney compensation in a class settlement is frequently computed using the time spent on the case, the per-hour rate of the attorneys, all adjusted by the “lodestar multiplier”. The multiplier reflects various considerations, for example, the fact that when plaintiff attorneys do not settle a case, they will frequently not be compensated. *See, e.g.*, Theodore Eisenberg & Geoffrey P. Miller, *Attorney Fees in Class Action Settlements: An Empirical Study*, 1 J. of Emp. Leg. Stud. 27 (2004); Brian Fitzpatrick, *An Empirical Study of Class Action Settlements and Their Fee Awards*, 7 J. of Emp. Leg. Stud. 811 (2010).

By reviewing the cases used in Section 8 of the Study, the Bureau documented lodestar multipliers in about 10 percent of the settlements. The average multiplier across those cases was 1.71, and thus the Bureau uses this number for calculations below.<sup>596</sup> Thus, the Bureau assumes that in all cases the plaintiff's attorney's fees awarded were 171 percent of the base amount, including in cases where the Bureau did not find a lodestar multiplier, which also include the cases where attorneys were compensated based on a percentage of the settlement amount.

The Bureau also notes that the estimates provided below are exclusively for the cost of additional Federal class litigation filings and settlements. The Bureau does not attempt to monetize the costs of additional state class litigation filings and settlements because limitations on the systems to search and retrieve state court cases precluded the Bureau from developing sufficient data on the size or costs of state court class action settlements. Based on the Study's analysis of cases filed, the Bureau believes that there is roughly the same number of class settlements in state courts as there is in Federal courts across affected markets;<sup>597</sup> however, the Bureau generally believes that the amounts at stake are not nearly as large in state courts.<sup>598</sup> The Bureau notes that while the total number of putative class cases filed might be similar in Federal and state courts, the relative frequency of state and Federal class actions may vary in different markets.<sup>599</sup> For example, there might be considerably more putative state class actions filed

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<sup>596</sup> Despite the small sample, this number is consistent with the finding by Professor Fitzpatrick of a 1.65 average. See Fitzpatrick, *supra* note 594, at 834.

<sup>597</sup> The Study found 470 putative Federal class actions filed between 2010 through 2012 versus 92 putative state class actions. However, the state class actions were only for jurisdictions representing 18.1 percent of the U.S. population (92/.181=508). See Study, *supra* note 2, section 6 at 16-17. Note that the scope of Section 6 included six markets, not all the markets that would be affected.

<sup>598</sup> Especially due to the Class Action Fairness Act of 2005, *supra* note 54, which in many cases allows defendants to remove class actions to Federal court when \$5 million or more are at stake and other jurisdictional requirements are met.

<sup>599</sup> See Study, *supra* note 2, section 6 at 19 tbl. 4.

against auto lenders or smaller payday operators than putative Federal class cases. On the other hand, there might be considerably more putative Federal class actions filed against large national banks than putative state class actions.

In some markets, such as the payday loan market, there were Federal class settlements related to debt collection practices, which this Part classifies as relating to the debt collection market.

#### *Covered Persons' Costs Due to Additional Class Litigation*

The Bureau estimates that the proposed rule would create class action exposure for about 53,000 providers (those who fall within the coverage of the proposed rule and currently have an arbitration agreement).<sup>600</sup> Based on the calculation described above, the Bureau's model estimates that this class action exposure would result – on an annual basis – in about 103 additional class settlements in Federal court. In those cases, the Bureau estimates that an additional \$342 million would be paid out to consumers, an additional \$66 million would be paid out to plaintiff's attorneys, and an additional \$39 million would be spent by providers on their own attorney's fees and internal staff and management time.<sup>601</sup>

These numbers should be compared to the number of accounts across the affected markets. While the total number of all accounts across all markets is unavailable, there are, for example, hundreds of millions of accounts in the credit card market alone. Thus, averaged

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<sup>600</sup> See IRFA Analysis below for the data used to arrive at this estimate.

<sup>601</sup> These numbers do not include any estimates from costs or benefits from increased investment in compliance with the law. As discussed above, the Bureau is not estimating those numbers. The Bureau has also performed a sensitivity analysis by using market shares of providers with arbitration agreements in the checking account and credit card markets instead of prevalence that is unadjusted by market share. The Bureau used the numbers reported in Section 2 of the Study for this sensitivity analysis. This other specification changes the results to about 109 additional Federal class settlements, an additional \$475 million paid out to consumers, an additional \$114 million paid out to plaintiff's attorney's fees, and an additional \$67 million for defendants' attorney's fees and internal staff and management time per year.

across all markets, the monetized estimates provided above amount to less than one dollar per account per year. However, this exposure could be higher for particular markets.

The Bureau believes that these providers would enter into a similar number of class settlements in state court; however, with markedly lower amounts paid out to consumers and attorneys on both sides. Many cases also feature in-kind relief.<sup>602</sup> However, as in the Study, the Bureau is unable to quantify this cost in a way that would be comparable with payments to class members. Similarly, injunctive relief could result in substantial forgone profit (and a corresponding substantial benefit to the consumers), but cannot be easily quantified.<sup>603</sup>

The Bureau performed a similar analysis to estimate the number of cases that would be filed as putative class actions, but would not result in a class settlement. Based on the data used in the Study, the Bureau believes that roughly 17 percent of cases that are filed as class litigations end up settling on a classwide basis.<sup>604</sup> For purposes of this estimate the Bureau again assumed that these putative class actions were all brought against providers without an arbitration agreement. This is a conservative assumption; it may be that the very reason that some of these putative class actions were resolved on an individual basis is precisely because of

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<sup>602</sup> See Study, *supra* note 2, section 8 at 4. As in the Study, the Bureau uses the term “in-kind relief” to refer to class settlements in which consumers were provided with free or discounted access to a service. *Id.*, section 8 at 4 n.6. While the Study quantified \$644 million of in-kind relief, that number is included in relief, but not in payments in the Study, and the Bureau continues to follow this approach here, both for the calculation of costs to providers and benefits to consumers.

<sup>603</sup> The Study quantified behavioral relief (defined as a part of injunctive relief) in the Study. The Bureau uses “behavioral relief” to refer to class settlements that contained a commitment by the defendant to alter its behavior prospectively, for example, by promising to change business practices in the future or implementing new compliance programs. The Bureau did not include a simple agreement to comply with the law, without more, as behavioral relief. Study, *supra* note 2, Appendix B at 135. If the Bureau were to count such cases, there would likely be significantly more cases with behavioral relief. As the Bureau notes in the Study, behavioral relief is seldom quantified in case records, and thus the Bureau does not quantify it. Study, *supra* note 2, section 8 at 5 n.10.

<sup>604</sup> The Bureau reported a lower number (12.3 percent) in the Study based on final settlements approved before March 1, 2014, though as noted in the Study, nearly 30 additional cases had a final settlement or proposed class settlement entered as of August 31, 2014. Study, *supra* note 2, section 6 at 7 and 36.

an arbitration agreement. Nonetheless, on this assumption and extrapolating from the estimated 103 additional Federal cases that would be settled on a classwide basis each year, the Bureau estimates that there would be 501 additional Federal court cases filed as class actions that would end up not settling on a classwide basis, assuming no change in filing behavior by plaintiff's attorneys.<sup>605</sup> Some of the Federal cases analyzed in the Study filed as class actions were filed against providers that had an arbitration agreement that applied to the case. Thus, the Bureau believes that such providers already face some exposure, which implies that both the 103 settled class cases and the 501 cases filed as class actions are likely overestimates of Federal court settlements.

In order to estimate the costs associated with these incremental Federal putative class actions, the Bureau notes that the Study showed that an average case filed as a putative class action in Federal court takes roughly 2.5 times longer to resolve if it is settled as a class case than if it is resolved in any other way.<sup>606</sup> The Bureau discusses two potential estimates below and presents the more conservative one in the table below.

For the purposes of the first defense cost estimate, the Bureau assumed that putative class action cases that are not settled on a class basis (for whatever reason) cost 40 percent (1 divided by 2.5) less to litigate. Therefore, the Bureau estimated that these additional 501 Federal class cases that do not settle on a class basis would result in \$76 million per year in defense costs to providers. The Bureau did not include in this estimate recovery amounts in these putative class cases that did not result in a class settlement, as the Bureau believes those are negligible amounts

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<sup>605</sup> The Bureau estimated 102.7 (rounded to 103) additional Federal class settlements. Thus, the calculation for additional Federal cases that would be settled on a classwide basis is  $(102.7/.17)*(1-.17)$ .

<sup>606</sup> See Study, *supra* note 2, section 6 at 46 tbl. 7.

(for example, a few thousand dollars per case that had an individual settlement). Based on similar numbers of Federal and State cases, it is likely that there would also be an additional 501 State cases filed that do not settle on class basis, whose cost the Bureau does not estimate due to the lack of nationally representative data; however, these cases would likely be significantly cheaper for providers.<sup>607</sup>

The Bureau believes that the calculation above might be an overestimate of time spent on such cases because both defendant's and plaintiff's attorneys frequently come to the conclusion, relatively early in the case, that the case will not result in a class settlement. Once such a conclusion is reached, the billable hours incurred by either side (in particular the defense) are likely significantly lower than for a case that is headed towards a class settlement, even if the final outcome of the two cases might be achieved in comparable calendar time. Similarly, many cases are resolved before discovery or motions on the pleadings; such cases are cheaper to litigate. In other words, at some point early in many putative class actions, the case becomes effectively an individual case (in terms of how the parties and their counsel treat the stakes of it), and from that point on, its cost should be comparable to the cost of an individual case (as opposed to a case settled on a classwide basis). The calculation above assumes that this point of transition to an individual case is the last day of the case.

In contrast, the opposite assumption is that from the first day of the case the parties (in particular, the defense) know that the case is not going to be settled on a classwide basis. Using this assumption, the 501 cases cost as much to defend as 501 individual cases. Using \$15,000

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<sup>607</sup> For the sensitivity analysis using market share prevalence data for checking account and credit card markets, the results are additional 530 Federal class cases that do not settle on class basis result in \$130 million in costs to providers.



per individual case as a defense cost estimate, the cost of these 501 cases would be approximately \$8 million per year.<sup>608</sup> Thus, the Bureau believes that the correct estimate is somewhere between \$8 and \$76 million per year. For the purposes of clearer presentation, the Bureau conservatively presents the \$76 million number in the table below.

The Bureau notes that for several markets the estimates of additional Federal class action settlements are low.<sup>609</sup> These low estimates could reflect some combination of the following four possibilities. First, as noted above, in some markets class actions are more commonly filed in state courts. Second, it is possible that in some markets, where there is less uncertainty, additional investment in compliance might result in no class actions filed.<sup>610</sup> Third, in some markets, by their nature, there will be few claims that can proceed as class actions, regardless of arbitration agreements, because there are not common issues that are predominant or because the market is highly dispersed. Fourth, in some markets the current prevalence of arbitration agreements is so high (over 80 percent) that any estimates are especially imprecise.

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<sup>608</sup> While the \$15,000 figure is hard to estimate, this estimate is consistent with data received from one of the SERs during the SBREFA process. See SBREFA Panel Report, *supra* note 332 at 18.

<sup>609</sup> As further discussed in Part IX below, a number of other markets are covered, but not sufficiently affected to the point that the Bureau would estimate the number of affected persons. The Bureau likewise does not generally include rows in the Federal class settlement estimate table for those markets.

<sup>610</sup> Although as the Bureau's estimates suggest, this is unlikely to be the case in many markets.

**Table 1: Five-Year Summary of Estimated Additional Federal Class Action Settlements**

NAICS	Description	Number of Lawsuits (data)	Total Payment (data)	Attorney Fees (data)	Prevalence (data)	Additional Federal Class Settlements (estimate)	Additional Total Payments (estimate)	Additional Attorney Fees (estimate)	Additional Defense Fees (estimate)	Additional Federal Class Cases Settled as Individual (estimate)	Additional Fees Due to Federal Class Cases Settled as Individual (estimate)
522298	Other nondepository credit, Pawnshops	0	0	0	0.1	0	0	0	0	0	0
541990	Credit Counseling and Debt Relief	4	\$ 5,591,756	\$ 3,379,013	0.65	7	\$ 10,384,690	\$ 6,275,310	\$ 3,679,151	36	\$ 7,185,166
561440	Debt Collectors	234	\$ 56,848,405	\$ 28,002,831	0.53	264	\$ 64,105,648	\$ 31,577,660	\$ 18,513,666	1,288	\$ 36,156,100
522110	Depository Institutions, Research Organization (LexisNexis), Student accounts, Student Loan Servicing	34	\$ 556,721,398	\$ 256,518,784	0.1	4	\$ 61,857,933	\$ 28,502,087	\$ 16,710,488	18	\$ 32,634,600
522291	P2P Lending, Other Personal Loans, Student Loan Issuance - Private, Third Party Payment Processing, Consumer Lending, Commercial Banking	4	\$ 86,154,716	\$ 11,149,054	0.9	36	\$ 775,392,444	\$ 100,341,486	\$ 58,829,207	176	\$ 114,889,981
561450	Credit Reporting Agencies, Credit Monitoring, Homeowners Insurance, Life Insurance (also includes NAICS 524126)	6	0	\$ 5,428,000	0.65	11	0	\$ 10,080,571	\$ 5,910,138	54	\$ 11,542,152
522210	Credit Cards, Consumer Lending	6	\$ 277,041,928	\$ 59,410,000	0.1	1	\$ 30,782,436	\$ 6,601,111	\$ 3,870,165	3	\$ 7,558,205
522320	Other Personal Loans, Other Money Transmitters / Remittances, Prepaid Cards, Payment Processing/Transfers, ACH systems, Check Guarantee, Third Party Financial Service Providers, Mobile Payments	3	\$ 2,911,654	\$ 8,450,000	0.35	2	\$ 1,567,814	\$ 4,550,000	\$ 2,667,619	8	\$ 5,209,704
522390	Payday Loan, Tribal Lending, Refund Anticipation Check, Deposit Advance, Servicing (non-mortgage), Virtual Currency, Traveler's Checks, Check Cashing, Mobile wallets, Debt Settlement/Relief, Marketplace loans, Tax Lending, Lump Sum Payment Company (payment advance)	1	\$ 56,770	\$ 57,780	0.9	9	\$ 510,930	\$ 520,020	\$ 304,883	44	\$ 595,418
522220	Installment Lending, Auto Title, Auto Finance, Truck/Boat/RV Finance, Non-Auto Consumer Product Leasing (also includes NAICS 532120)	12	\$ 84,935,366	\$ 6,752,360	0.9	108	\$ 764,418,294	\$ 60,771,237	\$ 35,629,567	527	\$ 69,582,449
441120	Buy-Here Pay-Here Auto Dealers	1	\$ 100,000	\$ 180,000	0.9	9	\$ 900,000	\$ 1,620,000	\$ 949,790	44	\$ 1,854,884
517110	Telephone - landline, Cable television, Cable Providers (First Party), Cell phones (also includes NAICS 517210)	7	\$ 29,775	\$ 8,991,981	0.9	63	\$ 267,975	\$ 80,927,826	\$ 47,447,173	308	\$ 92,661,538
<b>Total</b>		<b>312</b>	<b>\$ 1,070,391,768</b>	<b>\$ 388,319,802</b>		<b>514</b>	<b>\$ 1,710,188,164</b>	<b>\$ 331,767,309</b>	<b>\$ 194,511,848</b>	<b>2,507</b>	<b>\$ 379,870,197</b>
<b>Per year</b>						<b>103</b>	<b>\$ 342,037,633</b>	<b>\$ 66,353,462</b>	<b>\$ 38,902,370</b>	<b>501</b>	<b>\$ 75,974,039</b>

The Bureau notes that providers might attempt to manage the risks of increased class litigation exposure by opting for more comprehensive insurance coverage or a higher reimbursement limit. However, the Bureau is not able to model the impacts of insurance in providers' response to the proposed rule. During the Small Business Review Panel, the SERs reported that it often is not clear to them which type of class litigation exposure a policy covers nor was it clear that providers typically ask about this sort of coverage. The SERs explained that their coverage is often determined on a more specialized case-by-case basis that limits at least small providers' ability to plan ahead. Larger firms may have more sophisticated policies and more systematic understanding of their coverage, however, or they may self-insure. Finally, the insurance providers might require at least some of the changes to compliance and products discussed above as a prerequisite for coverage or for a discounted premium.

#### *Covered Persons' Costs Due to the Administrative Change Expense*

Providers that currently have arbitration agreements (or who purchase contracts with arbitration agreements that do not include the Bureau's language) would also incur administrative expenses to make the one-time change to the arbitration agreement itself (or a notice to consumers concerning the purchased contract). Providers are likely to incur a range of costs related to these administrative requirements.

The Bureau believes that providers that currently have arbitration agreements would manage and incur these costs in one of three ways. First, the Bureau believes that some providers rely exclusively on third-party contract forms providers with which they already have a relationship, and for these providers the cost of making the required changes to their contracts is negligible (*e.g.*, downloading a compliant contract from the third party's website, with the form likely being either inexpensive or free to download).

Second, there might be providers that perform an annual review of the contracts they use with consumers. As a part of that review (provided it comes before the proposed rule becomes effective), they would either revise their arbitration agreements or delete them, whether or not most of these contracts are supplied by third-party providers. For these providers, it is also unlikely that the proposed rule would cause considerable incremental expense of changing or taking out the arbitration agreement insofar as they already engage in a regular review, as long as this review occurs before the rule becomes effective.

Third, there are likely to be some providers that use contracts that they have highly customized to their own needs (relative to the first two categories above) and that might not engage in annual reviews. These would require a more comprehensive review in order to either change or remove the arbitration agreement.

The Bureau believes that smaller providers are likely to fall into the first category. The Bureau believes that the largest providers would fall into either the second or the third category. On average across all categories, the Bureau believes that the average provider's expense for the administrative change to be about \$400. This consists of approximately one hour of time from a staff attorney or a compliance person and an hour of supporting staff time. Given the Bureau's estimate of approximately 48,000 providers that use arbitration agreements,<sup>611</sup> the proposal's required contractual change would result in a one-time cost of \$19 million, or about \$4 million

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<sup>611</sup> See the Regulatory Flexibility Analysis below at Part IX. The Bureau estimates that 4,500 debt collectors would be subject to the rule but would not incur this cost because they do not act as the original provider of consumer financial products and services, and thus are unlikely to have contracts directly with the consumers with whom they interact.

per year total for all providers if amortized over five years.<sup>612</sup> Alternatively, providers might choose to drop arbitration agreements altogether, potentially resulting in lower administrative costs.

In addition to the one-time change described directly above, some providers could be affected on an ongoing or sporadic basis in the future as they acquire existing contracts as the result of regular or occasional activity, such as a merger. Under proposed § 1040.4(a)(2), that would require providers who become a party to an existing contract with a pre-dispute arbitration agreement that does not already contain the language mandated by proposed § 1040.4(a)(2) to amend the agreement to include that provision, or send the consumer a notice indicating that the acquirer would not invoke that pre-dispute arbitration agreement in a class action.<sup>613</sup> Various markets might incur different costs due to this proposed requirement.

For example, buyers of medical debt could incur additional costs due to additional due diligence they would undertake to determine which acquired debts arise from consumer credit transactions (that would be subject to the proposed rule), or alternatively by the additional exposure created from sending consumer notices on debts that did not arise from credit transactions (*i.e.*, potential over-compliance). The Bureau does not believe that the cost of sending such a notice would be burdensome to the buyers of medical debt. In particular, the Bureau believes that medical debt buyers typically send out a notice to the consumer upon acquisition of debt due to requirements of 15 U.S.C. 1692(g), when applicable. The Bureau

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<sup>612</sup> Some providers have multiple contracts: for example, some of the credit card issuers have filed dozens of contracts with the Bureau, *see* <http://www.consumerfinance.gov/credit-cards/agreements/>. Presumably, the marginal cost of changing each additional contract would be minimal, as long as each of the contracts used the same dispute resolution clause.

<sup>613</sup> The Bureau believes that medical debt buyers would be the most affected by this provision.

believes that these debt buyers could attach the additional notice that would be required by the proposed rule to this required FDCPA notice with a minimal increase in costs.

Indirect auto lenders might face a somewhat different impact. While a loan purchased from an auto dealer would be from a credit transaction, the dealer's contract might contain an arbitration agreement that does not include the language specified by the Bureau because the dealer would not be a provider under the rule. However, the Bureau believes that because dealers would be aware that their partner indirect auto lenders would be subject to the proposed rule, it is likely that dealers would voluntarily change their contracts to streamline the process for indirect auto lenders.

#### *Costs to Covered Persons from the Proposed Requirements Regarding Submission of Arbitral Records*

There would also be a minor cost related to the proposed rule's requirements regarding sending records to the Bureau related to providers' arbitrations. In the Study, the Bureau documented significantly fewer than 1,000 individual arbitrations per year.<sup>614</sup> Given that the proposed rule's requirements would involve sending records related to a particular arbitration to the Bureau, it is unlikely that the transmittal requirement would impose a cost of more than \$100 per arbitration – a conservative estimate for the time required to copy or scan the documents, locate the address where to send the documents, and any postage costs. To the extent covered persons would be required to redact specific identifiers (such as name, physical and email address, phone number, account number, and social security number), this cost might increase,

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<sup>614</sup> See generally Study, *supra* note 2, section 5. Relatedly, JAMS (the second largest provider of consumer arbitrations) reported about 114 consumer financial products or services arbitrations in 2015.

conservatively, by a few hundred dollars on average due to the time to train the staff on the specific identifiers and the time to redact the documents, for each arbitration.<sup>615</sup> Thus, the total cost of the proposed arbitration submission requirements is unlikely to reach \$1 million per year given the current frequency of individual arbitrations. Moreover, these costs could be lower to the extent that providers decide not to use arbitration agreements in response to the rule.

#### *Potential Pass-Through of Costs to Consumers*

The Bureau believes that most providers would pass through at least portions of some of the costs described above to consumers. This pass-through can take multiple forms, such as higher prices to consumers or reduced quality of the products or services they provide to consumers. The rate at which firms pass through changes in their marginal costs onto prices (or interest rates) charged to consumers is called the pass-through rate.<sup>616</sup>

A pass-through rate of 100 percent means that an increase in marginal costs would not be absorbed by the providers, but rather would be fully passed through to the consumers.<sup>617</sup>

Conversely, a pass-through rate of 0 percent would mean that consumers would not see a price

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<sup>615</sup> One of the SERs on the SBREFA Panel projected 2 to 6 hours of staff time. See SBREFA Panel Report, *supra* note 332 at 25.

<sup>616</sup> In some markets the provider does not have a direct relationship with the consumer, and thus the pass-through if any will be indirect. In other markets, providers are already charging a price at the usury limit, and thus would not be able to pass through any cost onto price.

<sup>617</sup> Even where providers pass on 100 percent of their costs, they may lose volume and thus experience lower profits. With regard to the proposal, however, in markets where arbitration agreements are extremely widespread, this would depend on the extent to which the market's aggregate demand curve is elastic. In other words, the entities' profits would decrease in proportion to the fraction of consumers who would stop buying the consumer financial products or services if most or all firms were to increase their prices at the same time. The Bureau is unaware of reliable estimates of this elasticity for the covered markets, with the exception of the credit card market, where such a loss would unlikely be significant given the likely modest per-consumer magnitude of the marginal cost increase. See David Gross & Nicholas Souleles, *Do Liquidity Constraints and Interest Rates Matter for Consumer Behavior? Evidence from Credit Card Data*, 149 Q. J. of Econ. 117 (2002). To the extent that credit cards and mortgages are indicative of other markets for consumer financial products and services, this effect is unlikely to be significant. See, e.g., Andreas Fuster & Basit Zafar, *The Sensitivity of Housing Demand to Financing Conditions: Evidence from a Survey* (Fed. Reserve Board of N.Y.C., Staff Rept. No. 702, 2015), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2535912](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2535912).

increase due to the proposal. As noted above, the monetized estimates of additional Federal class settlements above amount to less than one dollar per account per year when averaged across markets (however, it is possible that the number is higher for some markets). Thus, even 100 percent pass-through of the monetized costs of additional Federal class settlements in every market would result in an increase in prices of under one dollar per account per year when averaged across all markets.

Determining the extent of pass-through involves evaluating a trade-off between volume of business and margin (the difference between price and marginal cost) on each customer served. Any amount of pass-through increases price, and thus lowers volume. A pass-through rate below 100 percent means that a firm's margin per customer is lower than it was before the provider had to incur the new cost. Economic theory suggests that, without accounting for strategic effects of competition, the pass-through rate ends up somewhere in between the two extremes of: (1) no pass-through (and thus completely preserving the volume at the expense of lowering margin) and (2) full pass-through (completely preserving the margin at the expense of lowering volume).<sup>618</sup> For a case of a monopolist with a linear demand function (a price increase of a dollar results in the same change in quantity demanded regardless of the original price level) and constant marginal cost (each additional unit of output costs the same to produce as the previous unit), the theory predicts a pass-through rate of 50 percent. The rate would be higher or

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<sup>618</sup> It is theoretically possible to have a pass-through rate of over 100 percent, even without accounting for strategic effects of competition. These strategic effects tend to drive up the pass-through rate even higher. *See, e.g.,* Jeremy Bulow & Paul Pfleiderer, *A Note on the Effect of Cost Changes on Prices*, 91 *J. of Polit. Econ.* 182(1983),); Rajeev Tyagi, *A Characterization of Retailer Response to Manufacturer Trade Deals*, 36 *J. of Mktg. Res.* 510 (1999); E. Glen Weyl & Michal Fabinger, *Pass-Through as an Economic Tool: Principles of Incidence under Imperfect Competition*, 121 *J. of Pol. Econ.* 528 (2013); Alexei Alexandrov & Sergei Koulayev, *Using the Economics of the Pass-Through in Proving Antitrust Injury in Robinson-Patman Cases*, 60 *Antitrust Bull.* 345 (2015).



lower depending on how demand elasticity and economies of scale change with higher prices and lower outputs.<sup>619</sup> To the extent that a provider's fixed costs change, economic theory indicates that the profit-maximizing response is not to pass that change onto prices.

Economic theory does not provide useful guidance about what the magnitude of the pass-through of marginal cost is likely to be with regard to the proposed rule. The Bureau believes that providers might treat the administrative costs as fixed. Whether the costs due to additional compliance are marginal depends on the exact form of this spending, but most examples discussed above would likely qualify as largely fixed. The Bureau believes that providers might treat a large fraction of the costs of additional class litigation as marginal: payments to class members, attorney's fees (both defendant's and plaintiff's), and the cost of putative class cases that do not settle on a class basis. The extent to which these marginal costs are likely to be passed through to consumers cannot be reliably predicted, especially given the multiple markets affected. Empirical studies are mostly unavailable for the markets covered. Empirical studies for other products, mainly consumer package goods and commodities, do not produce a single estimate.<sup>620</sup>

The available pass-through estimates for the consumer financial products or services are largely for credit cards, where older literature found pass-through rates of close to 0 percent.<sup>621</sup>

More recently, researchers have analyzed the effects of regulation that effectively imposed price

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<sup>619</sup> In other words, these rates depend on curvatures (concavity/convexity) of cost and demand functions.

<sup>620</sup> See, e.g., RBB Economics, *Cost Pass-Through: Theory, Measurement, and Potential Policy Implications, A Report Prepared for the Office of Fair Trading*, (Feb. 2014), available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/320912/Cost\\_Pass-Through\\_Report.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/320912/Cost_Pass-Through_Report.pdf).

<sup>621</sup> See Lawrence Ausubel, *The Failure of Competition in the Credit Card Market*, 81 Am. Econ. Rev. 50 (1991); but see Todd Zywicki, *The Economics of Credit Cards*, 3 Chap. L. Rev. 79 (2000); Daniel Grodzicki, *Competition and Customer Acquisition in the U.S. Credit Card Market* (Working Paper, 2015), available at: [https://editorialexpress.com/cgi-bin/conference/download.cgi?db\\_name=IIOC2015&paper\\_id=308](https://editorialexpress.com/cgi-bin/conference/download.cgi?db_name=IIOC2015&paper_id=308).

ceilings on late payment and overlimit fees on credit cards and interchange fees on debit cards. These researchers, by-and-large, found evidence consistent with low to non-existent pass-through rates in these markets.<sup>622</sup> However, these findings do not necessarily imply low pass-through in other markets that would be affected by the proposed rule, as providers in different markets are likely to face cost and demand curves of different curvatures.

More directly related to the proposal, the Study analyzed the effect on prices of several large credit card issuers agreeing to drop their arbitration agreements for a period of time as a part of a class settlement.<sup>623</sup> The Bureau did not find a statistically significant effect on the prices that these issuers charged subsequent to the contract changes, relative to other large issuers that did not have to drop their arbitration agreements. To the extent that this finding implies low or non-existent price increases, it could be due to several reasons other than a low general industry pass-through rate. For example, issuers may have priced as if the expected litigation exposure was a fixed cost or as if most of the cost was expected to be due to investment in more compliance (and would be treated as a fixed cost).<sup>624</sup> The result also might not be representative for other issuers.

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<sup>622</sup> See Sumit Agarwal, Souphala Chomsisengphet, Neale Mahoney & Johannes Stroebel, *Regulating Consumer Financial Products: Evidence from Credit Cards*, 130 Q. J. of Econ. 1 (2015); Benjamin Kay, Mark Manuszak & Cindy Vojtech, *Bank Profitability and Debit Card Interchange Regulation: Bank Responses to the Durbin Amendment* (Fed. Reserve Board, Working Paper No. 2014-77, 2014), available at <http://www.federalreserve.gov/econresdata/feds/2014/files/201477pap.pdf>. But see Todd Zywicki, Geoffrey Manne & Julian Morris, *Price Controls on Payment Card Interchange Fees: The U.S. Experience*, (Geo. Mason L. & Econ., Research Paper No. 14-18, 2014), available at [http://papers.ssrn.com/sol3/Papers.cfm?abstract\\_id=2446080](http://papers.ssrn.com/sol3/Papers.cfm?abstract_id=2446080).

<sup>623</sup> See generally Study, *supra* note 2, section 10.

<sup>624</sup> See Study, *supra* note 2, section 10 (for other caveats to this analysis). See also Alexei Alexandrov, *Making Firms Liable for Consumers' Mistaken Beliefs: Theoretical Model and Empirical Applications to the U.S. Mortgage and Credit Card Markets*, Soc. Sci. Res. Network (Sept. 22, 2015).

### *C. Potential Benefits and Costs to Consumers*

#### *Potential Benefits to Consumers*

Consumers would benefit from the proposed class rule to the extent that providers would have a larger incentive to comply with the law; from the class payments in any class settlement that occurs due to a provider not being able to invoke an arbitration agreement in a class proceeding; and, from any new compliance with the law they experience as a result of injunctive relief in a settlement or as a result of changes in practices that the provider adopts in the wake of the settlement to avoid future litigation.<sup>625</sup>

Consumer benefits due to providers' larger incentive to comply with the law are directly related to the aforementioned investments by providers to reduce class litigation exposure. Specifically, consumers would benefit from the forgone harm resulting from fewer violations of law. A full catalog of how all laws applicable to affected products benefit consumers when they are followed is far beyond the scope of this analysis. However, a few examples of types of benefits are offered. These benefits could take a form that is easier to monetize – for example, a credit card issuer voluntarily discontinuing (or not initiating) a charge to consumers for a service that generates \$1 of benefit to consumers for every \$10 paid by consumers; a depository ceasing to charge overdraft fees with respect to transactions for which the consumer has sufficient funds on deposit at the time the transaction settles to cover the transaction; or, a lender ceasing to charge higher rates to minority than non-minority borrowers. Or this could take a form that is harder to monetize – for example, a debt collector investing more in insuring that the correct consumers are called and in complying with various provisions limiting certain types of contacts

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<sup>625</sup> See Part VI for a related discussion.

and calls under the FDCPA and TCPA; or, a creditor taking more time to assure the accuracy of the information furnished to a credit reporting agency or to investigate disputes of that information.

Just as the Bureau is unable to quantify and monetize the investment that providers would undertake to lower their exposure to class litigation, the Bureau is unable to quantify and monetize the extent of the consumer benefit that would result from this investment, or particular subcategories of investment such as improving disclosures, improving compliance management systems, expanding staff training, or other specific activities. The Bureau requests comment on any representative data sources that could assist the Bureau in both of these quantifications.

Consumers would also benefit from class payments that they receive from settlements of additional class actions. According to the calculation above, this benefit would be on the order of \$342 million per year for Federal class settlements, and an unquantified amount in State court settlements.<sup>626</sup>

Moreover, as noted above as well, the Bureau believes that there would also be significant benefits to consumers when settlements include in-kind and injunctive relief.<sup>627</sup> This relief can affect consumers beyond those receiving monetary remediation, including for example future customers of the provider or customers who fall outside of the class action but will stand to benefit from the injunctive relief. The Bureau is not aware of a consistent method of quantifying the total amounts of additional in-kind and injunctive relief from the approximately 103 additional Federal class settlements per year and a similar number of additional State class

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<sup>626</sup> As noted above, the calculation depends on many assumptions, and thus there are many reasons for why this number might be considerably higher or considerably lower.

<sup>627</sup> In a market with transaction costs (not subject to the Coase Theorem), the value of behavioral relief to consumers could be either roughly equal, higher or lower than the value to firms.

settlements.<sup>628</sup> The Bureau requests comment on whether the extent of this benefit, and the associated cost to providers, could be monetized, and if so how.

### *Potential Costs to Consumers*

The cost to consumers is mostly due to the aforementioned pass-through by providers, to the extent it occurs, as discussed above. The Bureau does not repeat this general discussion here.

A second possible impact could occur if some providers decide to remove arbitration agreements entirely from their contracts, although there is no empirical basis to determine the proportion of providers that would do so. Assuming that some providers would remove these agreements, some consumers who can currently resort to arbitration for filing claims against providers would no longer be able to do so if the provider is unwilling to engage in post-dispute arbitration. The Bureau is unable to determine empirically whether individual arbitration is more beneficial to consumers than individual litigation, and if so the magnitude of the additional consumer benefit of arbitration.<sup>629</sup> However, given that the Study found only several hundred individual arbitrations per year involving consumer financial products or services, the Bureau

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<sup>628</sup> One easier quantification to make is in the class settlement analysis in Section 8 of the Study where 13 percent of the settlements featured behavioral relief and 6 percent featured in-kind relief. Accordingly, out of the additional 103 cases, a reasonable quantification is that 13 percent will feature behavioral relief and 6 percent will feature in-kind relief. As noted above, while the Study quantified \$644 million of in-kind relief, that number is included in relief, but not in payments in the Study, and the Bureau continues to follow this approach here, both for the calculation of costs to providers and benefits to consumers. Similarly, as noted above, the Study did not include promises to obey the law going forward as specific enough to count toward behavioral relief, suggesting that injunctive relief overall is likely higher.

<sup>629</sup> See Study, *supra* note 2, section 6 at 2. Existing empirical evidence compiled by scholars prior to the Study mainly concerns employment, franchisee, and security arbitrations (note that FINRA rules require an option of class action in any arbitration agreement). The Bureau does not believe that these data are necessarily applicable to consumer financial products and services. Even that evidence is also largely inconclusive. See, e.g., Theodore Eisenberg & Elizabeth Hill, *Arbitration and Litigation of Employment Claims: An Empirical Comparison*, 58 *Disp. Res. J.* 44 (2004) (finding no statistical differences in a variety of outcomes between individual arbitration and individual litigation). See also Peter Rutledge, *Whither Arbitration?*, 6 *Geo. J. of L. & Pub. Pol'y* 549 at 557-9, (2008) (discussing several studies that compared outcomes in individual arbitration and individual litigation, typically showing comparable outcomes in the two fora). The Bureau notes that these and other similar comparative studies should be interpreted carefully for reasons stated in the Study. See Study, *supra* note 2, section 6 at 2-5.

believes that the magnitude of consumer benefit, if any, of individual arbitration over individual litigation would need to be implausibly large for some, or even all, providers that eliminated their arbitration agreements to make a noticeable difference to consumers in the aggregate.

In short, if a consumer initiates a formal dispute relating to a consumer financial product or service, it is possible that the consumer would fare somewhat better in individual arbitration than in individual litigation.<sup>630</sup> However, in practice, this comparison is not material for the analysis of consumer benefits and costs since consumers do not initiate formal individual disputes involving consumer financial products or services in notable numbers in any forum: the Bureau documented hundreds of individual arbitrations versus millions of consumers receiving relief through class actions.<sup>631</sup>

Moreover, the stakeholder feedback that the Bureau has received so far suggests that if any provider dropped arbitration agreements entirely, the decision could be a result of the provider not finding it cost-effective to support a dual-track system of litigation (on a class or putative class basis) and individual arbitrations. However, the Study shows that providers often do not invoke arbitration agreements in individual lawsuits,<sup>632</sup> and thus providers are already operating in such a dual-track system. Thus, the Bureau lacks sufficient information to believe that most, or even any, providers would indeed drop arbitration agreements altogether rather than adopting the Bureau's language if the rule is finalized as proposed. The Bureau requests comment on both providers' incentives to drop arbitration agreements altogether and on

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<sup>630</sup> Similarly, it is possible that the consumer would fare somewhat worse in individual arbitration than in individual litigation.

<sup>631</sup> If anything, the Study shows considerably more individual litigation (in Federal and in small claims courts) than individual arbitration. *See generally*, Study, *supra* note 2, sections 5 and 6.

<sup>632</sup> Study, *supra* note 2, section 1 at 15.

quantification of consumer benefit or cost of individual arbitration over and above individual litigation.

As discussed above, at least some providers might decide that a particular feature of a product makes the provider more susceptible to class litigation, and therefore the provider would decide to remove that feature from the product. A provider might make this decision even if that feature is actually beneficial to consumers and does not result in legal harm to consumers. In this case, consumers would incur a cost due to the provider's over-deterrence with respect to this particular decision. The Bureau is not aware of any data showing this theoretical phenomenon (over-deterrence) to be prevalent among providers who currently do not have an arbitration agreement or likely among providers who would be required to forgo using their arbitration agreement to block class actions. The Bureau requests comment on the extent of this phenomenon in the context of the proposed rule, and it specifically requests data and suggestions about how to quantify both the prevalence of this phenomenon and the magnitude of consumer harm if the phenomenon exists.

#### *D. Impact on Depository Institutions with No More Than \$10 Billion in Assets*

The prevalence of arbitration agreements for large depository institutions is significantly higher than that for smaller depository institutions.<sup>633</sup> Moreover, while more than 90 percent of depository institutions have no more than \$10 billion in assets, about one in five of the class settlements with depository institutions in the Study involved depository institutions under this threshold (approximately one class settlement per year). The magnitude of these settlements, measured by payments to class members, was also considerably smaller than settlements with

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<sup>633</sup> See generally Study, *supra* note 2, sections 2.

institutions above the threshold: the aggregated documented payments to class members from all cases that involve depository institutions with less than \$10 billion in assets was under \$2 million over the five years analyzed in the Study.

Thus, using the same method discussed above to estimate additional class settlements (and putative class cases) among depository institutions with no more than \$10 billion in assets suggests that the proposed rule would have practically no effect that could be monetized. Specifically, the calculation predicts approximately one additional Federal class settlement and about three putative Federal class cases over five years involving depositories below the \$10 billion threshold if the proposed rule is finalized.

However, there might be other ways in which impacts on smaller depository institutions, and smaller providers in general, would differ from impacts on larger providers. The Bureau describes some of these in this Section 1022(b)(2) Analysis.

One possibility might be that the managers of smaller providers (depository institutions or otherwise) are sufficiently risk averse, or generally sensitive to payouts, such that putative class actions have an *in terrorem* effect. To the extent this occurs, small providers may settle any such additional lawsuits for more than the expected value of an award if the case were likely to be certified as a class case and go to trial. However, the Study found that it is most common for class action settlements to be reached before a court has certified a case as a class case. Moreover, as noted above, the amount of any such settlement should be lower for smaller providers given the smaller magnitude of the case and the lower number of consumers affected. In addition, as noted above, the Bureau estimates the number of additional class lawsuits in general against small depository institutions to be extremely low. In particular, the Bureau believes that out of the 312 cases (over five years) that are used for the estimates of the impact



on the number of Federal class settlements, about one Federal class settlement per year involved smaller institutions (either depository or non-depositories) paying over \$1,000,000 to class members.

There is a significant amount of academic finance literature suggesting that management should not be risk averse, unless the case involves a possibility of a firm going bankrupt in case of a loss.<sup>634</sup> However, management of smaller providers, regardless of whether they are depository institutions, might be more risk averse because their shareholders or owners might be less diversified.

The bargaining theory literature generally suggests that the party with deeper pockets and relatively less at stake will be the party that gets the most out of the settlement.<sup>635</sup> It follows that smaller defendants might fare worse in terms of the settlements relative to their larger peers, all else being equal. However, from anecdotal evidence, the Bureau believes that, if the smaller defendants are sued at all, they are likely to be sued by smaller law firms. This could equalize bargaining power (as a smaller law firm might not be able to afford to be too aggressive even in a single proceeding) or tilt bargaining power more to a smaller defendant's side relative to their larger peers defending against larger law firms.

Finally, given the considerably lower frequency of class litigation for smaller providers, it is possible that it is not worth the cost for smaller providers to invest in lowering class litigation

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<sup>634</sup> See, e.g., Clifford Smith & René Stulz, *The Determinants of Firms' Hedging Policies*, 20 J. Fin. & Quantitative Analysis 391 (1985).

<sup>635</sup> More generally, economic theory suggests that the side that is more patient is going to get a better deal, all else being equal. For the canonical economic model of bargaining, see Ariel Rubinstein, *Perfect Equilibrium in a Bargaining Model*, 50 *Econometrica* 97 (1982).

exposure. This might also explain the relatively lower frequency of arbitration agreement use by smaller depositories.

#### *E. Impact on Rural Areas*

Rural areas might be differently impacted to the extent that rural areas tend to be served by smaller providers, as discussed above with regard to depository institutions with less than \$10 billion in assets and below with regard to providers of all types that are below certain thresholds for small businesses. In addition, markets in rural areas might also be less competitive.

Economic theory suggests that less competitive markets would have lower pass-through with all else being equal; therefore, if there were any price increase due to the proposed rule, it would be lower in rural areas.<sup>636</sup>

#### *F. Impact on Access to Consumer Financial Products and Services*

Given hundreds of millions of accounts across affected providers and the numerical estimates of costs above, the expected additional marginal costs due to additional Federal class settlements to providers are likely to be negligible in most markets. Each of the product markets affected has hundreds of competitors or more. Thus, the Bureau does not believe that this proposed rule would result in a noticeable impact on access to consumer financial products or services.

The Bureau does not believe that access to consumer financial products or services would be diminished due to effects on providers' continuing viability or, as discussed below in Part IX, due to effects on providers' access to credit to facilitate the operation of their businesses. It is possible that consumers might experience temporary access concerns if their particular provider

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<sup>636</sup> See Weyl and Fabinger, *supra* note 623 and Alexandrov and Koulayev, *supra* note 623.

was sued in a class action. These concerns might become permanent if such litigation significantly depleted the provider's financial resources, potentially resulting in the provider exiting the market.

Of course, the incentive for a class counsel to pursue a case to the point where it would cause a defendant's bankruptcy is low because this would leave little, or no, resources from which to fund a remedy for consumers in a class settlement or any fees for the class counsel and could make the process longer. In addition, the potential consumers of this provider presumably have the option of seeking this consumer financial product or service from a different company that is not facing a class action, and thus a bankruptcy scenario is substantially more of an issue for the particular provider affected than for the provider's consumers. Moreover, especially given the low prevalence of cases against smaller providers outlined above and the amounts of documented payments to class members, the Bureau does not believe that out of the Federal class settlements analyzed in the Study, many settlements threatened the continued existence of the defendant and the resulting access to credit.

## **IX. Regulatory Flexibility Analysis**

The Regulatory Flexibility Act (RFA) generally requires an agency to conduct an initial regulatory flexibility analysis (IRFA) and a final regulatory flexibility analysis (FRFA) of any rule subject to notice-and-comment rulemaking requirements.<sup>637</sup> These analyses must “describe the impact of the proposed rule on small entities.”<sup>638</sup> An IRFA or FRFA is not required if the

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<sup>637</sup> 5 U.S.C. 601, *et seq.*

<sup>638</sup> 5 U.S.C. 603(a). For purposes of assessing the impacts of the proposed rule on small entities, “small entities” is defined in the RFA to include small businesses, small not-for-profit organizations, and small government jurisdictions. 5 U.S.C. 601(6). A “small business” is determined by application of Small Business Administration regulations and reference to the North American Industry Classification System (NAICS) classifications and size

agency certifies that the proposed rule will not have a significant economic impact on a substantial number of small entities.<sup>639</sup> The Bureau also is subject to certain additional procedures under the RFA involving the convening of a panel to consult with small entity representatives prior to proposing a rule for which an IRFA is required.<sup>640</sup>

The Bureau is not certifying that the proposed rule would not have a significant economic impact on a substantial number of small entities within the meaning of the RFA. Accordingly, the Bureau convened and chaired a Small Business Review Panel under the Small Business Regulatory Enforcement Fairness Act (SBREFA) to consider the impact of the proposed rule on small entities that would be subject to that rule and to obtain feedback from representatives of such small entities. The Small Business Review Panel for this proposed rule is discussed in the SBREFA Panel Report.

Among other things, this IRFA estimates the number of small entities that will be subject to the proposed rule and describes the impact of the proposed rule on those entities. Throughout this IRFA, the Bureau draws on the Section 1022(b)(2) Analysis above.

Despite not certifying that the proposed rule would not have a significant economic impact on a substantial number of small entities at this time, the Bureau believes that the arguments and calculations outlined both in the Section 1022(b)(2) Analysis, as well as the arguments and calculations that follow, strongly suggest that the proposed rule would indeed not have a significant economic impact on a substantial number of small entities in any of the

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standards. 5 U.S.C. 601(3). A “small organization” is any “not-for-profit enterprise which is independently owned and operated and is not dominant in its field.” 5 U.S.C. 601(4). A “small governmental jurisdiction” is the government of a city, county, town, township, village, school district, or special district with a population of less than 50,000. 5 U.S.C. 601(5).

<sup>639</sup> 5 U.S.C. 605(b).

<sup>640</sup> 5 U.S.C. 609.

covered markets. The Bureau is requesting comment on the assumptions and methodology used, and on potential certification if the proposed rule is finalized.

In preparing this proposed rule and this IRFA, the Bureau has carefully considered the feedback from the SERs participating in the SBREFA process and the findings and recommendations in the SBREFA Panel Report. The Section-by-Section analysis of the proposed rule, above in Part VII, and this IRFA discuss this feedback and the specific findings and recommendations of the Small Business Review Panel, as applicable. The SBREFA process provided the Small Business Review Panel and the Bureau with an opportunity to identify and explore opportunities to minimize the burden of the proposed rule on small entities while achieving the proposed rule's purposes. As in other Bureau's rulemakings, it is important to note, however, that the Small Business Review Panel prepared the SBREFA Panel Report at a preliminary stage of the proposal's development and that the SBREFA Panel Report – in particular, the Small Business Review Panel's findings and recommendations – should be considered in that light. The proposed rule and this IRFA reflect further consideration, analysis, and data collection by the Bureau.

Under RFA section 603(a), an IRFA “shall describe the impact of the proposed rule on small entities.”<sup>641</sup> Section 603(b) of the RFA sets forth the required elements of this IRFA. Section 603(b)(1) requires this IRFA to contain a description of the reasons why action by the agency is being considered.<sup>642</sup> Section 603(b)(2) requires a succinct statement of the objectives of, and the legal basis for, the proposed rule.<sup>643</sup> This IRFA further must contain a description of

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<sup>641</sup> 5 U.S.C. 603(a).

<sup>642</sup> 5 U.S.C. 603(b)(1).

<sup>643</sup> 5 U.S.C. 603(b)(2).

and, where feasible, an estimate of the number of small entities to which the proposed rule will apply.<sup>644</sup> Section 603(b)(4) requires a description of the projected reporting, recordkeeping, and other compliance requirements of the proposed rule, including an estimate of the classes of small entities that will be subject to the requirement and the types of professional skills necessary for the preparation of the report or record.<sup>645</sup> In addition, the Bureau must identify, to the extent practicable, all relevant Federal rules which may duplicate, overlap, or conflict with the proposed rule.<sup>646</sup> Furthermore, the Bureau must describe any significant alternatives to the proposed rule which accomplish the stated objectives of applicable statutes and which minimize any significant economic impact of the proposed rule on small entities.<sup>647</sup> Finally, as amended by the Dodd-Frank Act, RFA section 603(d) requires that this IRFA include a description of any projected increase in the cost of credit for small entities, a description of any significant alternatives to the proposed rule which accomplish the stated objectives of applicable statutes and which minimize any increase in the cost of credit for small entities (if such an increase in the cost of credit is projected), and a description of the advice and recommendations of representatives of small entities relating to the cost of credit issues.<sup>648</sup>

*1. Description of the Reasons Why Agency Action Is Being Considered and Succinct Statement of the Objectives of, and Legal Basis For, the Proposed Rule*

As the Bureau outlined in the SBREFA Panel Report and discussed above, the Bureau is considering a rulemaking because it is concerned that consumers do not have sufficient

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<sup>644</sup> 5 U.S.C. 603(b)(3).

<sup>645</sup> 5 U.S.C. 603(b)(4).

<sup>646</sup> 5 U.S.C. 603(b)(5).

<sup>647</sup> 5 U.S.C. 603(b)(6).

<sup>648</sup> 5 U.S.C. 603(d)(1); Dodd-Frank section 1100G(d)(1).

opportunity to obtain remedies when they are legally harmed by providers of consumer financial products and services, because arbitration agreements effectively block consumers from participating in class proceedings. The Bureau is also concerned that by blocking class actions, arbitration agreements reduce deterrent effects and compliance incentives in connection with the underlying laws. Finally, the Bureau is concerned about the potential for systemic harm if arbitration agreements were to be administered in biased or unfair ways. Accordingly, the Bureau is considering proposals that would: (1) prohibit the application of certain arbitration agreements regarding consumer financial products or services as to class litigation; and (2) require submission of arbitral claims, awards, and two other categories of documents to the Bureau. This proposed rulemaking is pursuant to the Bureau's authority under sections 1022(b) and (c) and 1028 of the Dodd-Frank Act. The latter section directs the Bureau to study pre-dispute arbitration agreements in connection with the offering or providing of consumer financial products or services and authorizes the Bureau to regulate their use if the Bureau finds that certain conditions are met.<sup>649</sup>

*2. Description and, Where Feasible, Provision of an Estimate of the Number of Small Entities to Which the Proposed Rule Will Apply*

As noted in the SBREFA Panel Report, the Panel identified 22 categories of small entities that may be subject to the proposed rule. These were later narrowed (see discussion and table below with estimates of the number of entities in each market). The NAICS industry and SBA small entity thresholds for these 22 categories are the following:

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<sup>649</sup> 12 U.S.C. 5518(b).

<b>Table 2: SBA Small Entity Thresholds</b>		
<b>NAICS Description</b>	<b>NAICS Code</b>	<b>SBA Small Business Threshold</b>
All Other Nondepository Credit Intermediation	522298	\$38.5m in revenue
All Other Professional, Scientific, and Technical Services	541990	\$15m in revenue
Collection Agencies	561440	\$15m in revenue
Commercial Banking	522110	\$550m in assets
Commodity Contracts Dealing	523130	\$38.5m in revenue
Consumer Lending	522291	\$38.5m in revenue
Credit Bureaus	561450	\$15m in revenue
Credit Card Issuing	522210	\$550m in assets
Direct Life Insurance Carriers	524113	\$38.5m in revenue
Direct Property and Casualty Insurance Carriers	524126	1500 employees
Financial Transactions Processing, Reserve, and Clearinghouse Activities	522320	\$38.5m in revenue
Mortgage and Nonmortgage Loan Brokers	522310	\$7.5m in revenue
Other Activities Related to Credit Intermediation	522390	\$20.5m in revenue
Other Depository Credit Intermediation	522190	\$550m in assets
Passenger Car Leasing	532112	\$38.5m in revenue
Real Estate Credit	522292	\$38.5m in revenue
Sales Financing	522220	\$38.5m in revenue
Truck, Utility Trailer, and RV (Recreational Vehicle) Rental and Leasing	532120	\$38.5m in revenue
Used Car Dealers	441120	\$25m in revenue
Utilities (including Electric Power Generation, Transmission, and Distribution of Electric Power, Natural Gas, Water / Sewage, and other systems)	221	between \$15–\$27.5m in revenue or 250–1000 employees
Wired Telecommunications Carriers	517110	1500 employees
Wireless Telecommunications Carriers (except Satellite)	517210	1500 employees

For purposes of assessing the impacts of the proposals under consideration on small entities, “small entities” are defined in the RFA to include small businesses, small nonprofit



organizations, and small government jurisdictions that would be subject to the proposals under consideration. A “small business” is defined by the SBA Office of Size Standards for all industries through the NAICS.

To arrive at the number of entities affected, the Bureau began by creating a list of markets that would be covered if the proposals under consideration were to be adopted. The Bureau assigned at least one, but often several, NAICS codes to each market. For example, while payday and other installment loans are provided by storefront payday stores (NAICS 522390), they are also provided by other small businesses, such as credit unions (NAICS 522120). The Bureau estimated the number of small firms in each market-NAICS combination (for example, storefront payday lenders in NAICS 522390 would be such a market-NAICS combination), and then the Bureau added together all the markets within a NAICS code if there is more than one market within a NAICS code, accounting for the potential overlaps between the markets (for example, probably all banks that provide payday-like loans also provide checking accounts, and the Bureau does not double-count them, to the extent possible given the data).

The Bureau first attempted to estimate the number of firms in each market-NAICS combination by using administrative data (for example, Call Reports that credit unions have to file with the NCUA). When administrative data was not available, the Bureau attempted to estimate the numbers using public sources, including the Bureau’s previous rulemakings and impact analyses. When neither administrative nor other public data was available, the Bureau used the Census’s NAICS numbers. The Bureau estimated the number of small businesses

according to the SBA's size standards for NAICS codes (when such data was available).<sup>650</sup>

When the data was insufficient to precisely estimate the number of businesses under the SBA threshold, the Bureau based its estimate for the number of small businesses on the estimate that approximately 95 percent of firms in finance and insurance are small.<sup>651</sup>

NAICS numbers were taken from the 2012 NAICS Manual, the most recent version available from the Census Bureau. The data provided employment, average size, and an estimate of the number of firms for each industry, which are disaggregated by a six-digit ID. Other industry counts were taken from a variety of sources, including other Bureau rulemakings, internal Bureau data, public data and statistics, including published reports and trade association materials, and in some cases from aggregation websites. For a select number of industries, usually NAICS codes that encompass both covered and not covered markets, the Bureau estimated the covered market in this NAICS code using data from websites that aggregate information from multiple online sources. The reason the Bureau relied on this estimate instead of the NAICS estimate is that NAICS estimates are sometimes too broad. For example, the NAICS code associated with virtual wallets includes dozens of other small industries, and would overestimate the actual number of firms affected by an order of magnitude or more.

Although the Bureau attempted to account for overlaps wherever possible, a firm could be counted several times if it participates in different industries and was counted separately in each data source. While this analysis removes firms that were counted twice using the NAICS numbers, some double counting may remain due to overlap in non-NAICS estimates. For the

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<sup>650</sup> The Bureau also used data from the Census Bureau, including the Census Bureau's Statistics of U.S. Businesses.

<sup>651</sup> See Small Business Administration Office of Size Standards, *SBA's Size Standards Analysis: An Overview on Methodology and Comprehensive Size Standards Review*, Presentation of Sharma R. Khem at 4 (2011), available at [http://www.gtscoalition.com/wp-content/uploads/2011/07/Size-Stds-Presentation\\_Dr.-Sharma-SBA.pdf](http://www.gtscoalition.com/wp-content/uploads/2011/07/Size-Stds-Presentation_Dr.-Sharma-SBA.pdf).

NAICS codes that encompass several markets, the Bureau summed the numbers for each of the market-NAICS combinations to produce the table of affected firms.

In addition to estimating the number of providers in the affected markets, the Bureau also estimated the prevalence of arbitration agreements in these markets. The Bureau first attempted to estimate the prevalence of arbitration agreements in each market using public sources.

However, this attempt was unsuccessful.<sup>652</sup> For the markets covered in Section 2 of the Study that provided data on prevalence of arbitration agreements, the Bureau uses the numbers from the Study. The Bureau contacted trade associations to obtain supplemental data for the markets that were not covered in Section 2 of the Study.<sup>653</sup>

The table below sets forth potentially affected markets (and the associated NAICS codes) in which it appears reasonably likely that more than a few small entities use arbitration

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<sup>652</sup> The Bureau attempted to develop a methodology for sampling contracts on the Internet. The methodology involved attempting to sample the contracts of 20 businesses from randomly-selected states and different levels of web search relevance (to alleviate selection biases). However, providers generally do not provide their contracts or terms and conditions online. Even when some contracts are available online in a specific market, providers that provided such information are usually large, national corporations that operated in multiple states. The lack of provider-specific revenue and employment information also makes it hard to determine which of the sampled businesses are small according to the SBA threshold. After attempting this methodology for several markets, the Bureau decided to proceed by contacting trade associations instead. The Bureau attempted the sampling method for the following markets: Currency Exchange, Other Money Transmitters / Remittances, Telephone (Landline) Services, Cable Television. The Bureau also started work on a few other markets before determining that the results are unlikely to be sufficiently representative for the purposes of this analysis.

<sup>653</sup> The Bureau obtained the necessary PRA approval from OMB for the survey. The Bureau contacted national trade associations with a history of representation of providers in the relevant markets. The questions the Bureau posed related to the prevalence of arbitration agreements among providers in this market generally, as opposed to among the members of the trade association. The Bureau uses the prevalence numbers from the Study for checking/deposit accounts, credit cards, payday loans, prepaid cards, private student loans, and wired and wireless telecommunication providers. All other prevalence estimates used in this section and in the Section 1022(b)(2) Analysis are based on this survey of trade associations. In each such market (represented by a separate row in the table below), except credit monitoring and providers of credit reports, we relied on numbers from one trade association for that market. For credit monitoring and providers of credit reports, we received supplemental information from a trade association that we did not survey that lead us to adjust the estimate by averaging the two estimates. For the markets covered by the Study's prevalence analysis, the Bureau adjusted the numbers to fit into the four choices provided in the survey: 0-20 percent, 20-50 percent, 50-80 percent, and 80-100 percent. The prevalence column in the tables in this section and in the Section 1022(b)(2) Analysis provide the midpoint estimate (for example, 10 percent if the answer was 0-20 percent).

agreements. Some affected markets (and associated NAICS codes) are not listed because the number of small entities in the market using arbitration agreements is likely to be insignificant. For example, the Bureau did not list convenience stores (NAICS 445120). While consumers can cash a check at some grocery or convenience stores, the Bureau does not believe that consumers generally sign contracts that contain arbitration agreements with grocery or convenience stores when cashing checks; indeed, this is even less likely for check guarantee (NAICS 522390) and collection (NAICS 561440). For the same reason, currency exchange providers (NAICS 523130) are not listed on the table. The Bureau also did not list department stores (NAICS 4521) because the Bureau does not believe small department stores are typically involved in issuing their own credit cards, rather than partnering with an issuing bank that issues cards in the name of the department store.

Other notable exceptions were Other Depository Credit Intermediation (NAICS 522190) and attorneys who collect debt (NAICS 541110). The Bureau believes that for these codes virtually all providers that are engaged in these activities are already reporting under other NAICS codes (for example, Commercial Banking, NAICS 52211, or collection agencies, NAICS 561440).

In addition, the proposed rule would apply to mortgage referral providers for whom referrals are their primary business. For example, the Bureau estimates that there are 7,007 entities classified as mortgage and nonmortgage brokers (NAICS 522310), 6,657 of which are small.<sup>654</sup> However, the Bureau believes that arbitration agreements are not prevalent in the consumer mortgage market. With respect to brokering of credit more broadly, the Bureau also

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<sup>654</sup> NAICS 522292 is similarly excluded from estimates.

believes that some credit lead generators may be primarily engaged in the business of brokering and would be affected by the rule. The Bureau lacks data on the number of such businesses and the extent to which they are primarily engaged in brokering. The Bureau therefore requests this data and data on the use of contracts and on the prevalence of arbitration agreements by these providers.

Merchants are not listed in the table because merchants generally would not be covered by the proposal, except in limited circumstances. For example, the Bureau believes that most types of financing consumers use to buy nonfinancial goods or services from merchants is provided by third parties other than the merchant or, if the merchant grants a right of deferred payment, this is typically done without charge and for a relatively short period of time. For example, a provider of monthly services may bill in arrears, allowing the consumer to pay 30 days after services are rendered each month. Thus the Bureau believes that merchants rarely offer their own financing with a finance charge, or in an amount that significantly exceeds the market value of the goods or services sold.<sup>655</sup> In those rare circumstances (for example, acting as a TILA creditor due to lending with a finance charge), then the merchants would be covered by the proposal in those transactions (unless, in the case of offering credit with a finance charge, the merchant is a small entity and meets the other requirements of Dodd-Frank section 1027(a)(2)(D)). The Bureau lacks data on how frequently merchants engage in such transactions, whether in the education, health, or home improvement sectors, among others, and on how often pre-dispute arbitration agreements may apply to such transactions. The Bureau requests comment and data on the frequency of these transactions, by industry.

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<sup>655</sup> However, the Bureau includes buy-here-pay-here automobile dealers in the table below.

Similarly, the Bureau does not list utility providers (NAICS 221) because when these providers allow consumers to defer payment for these providers' services without imposing a finance charge, this type of credit is not subject to the proposed rule. In some cases, utility providers may engage in billing the consumer for charges imposed by a third-party supplier hired by the consumer. However, government utilities providing these services to consumers who are located in their territorial jurisdiction would be exempt and, with respect to private utility providers providing these services, the Bureau believes that these private utility providers' agreements with consumers, including their dispute resolution mechanisms, are generally regulated at a State or local level. The Bureau is not aware that those dispute resolution mechanisms provide for mandatory arbitration.<sup>656</sup>

Further, the proposal would apply to extensions of credit by providers of whole life insurance policies (NAICS 524113) to the extent that these companies are ECOA creditors and that activity is not the "business of insurance" under the Dodd-Frank section 1002(15)(C)(i) and 1002(3) and arbitration agreements are used for such policy loans. However, it is unlikely that a significant number of such providers would be affected because a number of state laws restrict the use of arbitration agreements in insurance products and, in any event, it is possible that the loan feature of the whole life policy could be part of the "business of insurance" depending on the facts and applicable law.<sup>657</sup>

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<sup>656</sup> The Bureau notes, for example, that in some situations, such as some consumer disputes heard by state utility regulators, consumers may be required to submit disputes to governmental administrative bodies prior to going to court. If courts review the determinations of those administrative bodies as agency administrative action, rather than an arbitral award, then the Bureau does not believe that processes such as these would be considered "arbitration" under proposed § 1040.2(d).

<sup>657</sup> See, e.g., Kan. Stat. Ann. § 5-401 (2015). These State laws involve interplay between the FAA and the McCarran-Ferguson Act, 15 U.S.C. 6701 *et seq.*

The Bureau also does not believe that a significant number of new car dealers offer or provide consumer financial products or services that render these dealers subject to the Bureau's regulatory jurisdiction. As a result, new car dealers (NAICS 44111) and passenger car leasing companies (NAICS 532112) are not included in the table below; rather, the table covers dealer portfolio leasing and lending with the used car dealer category (NAICS 441120) and indirect auto lenders with the sales financing category (NAICS 522220).

In addition, the Bureau does not believe that it is common for commodities merchants subject to CFTC jurisdiction to extend credit to consumers as defined by Regulation B.<sup>658</sup>

The Bureau does not account for various types of entities that are indirectly affected (and thus would likely not need to change their contracts) and for which the Bureau did not find any Federal class settlements in the Study (and thus would not be significantly affected by additional class litigation exposure). These entities include, for example, billing service providers for providers of merchant credit (third-party servicers NAICS 522390).

Similarly, the Bureau is unaware of the number of software developers (NAICS codes 511210 and 541511) that provide covered consumer financial products or services with arbitration agreements directly to consumers (such as payment processing products) that do not report in the NAICS codes listed either above or in the table below. The Bureau believes that the number of such software developers is low; however, the Bureau requests comment on this issue.

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<sup>658</sup> See U.S. Dept. of Treasury, *Blueprint for a Modernized Financial Regulatory Structure*, at 116 (2008), available at <https://www.treasury.gov/press-center/press-releases/Documents/Blueprint.pdf> (“In general, margin is a very different concept in the futures and securities worlds. In the securities context, margin means a minimum amount of equity that must be put down to purchase securities on credit, while in the futures context margin means a risk-based performance bond system which acts much like a security deposit.”).

Table 3: Estimated Number of Affected Entities by NAICS Code							
Description	NAICS	Markets Affected in This NAICS	Businesses	SBREFA Small Businesses	SBA Small Business Threshold	Percent Estimated to Use Arbitration Agreements <sup>655</sup>	Estimated Midpoint of Businesses Using Arbitration Agreements
All Other Nondepository Credit Intermediation	522298	Other Personal Loans, Pawnshops <sup>656</sup>	10,300	10,086	\$38.5m in revenue	0-20%	1,009
All Other Professional, Scientific, and Technical Services	541990	Credit Counseling	726	715	\$15m in revenue	50-80%	465
Collection Agencies	561440	Debt Collectors	4,500	4,356	\$15m in revenue	100%	4,356
Commercial Banking	522110	Depository Institutions, Student Loan Servicing	13,303	11,608	\$550 million in assets	0-20%	1,161
Consumer Lending	522291	P2P Lending, Other Personal Loans, Student Loan Issuance - Private, Third Party Payment Processing, Consumer Lending, Commercial Banking	6,620	6,416	\$38.5m in revenue	80-100%	5,775
Credit Bureaus and Direct Property and Casualty Insurance Carriers	561450 and 524126	Credit Reporting Agencies, <sup>657</sup> Credit Monitoring, Homeowners Insurance <sup>658</sup>	3,383	3,063	\$550m in assets	0-20%	306
Credit Card Issuing	522210	Credit Cards, Consumer Lending	444	422	\$550m in assets	0-20%	42
Financial Transactions Processing, Reserve, and Clearinghouse Activities	522320	Other Personal Loans, Other Money Transmitters / Remittances, Prepaid Cards, Payment Processing/Transfers, ACH Systems, Third Party Financial Service Providers, Mobile Payments	7,380	6,880	\$38.5m in revenue	20-50%	2,408
Other Activities Related to Credit Intermediation	522390	Payday Loan, Tribal Lending, Refund Anticipation Check, Deposit Advance, Servicing (non-mortgage), Virtual Currency, Money Order, Traveler's Checks, Mobile Wallets, Debt Settlement/Relief, Marketplace Loans, Tax Lending, Lump Sum Payment Company (payment advance)	11,023	10,812	\$20.5m in revenue	80-100%	9,731
Sales Financing and Truck, Utility Trailer, and RV (Recreational Vehicle) Rental and Leasing	522220 and 532120	Installment Lending, Auto Title Lending, Auto Finance, Truck/Boat/RV Finance	10,703	10,056	\$38.5m in revenue	80-100%	9,050
Used Car Dealers	441120	Buy-Here, Pay-Here Auto Dealers <sup>659</sup>	9,156	8,966	\$25m in revenue	80-100%	8,069
Wired and Wireless (except Satellite) Telecommunications Carriers	517110	Telephone - landline, Cable Television, Cable Providers (First Party), <sup>660</sup> Cell Phones <sup>661</sup>	7,756	7,528	1500 employees	80-100%	6,775

*3. Projected Reporting, Recordkeeping, and Other Compliance Requirements of the Proposed Rule, Including an Estimate of the Classes of Small Entities Which Will Be Subject to the Requirement and the Type of Professional Skills Necessary for the Preparation of the Report Reporting Requirements*

The providers that use arbitration agreements would have to change their contracts to state that the arbitration agreements cannot be used to block class litigation. The Bureau believes



that, given that the Bureau is specifying the language that must be used, this can be accomplished in minimal time by compliance personnel, who do not have to possess any specialized skills, and in particular who do not require a law degree.<sup>659</sup> Moreover, the Bureau believes that to the extent small covered entities use contracts from form providers, that task might be done by the providers themselves, requiring a simple check by the small provider's compliance staff to ensure that this has indeed been done. See the last column in the table above for the Bureau's estimate of the number of small providers that use arbitration agreements.

Additionally, as discussed above, debt buyers and other providers who become parties to existing contracts with pre-dispute arbitration agreements that do not contain the required language would be subject to the ongoing requirements of proposed § 1040.4(a)(2), which would require them to issue contract amendments or notices when they become party to a pre-existing contract that does not include the proposed mandated language. As discussed above, the Bureau believes that this cost and the skills required to satisfy this requirement would also be minimal since many of these providers typically send out notices for FDCPA purposes to consumers whose contracts these providers just acquired.

The proposed rule also includes a reporting requirement when covered entities exercise their arbitration agreements in individual lawsuits and in several other circumstances. Given the small number of individual arbitrations in the Study, the Bureau believes that there would be at most a few hundred small covered entities affected by this requirement each year, and most likely considerably fewer since most defendants that participated in arbitrations analyzed by the

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<sup>659</sup> The Bureau is aware that many small providers do not employ dedicated compliance staff, and uses the term broadly to denote any personnel who engage in compliance activities.

Study were large repeat players.<sup>660</sup> Each instance of reporting consists of sending the Bureau already existing documents, potentially redacting specified categories of personally identifiable information pursuant to proposed rule. As discussed above, the Bureau believes that fulfilling the requirement would not require any specialized skills and would require minimal time.

The Bureau requests comment on whether there are any additional costs or skills required to comply with reporting, recordkeeping, and other compliance requirements of the proposed rule that the Bureau had not mentioned here. As noted in its Section 1022(b)(2) Analysis above, the Bureau believes that the vast majority of the proposed rule's impact is due to additional exposure to class litigation and to any voluntary investment (spending) in reducing that exposure that providers might undertake. The Bureau believes that neither of these categories is a reporting, recordkeeping, or other compliance requirement; however, the Bureau discusses them below.

The costs and types of additional investment to reduce additional exposure to class litigation and the components of the cost of additional class litigation itself are described above in the Section 1022(b)(2) Analysis. As noted above, it is difficult to quantify how much all covered providers, including small entities, would invest in additional compliance; that applies to all covered providers.

With respect to additional class litigation exposure, using the same calculation as in the Section 1022(b)(2) Analysis, limited to providers below the SBA threshold for their markets,<sup>661</sup>

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<sup>660</sup> See Study, *supra* note 2, section 5 at 59.

<sup>661</sup> The Bureau attempted to classify defendants of the class settlements from the Study on whether they meet the SBA threshold for a small business in the defendant's market. Some of the markets were relatively easy to classify; for example, the Bureau has the data on depository institutions' assets and that is the only data necessary to determine whether depository institutions are SBA small. Other markets were considerably more difficult, in

the Bureau estimates that the proposed rule would result in about 25 additional Federal class settlements, and in those cases, an additional \$3 million paid out to consumers, an additional \$2 million paid out in plaintiff's attorney's fees, and an additional \$1 million for defendant's attorney's fees and internal staff and management time per year. The Bureau also estimates 121 additional Federal cases filed as class litigation that would end up not settling on class basis, resulting in an additional \$2 million in fees per year. These aggregate \$8 million per year for Federal class litigation should be juxtaposed with an estimated 51,000 providers below the SBA thresholds that use arbitration agreements, resulting in well under a 1 percent chance per year of those entities being subject to a putative Federal class litigation, a much lower chance of any of those cases resulting in a class settlement, and an expected cost of about \$200 per year from Federal class cases per entity.

While the expected cost per provider that the Bureau can monetize is about \$200 per year from Federal class cases, these costs would not be evenly distributed across small providers. In particular, the estimates above suggest that about 25 providers per year would be involved in an additional Federal class settlement – a considerably higher expense than \$200 per year, as noted in the Section 1022(b)(2) Analysis above. In addition, the additional Federal cases filed as class litigation that would end up not settling on class basis (121 per year according to the estimates above) are also likely to result in a considerably higher expense than \$200. However, the vast majority of the 51,000 providers would not experience any of these effects.

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particular debt collectors. The Bureau used trade publications and internal expertise to the extent possible to classify debt collectors into large and small; however, it is likely that the Bureau made mistakes in this classification in at least several cases. The mistakes were likely made in both directions: some debt collectors that were SBA small at the time of the settlement were classified as large, and other debt collectors that were not SBA small at the time of the settlement were classified as small.

As discussed above, these entities would also face increased exposure to state class litigation. While the Study's Section 6 reports similar numbers for State and Federal cases, it is likely that the State to Federal class litigation ratio is higher for small covered entities to the extent that they are more likely to serve consumers only in one State. However, as discussed above, the Bureau believes that State class litigation is also likely to generate lower costs than Federal litigation. The Bureau believes that these calculations strongly suggest that the proposed rule would not have a significant economic impact on a substantial number of small entities within the meaning of the RFA; however, the Bureau requests comment on that preliminary conclusion.

The Bureau notes that the estimates are higher for small debt collectors than for other categories: small debt collectors account for 22 of the 25 Federal settlements estimated above for small providers overall, and \$5 million (out of \$8 million for small providers) in costs combined. With about 4,400 debt collectors below the SBA thresholds, the estimates suggest a roughly 2 percent chance per year of being subject to an additional putative Federal class litigation, a lower than 1 percent chance of that resulting in a Federal class settlement, and an expected cost of about \$1,100 per year from these additional settlements. The same State class litigation assumptions outlined above apply to smaller debt collectors.

As evident from the data and from feedback received during the SBREFA process, providers that are debt collectors might be the most affected relative to providers in other markets, despite the fact that debt collectors do not enter into arbitration agreements directly and already frequently collect on debt without an arbitration agreement in the original contract. However, for the reasons described above, the Bureau believes it is unlikely that class settlement amounts would in fact drive companies out of business. Indeed, as discussed above, debt

collectors already face class litigation exposure in connection with a significant proportion of debt they collect. Much of that debt comes from creditors that do not have arbitration agreements, and even where the credit contract includes an arbitration agreement, collectors are not always able to invoke the agreements successfully.

*4. Identification, to the Extent Practicable, of All Relevant Federal Rules Which May Duplicate, Overlap, or Conflict with the Proposed Rule*

Several other Federal laws and regulations address the use of arbitration agreements. For example, arbitration agreements that apply to class litigation have been prohibited in securities contracts between broker dealers and their customers since 1992.<sup>662</sup> The Military Lending Act and its implementing regulations, which were recently expanded by the Department of Defense to reach most forms of credit accessed by servicemembers and their families, prohibit arbitration agreements in consumer credit contracts with certain covered servicemembers or their dependents.<sup>663</sup>

In addition to providing the Bureau the authority to regulate the use of arbitration agreements in consumer financial contracts, the Dodd-Frank Act prohibited all arbitration agreements in consumer mortgages<sup>664</sup> and authorized the Securities and Exchange Commission to regulate arbitration agreements in contracts between consumers and securities broker-dealers or investment advisers.<sup>665</sup> The Department of Health and Human Services also recently proposed regulations that would regulate the use of arbitration agreements in long-term care

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<sup>662</sup> Financial Industry Regulatory Authority (FINRA) Rule 2268(f).

<sup>663</sup> 10 U.S.C. 987, as implemented by 32 CFR 232.8(c).

<sup>664</sup> Dodd-Frank section 1414(a). That prohibition was implemented in Regulation Z by the Bureau's Loan Originator Compensation Rule. 12 CFR 1026.36(h).

<sup>665</sup> Dodd-Frank section 921.

contracts with consumers.<sup>666</sup> Finally, the Department of Education released a proposal that, among other things, “would protect students from the use of mandatory arbitration provisions in enrollment agreements” for postsecondary schools.<sup>667</sup>

*5. Description of Any Significant Alternatives to the Proposed Rule Which Accomplish the Stated Objectives of Applicable Statutes and Minimize Any Significant Economic Impact of the Proposed Rule on Small Entities*

The Bureau describes several potential alternatives below. The Bureau believes that none of these are significant alternatives insofar as they would not accomplish the goal of the proposed rulemaking with substantially less regulatory burden. Unless otherwise noted, the Bureau discusses these alternatives both for SBA small providers and for larger providers as well. The Bureau requests comment on these and other potential alternatives and on their further quantification.

*Potential Alternatives Involving Disclosure, Consumer Education, Opt-in, or Opt-out Requirements*

In principle, effective disclosures coupled with consumer education could make consumers more cognizant in selecting a financial product or service, of the existence and consequences of an arbitration provision in the standard form contract and, *ex post*, could make consumers who have a dispute with the provider cognizant of the option of pursuing the dispute

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<sup>666</sup> Reform of Requirements for Long-Term Care Facilities, 80 FR 42168, 42264–65 (July 16, 2015) (proposing to require that arbitration agreements be explained in understandable language, acknowledged by the resident, provide for a convenient venue and a neutral arbiter, entered into on a voluntary basis, not be made a condition of admission, and not restrict or discourage communication with government authorities).

<sup>667</sup> Press Release, U.S. Department of Education, *U.S. Department of Education Takes Further Steps to Protect Students from Predatory Higher Education Institutions* (Mar. 11, 2016), <https://www.ed.gov/news/press-releases/us-department-education-takes-further-steps-protect-students-predatory-higher-education-institutions>.

in arbitration. But the market failure this proposal seeks to address arises from the fact that consumers often lack awareness that they have a legal claim and, moreover, that even when they are aware of such claims, many are negative-value claims so that it is not practical for them to be pursued in any formal forum on an individual basis. Accordingly, individual enforcement mechanisms provide insufficient incentives to comply with the law. Thus, while a hypothetical perfect disclosure might give consumers an informed choice of whether to patronize a provider with an arbitration agreement, providers with arbitration agreements would still have a lower incentive to comply with the law under a disclosure intervention approach. The Bureau notes that in addition to not meeting the goals of this proposed rulemaking, all of the potential alternatives in this subsection would also impose costs on providers.<sup>668</sup>

Furthermore, there is reason to doubt that disclosures would be very effective in raising consumer awareness in any event. The Study indicates that the current consumer understanding of arbitration agreement is low,<sup>669</sup> and the Bureau believes that even with the most effective disclosures and education it is unlikely that many consumers would, at the outset of a customer relationship, anticipate that the provider will act unlawfully and assess the value of these dispute-resolution rights in a hypothetical future scenario.<sup>670</sup> Therefore, the Bureau believes that it would be difficult, if not impossible, for a disclosure to cause even a significant percentage of

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<sup>668</sup> See Omri Ben-Shahar & Carl Schneider, *The Failure of Mandated Disclosure*, 159 U. Pa. L. Rev. 647 (2011) on disclosures.

<sup>669</sup> Despite contract language and placement that is not dramatically different from that of other contract provisions.

<sup>670</sup> See Study, *supra* note 2, section 3 at 16-23.

consumers to factor the presence of an arbitration agreement into their shopping behavior,<sup>671</sup> let alone to address the market failure discussed above.

Similar concerns arise with regard to opt-in and opt-out regimes. An opt-out regime would require providers to give consumers an option to opt out of the arbitration agreement when the consumer signs the contract or for some additional period. An opt-in regime would presume that a consumer is not bound by the arbitration agreement, unless a consumer affirmatively indicates otherwise. Many providers currently offer arbitration agreements that allow consumers to opt out at the point of contract formation or for a limited period afterward.<sup>672</sup> In contrast, the Bureau is unaware of a significant number of providers offering opt-in agreements.

Much as with disclosures, the Bureau believes that opt-in and opt-out arrangements would not meet the objectives of the proposed rule because neither would alleviate the market failure that the proposed rule is designed to address. Further, and again similar to disclosures, the fact that opt-out agreements are already used by a number of providers in markets for consumer financial services today but that very few consumers are aware whether they have arbitration agreements in their contracts suggest that such regimes are subject to many of the same awareness and effectiveness issues discussed above with regard to disclosures. Finally, economic theory suggests that even with regard to a more consumer-friendly “opt-in” system, an

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<sup>671</sup> Economic theory suggests that even that might not be sufficient. *See, e.g.*, R. Ted Cruz & Jeffrey Hinck, *Not My Brother's Keeper: The Inability of an Informed Minority to Correct for Imperfect Information*, 47 *Hastings L. J.* 635 (1995) and Mark Armstrong, *Search and Ripoff Externalities*, 47 *Rev. Indus. Org.* 273 (2015).

<sup>672</sup> *See Study, supra* note 2, section 2 at 31.



individual consumer would not have a sufficient incentive, from the market perspective, to refuse an opt-in offer.<sup>673</sup>

Consider an individual consumer's decision to opt-in. First, suppose that this consumer expects other consumers to opt-in. In this case, this individual consumer does not benefit from refusing an opt-in offer: the option of class litigation is not valuable if there are not enough consumers that could be in the potential class. Instead, suppose that this consumer expects other consumers to refuse the opt-in. In this case, the provider has a sufficient incentive to comply, and this individual consumer still does not benefit from refusing an opt-in offer.<sup>674</sup> In short, regardless of whether other consumers opt-in or refuse to opt-in, this individual consumer's choice does not matter for the provider's compliance incentives, so this individual consumer will not take even the minimal effort (or forgo even a minimal incentive) to refuse an opt-in offer: consumers free-ride on other consumers.<sup>675</sup> Other consumers will think similarly, and thus an insufficient number of consumers will refuse an opt-in offer. Similar incentives are at play with an opt-out requirement. In general, a similar problem arises in provision of public goods and in other collective action settings.<sup>676</sup>

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<sup>673</sup> An opt-in offer would involve a consumer entering an arbitration agreement only if the consumer were given the choice to enter the agreement (unconditional on the provision of the consumer financial product or service), followed by the consumer explicitly agreeing to the arbitration agreement. For example, this could be accomplished by having a checkbox in the contract by the arbitration agreement.

<sup>674</sup> Assuming the consumer is indifferent between individual arbitration and individual litigation.

<sup>675</sup> It is likely that there is some inertia in consumer's choice of whether to opt-in: if not prompted by the provider, the consumer is unlikely to opt-in by him or herself. However, even suggestions by providers' employees, let alone monetary incentives, while signing the contract could reverse this inertia.

<sup>676</sup> See, e.g., Paul Samuelson, *The Pure Theory of Public Expenditure*, 36 *Rev. of Econ. & Stat.* 387 (1954); Mancur Olson, *The Logic of Collective Action* (H. Univ. Press 1965); Elinor Ostrom, *How Types of Goods and Property Rights Jointly Affect Collective Action*, 15 *J. of Theo. Pol.* 239 (2003). See also Eric Rasmusen, J. Mark Ramseyer & John Wiley, Jr., *Naked Exclusion*, 81 *Am. Econ. Rev.* 1137; Ilya Segal & Michael Whinston, *Naked Exclusion: Comment*, 90 *Am. Econ. Rev.* 296 (2000) (treatment of a similar problem in industrial organization); Keith Hylton, *The Economics of Class Actions and Class Action Waivers* (Forthcoming, *Sup. Ct. Econ. Rev.*, 2015), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2277562](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2277562); David Rosenberg & Kathryn Spier, *Incentives to*

The Study shows that, currently, consumers are unlikely to even attempt such a calculation. Most, if not virtually all, consumers do not realize the significance of an arbitration agreement that can block class litigation, most consumers do not have an option to opt out of the agreement (though in some markets such as payday loans and private student loans opt-outs appear to be the norm), and in many markets the vast majority of providers use arbitration agreements.<sup>677</sup> However, the presence of the collective action problem discussed directly above shows that resolving these current issues, such as lack of consumer awareness, would still not get to the core of the public good/collective action market failure.

#### *Total Ban of Pre-Dispute Arbitration Agreements*

Under this potential alternative, arbitration would only occur if parties agree to it after a dispute arises. The primary difference between this option and the proposed rule is that individual disputes would not be subject to mandatory pre-dispute arbitration agreements. The Study could not determine empirically whether individual arbitration is more beneficial to consumers than individual litigation.<sup>678</sup> Compared with the proposed rule, this potential alternative would result in approximately the same cost to providers (either large or small), since providers rarely, if ever, face any individual arbitration currently. In addition, if providers were not allowed to maintain individual pre-dispute arbitration programs for consumers, then there is a

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*Invest in Litigation and the Superiority of the Class Action*, 6 J. of Legal Analysis 305 (2014); Eric Posner, Kathryn Spier & Adrian Vermeule, *Divide and Conquer*, 2 J. of Legal Analysis 417 (2010). The case of this rulemaking is somewhat more complicated than the standard underprovision of public goods, since there are strategic providers that react to the public good underprovision.

<sup>677</sup> See generally Study, *supra* note 2, sections 2 and 3. Consumers failing to realize the importance of arbitration agreements might be due to several reasons. This could either be due to behavioral or cognitive biases, rational inattention due to the issue not being sufficiently important to invest in learning, or it could be rational consumers with correct expectations not investing into learning the issue due to the collective action problem.

<sup>678</sup> See Part VI.A.

risk that individual dispute resolution costs could increase; however, given the low number of such disputes, this cost increase would not be noticeable.

This potential alternative alleviates the market failure discussed in the Section 1022(b)(2) Analysis above and gives the providers same incentives to comply with the law as the proposed rule. However, this potential alternative could be more costly if individual arbitration proceedings are less expensive than individual litigation and parties do not voluntarily agree to post-dispute individual arbitration.

The Bureau believes that the current level of individual arbitrations, summed over all affected consumer financial products or services providers, is hundreds of arbitrations per year.<sup>679</sup> The Study does not identify a quantifiable comparison of the relative benefits and costs of individual arbitration relative to individual litigation. However, given the number of such arbitrations relative to the magnitude of quantifiable impacts of class litigation in the Section 1022(b)(2) Analysis (ignoring those impacts that are not quantifiable), the per-case differences between individual arbitration and litigation would have to be implausibly large to result in even a noticeable difference between benefits and costs, either to consumers or to providers, of this potential alternative relative to the proposed rule. The Bureau does not possess any evidence that shows that the per-case differences are indeed that large. Thus, the Bureau does not believe a total ban to be preferable with regard to regulatory burden.

#### *Various Specific Exceptions to the Proposed Rule*

During the SBREFA process, some of the SERs stated that some of the statutes (for example, TCPA) are particularly problematic and onerous if arbitration agreements cannot be

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<sup>679</sup> See Study, *supra* note 2, section 5 at 20.

used to block class litigation. The Bureau understands the SERs' argument that cases putatively seeking very large amounts of damages have a potential to amplify SERs' costs.

The Bureau's analysis of this argument is discussed in greater detail above in Part VI. From an economic theory perspective, the potential for these cases to be filed seeking very large damages also amplifies the incentive to comply with the law (for example, TCPA), and thus amplifies the benefits to consumers, even if providers pass on some of the costs to consumers in terms of higher prices. Thus, unless there is considerable evidence that compliance with or the remedial scheme established by a particular statute is against the public good the Bureau believes this issue, for the reasons discussed in Part VI, may be more appropriately addressed by Congress, state legislatures, and the courts.<sup>680</sup>

#### *Small Entity Exemption*

As outlined above in the Section-by-Section analysis to proposed § 1040.4(a), the Bureau requests comment on a small entity exemption, including which thresholds could be used for such an exemption for each market covered. The Bureau's estimates, based on current litigation levels, suggest that small providers would not be particularly affected by this proposed rule. However, a handful of small providers would likely face a Federal class action settlement due to this rule (and slightly higher numbers for providers who are debt collectors), and all small providers that have arbitration agreements would incur a cost of changing these agreements.<sup>681</sup>

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<sup>680</sup> The Bureau has also heard from stakeholders that other statutes with statutory damages should be exempted from the proposal. For example, some argue that allowing consumers to bring class actions pursuant to the Credit Repair Organizations Act (CROA) against providers that offer credit monitoring products could threaten the availability of those products due to the challenge of complying with CROA (to the extent it applies to those products).

<sup>681</sup> The Bureau notes again that the vast majority of the estimated additional Federal class action settlements in this Section 1022(b)(2) Analysis would be class action settlements with debt collectors. A small entity exemption would be unlikely to change that, as even small debt collectors would likely be collecting on debt of larger credit card

Thus, a small entity exemption would barely change the aggregate monetized costs and benefits, both to consumers and to providers.

The Bureau is concerned, however, that an exemption would eliminate the additional incentives to comply with the law provided by the exposure to class litigation. This is a particular concern for markets such as payday loans, where the vast majority of the market currently uses arbitration agreements, and thus it is harder to estimate the impact of the proposed rule and this potential alternative. Moreover, the Bureau is concerned that smaller providers without arbitration agreements might not be representative of small providers with arbitration agreements: in other words, that the providers that currently might not be complying with the law to the full extent might self-select into inserting arbitration agreements in their contracts.

At the same time, the Bureau acknowledges that, as discussed above, based on the evidence from providers that do not currently have arbitration agreements, the low monetized impact of class litigation estimated for small providers might suggest that the proposed rule would create weaker incentives to comply than for larger providers, since a given small provider is highly unlikely to face a class action. Moreover, as noted by the SERs during the SBREFA process, many small providers believe that they are already complying with the law to the fullest extent, notwithstanding the presence of arbitration agreements in their contracts. As discussed above, the Bureau is seeking comment on all issues relating to a small entity exemption.

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issuers whose arbitration agreements, if existent, could not be used to invoke in class litigation. *See* proposed § 1040.4(a)(1).

### *Public Options*

Various stakeholders suggested alternatives related to public enforcement. Aside from an alternative that the Bureau does not have the power to accomplish – sizably increasing enforcement at all regulators of the providers affected by the proposed rule – most of these suggestions would mostly duplicate what the providers can do already. For example, providers that discover a compliance issue before a class action is filed can already (and sometimes do) submit a description of the compliance issue to their regulator and attempt to work out a solution (that may or may not involve fines and payments to consumers). If consumers are compensated during the process, then there is less potential recovery for any following private litigation. Moreover, as the Study demonstrates, such private litigation following the same matter decided by public enforcement is rare.<sup>682</sup> Given that the suggested mechanisms could be used by providers today if they felt sufficient incentive to reduce compliance and litigation risk, the Bureau does not believe that these options could be relied upon to achieve the policy goals of the proposed rule.

### *Request for Comment*

The Bureau requests comment on these and any other alternative policy options that may accomplish the goals of the proposed rulemaking with substantially less regulatory burden, including a detailed description of the option and any evidence that would indicate that the option could achieve such goals.

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<sup>682</sup> See Study, *supra* note 2, section 9 at 13-16.

#### *6. Discussion of Impact on Cost of Credit for Small Entities*

Although SERs expressed concern that the proposed rule could affect costs that they bear when they seek out business credit to facilitate their operations, the Bureau believes based on its estimates derived from current litigation levels as discussed above that the vast majority of small providers' cost of credit would not be impacted by the proposed rule. However, given a higher likelihood that a smaller debt collector would be subject to incremental class litigation at any given time, it is possible that a fraction of small debt collectors might experience an adverse impact on their cost of credit if they were subject to ongoing class litigation at a time when they were seeking credit. However, the Study indicated that the majority of cases filed as class actions are resolved within a few months, such that any such adverse impact is likely to be only temporary.

#### *7. Description of Any Significant Alternatives to the Proposed Rule Which Accomplish the Stated Objectives of Applicable Statutes and Which Minimize Any Increase in the Cost of Credit for Small Entities*

As stated above, the Bureau does not believe that the vast majority of the small providers' cost of credit will be impacted. The Bureau also is not aware of any significant alternatives that would minimize the impact on small debt collectors' cost of credit while accomplishing the objectives of the proposed rule. The Bureau notes that any alternatives would be particularly complicated with regard to application to smaller debt collectors, as they typically use the contract of another firm, for example a credit card issuer.

*8. Description of the Advice and Recommendations of Representatives of Small Entities relating to Issues Described in 6 and 7 Above*

As noted in the SBREFA Panel Report, the small entity representatives (SERs) expressed concerns about how the proposals under consideration would affect their borrowing costs. One SER believed his business would lose its line of credit if it could not use arbitration agreements to block class actions. Another SER stated that the class proposal under consideration would increase her business's borrowing costs, and also that drawing on its credit to pay litigation costs related to a class action would "raise warning signs" for her business's lender. Another SER stated that mere exposure to class action liability would cause his business's lender to "raise an eyebrow." One debt collector SER stated that his company's bank had closed its line of credit in recent years due to concerns over the industry but that the company was able to obtain a line of credit at another bank relatively quickly. None of these SERs reported that they actually had spoken with their lender or that, when they sought credit in the past, their lender inquired as to whether they used arbitration agreements in their consumer contracts.

In general, SERs in the business of extending credit stated that the proposal under consideration regarding class actions might cause them to increase the cost of credit they offer to their consumers. One of these SERs stated that the proposal may increase his business's expenses overall – such as insurance premiums, compliance investment, and exposure to class actions for which his business is uninsured – and, due to that SER's thin margins, such increases may require his business to increase the cost of consumer credit. However, another SER – a short-term, small-dollar lender – stated that he would be unable to increase the cost of his business's consumer loans due to limitations imposed by state law. Another SER, a buy-here-



pay-here auto dealer, stated that, in addition to potentially raising the cost of credit, his business could recoup costs by increasing its debt collection and collateral recovery efforts.

Three SERs predicted that, if the class proposal under consideration goes into effect, some small entities would reduce their product offerings. One of these SERs speculated that products designed for underserved groups may be especially vulnerable because cases involving such products are more attractive to plaintiff's attorneys.

## **X. Paperwork Reduction Act**

Under the Paperwork Reduction Act of 1995 (PRA), Federal agencies are generally required to seek the Office of Management and Budget's (OMB) approval for information collection requirements prior to implementation. Under the PRA, the Bureau may not conduct or sponsor – and, notwithstanding any other provision of law, a person is not required to respond to – an information collection unless the information collection displays a valid control number assigned by OMB.<sup>683</sup>

As part of its continuing effort to reduce paperwork and respondent burden, the Bureau conducts a preclearance consultation program to provide the general public and Federal agencies with an opportunity to comment on new information collection requirements in accordance with the PRA.<sup>684</sup> This helps ensure that the public understands the Bureau's requirements or instructions; respondents can provide the requested data in the desired format; reporting burden (time and financial resources) is minimized; collection instruments are clearly understood; and the Department can properly assess the impact of collection requirements on respondents.

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<sup>683</sup> 44 U.S.C. 3507(a).

<sup>684</sup> 44 U.S.C. 3506(c)(2)(A).

The Bureau believes that this proposed rule would impose the following two new information collection requirements (recordkeeping, reporting, or disclosure requirements) on covered entities or members of the public that would constitute collections of information requiring OMB approval under the PRA. Both information collections would apply to agreements entered into after the compliance date of the rule.<sup>685</sup>

The first information collection requirement relates to proposed disclosure requirements. The proposal would require providers that enter into arbitration agreements with consumers to ensure that these arbitration agreements contain a specified provision, with two limited exceptions as described below.<sup>686</sup> The specified provision would effectively state that no person can use the agreement to stop the consumer from being part of a class action case in court.<sup>687</sup> The Bureau proposed this language and, if the rule is adopted as proposed, providers would be required to use it unless an enumerated exception applies. The Bureau is also proposing to permit providers to use an alternative provision in connection with arbitration agreements in contracts for multiple products or services, some of which are not covered by the proposed rule.<sup>688</sup>

The proposed rule contains two exceptions to this first information collection requirement. Under the first exception, if a provider enters into an arbitration agreement that

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<sup>685</sup> See proposed § 1040.5(a).

<sup>686</sup> See proposed § 1040.4(a)(2). In addition to the one-time change described directly above, some providers could be affected on an ongoing basis or sporadic basis in the future as they acquire existing contracts as the result of regular or occasional activity, under proposed § 1040.4(a)(2). As noted above in the Section 1022(b)(2) Analysis, the Bureau believes that this requirement does not impose a material burden, and thus the Bureau does not further discuss it in this Section 1022(b)(2) Analysis.

<sup>687</sup> See proposed § 1040.4(a)(2)(i).

<sup>688</sup> See proposed § 1040.4(a)(2)(ii).

existed previously (and was entered into by another person after the compliance date),<sup>689</sup> and the agreement does not already contain the provision required by proposed § 1040.4(a)(2)(i) (or the alternative provision permitted by proposed § 1040.4(a)(2)(ii)), the provider must either ensure that the agreement is amended to contain a specified provision or send any consumer to whom the agreement applies a written notice containing specified language. The provider is required to ensure the agreement is amended or provide the written notice within 60 days of entering into the agreement.<sup>690</sup> Under the second exception, the requirement to ensure that an arbitration agreement entered into after the compliance date contains the provision required by proposed § 1040.4(a)(2)(i) (or the alternative provision permitted by proposed § 1040.4(a)(2)(ii)) would not apply to an arbitration agreement for a general-purpose reloadable prepaid card if certain conditions are satisfied with respect to when the card was packaged and purchased in relation to the compliance date. For a prepaid card provider that has the ability to contact the consumer in writing, the provider must also, within 30 days of obtaining the consumer's contact information, notify the consumer in writing that the arbitration agreement complies with the requirements of proposed § 1040.4(a)(2) by providing an amended arbitration agreement to the consumer.<sup>691</sup>

The second information collection requirement relates to proposed reporting requirements. The proposal would require providers to submit specified arbitral records to the Bureau relating to any arbitration agreement entered into after the compliance date.<sup>692</sup> The proposal would require the submission of two general categories of documents to the Bureau.

The first category would require providers to submit certain records in connection with any claim

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<sup>689</sup> See proposed comment 4(a)(2)-2 for an example of when this could occur.

<sup>690</sup> See proposed § 1040.4(a)(2)(iii).

<sup>691</sup> See proposed § 1040.5(b).

<sup>692</sup> See proposed § 1040.4(b).

filed in arbitration by or against the provider concerning a covered consumer financial product or service. In particular, providers would be required to submit the following four types of documents in connection with any claim filed in arbitration: (A) the initial claim and any counterclaim, (B) the arbitration agreement filed with the arbitrator or arbitration administrator, (C) the judgment or award, if any, issued by the arbitrator or arbitration administrator, and (D) if an arbitrator or arbitration administrator refuses to administer or dismisses a claim due to the provider's failure to pay required filing or administrative fees, any communication the provider receives from the arbitrator or an arbitration administrator related to such a refusal.<sup>693</sup> The second category would require providers to submit any communications the provider receives from an arbitrator or arbitration administrator related to a determination that an arbitration agreement covered by the proposed rule does not comply with the administrator's fairness principles, rules, or similar requirements.<sup>694</sup>

The proposal would require providers to submit any record described above to the Bureau within 60 days of filing by the provider or, in the case of records filed by other persons (such as arbitrators, arbitration administrators, or consumers), receipt by the provider.<sup>695</sup> The proposal would further require that, before submitting these records to the Bureau, a provider must redact any of nine specific types of information to the extent such information appears in any of these documents.<sup>696</sup>

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<sup>693</sup> See proposed § 1040.4(b)(1)(i).

<sup>694</sup> See proposed § 1040.4(b)(1)(ii).

<sup>695</sup> See proposed § 1040.4(b)(2).

<sup>696</sup> See proposed § 1040.4(b)(3). These types of information proposed are: (i) names of individuals, except for the name of the provider or the arbitrator where either is an individual; (ii) addresses of individuals, excluding city, state, and zip code; (iii) email addresses of individuals; (iv) telephone numbers of individuals; (v) photographs of

The estimated burden on Bureau respondents from the proposed adoption of Part 1040 are summarized below. A complete description of the information collection requirements, including the burden estimate methods, is provided in the information collection request (ICR) that the Bureau has submitted to OMB under the requirements of the PRA.

		Number of Respondents	Average Burden per Respondent	Total One-time Burden (hours)	Hourly Rate	Total Costs (One-time Burden)
1040.4(a)(2)	Provision required in covered pre-dispute arbitration agreements	48,000	2	96,000	\$200	\$19,200,000
1040.4(b)	Submission of arbitral records	0	0	0	\$0	\$0
<b>Total</b>		<b>48,000</b>	<b>2</b>	<b>96,000</b>		<b>\$19,200,000</b>

		Number of Respondents	Average Annual Burden per Respondent	Total One-time Burden (hours)	Hourly Rate	Total Costs (One-time Burden)
1040.4(a)(2)	Provision required in covered pre-dispute arbitration agreements	0	0	0	\$0	0
1040.4(b)	Submission of arbitral records	Up to 500	1	0	\$500	\$250,000
<b>Total</b>		<b>0</b>	<b>1</b>	<b>0</b>		<b>\$250,000</b>

Please send your comments to the Office of Information and Regulatory Affairs, OMB, Attention: Desk Officer for the Bureau of Consumer Financial Protection. Send these comments by e-mail to [oir\\_submission@omb.eop.gov](mailto:oir_submission@omb.eop.gov) or by fax to (202) 395-6974. If you wish to share your comments with the Bureau, please send a copy of these comments to the docket for this proposed rule at [www.regulations.gov](http://www.regulations.gov). The ICR submitted to OMB requesting approval under the PRA for the information collection requirements contained herein is available at [www.regulations.gov](http://www.regulations.gov) as well as OMB's public-facing docket at [www.reginfo.gov](http://www.reginfo.gov).

*Title of Collection:* Arbitration Agreements, Disclosure and Reporting Requirements.

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individuals; (vi) account numbers; (vii) Social Security and tax identification numbers; (viii) driver's license and other government identification numbers; and (ix) passport numbers.

*OMB Control Number:* 3170-XXXX.

*Type of Review:* New collection (Request for a new OMB control number).

*Affected Public:* Private Sector.

Comments are invited on: (a) whether the collection of information is necessary for the proper performance of the functions of the Bureau, including whether the information will have practical utility; (b) the accuracy of the Bureau's estimate of the burden of the collection of information, including the validity of the methods and the assumptions used; (c) ways to enhance the quality, utility, and clarity of the information to be collected; and (d) ways to minimize the burden of the collection of information on respondents, including through the use of automated collection techniques or other forms of information technology. Comments submitted in response to this notice will be summarized and/or included in the request for OMB approval. All comments will become a matter of public record.

If applicable, in any notice of final rule the Bureau would display the control number assigned by OMB to any information collection requirements proposed herein and adopted in any final rule. If the OMB control number has not been assigned prior to publication of any final rule in the Federal Register, the Bureau would publish a separate notice in the Federal Register prior to the effective date of any final rule.

Note: The following appendix will not appear in the Code of Federal Regulations.

#### **APPENDIX A TO SECTION 1022(b)(2) ANALYSIS – CASES ANALYZED**

As stated in the Bureau’s analysis of the costs, benefits, and impacts of the proposed class rule under Dodd-Frank section 1022(b)(2), the Bureau’s estimate of additional federal class litigation costs, benefits, and impacts seeks to use the federal class settlements identified in the Bureau’s Study to project the number and size of incremental class action settlements expected to result if the proposal were finalized, as well as other additional costs associated with incremental class litigation. To make that projection the Bureau has sought to confine its analysis to class settlements of class action cases of a type from which providers of consumer financial services are today able to insulate themselves by using an arbitration agreement but would not be able to do so under the proposed rule. For that reason, in making its projections the Bureau excluded two types of federal class settlements that were analyzed in Section 8 of the Study: (1) class action settlements involving providers or financial products or services which fall outside the scope of the proposal so that providers would still be able to insulate themselves from such cases under the proposal;<sup>697</sup> and (2) class action settlements involving claims of a type that could not have been affected by the presence of an arbitration agreement because there was no contract or privity of contract between the provider and the members of the class, or because of legal constraints on use of arbitration agreements.<sup>698</sup> Examples of the first type include class settlements involving real estate settlement services, insurance firms providing ancillary (add-on)

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<sup>697</sup> Persons offering or providing similar products or services might be covered by the proposed rule in some circumstances; the Bureau’s estimates are not a legal determination of coverage.

<sup>698</sup> In addition, two debt collection cases were inadvertently included in the set of cases analyzed in Section 8 twice. The Bureau therefore removed the two duplicates from the set of cases analyzed in the Section 1022(b)(2) Analysis.

products which take the form of insurance, claims against credit reporting agencies where the claims did not relate to the provision of a consumer report or related information, and class settlements by merchants of claims concerning ATM “sticker” notice requirements previously required by EFTA.<sup>699</sup> Examples of the second type include class settlements by financial institutions of claims by non-customers concerning ATM “sticker” notice requirements previously required by EFTA, and class settlements of claims involving check cashing by merchants. In total 117 of the 419 federal class settlements analyzed in Section 8 of the Study were not used for purposes of these projections. The largest group excluded – over half of the total – were EFTA ATM class settlements. The 117 federal class settlements in the above categories are identified in Appendix B to the proposed rule.

In addition, to avoid potential underestimates of the costs of the proposal in the Bureau’s Section 1022(b)(2) Analysis, the Bureau included for purposes of its calculations 10 federal class settlements that were identified as part of the Study but were not include in the results reported in the Study. Seven of these cases involve allegations of “cramming” of third-party charges on consumer telecommunications bills. One case involved long-term auto leasing.<sup>700</sup> The other two cases appeared to be companion class settlements to a payday loan debt collection class settlement that was included in Section 8 of the Study.<sup>701</sup>

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<sup>699</sup> In addition, a class settlements of a dispute concerning a merchant’s disclosures on a prepaid funeral plan was analyzed in Section 8 of the Study, but was not used as a basis for the Bureau’s estimate of impacts. As a result the Bureau did not find any merchant TILA creditor (based on allegations of consumer credit with a finance charge) federal class settlements. Such settlements, however, may exist in state courts.

<sup>700</sup> The case materials reviewed by the Bureau do not definitively establish whether the automobile leases at issue would be covered under proposed § 1040.3(a)(2).

<sup>701</sup> These settlements resolved alleged FDCPA violations asserted by the same consumer, in the same court, by the same law firm, in the same month, against a group of defendants involved in an apparently related set of activities in the payday lending market.



After accounting for all of the foregoing adjustments, the list below identifies the resulting set of 312 federal class settlements used in the Section 1022(b)(2) Analysis to project the estimated impact of the proposed rule on federal class litigation against providers, with 10 added cases noted with a “\*.” (Cases consolidated in the checking account overdraft reordering multidistrict litigation are listed under their original docket numbers, but are consolidated under Docket 1:09-MD-2036-JLK in the U.S. District Court, Southern District of Florida; these settlements are noted with “\*\*.”)

*Adams v. LVNV Funding L.L.C.*, 1:09-CV-06469 (N.D. Ill.);  
*Ajiere v. Tressler, Soderstrom, Maloney & Priess, L.L.P.*, 1:09-CV-06125 (N.D. Ill.);  
*Anama v. AFNI, Inc.*, 1:07-CV-04251 (N.D. Ill.);  
*Anderson v. Nationwide Credit, Inc.*, 2:10-CV-03825 (E.D.N.Y.);  
*Anokhin v. Continental Service Group, Inc.*, 1:10-CV-02890 (E.D.N.Y.);  
*Aramburu v. Healthcare Financial Services, Inc.*, 1:02-CV-06535 (E.D.N.Y.);  
*Arlozynski v. Rubin & Debski, P.A.*, 8:09-CV-02321 (M.D. Fla.);  
*Arroyo v. Professional Recovery Services, Inc.*, 1:09-CV-00750 (E.D. Cal.);  
*Arthur v. SLM Corp.*, 2:10-CV-00198 (W.D. Wash.);  
*Asch v. Teller Levit & Silvertrust, P.C.*, 1:00-CV-03290 (N.D. Ill.);  
*Aspan v. Hudson & Keyse, L.L.C.*, 1:08-CV-02826 (N.D. Ill.);  
*Baron v. Direct Capital Corp.*, 2:09-CV-00669 (W.D. Wash.);  
*Barrera v. Resurgence Financial, L.L.C.*, 1:08-CV-03519 (N.D. Ill.);  
*Bennett v. Weltman Weinberg & Reis Co.*, 1:07-CV-01818 (N.D. Ohio);  
*Bertram Robison v. WFS Financial Inc.*, 8:06-CV-01072 (C.D. Cal.);  
*Bibb v. Friedman & Wexler L.L.C.*, 2:07-CV-02173 (C.D. Ill.);  
*Bicking v. Law Offices of Rubenstein & Cogan*, 3:11-CV-00078 (E.D. Va.);  
*Blair v. Phillips & Cohen Associates, Ltd.*, 1:09-CV-05271 (N.D. Ill.);  
*Blake v. Smith Thompson Shaw & Manausa P.A.*, 4:08-CV-00358 (N.D. Fla.);  
*Blarek v. Encore Receivable Management Inc.*, 2:06-CV-00420 (E.D. Wis.);  
*Blodgett v. Regent Asset Management Solutions, Inc.*, 0:09-CV-03210 (D. Minn.);  
*Blue v. Unifund CCR Partners*, 1:09-CV-01777 (N.D. Ill.);  
*Boettger v. Sula*, 1:12-CV-00002 (S.D. Iowa);  
*Bogner v. Masari Investments, L.L.C.*, 2:08-CV-01511 (D. Ariz.);  
*Bradshaw v. Hilco Receivables, L.L.C.*, 1:10-CV-00113 (D. Md.);  
*Brown v. Syndicated Office Systems, Inc.*, 9:10-CV-80465 (S.D. Fla.);  
*Buchman v. Bray & Lunsford, P.A.*, 8:07-CV-01752 (M.D. Fla.);  
*Burton v. Northstar Location Services, L.L.C.*, 1:08-CV-05751 (N.D. Ill.);  
*Cady v. Codilis & Associates, P.C.*, 1:08-CV-01901 (N.D. Ill.);

*Cain v. Consumer Portfolio Services, Inc.*, 1:10-CV-02697 (N.D. Ill.);  
*Cain v. J.P.T. Automotive, Inc.*, 2:05-CV-03805 (E.D.N.Y.);  
*Calloway v. Cash America Net of California, L.L.C.*, 5:09-CV-04858 (N.D. Cal.);  
*Carlsen v. Freedom Debt Relief L.L.C.*, 2:09-CV-00055 (E.D. Wash.);  
*Carpenter v. Persolve, L.L.C.*, 3:07-CV-00633 (S.D. Ill.);  
*Case v. Bank of Oklahoma, N.A. (In re Checking Account Overdraft Litig.)\*\**, 5:10-00901-L (W.D. Okla.);  
*Castellano v. Global Credit & Collection Corp.*, 2:10-CV-05898 (E.D.N.Y.);  
*Caston-Palmer v. NCO Portfolio Management, Inc.*, 1:08-CV-02818 (N.D. Ill.);  
*Catala v. Resurgent Capital Services L.P.*, 3:08-CV-02401 (S.D. Cal.);  
*Cervantes v. Pacific Bell L.L.C.\**, 3:05-CV-01469 (S.D. Cal.);  
*Cheney v. Tek-Collect Inc.*, 1:09-CV-08052 (N.D. Ill.);  
*Chulsky v. Hudson Law Offices, P.C.*, 3:10-CV-03058 (D.N.J.);  
*Clendenin v. Carecredit, L.L.C.*, 1:08-CV-06559 (N.D. Ill.);  
*Cole v. Portfolio Recovery Associates, L.L.C.*, 4:08-CV-00036 (D. Mont.);  
*Cole v. Wells Fargo Bank N.A.*, 2:07-CV-00916 (W.D. Wash.);  
*Colello v. Franklin Collection Service, Inc.*, 1:10-CV-06229 (N.D. Ill.);  
*Corsick v. West Asset Management, Inc.*, 5:09-CV-03053 (N.D. Cal.);  
*Cosgrove v. Citizens Automobile Finance, Inc.*, 5:09-CV-01095 (E.D. Pa.);  
*Cotton v. Asset Acceptance, L.L.C.*, 1:07-CV-05005 (N.D. Ill.);  
*Cotton v. National Action Financial Services, Inc.*, 1:10-CV-04709 (N.D. Ill.);  
*Cox v. Unifund CCR Partners*, 1:08-CV-01005 (N.D. Ill.);  
*Craddock v. Hayt, Hayt & Landau, L.L.C.*, 3:09-CV-00595 (D.N.J.);  
*Craft v. North Seattle Community College Foundation*, 3:07-CV-00132 (M.D. Ga.);  
*Cruz-Martinez v. Hellmuth & Johnson, P.L.L.C.*, 0:08-CV-04289 (D. Minn.);  
*Cyrus Ahmad Ebrahimi v. West Asset Management Inc.*, 8:09-CV-01109 (C.D. Cal.);  
*Dalton v. Cardworks Services, L.L.C.*, 1:09-CV-00563 (S.D. Ala);  
*Davis v. Riddle & Associates, P.C.*, 2:07-CV-00284 (E.D. Pa.);  
*Day v. Persels & Associates, L.L.C.*, 8:10-CV-02463 (M.D. Fla.);  
*Dee v. Bank of The West (In re Checking Account Overdraft Litig.)\*\**, 4:10-CV-02736 (N.D. Cal.);  
*D'Elia v. First Capital, L.L.C.*, 1:07-CV-06042 (N.D. Ill.);  
*Diangelo v. Unifund CCR Partners*, 1:08-CV-03205 (N.D. Ill.);  
*Dobson v. Asset Acceptance L.L.C.*, 1:07-CV-06203 (N.D. Ill.);  
*Donahue v. Weltman, Weinberg & Reis Co., L.P.A.*, 1:10-CV-04619 (N.D. Ill.);  
*Douma v. Law Offices of Mitchell N. Kay P.C.*, 1:09-CV-09957 (S.D.N.Y.);  
*Drinkman, Robert v. Encore Receivable Management, Inc.*, 3:07-CV-00363 (W.D. Wis.);  
*Ducharme v. John C. Heath Attorney at Law P.L.L.C.*, 3:10-CV-02763 (N.D. Cal.);  
*Duffy v. Oliphant Financial L.L.C.*, 2:07-CV-03657 (E.D.N.Y.);  
*Duhadway v. Credigy Receivables Inc.*, 1:08-CV-00852 (N.D. Ill.);  
*Durham v. Continental*, 3:07-CV-01763 (S.D. Cal.);  
*Eason v. AFNI, Inc.*, 8:08-CV-00128 (D. Md.);  
*Eatmon v. Palisades Collection, L.L.C.*, 2:08-CV-00306 (E.D. Tex.);  
*Eddie Wayne Hutchison v. Progressive Management Systems, Inc.*, 2:07-CV-07464 (C.D. Cal.);  
*Elizabeth Lavalley v. Chex Systems, Inc.*, 8:08-CV-01383 (C.D. Cal.);

*Elsey v. Pierce & Associates, P.C.*, 1:08-CV-02538 (N.D. Ill.);  
*Esslinger v. HSBC Bank USA Inc.*, 2:10-CV-03213 (E.D. Pa.);  
*Fahme v. I.C. System, Inc.*, 1:08-CV-01487 (E.D.N.Y.);  
*Faloney v. Wachovia Bank, N.A.*, 2:07-CV-01455 (E.D. Pa.);  
*Fike v. The Bureaus, Inc.*, 1:09-CV-02558 (N.D. Ill.);  
*Flores v. OneWest Bank, F.S.B., d/b/a IndyMac Federal Bank*, 1:09-CV-04042 (N.D. Ill.);  
*Ford v. Verisign Inc.\**, 3:05-CV-00819 (S.D. Cal.);  
*Foster v. Velocity Investments, L.L.C.*, 1:07-CV-00824 (N.D. Ill.);  
*Foster v. D.B.S. Collection Agency*, 2:01-CV-00514 (S.D. Ohio);  
*Foti v. NCO Financial Systems, Inc.*, 1:04-CV-00707 (S.D.N.Y.);  
*Fragoso v. HBLC, Inc.*, 1:07-CV-05482 (N.D. Ill.);  
*Frances Anne Ramsey v. Prime Healthcare Services Inc.*, 8:08-CV-00820 (C.D. Cal.);  
*Francisco Marengo v. Visa Inc.*, 2:10-CV-08022 (C.D. Cal.);  
*Friedrichs v. BMW Financial Services L.L.C.*, 4:08-CV-04486-PJH (C.D. Cal.);  
*Froumy v. Stark & Stark*, 3:09-CV-04890 (D.N.J.);  
*Gaalswyk-Knetzke v. The Receivable Management Services Corp.*, 8:08-CV-00493 (M.D. Fla.);  
*Gail v. Law Offices of Weltman Weinberg & Reis Co. L.P.A.*, 2:05-CV-00721 (E.D. Wis.);  
*Gailin R. Brown v. Dean J. Jungers*, 8:08-CV-00451 (D. Neb.);  
*Galbraith v. Resurgent Capital Services*, 2:05-CV-02133 (E.D. Cal.);  
*Garland v. Cohen & Krassner*, 1:08-CV-04626 (E.D.N.Y.);  
*Garland v. Greenberg*, 1:09-CV-02643 (E.D.N.Y.);  
*Garnett v. Lasalle Bank Corp.*, 1:08-CV-01872 (N.D. Ill.);  
*Garo v. Global Credit & Collection Corp.*, 2:09-CV-02506 (D. Ariz.);  
*Gaudalupe v. Miller Law Offices, P.L.L.C.*, 1:06-CV-03044 (E.D.N.Y.);  
*Gillespie v. Equifax Inc.*, 1:05-CV-00138 (N.D. Ill.);  
*Goodie v. Weinstock, Friedman & Friedman, P.C.*, 1:10-CV-01870 (D. Md.);  
*Grannan v. Alliant Law Group, P.C.*, 5:10-CV-02803 (N.D. Cal.);  
*Gravina v. Client Services, Inc.*, 2:08-CV-03634 (E.D.N.Y.);  
*Gray v. Mobile Messenger\**, 0:08-CV-61089 (S.D. Fla.);  
*Griffin v. Capital One Bank*, 8:08-CV-00132 (M.D. Fla.);  
*Guidos v. Northstar Education Finance, Inc.*, 0:08-CV-04837 (D. Minn.);  
*Gunther v. Capital One, N.A.*, 2:09-CV-02966 (E.D.N.Y.);  
*Gutierrez v. LVNV Funding, L.L.C.*, 3:08-CV-00225 (W.D. Tex.);  
*Haidee Estrella v. Freedom Financial Network L.L.C.*, 3:09-CV-03156 (N.D. Cal.);  
*Halbert v. Biehl & Biehl, Inc.*, 1:09-CV-06221 (N.D. Ill.);  
*Halbert v. Creditors Interchange Receivable Management, L.L.C.*, 1:09-CV-06207 (N.D. Ill.);  
*Hale v. AFNI, Inc.*, 1:08-CV-03918 (N.D. Ill.);  
*Hall v. Bronson & Migliaccio, L.L.P.*, 1:07-CV-00255 (S.D. Ohio);  
*Hall v. Capital One Auto Finance, Inc.*, 1:08-CV-01181 (N.D. Ohio);  
*Harris v. D. Scott Carruthers & Associates*, 8:09-CV-00154 (D. Neb.);  
*Hartt v. Flagship Credit Corp.*, 2:10-CV-00822 (E.D. Pa.);  
*Hauk v. LVNV Funding, L.L.C.*, 1:09-CV-03238 (D. Md.);  
*Hearsh v. OSI Collection Services, Inc.*, 1:07-CV-00097 (N.D. Ill.);  
*Henry McMullen v. Jennings & Valancy, P.A. v. Jennings & Valancy, P.A.*, 0:10-CV-60050 (S.D. Fla.);

*Herkert v. Midland Funding NNC-2 Corp.*, 1:08-CV-00760 (N.D. Ill.);  
*Holman v. Student Loan Xpress, Inc.*, 8:08-CV-00305 (M.D. Fla.);  
*Horton v. IQ Telecom, Inc.*, 1:07-CV-02478 (N.D. Ill.);  
*Housenkamp v. Weltman, Weinberg & Reis, Co. of Michigan*, 1:09-CV-10613 (E.D. Mich.);  
*Howell v. Capital Management Services L.P.*, 1:10-CV-00184 (N.D. Ind.);  
*Huffman v. Zwicker & Associates, P.C.*, 1:07-CV-01369 (E.D. Cal.);  
*Hughes v. Harvest Credit Management VII, L.L.C.*, 1:08-CV-03685 (N.D. Ill.);  
*Hunt v. Check Recovery Systems, Inc.*, 4:05-CV-04993 (N.D. Cal.);  
*Hurwitz v. Ameriquest Recovery Services, L.L.C.*, 1:06-CV-01440 (E.D.N.Y.);  
*In re: Chase Bank USA, N.A. "Check Loan" Contract Litigation*, 3:09-MD-02032 (N.D. Cal.);  
*In re: Currency Conversion Fee Antitrust Litigation*, 1:01-MD-01409 (S.D.N.Y.);  
*In re: Lifelock, Inc., Marketing & Sales Practices Litigation*, 2:08-MD-01977 (D. Ariz.);  
*Jackson v. Metscheck, Inc.*, 1:11-CV-02735 (N.D. Ga.);  
*Jancik v. Cavalry Portfolio Services L.L.C.*, 0:06-CV-03104 (D. Minn.);  
*Janice J. Abat v. JPMorgan Chase & Co.*, 8:07-CV-01476 (C.D. Cal.);  
*Jenkins v. Hyundai Motor Finance Co.*, 2:04-CV-00720 (S.D. Ohio);  
*Johnson v. Kleinsmith & Associates P.C.*, 3:09-CV-00003 (D.N.D.);  
*Johnson v. Law Offices of Brachfeld & Associates*, 8:09-CV-00336 (D. Neb.);  
*Johnson v. Midland Funding*, 1:09-CV-02391 (D. Md.);  
*Jones v. Client Services, Inc.*, 2:10-CV-00343 (E.D. Pa.);  
*Jones v. Hoffman Swartz\**, 1:10-CV-07632 (N.D. Ill.);  
*Jones v. National Credit Adjusters, L.L.C.*, 1:10-CV-08027 (N.D. Ill.);  
*Jones v. Rory Vohwinkel\**, 1:10-CV-07954 (N.D. Ill.);  
*Julks v. Atlantic Funding Group, L.L.C.*, 1:06-CV-11704 (D. Mass.);  
*Kadlec v. Weltman, Weinberg & Reis Co., L.P.A.*, 3:10-CV-00223 (W.D. Tex.);  
*Kalish v. Kapp & Kalamotousakis, L.L.P.*, 1:06-CV-04933 (S.D.N.Y.);  
*Keck v. Bank of America*, 3:08-CV-01219 (N.D. Cal.);  
*Kern v. LVNV Funding L.L.C.*, 1:09-CV-02202 (N.D. Ill.);  
*Kight v. Eskanos & Adler, P.C.*, 3:05-CV-01999 (S.D. Cal.);  
*Kindler v. Mitsubishi Motors Credit of America, Inc.*, 4:09-CV-00315 (W.D. Mo.);  
*King v. United SA Federal Credit Union*, 5:09-CV-00937 (W.D. Tex.);  
*Kiousis v. Encore Receivable Management, Inc.*, 1:11-CV-00033 (N.D. Ill.);  
*Kirk v. Gobel*, 2:08-CV-00344 (E.D. Wash.);  
*Kish v. Suntrust Banks, Inc.*, 1:06-CV-00968 (N.D. Ga.);  
*Kistner v. Law Offices of Michael P. Margelefsky, L.L.C.*, 3:05-CV-07238 (N.D. Ohio);  
*Krech v. Efunts Corp.*, 1:08-CV-00985 (N.D. Ill.);  
*Lacour v. Whitney Bank*, 8:11-CV-01896 (M.D. Fla.);  
*Lagana v. Stephen Einstein & Associates, P.C.*, 1:10-CV-04456 (S.D.N.Y.);  
*Landrum v. Meadows Credit Union*, 4:08-CV-00441 (W.D. Mo.);  
*Langendorfer v. Kaufman*, 1:10-CV-00797 (S.D. Ohio);  
*Lantrip v. Dodeka L.L.C.*, 2:08-CV-00476 (E.D. Tex.);  
*Larsen v. Union Bank, N.A. (In re Checking Account Overdraft Litig.)\*\**, 4:09-CV-3250 (N.D. Cal.);  
*Lau v. Arrow Financial Services, L.L.C.*, 1:06-CV-03141 (N.D. Ill.);  
*Laura Hoffman v. Citibank (South Dakota) N.A.*, 8:06-CV-00571 (C.D. Cal.);

*Layman v. Forster*, 1:09-CV-00733 (S.D. Ind.);  
*Lefoll v. Key Hyundai of Manchester L.L.C.*, 3:08-CV-01593 (D. Conn.);  
*Lemieux v. Global Credit & Collection Corp.*, 3:08-CV-01012 (S.D. Cal.);  
*Lewis v. Northeast Credit & Collections, Inc.*, 7:07-CV-11593 (S.D.N.Y.);  
*Lige v. Titanium Solutions Inc.*, 2:06-CV-00400 (N.D. Ind.);  
*Limpert v. Cambridge Credit Counseling Corp.*, 2:03-CV-05986 (E.D.N.Y.);  
*Lofton v. Bank of America Corp.*, 3:07-CV-05892 (N.D. Cal.);  
*Lopez v. JPMorgan Chase Bank (In re Checking Account Overdraft Litig.)\*\**, 1:09-CV-23127-JLK (S.D. Fla.);  
*Louie v. Weltman, Weinberg & Reis Co., L.P.A.*, 1:11-CV-01758 (N.D. Ill.);  
*Luxford v. Resurgent Capital Services, L.P.*, 4:09-CV-02809 (N.D. Cal.);  
*Makson v. Portfolio Recovery Associates, L.L.C.*, 3:07-CV-00582 (E.D. Va.);  
*Margulin v. Trojan Professional Services Inc.*, 1:08-CV-07052 (N.D. Ill.);  
*Markey v. Robert Joseph Williams Co., L.L.C.*, 1:08-CV-04304 (D.N.J.);  
*Marshall-Mosby v. Blitt & Gaines, P.C.*, 1:08-CV-00758 (N.D. Ill.);  
*Martin v. Cavalry Portfolio Services, L.L.C.*, 1:07-CV-04745 (N.D. Ill.);  
*Martin v. J.C. Christensen & Associates, Inc.*, 1:09-CV-05726 (N.D. Ill.);  
*Martinez v. Elite Recovery Services, Inc.*, 3:08-CV-00967 (D.N.J.);  
*Martinez v. FMS, Inc.*, 3:07-CV-01157 (M.D. Fla.);  
*Martsolf v. JBC Legal Group, P.C.*, 1:04-CV-01346 (M.D. Pa.);  
*Mathena v. Webster Bank N.A.*, 3:10-CV-01448 (D. Conn.);  
*Matthew v. Premium Asset Recovery Corp.*, 1:07-CV-04306 (N.D. Ill.);  
*Mayfield v. Memberstrust Credit Union*, 3:07-CV-00506 (E.D. Va.);  
*Mckenna v. Pollack & Rosen, P.A.*, 0:11-CV-62134 (S.D. Fla.);  
*Mcnulty v. Edwin A. Abrahamsen & Associates. P.C.*, 2:08-CV-00422 (W.D. Pa.);  
*Meselsohn v. First National Collection Bureau, Inc.*, 1:06-CV-03324 (E.D.N.Y.);  
*Meselsohn v. Lerman*, 2:06-CV-04115 (E.D.N.Y.);  
*Mesick v. Freedman, Anselmo, Lindberg & Rappe, L.L.C.*, 1:08-CV-02695 (N.D. Ill.);  
*Mikovic v. Financial Medical Systems, Inc.*, 2:10-CV-02457 (E.D.N.Y.);  
*Milam v. Credigy Receivables, Inc.*, 1:07-CV-04417 (N.D. Ill.);  
*Miller v. Midland Credit Management, Inc.*, 1:08-CV-00780 (N.D. Ill.);  
*Milo v. Barneys New York, Inc.*, 1:10-CV-03133 (S.D.N.Y.);  
*Mitchem v. Illinois Collection Service, Inc.*, 1:09-CV-07274 (N.D. Ill.);  
*Mitchem v. Northstar Location Services L.L.C.*, 1:09-CV-06711 (N.D. Ill.);  
*Moorehead v. Franklin Collection Service, Inc.*, 1:11-CV-05936 (N.D. Ill.);  
*Muha v. Encore Receivable Management Inc.*, 2:05-CV-00940 (E.D. Wis.);  
*Mund v. EMCC, Inc.*, 0:08-CV-00936 (D. Minn.);  
*Murphy v. Capital One Bank*, 1:08-CV-00801 (N.D. Ill.);  
*Navarrette v. TD Banknorth, N.A.*, 5:07-CV-02767 (N.D. Cal.);  
*Nobles v. MBNA Corp.*, 3:06-CV-03723 (N.D. Cal.);  
*Noel Frederick v. FIA Card Services, N.A.*, 2:09-CV-03419 (C.D. Cal.);  
*Norman v. Franklin Collection Services, Inc.*, 1:08-CV-00177 (N.D. Miss.);  
*O'Connor v. AR Resources Inc*, 3:08-CV-01703 (D. Conn.);  
*Pabon-Aponte v. Empresas Berrios, Inc.*, 3:06-CV-01865 (D.P.R.);  
*Palmer v. Far West Collection Services, Inc.*, 5:04-CV-03027 (N.D. Cal.);

*Parlier v. LVNV Funding, L.L.C.*, 1:11-CV-01586 (N.D. Ill.);  
*Pascal v. Feigelson*, 7:08-CV-00550 (S.D.N.Y.);  
*Passafiume v. National Recovery Agency, Inc.*, 2:10-CV-00796 (E.D.N.Y.);  
*Pawelczak v. Bureau of Collection Recovery, L.L.C.*, 1:11-CV-01415 (N.D. Ill.);  
*Perez v. Complete Collection Service of South Florida, Inc.*, 0:09-CV-61124 (S.D. Fla.);  
*Perry v. Harris Financial Management, L.L.C.*, 1:07-CV-05177 (N.D. Ill.);  
*Peterson v. Resurgent Capital Services L.P.*, 2:07-CV-00251 (N.D. Ind.);  
*Philip Rannis v. Fair Credit Lawyers Inc.*, 5:06-CV-00373 (C.D. Cal.);  
*Poet v. Security Credit Systems, Inc.*, 1:10-CV-01068 (D.N.J.);  
*Powell v. Procollect, Inc.*, 3:11-CV-00846 (N.D. Tex.);  
*Pozzuolo v. NCO Financial Systems, Inc.*, 2:07-CV-01295 (E.D. Pa.);  
*Prescott v. Autovest, L.L.C.*, 2:11-CV-00219 (E.D. Tex.);  
*Prieto v. HBLC, Inc.*, 1:08-CV-02718 (N.D. Ill.);  
*Quesenberry v. Alliant Law Group P.C.*, 4:09-CV-00414 (E.D. Tex.);  
*Quinones-Malone v. Pellegrino & Feldstein, L.L.C.*, 2:08-CV-03295 (D.N.J.);  
*Quiroz v. Revenue Production Management, Inc.*, 1:08-CV-00879 (N.D. Ill.);  
*Radicchi v. Palisades Collection L.L.C.*, 1:08-CV-02607 (E.D.N.Y.);  
*Ramirez v. Green Tree Servicing L.L.C.*, 1:09-CV-01195 (N.D. Ill.);  
*Ramirez v. Palisades Collection, L.L.C.*, 1:07-CV-03840 (N.D. Ill.);  
*Rayl v. Moores*, 1:09-CV-00554 (S.D. Ind.);  
*Reed v. Icon Fitness & Arvest Bank & Dent-A-Med*, 3:08-CV-00677 (E.D. Va.);  
*Reeves v. New Horizons Financial Services, Inc.*, 0:08-CV-04866 (D. Minn.);  
*Reichel v. Academy Collection Service Management, L.L.C., n/k/a Monarch Recovery Management, Inc.*, 1:10-CV-01119 (C.D. Ill.);  
*Rice v. Praxis Financial Solutions, Inc.*, 1:11-CV-08488 (N.D. Ill.);  
*Richard v. West Asset Management, Inc.*, 1:09-CV-03864 (N.D. Ill.);  
*Richardson v. Allied Interstate, Inc.*, 3:09-CV-02265 (D.N.J.);  
*Ritthaler v. Riddle & Associates, P.C.*, 1:08-CV-06920 (N.D. Ill.);  
*Robinson v. Thompson*, 3:10-CV-04143 (D.N.J.);  
*Rodriguez v. Sallie Mae (SLM) Corp.*, 3:07-CV-01866 (D. Conn.);  
*Rosenau v. Unifund Corp.*, 2:06-CV-01355 (E.D. Pa.);  
*Rubinstein v. Department Stores National Bank*, 1:08-CV-01596 (S.D.N.Y.);  
*Russo v. Puckett & Redford P.L.L.C.*, 2:09-CV-00433 (W.D. Wash.);  
*Ruth v. Triumph Partnerships L.L.C.*, 3:06-CV-50042 (N.D. Ill.);  
*Rutha Smith v. Heritage Financial Recovery Services*, 2:10-CV-03922 (D.N.J.);  
*Ryder v. Diversified Ambulance Billing L.L.C.*, 8:09-CV-02058 (M.D. Fla.);  
*Ryder v. Equifax Information Services, L.L.C.*, 1:09-CV-07626 (N.D. Ill.);  
*Sachar v. Iberiabank Corp. (In re Checking Account Overdraft Litig.)\*\**, 1:11-CV-22844-JLK (S.D. Fla.);  
*Sadler v. Midland Credit Management, Inc.*, 1:06-CV-05045 (N.D. Ill.);  
*Sanchez v. Northstar Location Services, L.L.C.*, 1:08-CV-04885 (N.D. Ill.);  
*Santoro v. Aargon Agency, Inc.*, 2:07-CV-01003 (D. Nev.);  
*Sargent v. Hibbard*, 1:08-CV-01463 (S.D. Ind.);  
*Sargent v. St. Vincent Hospital & Health Care Center, Inc.*, 1:08-CV-01464 (S.D. Ind.);  
*Savedoff v. Access Group, Inc.*, 1:06-CV-00135 (N.D. Ohio);

*Sally v. Hilco Receivables*, 1:04-CV-03035 (N.D. Ill.);  
*Schulte v. Fifth Third Bank*, 1:09-CV-06655 (N.D. Ill.);  
*Seawell v. Universal Fidelity Corp.*, 2:05-CV-00479 (E.D. Pa.);  
*Sergio Cedeno v. Bureau of Collection Recovery Inc.*, 8:10-CV-01960 (C.D. Cal.);  
*Serren v. LVNV Funding, L.L.C.*, 1:06-CV-03574 (N.D. Ill.);  
*Shane v. Ferrucci*, 1:11-CV-00946 (S.D. Ind.);  
*Shelton v. Crescent Bank & Trust*, 1:08-CV-01799 (D. Md.);  
*Shippey v. Weltman, Weinberg & Reis Co., L.P.A.*, 3:10-CV-00303 (W.D. Pa.);  
*Short v. Anastasi & Associates*, 0:11-CV-01612 (D. Minn.);  
*Silva v. Patenaude & Felix*, 5:08-CV-03019 (N.D. Cal.);  
*Sims v. Cellco Partnership\**, 3:07-CV-01510 (N.D. Cal.);  
*Skusenas v. Linebarger, Goggan, Blair & Sampson, L.L.P.*, 1:10-CV-08119 (N.D. Ill.);  
*Slade v. Law Offices of Daniel C Consuegra P.L.*, 4:11-CV-00005 (N.D. Fla.);  
*Smith v. Allied Interstate, Inc.*, 1:08-CV-06986 (S.D.N.Y.);  
*Smith v. GB Collects, L.L.C.*, 1:09-CV-05917 (D.N.J.);  
*Smith v. Lyons, Doughty & Veldhuis, P.C.*, 1:07-CV-05139 (D.N.J.);  
*Smith v. Professional Billing & Management Services, Inc.*, 1:06-CV-04453 (D.N.J.);  
*Smith v. Syndicated Office Systems, Inc.*, 3:07-CV-00131 (W.D. Tex.);  
*Soutter v. Equifax Information Services, L.L.C.*, 2:10-CV-03574 (E.D. Pa.);  
*Starzynski v. Friedman & Wexler, L.L.C.*, 1:07-CV-01254 (N.D. Ill.);  
*Steele v. Paypal, Inc.*, 1:05-CV-01720 (E.D.N.Y.);  
*Stern v. Cingular\**, 2:05-CV-08842 (C.D. Cal.);  
*Swain v. Cach, L.L.C.*, 5:08-CV-05562 (N.D. Cal.);  
*Sylverne v. Data Search N.Y., Inc.*, 1:08-CV-00031 (N.D. Ill.);  
*Sypniewski v. NCO Financial Systems, Inc.*, 1:08-CV-00239 (N.D. Ill.);  
*Taylor v. Apex Financial Management L.L.C.*, 2:09-CV-00229 (E.D. Tex.);  
*Tenerelli v. Cardworks Servicing, L.L.C.*, 1:09-CV-02651 (N.D. Ill.);  
*Thomas v. CitiFinancial Auto Ltd.*, 1:07-CV-00721 (D. Md.);  
*Thornton v. Belkin, Burden, Wenig & Goldman, L.L.P.*, 1:09-CV-05901 (S.D.N.Y.);  
*Thornton v. Midland Credit Management, Inc.*, 1:09-CV-05685 (N.D. Ill.);  
*Tidwell v. Asset Recovery Solutions, L.L.C.*, 1:09-CV-04022 (E.D.N.Y.);  
*Tornes v. Bank of America (In re: Checking Account Overdraft Litig)\*\**, 1:08-CV-23323-JLK  
(S.D. Fla);  
*Trempe v. HBLC, Inc.*, 1:07-CV-05945 (N.D. Ill.);  
*Trombley v. National City Bank*, 1:10-CV-00232 (D.D.C.);  
*Urbaniak v. Asset Acceptance, L.L.C.*, 1:08-CV-00551 (N.D. Ill.);  
*Urbaniak v. Credigy Receivables, Inc.*, 1:07-CV-06326 (N.D. Ill.);  
*Utility Consumers' Action Network v. Sprint Solutions\**, 3:07-CV-02231 (S.D. Cal.);  
*Valdez v. Sprint Nextel\**, 3:06-CV-07587 (N.D. Cal.);  
*Vallejo, Jr. v. National Credit Adjusters L.L.C.*, 2:10-CV-00103 (N.D. Ind.);  
*Varela v. Moskowitz, Mandell, Salim & Simowitz, P.A.*, 0:07-CV-61143 (S.D. Fla);  
*Vasilas v. Subaru of America\**, 1:07-CV-02374 (S.D.N.Y.);  
*Villaflor v. Equifax Information Services, L.L.C.*, 3:09-CV-00329 (N.D. Cal.);  
*Villasenor v. American Signature, Inc.*, 1:06-CV-05493 (N.D. Ill.);  
*Vincent v. Wolpoff & Abramson, L.L.P.*, 2:08-CV-00423 (W.D. Pa.);

*Voris v. Resurgent Capital Services L.P.*, 3:06-CV-02253 (S.D. Cal.);  
*Walker v. Discover Financial Services, Inc.*, 1:10-CV-06994 (N.D. Ill.);  
*Wang v. Asset Acceptance L.L.C.*, 3:09-CV-04797 (N.D. Cal.);  
*Wanty v. Messerli & Kramer P.A.*, 2:05-CV-00350 (E.D. Wis.);  
*Washington v. Unifund CCR Partners*, 1:07-CV-00150 (N.D. Ill.);  
*Watts v. Capital One Auto Finance, Inc.*, 1:07-CV-03477 (D. Md.);  
*Weinstein v. Asset Acceptance L.L.C.*, 1:07-CV-05967 (N.D. Ill.);  
*Werts v. Midland Funding, L.L.C.*, 1:09-CV-02311 (D.D.C.);  
*Wess v. Storey*, 2:08-CV-00623 (S.D. Ohio);  
*Whelan v. Keybank U.S.A., N.A.*, 1:03-CV-01118 (N.D. Ohio);  
*Whitehead-Bey v. Advantage Assets II, Inc.*, 2:11-CV-05199 (E.D. Pa.);  
*Wilfong v. National Capital Management, L.L.C.*, 1:12-CV-02979 (N.D. Ill.);  
*Wilhelm v. Allied Interstate, Inc.*, 1:07-CV-01497 (N.D. Ill.);  
*Williams v. Brock & Scott, P.L.L.C.*, 1:09-CV-00722 (M.D.N.C.);  
*Williamson v. Unifund CCR Partners*, 8:08-CV-00218 (D. Neb.);  
*Wilson v. Cybrcollect, Inc.*, 5:09-CV-00963 (N.D. Cal.);  
*Woldman v. Chase Bank U.S.A., N.A.*, 1:10-CV-00865 (N.D. Ill.);  
*Wysocki v. City National Bank*, 1:10-CV-03850 (N.D. Ill.);  
*Ybarrondo v. NCO Financial Systems*, 3:05-CV-02057 (S.D. Cal.);  
*Ziogiannis v. Professional Recovery Consultants, Inc.*, 2:11-CV-00887 (E.D.N.Y.);  
*Zugay v. Professional Recovery Consultants, Inc.*, 1:10-CV-01944 (E.D.N.Y.).



Note: The following appendix will not appear in the Code of Federal Regulations.

**APPENDIX B TO SECTION 1022(b)(2) ANALYSIS – CASES NOT USED IN PROJECTING**

**INCREMENTAL COSTS FROM PROPOSAL**

*Adighibe v. Clifton Telecard Alliance (CTA)*, 2:07-CV-01250 (D.N.J.);  
*Angela Minor v. Real Page, Inc.*, 4:09-CV-00439 (E.D. Tex.);  
*Anthony v. Fifth Third Bank*, 1:08-CV-04359 (N.D. Ill.);  
*Barandas v. Old Republic National Title Insurance Co.*, 2:06-CV-01750 (D.N.J.);  
*Barlo v. First Financial Bank N.A.*, 2:10-CV-00235 (N.D. Ind.);  
*Barreto v. Center Bank*, 1:10-CV-06554 (N.D. Ill.);  
*Bernal v. American Money Centers Inc.*, 2:05-CV-01327 (E.D. Wis.);  
*Blaylock v. First American Title Insurance Co.*, 2:06-CV-01667 (W.D. Wash.);  
*Boecherer v. Burling Bank*, 1:08-CV-01332 (N.D. Ill.);  
*Bowen v. Groome*, 3:11-CV-00139 (S.D. Ill.);  
*Brake v. Highland Corp.*, 3:11-CV-00620 (M.D. Tenn.);  
*Bruner v. America United Bank & Trust Co.*, 1:08-CV-00124 (N.D. Ill.);  
*Castro v. Old Republic National Title Insurance Co.*, 3:06-CV-00784 (D. Conn.);  
*Charles v. Lawyers Title Insurance Corp.*, 2:06-CV-02361 (D.N.J.);  
*Chernyavsky v. Inland Bank & Trust*, 1:08-CV-04009 (N.D. Ill.);  
*Clay William Fisher v. Finance America*, 8:05-CV-00888 (C.D. Cal.);  
*Cole v. Automated Financial, L.L.C.*, 1:11-CV-03299 (N.D. Ill.);  
*Couch v. Indians, Inc.*, 1:11-CV-00963 (S.D. Ind.);  
*Cummings v. Resource Federal Credit Union*, 1:10-CV-01309 (W.D. Tenn.);  
*Donald R Chastain v. Union Security Life Insurance Co.*, 2:06-CV-05885 (C.D. Cal.);  
*Dover v. GNC Community Federal Credit Union*, 2:09-CV-00810 (W.D. Pa.);  
*Dragotta v. Northwest Bancorp, Inc.*, 2:09-CV-00632 (W.D. Pa.);  
*Dragotta v. West View Savings Bank*, 2:09-CV-00627 (W.D. Pa.);  
*Drexler v. George Loukas Real Estate, Inc.*, 1:07-CV-05471 (N.D. Ill.);  
*Ellens v. Genworth Life & Annuity Insurance Co.*, 1:08-CV-02640 (N.D. Ohio);  
*Escalante v. Lincoln Park Savings Bank*, 1:08-CV-06152 (N.D. Ill.);  
*Escalante v. Travelex Currency Services, Inc.*, 1:09-CV-02209 (N.D. Ill.);  
*Estate of Frank Townsend v. Protective Life Insurance Co.*, 1:10-CV-02365 (N.D. Ohio);  
*Evans & Green, L.L.P. v. Mortgage Depot, L.L.C.*, 6:07-CV-03275 (W.D. Mo.);  
*Ewing v. Administrative Systems Inc.*, 2:08-CV-00797 (W.D. Wash.);  
*Flores v. Bank*, 1:07-CV-06403 (N.D. Ill.);  
*Gaylor v. Comala Credit Union*, 2:10-CV-00725 (M.D. Ala.);  
*Gendernalik v. Fred Hunter Memorial Sevices, Inc.*, 0:08-CV-60274 (S.D. Fla);  
*Gibilante v. Wachovia Mortgage Corp.*, 2:07-CV-02236 (E.D. Pa.);  
*Goldshteyn v. Argonne Credit Union*, 1:10-CV-05402 (N.D. Ill.);  
*Greiff v. First Commonwealth Bank*, 2:10-CV-01224 (W.D. Pa.);  
*Greiff v. Jamestown Area Community Federeal Credit Union*, 1:10-CV-00404 (W.D.N.Y);  
*Hall v. Vitran Express, Inc.*, 1:09-CV-00800 (N.D. Ohio);  
*Hamilton v. Wells Fargo Bank, N.A.*, 4:09-CV-04152 (N.D. Cal.);

*Hansen v. Monumental Life Insurance Co.*, 3:05-CV-01905 (D. Conn.);  
*Harrison v. First Independence Bank*, 5:09-CV-12684 (E.D. Mich.);  
*Harrison v. Flagstar Bank F.S.B.*, 5:09-CV-12687 (E.D. Mich.);  
*Hart v. Guardian Credit Union*, 2:10-CV-00855 (M.D. Ala.);  
*Hays v. Commonwealth Land Title Insurance Co.*, 3:10-CV-05336 (N.D. Cal.);  
*Helkowski v. Clearview Federal Credit Union*, 2:09-CV-00609 (W.D. Pa.);  
*Howard v. Canandaigua National Bank & Trust*, 6:09-CV-06513 (W.D.N.Y.);  
*Hrnyak v. Mid-West National Life Insurance Co. of Tennessee*, 1:08-CV-02642 (N.D. Ohio);  
*In Re: Trans Union Corp. v. Trans Union L.L.C.*, 1:00-CV-04729 (N.D. Ill.);  
*Jackman v. Global Cash Access Holdings, Inc.*, 2:09-CV-00897 (W.D. Pa.);  
*Katz v. Palisades Federal Credit Union*, 7:09-CV-01745 (S.D.N.Y.);  
*Kinder v. Elga Credit Union*, 5:10-CV-11549 (E.D. Mich.);  
*Kinder v. Lenco Credit Union*, 5:11-CV-11655 (E.D. Mich.);  
*Kistner v. Corus Bank, N.A.*, 1:08-CV-02797 (N.D. Ill.);  
*Lengrand v. Wellpoint, Inc.*, 3:11-CV-00333 (E.D. Va.);  
*Lentini v. Fidelity National Title Insurance Co. of New York*, 3:06-CV-00572 (D. Conn.);  
*Lindsey v. American Security Insurance Co.*, 2:08-CV-00126 (E.D. Ky.);  
*Lindsey v. Unitrin Auto & Home Insurance Co.*, 2:08-CV-00127 (E.D. Ky.);  
*Lockwood v. Certegy Check Services, Inc.*, 8:07-CV-01434 (M.D. Fla.);  
*Louisma v. Automated Financial, LLC*, 1:11-CV-02104 (N.D. Ill.);  
*Mains v. DB Direct*, 2:07-CV-02037 (C.D. Ill.);  
*Markoff v. Independent Bank Corp.*, 2:09-CV-12639 (E.D. Mich.);  
*Marsh v. ATM Capital Management, Inc.*, 1:07-CV-05808 (N.D. Ill.);  
*Marsi Zintel v. Pacific Community Federal Credit Union*, 2:09-CV-05517 (C.D. Cal.);  
*Mathias v. Carver Federal Savings Bank*, 1:08-CV-05041 (E.D.N.Y.);  
*McCormick v. 7-11, Inc.*, 3:06-CV-00127 (N.D. Tex.);  
*McGill v. Parker Centennial Assurance Co.*, 1:08-CV-02766 (N.D. Ohio);  
*McKinnie v. JP Morgan Chase Bank N.A.*, 2:07-CV-00774 (E.D. Wis.);  
*Mendelovits v. Albany Bank & Trust Co., N.A.*, 1:08-CV-03870 (N.D. Ill.);  
*Mills v. HEB Grocery Co., L.P.*, 4:10-CV-04974 (S.D. Tex.);  
*Neals v. Mortgage Guarantee Insurance Corp.*, 2:10-CV-01291 (W.D. Pa.);  
*Nguyen v. South Central Bank*, 1:11-CV-02612 (N.D. Ill.);  
*Nicholas v. RBS Citizens, N.A.*, 2:09-CV-01697 (E.D.N.Y.);  
*Nolf v. Allegheny Valley Bank of Pittsburgh*, 2:09-CV-00645 (W.D. Pa.);  
*Ori v. Fifth Third Bank*, 2:08-CV-00432 (E.D. Wis.);  
*Orser v. Select Portfolio Servicing Inc.*, 2:05-CV-01507 (W.D. Wash.);  
*Pamela Phillips v. Accredited Home Lenders Holding Co.*, 2:06-CV-00057 (C.D. Cal.);  
*Parker v. First-Citizens Bank & Trust Co.*, 3:09-CV-00588 (M.D. Tenn.);  
*Patrick Mahoney v. Fidelity National Title Co.*, 8:08-CV-00561 (C.D. Cal.);  
*Paul Zintel v. Ironstone Bank*, 8:09-CV-00867 (C.D. Cal.);  
*Pavle v. Arizona Central Credit Union*, 4:10-CV-00234 (D. Ariz.);  
*Perez v. First American Title Insurance Co.*, 2:08-CV-01184 (D. Ariz.);  
*Piontek v. Baltimore County Savings Bank, F.S.B.*, 1:10-CV-03101 (D. Md.);  
*Piontek v. CU Service Network, L.L.C.*, 8:10-CV-01202 (D. Md.);  
*Piontek v. Frederick County Bank*, 8:10-CV-01912 (D. Md.);

*Piontek v. VIST Financial Corp.*, 5:10-CV-02715 (E.D. Pa.);  
*Polevoy v. Devon Bank*, 1:08-CV-04822 (N.D. Ill.);  
*Popovic v. Dollar Bank*, 2:10-CV-00432 (W.D. Pa.);  
*Popovic v. USX Federal Credit Union*, 2:09-CV-00631 (W.D. Pa.);  
*Press v. Catskill Hudson Bank*, 7:08-CV-11335 (S.D.N.Y.);  
*Reich v. GCM Federal Credit Union*, 0:10-CV-00606 (D. Minn.);  
*Richardson v. Harris County Federal Credit Union*, 4:11-CV-01550 (S.D. Tex.);  
*Richardson v. Houston Federal Credit Union*, 4:10-CV-03768 (S.D. Tex.);  
*Rodriguez v. Corus Bank, N. A.*, 1:08-CV-03511 (N.D. Ill.);  
*Rodriguez v. United Title Co.*, 3:05-CV-01019 (S.D. Cal.);  
*Rushton v. First National Bank in Cooper*, 4:11-CV-00038 (E.D. Tex.);  
*Ryals v. Hireright Solutions, Inc.*, 3:09-CV-00625 (E.D. Va.);  
*Ryan v. ATM Link, Inc.*, 1:09-CV-07747 (N.D. Ill.);  
*Sebrow v. HSBC Bank, U.S.A., N.A.*, 2:08-CV-03162 (E.D.N.Y.);  
*Shaked v. Wachovia Bank, N.A.*, 7:08-CV-06984 (S.D.N.Y.);  
*Shelton v. Crescent Bank & Trust*, 1:08-CV-01799 (D. Md.);  
*Siragusa v. Advance Financial Federal Credit Union*, 2:09-CV-00328 (N.D. Ind.);  
*Siragusa v. Corporate America Family Credit Union*, 1:08-CV-04007 (N.D. Ill.);  
*Siragusa v. North Community Bank*, 1:09-CV-02687 (N.D. Ill.);  
*Smith v. Credit Union 1*, 1:07-CV-05939 (N.D. Ill.);  
*Stone v. Corus Bank, N.A.*, 1:08-CV-01746 (N.D. Ill.);  
*Stone v. Marquette Bank*, 1:08-CV-06388 (N.D. Ill.);  
*Syran v. LexisNexis Group*, 3:05-CV-00909 (S.D. Cal.);  
*Taylor v. Apex Financial Management L.L.C.*, 2:09-CV-00229 (E.D. Tex.);  
*Tedrow v. Cowles*, 2:06-CV-00637 (S.D. Ohio);  
*Thomas v. Investex Credit Union*, 4:11-CV-00354 (S.D. Tex.);  
*Thomas v. Mid-Missouri Bank*, 6:10-CV-03139 (W.D. Mo.);  
*Tovar v. Plaza Bank*, 1:08-CV-04008 (N.D. Ill.);  
*Vasuki Parthiban v. GMAC Mortgage Corp.*, 8:05-CV-00768 (C.D. Cal.);  
*Webb v. Cleverbridge, Inc.*, 1:11-CV-04141 (N.D. Ill.);  
*Wike v. Vertrue, Inc.*, 3:06-CV-00204 (M.D. Tenn.);  
*Williams v. Staffing Solutions Southeast, Inc.*, 1:10-CV-00956 (N.D. Ill.);  
*Witriol v. LexisNexis Group*, 3:06-CV-02360 (S.D. Cal.).

## List of Subjects in 12 Part 1040

Banks, Banking, Business and industry, Claims, Consumer Protection, Contracts, Credit, Credit unions, Finance, National banks, Reporting and recordkeeping requirements, Savings associations.

### Authority and Issuance

For the reasons set forth above, the Bureau proposes to add part 1040 to Chapter X in Title 12 of the Code of Federal Regulations, as set forth below:

#### **PART 1040—ARBITRATION AGREEMENTS**

Sec.

1040.1 Authority, purpose, and enforcement.

1040.2 Definitions.

1040.3 Coverage.

1040.4 Limitations on the use of pre-dispute arbitration agreements.

1040.5 Compliance date and temporary exception.

Supplement I to Part 1040—Official Interpretations.

1. The authority citation for part 1040 reads as follows:

**Authority:** 12 U.S.C. 5512(b) and (c) and 5518(b).

#### **§ 1040.1 Authority, purpose, and enforcement.**

(a) *Authority.* The regulation in this part is issued by the Bureau of Consumer Financial Protection (Bureau) pursuant to sections 1022(b)(1) and (c) and 1028(b) of the Dodd-Frank Act (12 U.S.C. 5512(b) and (c) and 5518(b)).

(b) *Purpose.* The purpose of this part is the furtherance of the public interest and the protection of consumers regarding the use of agreements for consumer financial products and services providing for arbitration of any future dispute.

## **§ 1040.2 Definitions.**

(a) *Class action* means a lawsuit in which one or more parties seek class treatment pursuant to Federal Rule of Civil Procedure 23 or any State process analogous to Federal Rule of Civil Procedure 23.

(b) *Consumer* means an individual or an agent, trustee, or representative acting on behalf of an individual.

(c) *Provider* means:

(1) A person as defined by 12 U.S.C. 5481(19) that engages in offering or providing any of the consumer financial products or services covered by § 1040.3(a) to the extent that the person is not excluded under § 1040.3(b); or

(2) An affiliate of a provider as defined in paragraph (c)(1) of this section when that affiliate is acting as a service provider to the provider as defined in paragraph (c)(1) of this section with which the service provider is affiliated consistent with 12 U.S.C. 5481(6)(B).

(d) *Pre-dispute arbitration agreement* means an agreement between a provider and a consumer providing for arbitration of any future dispute between the parties.

## **§ 1040.3 Coverage.**

(a) *Covered consumer financial products and services.* This part generally applies to pre-dispute arbitration agreements for the following products or services when they are consumer financial products or services as defined by 12 U.S.C. 5481(5):

(1)(i) Providing an “extension of credit” that is “consumer credit” as defined in Regulation B, 12 CFR 1002.2;

(ii) Acting as a “creditor” as defined by 12 CFR 1002.2(l) by “regularly participat[ing] in a credit decision” consistent with its meaning in 12 CFR 1002.2(l) concerning “consumer credit” as defined by 12 CFR 1002.2(h);

(iii) Acting, as a person’s primary business activity, as a “creditor” as defined by 12 CFR 1002.2(l) by “refer[ring] applicants or prospective applicants to creditors, or select[ing] or offer[ing] to select creditors to whom requests for credit may be made” consistent with its meaning in 12 CFR 1002.2(l);

(iv) Acquiring, purchasing, or selling an extension of consumer credit covered by paragraph (a)(1)(i) of this section; or

(v) Servicing an extension of consumer credit covered by paragraph (a)(1)(i) of this section; or

(2) Extending automobile leases as defined by 12 CFR 1090.108 or brokering such leases;

(3) Providing services to assist with debt management or debt settlement, modify the terms of any extension of consumer credit covered by paragraph (a)(1)(i) of this section, or avoid foreclosure;

(4) Providing directly to a consumer a consumer report as defined by the Fair Credit Reporting Act, 15 U.S.C. 1681a(d), a credit score, or other information specific to a consumer from such a consumer report, except when such consumer report is provided by a user covered by 15 U.S.C. 1681m solely in connection with an adverse action as defined in 15 U.S.C. 1681a(k) with respect to a product or service not covered by any of paragraphs (1) through (3) or (5) through (10) of this section;

(5) Providing accounts subject to the Truth in Savings Act, 12 U.S.C. 4301 *et seq.*, as implemented by 12 CFR part 707, and Regulation DD, 12 CFR part 1030;

(6) Providing accounts or remittance transfers subject to the Electronic Fund Transfer Act, 15 U.S.C. 1693 *et seq.*, as implemented by Regulation E, 12 CFR part 1005;

(7) Transmitting or exchanging funds as defined by 15 U.S.C. 5481(29) except when integral to another product or service that is not covered by section 1040.3;

(8) Accepting financial or banking data or providing a product or service to accept such data directly from a consumer for the purpose of initiating a payment by a consumer via any payment instrument as defined by 15 U.S.C. 5481(18) or initiating a credit card or charge card transaction for the consumer, except when the person accepting the data or providing the product or service to accept the data also is selling or marketing the nonfinancial good or service for which the payment or credit card or charge card transaction is being made;

(9) Check cashing, check collection, or check guaranty services; or

(10) Collecting debt arising from any of the consumer financial products or services described in paragraphs (1) through (9) of this section by:

(i) A person offering or providing the product or service giving rise to the debt being collected, an affiliate of such person, or, a person acting on behalf of such person or affiliate;

(ii) A person purchasing or acquiring an extension of consumer credit covered by paragraph (a)(1)(i) of this section, an affiliate of such person, or, a person acting on behalf of such person or affiliate; or

(iii) A debt collector as defined by 15 U.S.C. 1692a(6).

(b) *Excluded persons.* This part does not apply to the following persons to the extent they are offering or providing any of the following products and services:

(1) Broker dealers to the extent that they are providing products or services described in paragraph (a) of this section that are subject to rules promulgated or authorized by the U.S. Securities and Exchange Commission prohibiting the use of pre-dispute arbitration agreements in class action litigation and providing for making arbitral awards public;

(2) (i) The federal government and any affiliate of the Federal government providing any product or service described in paragraph (a) of this section directly to a consumer; or

(ii) A State, local, or tribal government, and any affiliate of a State, local, or tribal government, to the extent it is providing any product or service described in paragraph (a) of this section directly to a consumer who resides in the government's territorial jurisdiction;

(3) Any person when providing a product or service described in paragraph (a) of this section that the person and any of its affiliates collectively provide to no more than 25 consumers in the current calendar year and to no more than 25 consumers in the preceding calendar year;

(4) Merchants, retailers, or other sellers of nonfinancial goods or services to the extent they:

(i) Provide an extension of consumer credit covered by paragraph (a)(1)(i) of this section that is of the type described in 12 U.S.C. 5517(a)(2)(A)(i) and they would be subject to the Bureau's authority only under 12 U.S.C. 5517(a)(2)(B)(i) but not 12 U.S.C. 5517(a)(2)(B)(ii) or (iii); or

(ii) Purchase or acquire an extension of consumer credit excluded by paragraph (b)(4)(i) of this section; or

(5) Any person to the extent the limitations in 12 U.S.C. 5517 or 5519 apply to the person or a product or service described in paragraph (a) of this section that is offered or provided by the person.



**§ 1040.4 Limitations on the use of pre-dispute arbitration agreements.**

(a) *Use of pre-dispute arbitration agreements in class actions.*

(1) *General rule.* A provider shall not seek to rely in any way on a pre-dispute arbitration agreement entered into after the date set forth in § 1040.5(a) with respect to any aspect of a class action that is related to any of the consumer financial products or services covered by § 1040.3 including to seek a stay or dismissal of particular claims or the entire action, unless and until the presiding court has ruled that the case may not proceed as a class action and, if that ruling may be subject to appellate review on an interlocutory basis, the time to seek such review has elapsed or the review has been resolved.

(2) *Provision required in covered pre-dispute arbitration agreements.* Upon entering into a pre-dispute arbitration agreement for a product or service covered by § 1040.3 after the date set forth in § 1040.5(a):

(i) Except as provided in paragraphs (a)(2)(ii) or (iii) of this section or in § 1040.5(a), a provider shall ensure that the agreement contains the following provision: “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.”

(ii) When the pre-dispute arbitration agreement is for multiple products or services, only some of which are covered by § 1040.3, the provider may include the following alternative provision in place of the one otherwise required by paragraph 4(a)(2)(i) of this section: “We are providing you with more than one product or service, only some of which are covered by the Arbitration Agreements Rule issued by the Consumer Financial Protection Bureau. 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. This provision applies only to class action claims concerning the products or services covered by that Rule.”

(iii) When the pre-dispute arbitration agreement existed previously between other parties and does not contain either the provision required by paragraph (a)(2)(i) of this section or the alternative permitted by paragraph (a)(2)(ii) of this section, the provider shall either ensure the agreement is amended to contain the provision specified in paragraph (a)(2)(iii)(A) of this section or provide any consumer to whom the agreement applies with the written notice specified in paragraph (a)(2)(iii)(B) of this section. The provider shall ensure the agreement is amended or provide the notice to consumers within 60 days of entering into the pre-dispute arbitration agreement.

(A) *Agreement provision.* “We agree that neither we nor anyone else who later becomes a party to this pre-dispute arbitration agreement will use it 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.”

(B) *Notice.* “We agree not to use any pre-dispute arbitration 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.”

(b) *Submission of arbitral records.* For any pre-dispute arbitration agreement entered into after the date set forth in § 1040.5(a), a provider shall comply with the requirements set forth below.

(1) *Records to be submitted.* A provider shall submit a copy of the following records to the Bureau, in the form and manner specified by the Bureau:

(i) In connection with any claim filed in arbitration by or against the provider concerning any of the consumer financial products or services covered by § 1040.3;

(A) The initial claim and any counterclaim;

(B) The pre-dispute arbitration agreement filed with the arbitrator or arbitration administrator;

(C) The judgment or award, if any, issued by the arbitrator or arbitration administrator; and

(D) If an arbitrator or arbitration administrator refuses to administer or dismisses a claim due to the provider's failure to pay required filing or administrative fees, any communication the provider receives from the arbitrator or an arbitration administrator related to such a refusal; and

(ii) Any communication the provider receives from an arbitrator or an arbitration administrator related to a determination that a pre-dispute arbitration agreement for a consumer financial product or service covered by § 1040.3 does not comply with the administrator's fairness principles, rules, or similar requirements, if such a determination occurs.

(2) *Deadline for submission.* A provider shall submit any record required pursuant to paragraph (b)(1) of this section within 60 days of filing by the provider of any such record with the arbitrator or arbitration administrator and within 60 days of receipt by the provider of any such record filed or sent by someone other than the provider, such as the arbitration administrator or the consumer.

(3) *Redaction.* Prior to submission of any records pursuant to paragraph (b)(1) of this section, a provider shall redact the following information:

(i) Names of individuals, except for the name of the provider or the arbitrator where either is an individual;

- (ii) Addresses of individuals, excluding city, State, and zip code;
- (iii) Email addresses of individuals;
- (iv) Telephone numbers of individuals;
- (v) Photographs of individuals;
- (vi) Account numbers;
- (vii) Social Security and tax identification numbers;
- (viii) Driver's license and other government identification numbers; and
- (ix) Passport numbers.

**§ 1040.5 Compliance date and temporary exception.**

(a) *Compliance date.* Compliance with this part is required for any pre-dispute arbitration agreement entered into after **[INSERT DATE THAT IS 211 DAYS AFTER PUBLICATION OF THE FINAL RULE IN THE FEDERAL REGISTER]**.

(b) *Exception for pre-packaged general-purpose reloadable prepaid card agreements.* Section 1040.4(a)(2) shall not apply to a provider that enters into a pre-dispute arbitration agreement for a general-purpose reloadable prepaid card if the requirements set forth in either paragraphs (b)(1) or (2) of this section are satisfied.

(1) For a provider that does not have the ability to contact the consumer in writing:

(i) The consumer acquires a general-purpose reloadable prepaid card in person at a retail store;

(ii) The pre-dispute arbitration agreement was inside of packaging material when the general-purpose reloadable prepaid card was acquired; and

(iii) The pre-dispute arbitration agreement was packaged prior to the compliance date of the rule.

(2) For a provider that has the ability to contact the consumer in writing:

(i) The provider meets the requirements set forth in paragraphs (1)(i) through (iii) of this section; and

(ii) Within 30 days of obtaining the consumer's contact information, the provider notifies the consumer in writing that the pre-dispute arbitration agreement complies with the requirements of § 1040.4(a)(2) by providing an amended pre-dispute arbitration agreement to the consumer.

## **Supplement I to Part 1040—Official Interpretations**

### *Section 1040.2—Definitions*

#### *2(c) Provider.*

1. *Providers of multiple products or services.* A provider as defined in § 1040.2(c) that also engages in offering or providing products or services not covered by § 1040.3 must comply with this part only for the products or services that it offers or provides that are covered by § 1040.3. For example, a merchant that transmits funds for its customers would be covered pursuant to § 1040.3(a)(6) with respect to the transmittal of funds. That same merchant generally would not be covered with respect to the sale of durable goods to consumers, except as provided in 12 U.S.C. 5517(a)(2)(B)(ii) or (iii).

#### *2(d) Pre-dispute arbitration agreement.*

1. *Form of pre-dispute arbitration agreements.* A pre-dispute arbitration agreement for a consumer financial product or service includes any agreement between a provider and a consumer providing for arbitration of any future disputes between the parties, regardless of its form or structure. Examples include a standalone pre-dispute arbitration agreement that applies to a product or service, as well as a pre-dispute arbitration agreement that is included within,

annexed to, incorporated into, or otherwise made a part of a larger agreement that governs the terms of the provision of a product or service.

*Section 1040.3—Coverage*

*3(a) Covered products or services.*

1. *Consumer financial products or services pursuant to 12 U.S.C. 5481(5).* Section 1040.3(a) provides that the products or services listed in paragraph (a) of this section are covered by Part 1040 when they are consumer financial products or services as defined by 12 U.S.C. 5481(5). Products or services generally meet this definition in either of two ways: they are offered or provided for use by consumers primarily for personal, family, or household purposes, or they are delivered, offered, or provided in connection with such products or services. Examples of the second type of consumer product or service include debt collection, when the underlying loan that is the subject of collection is a consumer financial product or service.

*Paragraph (a)(1)(i).*

1. *Coverage of extensions of consumer credit by creditors.* A transaction is only an extension of consumer credit, as defined by Regulation B, if the credit is extended by a “creditor.” Persons who do not regularly participate in credit decisions in the ordinary course of business, for example, are not creditors as defined by Regulation B. 12 CFR 1002.2(l).

*Paragraph (a)(1)(iii).*

1. *Offering or providing referral or creditor selection services.* Section 1040.3(a)(1)(iii) includes in the coverage of Part 1040 providing referrals or providing or offering creditor selection consistent with the meaning in 12 CFR 1002.2(l) by a creditor as its primary business. A person whose primary business is the sale of non-financial goods or services that also provides

or offers the services described in section 1040.3(a)(1)(iii) would not be covered under section 1040.4(a)(1)(iii) because the referrals are not its primary business.

*Paragraph (a)(1)(v).*

1. *Servicing of credit.* Section 1040.3(a)(1)(v) includes in the coverage of Part 1040 servicing of extensions of consumer credit. Servicing of extensions of consumer credit includes, but is not limited to, student loan servicing as defined in 12 CFR 1090.106 and mortgage loan servicing as defined in 12 CFR 1024.2(b).

*Paragraph (a)(3).*

1. *Debt relief products and services.* Section 1040.3(a)(3) includes in the coverage of Part 1040 services that offer to renegotiate, settle, or modify the terms of a consumer's debt. Providers of these services would be covered by section 1040.3(a)(3) regardless of the source of the debt, including but not limited to when seeking to relieve consumers of a debt that does not arise from a consumer credit transaction as described by section 1040.3(a)(1)(i) or from a consumer financial product or service more generally.

*Paragraph (a)(8).*

1. *Credit card and charge card transactions.* Section 1040.3(a)(8) includes in the coverage of Part 1040 certain payment processing activities involving the initiation of credit card or charge card transactions. The terms "credit card" and "charge card" are defined in Regulation Z, 12 CFR 1026.2(a)(15). For purposes of section 1040.3(a)(8), those definitions in Regulation Z apply.

*Paragraph (a)(10).*

1. *Collection of debt by the same person arising from covered and non-covered products and services.* Section 1040.3(a)(10)(i) includes in the coverage of Part 1040 the collection of

debt by a provider that arises from its providing any of the products and services described in paragraphs (1) through (9) of section 1040.3(a), including for example an extension of consumer credit described in section 1040.3(a)(1). If the person collecting such debt also collects other debt that does not arise from any of the products and services described in paragraphs (1) through (9) of section 1040.3(a), the collection of that other debt is not included in the coverage of section 1040.3(a)(10)(i). For example, if a creditor extended consumer credit to consumers and business credit to other persons, section 1040.3(a)(10)(i) would include in the coverage of Part 1040 the collection of the consumer credit but not the collection of the business credit. Similarly, if a debt buyer purchases a portfolio of credit card debt that includes both consumer and business debt, section 1040.3(a)(10)(ii) would include in the coverage of Part 1040 only the collection of the consumer credit card debt.

*2. Collection of debt by affiliates.* Subparagraphs (i) and (ii) of section 1040.3(a)(10) cover certain collection activities not only by providers themselves, but also by their affiliates. The term “affiliate” is defined in 12 U.S.C. 5481(1) as any person that controls, or is controlled by, or is under common control with another person.

*3(b) Excluded persons.*

*Paragraph (b)(1).*

*1. Exclusion for broker dealers to the extent they are subject to certain rules promulgated by the Financial Industry Regulatory Authority.* Section 1040.3(b)(1) excludes from the coverage of Part 1040 broker dealers to the extent they are subject to rules promulgated or authorized by the U.S. Securities and Exchange Commission (SEC) prohibiting the use of pre-dispute arbitration agreements in class action litigation and providing that arbitral awards be made public. Rules authorized by the SEC as referenced in section 1040.3(b)(1) include those



promulgated by the Financial Industry Regulatory Authority (FINRA) and authorized by the SEC, such as FINRA Rule 2268: Requirements When Using Predispute Arbitration Agreements for Customer Accounts, FINRA Rule 12204: Class Action Claims, and FINRA Rule 12904: Awards.

*Paragraph (b)(2).*

1. *Exclusion only for governments and their affiliates.* Section 1040.3(b)(2) excludes from the coverage of Part 1040 governments and their affiliates under certain circumstances. The term “affiliate” is defined in 12 U.S.C. 5481(1) as any person that controls, or is controlled by, or is under common control with another person. One of the requirements for this exclusion in section 1040.3(b)(2) to apply to a government or government affiliate is that the government or government affiliate itself be providing the covered product or service directly to consumers. As a result, the exclusion does not extend to an entity that may provide services on behalf of a government or government affiliate, when the entity is not itself a government or government affiliate.

2. *Examples of consumer financial products or services provided directly by a government or government affiliate to consumers who reside in the territorial jurisdiction of the government.* Section 1040.3(b)(2)(ii) excludes from the coverage of Part 1040 State, local, or tribal governments and their affiliates when directly providing a consumer financial product or service to consumers who reside in the government’s territorial jurisdiction.

i. Such products or services provided to a consumer who resides in the territorial jurisdiction of the government may include, but are not limited to, the following:

A. A bank that is an affiliate of a State government providing a student loan or deposit account directly to a resident of the State; or

B. A utility that is an affiliate of a State or municipal government providing credit or payment processing services directly to a consumer who resides in the State or municipality to allow a consumer to purchase energy from an energy supplier that is not an affiliate of the same State or municipal government.

ii. Such products or services provided to a consumer who does not reside in the territorial jurisdiction of the government may include, but are not limited to, the following:

A. A bank that is an affiliate of a State government providing a student loan to a student who resides in another State; or

B. A tribal government affiliate providing a short-term loan to a consumer who does not reside in the tribal government's territorial jurisdiction and completes the transaction via the Internet.

*Paragraph (b)(3).*

1. *Including consumers to whom affiliates offer or provide a product or service toward the numerical threshold for exemption of a person under Section 1040.4(b)(3).* Section 1040.3(b)(3) provides an exclusion to persons offering or providing a service covered by Section 1040.3(a) if no more than 25 consumers are offered the product or service in the current and prior calendar years by the person and its affiliates. For purposes of this test, the number of consumers to whom affiliates of a person offer or provide a product or service is combined with the number of consumers to whom the person itself offers or provides that product or service. The term "affiliate" is defined in 12 U.S.C. 5481(1) as any person that controls, or is controlled by, or is under common control with another person.

*Section 1040.4—Limitations on the Use of Pre-Dispute Arbitration Agreements*

1. *Enters into a pre-dispute arbitration agreement.* Section 1040.4 applies to providers that enter into pre-dispute arbitration agreements after the date set forth in § 1040.5(a).

i. Examples of when a provider enters into a pre-dispute arbitration agreement for purposes of § 1040.4 include but are not limited to when the provider:

A. Provides to a consumer a new product or service that is subject to a pre-dispute arbitration agreement, and the provider is a party to the pre-dispute arbitration agreement;

B. Acquires or purchases a product covered by § 1040.3(a) that is subject to a pre-dispute arbitration agreement and becomes a party to that pre-dispute arbitration agreement, even if the person selling the product is excluded from coverage under § 1040.3(b); or

C. Adds a pre-dispute arbitration agreement to an existing product or service.

ii. Examples of when a provider does not enter into a pre-dispute arbitration agreement for purposes of § 1040.4 include but are not limited to when the provider:

A. Modifies, amends, or implements the terms of a product or service that is subject to a pre-dispute arbitration agreement that was entered into before the date set forth in § 1040.5(a); or

B. Acquires or purchases a product that is subject to a pre-dispute arbitration agreement but does not become a party to the pre-dispute arbitration agreement.

2. *Application of section 1040.4 to providers that do not enter into pre-dispute arbitration agreements.* Pursuant to § 1040.4(a)(1), a provider cannot rely on any pre-dispute arbitration agreement entered into by another person after the effective date with respect to any aspect of a class action concerning a product or service covered by § 1040.3 and pursuant to § 1040.4(b) may be required to submit certain specified records related to claims filed in arbitration pursuant to such pre-dispute arbitration agreements. *See* comment 4(a)(2)-1,

however, which clarifies that § 1040.4(a)(2) does not apply to providers that do not enter into pre-dispute arbitration agreements.

For example, when a debt collector collecting on consumer credit covered by § 1040.3(a)(1)(i) has not entered into a pre-dispute arbitration agreement, § 1040.4(a)(1) nevertheless prohibits the debt collector from relying on a pre-dispute arbitration agreement entered into by the creditor with respect to any aspect of a class action filed against the debt collector concerning its debt collection products or services covered by section § 1040.3. Similarly, section 1040.4(a)(1) would also prohibit the debt collector from relying with respect to any aspect of such a class action on a pre-dispute arbitration agreement entered into by a merchant creditor who was excluded from coverage by § 1040.3(b)(5).

*4(a) Use of pre-dispute arbitration agreements in class actions.*

*4(a)(1) General rule.*

1. *Reliance on a pre-dispute arbitration agreement.* Section 1040.4(a)(1) provides that a provider shall not seek to rely in any way on a pre-dispute arbitration agreement entered into after the compliance date set forth in § 1040.5(a) with respect to any aspect of a class action concerning any of the consumer financial products or services covered by § 1040.3. Reliance on a pre-dispute arbitration agreement with respect to any aspect of a class action includes, but is not limited to, any of the following:

- i. Seeking dismissal, deferral, or stay of any aspect of a class action;
- ii. Seeking to exclude a person or persons from a class in a class action;
- iii. Objecting to or seeking a protective order intended to avoid responding to discovery in a class action;

iv. Filing a claim in arbitration against a consumer who has filed a claim on the same issue in a class action;

v. Filing a claim in arbitration against a consumer who has filed a claim on the same issue in a class action after the trial court has denied a motion to certify the class but before an appellate court has ruled on an interlocutory appeal of that motion, if the time to seek such an appeal has not elapsed or the appeal has not been resolved; and

vi. Filing a claim in arbitration against a consumer who has filed a claim on the same issue in a class action after the trial court in that class action has granted a motion to dismiss the claim and, in doing so, the court noted that the consumer has leave to refile the claim on a class basis, if the time to refile the claim has not elapsed.

2. *Class actions concerning multiple products or services.* In a class action concerning multiple products or services only some of which are covered by § 1040.3, the prohibition in § 1040.4(a)(1) applies only to claims that concern the consumer financial products or services covered by § 1040.3.

*4(a)(2) Required provision.*

1. *Application of section 1040.4(a)(2) to providers that do not enter into pre-dispute arbitration agreements.* Section 1040.4(a)(2) sets forth requirements only for providers that enter into pre-dispute arbitration agreements for a covered product or service. Accordingly, the requirements of § 1040.4(a)(2) do not apply to a provider that does not enter into a pre-dispute arbitration agreement with a consumer.

2. *Entering into a pre-dispute arbitration agreement that had existed previously between other parties.* Section 1040.4(a)(2)(iii) requires a provider that enters into a pre-dispute arbitration agreement that had existed previously as between other parties and does not contain

the provision required by § 1040.4(a)(2)(i) or (ii), either to ensure the agreement is amended to contain the required provision or to provide a written notice to any consumer to whom the agreement applies. This could occur, when, for example, Bank A is acquiring Bank B after the compliance date specified in § 1040.5(a), and Bank B had entered into pre-dispute arbitration agreements before the compliance date specified in § 1040.5(a). If, as part of the acquisition, Bank A enters into the pre-dispute arbitration agreements of Bank B, Bank A would be required either to ensure the account agreements were amended to contain the provision required by § 1040.4(a)(2)(i), the alternative permitted by § 1040.4(a)(2)(ii), or to provide the notice specified in § 1040.4(a)(2)(iii). See comment 4-1 for examples of when a provider enters into a pre-dispute arbitration agreement.

3. *Notice to consumers.* Section 1040.4(a)(2)(iii) requires a provider that enters into a pre-dispute arbitration agreement that does not contain the provision required by § 1040.4(a)(2)(i) or (ii) to either ensure the agreement is amended to contain a specified provision or to provide any consumers to whom the agreement applies with written notice stating the provision. The notice may be provided in any way that the provider communicates with the consumer, including electronically. The notice may be provided either as a standalone document or included in another notice that the customer receives, such as a periodic statement, to the extent permitted by other laws and regulations.

*4(b) Submission of arbitral records.*

1. *Submission by entities other than providers.* Section 1040.4(b) requires providers to submit specified arbitral records to the Bureau. Providers are not required to submit the records themselves if they arrange for another person, such as an arbitration administrator or an agent of the provider, to submit the records on the providers' behalf. The obligation to comply with

§ 1040.4(b) nevertheless remains on the provider and thus the provider must ensure that the person submits the records in accordance with § 1040.4(b).

*4(b)(1) Records to be submitted.*

*Paragraph 4(b)(1)(ii).*

1. *Determinations that a pre-dispute arbitration agreement does not comply with an arbitration administrator's fairness principles.* Section 1040.4(b)(1)(ii) requires submission to the Bureau of any communication the provider receives related to any arbitration administrator's determination that the provider's pre-dispute arbitration agreement entered into after the date set forth in § 1040.5(a) does not comply with the administrator's fairness principles or rules. The submission of such records is required both when the determination occurs in connection with the filing of a claim in arbitration as well as when it occurs if no claim has been filed. Further, when the determination occurs with respect to a pre-dispute arbitration agreement that the provider does not enter into with a consumer, submission of any communication related to that determination is not required. For example, if the provider submits a prototype pre-dispute arbitration agreement for review by the arbitration administrator and never includes it in any consumer agreements, the pre-dispute arbitration agreement would not be entered into and thus submission to the Bureau of communication related to a determination made by the administrator concerning the pre-dispute arbitration agreement would not be required.

2. *Examples of fairness principles, rules, or similar requirements.* Section 1040.4(b)(1)(ii) requires submission to the Bureau of records related to any administrator's determination that a provider's pre-dispute arbitration agreement violates the administrator's fairness principles, rules, or similar requirements. What constitutes an administrator's fairness

principles, rules, or similar requirements should be interpreted broadly. Examples of such principles or rules include, but are not limited to:

- i. The American Arbitration Association’s Consumer Due Process Protocol; or
- ii. JAMS Policy on Consumer Arbitrations Pursuant to Pre-Dispute Clauses Minimum Standards of Procedural Fairness.

*4(b)(3) Redaction.*

1. *Redaction by entities other than providers.* Section 1040.4(b)(3) requires providers to redact records before submitting them to the Bureau. Providers are not required to perform the redactions themselves and may arrange for another person, such as an arbitration administrator, or an agent of the provider, to redact the records. The obligation to comply with § 1040.4(b) nevertheless remains on the provider and thus the provider must ensure that the person redacts the records in accordance with § 1040.4(b).

*Section 1040.5—Compliance Date and Temporary Exception*

*5(b) Exception for pre-packaged general-purpose reloadable prepaid card agreements.*


*Paragraph 5(b)(2).*

1. *Examples.* Section 1040.5(b)(2)(ii) requires a provider that has the ability to contact the consumer in writing to provide an amended pre-dispute arbitration agreement to the consumer in writing within 30 days after the issuer has the ability to contact the consumer. A provider is able to contact the consumer when, for example, the provider has the consumer’s mailing address or email address.



**[THIS SIGNATURE PAGE PERTAINS TO THE PROPOSED RULE TITLED  
“ARBITRATION AGREEMENTS”]**

Dated: May 3, 2016.

  
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**Richard Cordray,**

*Director, Bureau of Consumer Financial Protection.*