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**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:** Final Rule; official interpretations.

**SUMMARY:** Pursuant to section 1028(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Bureau of Consumer Financial Protection (Bureau) is issuing this final rule to regulate arbitration agreements in contracts for specified consumer financial product and services. First, the final rule prohibits 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 concerning the covered consumer financial product or service. Second, the final rule requires covered providers that are involved in an arbitration pursuant to a pre-dispute arbitration agreement to submit specified arbitral records to the Bureau and also to submit specified court records. The Bureau is also adopting official interpretations to the regulation.

**DATES:** *Effective date*: This regulation is effective [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

*Compliance date*: Mandatory compliance for pre-dispute arbitration agreements entered into on or after March 19, 2018.

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**SUPPLEMENTARY INFORMATION:**

## I. Summary of the Final Rule

On May 24, 2016, the Bureau of Consumer Financial Protection published a proposal to establish 12 CFR part 1040 to address certain aspects of consumer finance dispute resolution.[1] Following a public comment period and review of comments received, the Bureau is now issuing a final rule 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).[2] In 2015, the Bureau published and delivered to Congress a study of arbitration (Study).[3] In the Dodd-Frank Act, Congress also authorized the Bureau, after completing the 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.[4] Congress also required that the findings in any such rule be consistent with the Bureau's Study.[5] In accordance with this authority, the final rule issued today imposes two sets of limitations on the use of pre-

[1] Arbitration Agreements, 81 FR 32830 (May 24, 2016).
[2] Public Law 111-203, 124 Stat. 1376 (2010), section 1028(a).
[3] 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. Specific portions of the Study are cited in this final rule where relevant, and the entire Study will be included in the docket for this rulemaking at www.regulations.gov.
[4] Dodd-Frank section 1028(b).
[5] *Id.*

dispute arbitration agreements by covered providers of consumer financial products and services. First, the final rule prohibits providers from using a pre-dispute arbitration agreement to block consumer class actions in court and requires most providers to insert language into their arbitration agreements reflecting this limitation. This final rule is based on the Bureau's 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 final rule requires providers that use pre-dispute arbitration agreements to submit certain records relating to arbitral and court proceedings to the Bureau. The Bureau will use the information it collects to continue monitoring arbitral and court proceedings to determine whether there are developments that raise consumer protection concerns that may warrant further Bureau action. The Bureau is also finalizing provisions that will require it to publish the materials it collects on its website with appropriate redactions as warranted, to provide greater transparency into the arbitration of consumer disputes.

The final rule applies 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, subject to certain exclusions specified in the rule, providers that are engaged in:

- extending consumer credit, participating in consumer credit decisions, or referring or selecting creditors for non-incidental consumer credit, each when done by a creditor under Regulation B implementing the Equal Credit Opportunity Act (ECOA), acquiring or selling consumer credit, and servicing an extension of consumer credit;

- extending or brokering automobile leases as defined in Bureau regulation;
- providing services to assist with debt management or debt settlement, to modify the terms of any extension of consumer credit, or to avoid foreclosure, and providing products or services represented to remove derogatory information from, or to improve, a person's credit history, credit record, or credit rating;
- providing directly to a consumer a consumer report as defined in the Fair Credit Reporting Act (FCRA), a credit score, or other information specific to a consumer derived from a consumer file, except for certain exempted adverse action notices (such as those provided by employers);
- providing accounts under the Truth in Savings Act (TISA) and accounts and remittance transfers subject to the Electronic Fund Transfer Act (EFTA);
- transmitting or exchanging funds (except when necessary to another product or service not covered by this rule offered or provided by the person transmitting or exchanging funds), 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 (FDCPA).

Consistent with the Dodd-Frank Act, the final rule applies only to agreements entered into after the end of the 180-day period beginning on the regulation's effective date.[6] The Bureau is adopting an effective date of 60 days after the final rule is published in the *Federal Register*. To facilitate implementation and ensure compliance, the final rule requires providers in most cases to insert specified language into their arbitration agreements to explain the effect of the rule. The final rule also permits providers of general-purpose reloadable prepaid cards 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 final 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.[7] 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 final rule generally refers to as "arbitration agreements"[8] – have a long history, primarily in commercial contracts, where companies historically had bargained to create agreements tailored to their needs.[9] In 1925, Congress passed what is now known as the Federal Arbitration Act

[6] Dodd-Frank section 1028(d).
[7] "Arbitration," Black's Law Dictionary (10th ed. 2014).
[8] Section 1040.2(d) defines the phrase "pre-dispute arbitration agreement." When referring to the definition, in § 1040.2(d), this final rule uses the full term or otherwise clarifies the intended usage.
[9] *See infra* Part II.C.

(FAA) to require that courts enforce agreements to arbitrate, including those entered into both before and after a dispute has arisen.[10]

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. As is underscored by the range of comments received on the proposal, 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 agreements are salient to consumers, whether arbitration has proved to be a fair and efficient dispute resolution mechanism, and whether arbitration agreements effectively discourage and limit the filing or resolution of certain claims in court or in arbitration.

In recent years, 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,[11] authorized the Securities and Exchange Commission (SEC) to regulate arbitration agreements in contracts between consumers and securities broker-dealers and investment advisers,[12] and prohibited the use of arbitration agreements in connection with certain whistleblower proceedings.[13]

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

[10] 9 U.S.C. 1 *et seq.*
[11] Dodd-Frank section 1414(e) (codified as 15 U.S.C. 1639c(e)).
[12] Dodd-Frank sections 921(a) and 921(b) (codified as 15 U.S.C. 78o(o) and 15 U.S.C. 80b-5(f)).
[13] Dodd-Frank section 922(b) (codified as 18 U.S.C. 1514A(e)).

if it finds that such action is in the public interest and for the protection of consumers.[14] Congress also required that the findings in any such rule be consistent with the study.[15] The Bureau solicited input on the appropriate scope, methods, and data sources for the study in 2012[16] and released results of its three-year Study in March 2015.[17] Part III of this final rule summarizes the Bureau's process for completing the Study and its results. To place these results 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 typically 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 and, depending on the contract and the product or service, a service provider to the underlying provider.

[14] Dodd-Frank section 1028(b).
[15] *Id.*
[16] 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).
[17] Study, *supra* note 3. 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).

*Early Consumer Protection in the Law*

Prior to the twentieth century, the law generally embraced the notion of *caveat emptor*, or "buyer beware" in consumer affairs.[18] 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 consumers, such as the Wheeler-Lea Act of 1938.[19] 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.[20] 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.[21] The CCPA included the Truth in Lending Act (TILA), which imposed disclosure and other requirements on creditors.[22] 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.[23]

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

[18] *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 Application of Consumer Protection Law: Judicial Activism or Legislative Directive," 32 Santa Clara L. Rev. 347, at 351-55 (1992).
[19] Wheeler-Lea Act of 1938, Public Law 75-447, 52 Stat. 111 (1938).
[20] *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).
[21] Public Law 90-321, 82 Stat. 146 (1968).
[22] *Id.* at title I.
[23] 15 U.S.C. 1640(a).

violations. For example, in 1970, Congress passed the 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.[24] In 1974, Congress passed the ECOA to prohibit creditors from discriminating against applicants with respect to credit transactions.[25] In 1977, Congress passed the FDCPA to promote the fair treatment of consumers who are subject to debt collection activities.[26]

In the 1960s, States began passing their own consumer protection statutes modeled on the FTC Act to prohibit unfair and deceptive practices. Unlike the FTC Act, however, these State statutes typically provide for private enforcement.[27] 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.[28] Currently, 49 of the 50 States and the District of Columbia have State consumer protection statutes modeled on the FTC Act that allow for private rights of action.[29]

[24] Public Law 91-508, 84 Stat. 1114-2 (1970).
[25] Congress amended that law in 1976. Public Law 94-239, 90 Stat. 251 (1976).
[26] 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.
[27] Victor E. Schwartz & Cary Silverman, "Common Sense Construction of Consumer Protection Acts," 54 U. Kan. L. Rev. 1, at 15-16 (2005).
[28] *Id.*
[29] *Id.* at 16. Every State prohibits deception; some prohibit unfair practices as well. *See* Carolyn L. Carter, "Consumer Protection in the States," Nat'l Consumer L. Ctr., at 5 (2009), *available at* 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 the wave of consumer financial protection statutes described above, 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 an individual to group his or her claims together with those of other, absent individuals in one lawsuit under certain circumstances and to obtain monetary or injunctive relief for the group. 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 class actions.[30]

Indeed, Congress affirmatively calibrated enforcement through private class actions in several of the consumer protection statutes by specifically referring to class actions and adopting statutory damage schemes that are capped by a percentage of the defendants' net worth.[31] For example, when consumers initially sought to bring TILA class actions, a number of courts applying Federal Rule 23 denied motions to certify a class because of the prospect of extremely large damages resulting from the aggregation of a large number of claims for statutory damages.[32] 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.[33] Congress has twice increased the cap on class action damages in TILA: to $500,000 in 1976 and $1,000,000 in

[30] *See, e.g.*, *Wilcox* v. *Commerce Bank of Kansas City*, 474 F.2d 336, 343-44 (10th Cir. 1973).
[31] 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.
[32] *See, e.g.*, *Ratner* v. *Chem. Bank N.Y. Trust Co.*, 54 F.R.D. 412, 416 (S.D.N.Y. 1972).
[33] *See* Public Law 93-495, 88 Stat. 1518, section 408(a).

2010.[34] Many other statutes similarly cap damages in class actions.[35] 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.[36] Similarly, many State legislatures contemplated consumers' filing of class actions to vindicate violations of their versions of the FTC Act.[37] A minority of States expressly prohibit class actions to enforce their FTC Acts.[38]

*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.[39] 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 represent a group of people with common interests.[40] 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

[34] Truth in Lending Act Amendments, Public Law 94-240, 90 Stat. 260 (1976); Dodd-Frank section 1416(a)(2).
[35] 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), and 15 U.S.C. 1693m(a)(2)(B) (EFTA).
[36] *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."
[37] The UDAP laws of at least 14 States expressly permit class action lawsuits. *See, e.g.*, Cal. Bus. & Prof. Code 17203 (2016); Haw. Rev. Stat. Ann. sec. 480-13.3 (2015); Idaho Code Ann. sec. 48-608(1) (2015); Ind. Code Ann. sec. 24-5-0.5-4(b) (2015); Kan. Stat. Ann. sec. 50-634(c) and (d) (2012); Mass. Gen. Laws ch. 93A, sec. 9(2) (2016); Mich. Comp. Laws sec. 445.911(3) (2015); Mo. Rev. Stat. sec. 407.025(2) and (3) (2015); N.H. Rev. Stat. sec. 358-A:10-a (2015); N.M. Stat. sec. 57-12-10(E) (2015); Ohio Rev. Code sec. 1345.09(B) (2016); R.I. Gen. Laws sec. 6-13.1-5.2(b) (2015); Utah Code secs. 13-11-19 and 20 (2015); Wyo. Stat. sec. 40-12-108(b) (2015).
[38] *See, e.g.*, Ala. Code sec. 8-19-10(f) (2002); Ga. Code Ann. sec. 10-1-399 (2015); La. Rev. Stat. Ann. sec. 51:1409(A) (2006); Mont. Code Ann. sec. 30-14-133(1) (2003); S.C. Code Ann. sec. 37-5-202(1) (1999).
[39] *Ortiz* v. *Fibreboard Corp.*, 527 U.S. 815, 832-33 (1999).
[40] 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, at 704 (2013) (citing Stephen C. Yeazell, From Medieval Group Litigation to the Modern Class Action 40 (1987)).

not they were participants in the suit – and contained most of the basic elements of what is now called class action litigation.[41]

The bill of peace was recognized in early United States case law and ultimately adopted by several State courts and the Federal courts.[42] 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 Federal Rule 23 established a procedure for class actions.[43] That procedure's ability to bind absent class members was never clear, however.[44]

That changed in 1966, when Federal Rule 23 was amended to create the class action mechanism that largely persists in the same form to this day.[45] Federal Rule 23 was amended at least in part to promote efficiency in the courts and to provide for compensation of individuals when many are harmed by the same conduct.[46] The 1966 revisions to Federal 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

[41] 7A Charles Alan Wright & Arthur R. Miller, "Federal Practice and Procedure: Civil §1751" (3d ed. 2002).
[42] *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.*
[43] *See* Fed. R. Civ. P. 23 (1938).
[44] *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.").
[45] *See, e.g.*, Robert H. Klonoff, "The Decline of Class Actions," 90 Wash. U. L. Rev. 729, at 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"). In 1966, a member of the Advisory Committee explained that the class action device was designed to bind all absent class members because "Requiring … individuals affirmatively to request inclusion in the lawsuit would result in freezing out the claims of people—especially small claims held by small people—who for one reason or another, ignorance, timidity, unfamiliarity with business or legal matters, will simply not take the affirmative step. The moral justification for treating such people as null quantities is questionable. For them the class action serves something like the function of an administrative proceeding where scattered individual interests are represented by the Government." Benjamin Kaplan, "Continuing the Work of the Civil Committee: 1966 Amendments of the Federal Rules of Civil Procedure (i)," 81 Harv. L. Rev. 356, at 397-98 (1967).
[46] *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.").

fashion under Rule 23."[47] 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."[48] Class actions have been brought not only by individuals, but also by companies, including financial institutions.[49]

*Class Action Procedure Pursuant to Federal Rule 23*

A class action can be filed and maintained under Federal Rule 23 in any case where there is a private right to bring a civil action in Federal court, unless otherwise prohibited by law.[50] Pursuant to Federal Rule 23(a), a class action must meet all of the following requirements: (1) a class of a size such that joinder of 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.[51] 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 Federal Rule 23(b), a class action also must meet one of the following requirements: (1) prosecution of separate actions risks either

[47] *Califano* v. *Yamasaki*, 442 U.S. 682, 701 (1979).
[48] *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 Federal 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.").
[49] *See, e.g.*, Class Action Complaint, Bellwether Community Credit Union v. Chipotle Mexican Grill Inc., No.17-01102 (D.Colo. May 4, 2017), ECF No. 1 (asserting class action claims on behalf of financial institutions against Chipotle for data breach that exposed customers' names and debit and credit card numbers to hackers); Consumer Plaintiffs' Consolidated Class Action Complaint at 1, 5, In re: The Home Depot, Inc. Customer Data Breach Litig., No. 14-02583 (N.D. Ga. May 27, 2015), ECF No. 93 (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"); Memorandum and Order at 2, 14, In re: Target Corp. Customer Data Security Breach Litig., No. 14-2522 (D. Minn. Sept. 15, 2015), ECF 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).
[50] As one commenter noted, it is a procedural right not a substantive one.
[51] Fed. R. Civ. P. 23(a)(1) through (4).

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 Federal 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.[52] 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.[53] 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.[54] Those similarly situated individuals may be a small group (as few as 40 or even less) or as many as millions that 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 Federal Rule 23, including the requirements of Federal 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

[52] *See, e.g., Amchem Prod., Inc.*, 521 U.S. at 619-21.
[53] *See* Fed. R. Civ. P. 23(e).
[54] Federal Rule 23 also permits a class of defendants.

of the class are bound by the eventual outcome of the case.[55] 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 Federal 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.[56] Among its tasks, a court must review any attempts to settle or voluntarily dismiss the case on behalf of the class,[57] may reject any settlement agreement if it is not "fair, reasonable and adequate,"[58] and must ensure that the payment of attorney's fees is "reasonable."[59] 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.

In addition to proceedings in Federal court, every State except Virginia and Mississippi has established procedures permitting individuals to file a class action; almost all of these States have adopted class action procedures analogous to Federal Rule 23.[60]

*Developments in Class Action Procedure over Time*

Since the 1966 amendments, Federal Rule 23 has generated a significant body of case law as well as significant controversy.[61] In response, Congress and the Advisory Committee on

[55] 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).
[56] Fed. R. Civ. P. 23(g).
[57] *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.
[58] Fed. R. Civ. P. 23(e)(2).
[59] Fed. R. Civ. P. 23(h).
[60] *See* Marcy Hogan Greer, "A Practitioner's Guide to Class Actions" at 142 (A.B.A. 2010). One State, Utah, authorizes providers of closed-end consumer credit to include in the credit contract a provision that would waive the consumer's right to participate in a class action. Utah Code 70C-3-14; "Mississippi does not permit class actions of any kind. When Mississippi adopted civil rules modeled on the Federal Rules of Civil Procedure, it expressly omitted Rule 23." (footnote omitted). *Id.* at 1013.

the Federal Rules of Civil Procedure (which has been delegated the authority to change Federal Rule 23 under the Rules Enabling Act) have made a series of targeted changes to Federal Rule 23 to calibrate the equities of class plaintiffs and defendants. Meanwhile, the courts have also addressed concerns about Federal 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.[62] 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.[63] Among other things, CAFA expanded the subject matter jurisdiction of Federal courts to allow them to adjudicate most large class actions.[64] The Advisory Committee also periodically reviews and updates Federal Rule 23. In 1998, the Advisory Committee amended Federal Rule 23 to permit interlocutory appeals of class certification decisions, given the unique importance of the certification decision, which can dramatically change the dynamics of a class action case.[65] In 2003, the Advisory Committee amended Federal 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.[66] In 2015, the Advisory

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[61] *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, at 610 (participants in the debate "quickly exhausted virtually every claim for and against an invigorated Rule 23").
[62] Private Securities Litigation Reform Act of 1995, Public Law 104-67, 109 Stat. 737 (1995).
[63] Class Action Fairness Act of 2005, Public Law 109-2, 119 Stat. 4 (2005).
[64] 28 U.S.C. 1332(d), 1453, and 1711-15.
[65] Fed. R. Civ. P. 23(f). *See also* Herbert B. Newberg, et al., "Newberg on Class Actions," at § 7:41 (5th ed. Thomson Reuters 2016); 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).
[66] 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).").

Committee further identified several issues that "warrant serious examination" and presented "conceptual sketches" of possible further amendments.[67]

Federal courts have also shaped class action practice through their interpretations of Federal 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 Federal Rule 23(a)(2), holding that in the absence of a common question among putative class members class certification is not appropriate.[68] In *Comcast Corp.* v. *Behrend*, the Court held that district courts must undertake a "rigorous analysis" of whether the damages model supporting a plaintiff's case is consistent with its theory of liability for purposes of satisfying the predominance requirements in Federal Rule 23(b)(3) and that that in the absence of such a model of individual damages may foreclose class certification.[69] In *Campbell-Ewald Co.* v. *Gomez*, 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 that relief.[70] 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.[71] Finally, in *Spokeo, Inc.* v. *Robins*, a class action alleging a violation of Federal law, the Court reiterated that to have standing in Federal court a plaintiff must allege an injury in fact – specifically, "'an invasion of a legally protected interest' that is 'concrete and particularized' and 'actual or imminent, not

[67] *See, e.g.*, Rule 23 Subcomm. Rept., Advisory Committee on Rules of Civil Procedure, at 243-97 (2015), *available at* http://www.uscourts.gov/rules-policies/archives/agenda-books/advisory-committee-rules-civil-procedure-april-2015.
[68] 564 U.S. 338, 131 S. Ct. 2541 (2011); *see also* Klonoff, *supra* note 45, at 775.
[69] 133 S. Ct. 1426 (2013).
[70] *Campbell-Ewald Co.* v. *Gomez*, 136 S. Ct. 663, 670 (2016).
[71] *Tyson Foods, Inc.* v. *Bouaphakeo*, 136 S. Ct. 1036, 1046-48 (2016).

conjectural or hypothetical.'"[72] The case was remanded to the Ninth Circuit to determine whether the plaintiff had alleged an actual injury under the FCRA.[73]

*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.[74] 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.[75] Second, with some exceptions, either side can use the arbitration agreement to require that a dispute that has been filed in court instead proceed in arbitration.[76] The typical agreement also specifies an organization called an arbitration administrator. Administrators, which may be for-profit or nonprofit 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.[77] Parties usually have very limited rights to appeal from a decision in arbitration to a court.[78] Most arbitration also provides for limited or streamlined discovery procedures as compared to those in many court proceedings.[79]

[72] *Spokeo, Inc.* v. *Robins*, 135 S. Ct. 1892 (2015).
[73] *Id.* Following remand, the *Spokeo* case remains pending in the Ninth Circuit. *See Robins* v. *Spokeo Inc*., No. 11-56843 (9th Cir).
[74] *See* "Arbitration," *supra* note 7.
[75] *Id.*
[76] 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 3, section 2 at 33-34.
[77] *See id.* section 2 at 34-40.
[78] *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, *infra* note 150, at 6 n.4.
[79] *See* Study, *supra* note 3, section 4 at 16-17.

*History of Arbitration*

The use of arbitration to resolve disputes between parties is not new.[80] In England, the historical roots of arbitration date to the medieval period, when merchants adopted specialized rules to resolve disputes between them.[81] English merchants began utilizing arbitration in large numbers during the nineteenth century.[82] However, English courts were hostile towards arbitration, limiting its use through doctrines that rendered certain types of arbitration agreements unenforceable.[83] Arbitration in the United States in the eighteenth and nineteenth centuries reflected both traditions: it was used primarily by merchants, and courts were hostile toward it.[84] Through the early 1920s, United States courts often refused to enforce arbitration agreements and awards.[85]

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.[86] 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.[87] 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

[80] 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, at 134-36 (2002); Derek Roebuck, "Roman Arbitration" (Holo. Books 2004).
[81] *See, e.g.*, Jeffrey W. Stempel, "Pitfalls of Public Policy: The Case of Arbitration Agreements," 22 St. Mary's L. J. 259, at 269-70 (1990).
[82] *Id.*
[83] *See, e.g.*, Schmitz, *supra* note 80, at 137-39.
[84] *See, e.g.*, Stempel, *supra* note 81, at 273-74.
[85] David S. Clancy & Matthew M.K. Stein, "An Uninvited Guest: Class Arbitration and the Federal Arbitration Act's Legislative History," 63(1) Bus. L. 55, at 58 and n.11 (2007) (*citing, inter alia*, *Haskell* v. *McClintic-Marshall Co*., 289 F. 405, 409 (9th Cir. 1923) (refusing to enforce an 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).
[86] 43 N.Y. Stat. 833 (1925).
[87] *Id.*

(FAA).[88] 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."[89]

*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.[90] Beginning in the 1980s, however, companies began to use arbitration agreements in form contracts with consumers, investors, employees, and franchisees that were not the result of individually negotiated terms.[91] By the 1990s, this trend began to spread more broadly within the consumer financial services industry.[92]

One notable feature of these agreements is that they could be used to block class action litigation and often class arbitration as well.[93] 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

[88] 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. L. & Bus. 745, at 754 n.45 (2009).
[89] 9 U.S.C. 2.
[90] *See, e.g.*, Soia Mentschikoff, "Commercial Arbitration," 61 Colum. L. Rev. 846, at 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 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.
[91] Stephen J. Ware, "Arbitration Clauses, Jury-Waiver Clauses and Other Contractual Waivers of Constitutional Rights," 67 L. & Contemp. Probs. 179 (2004).
[92] *See* 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 Consumer Fin. L. Q. Rep. 365, at 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. Bus. J. 917, at 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").
[93] *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.").

arbitration as well, rendering plaintiffs unable to pursue class claims in either litigation or arbitration.[94] More recently, some consumer financial providers themselves have disclosed in their filings with the SEC that they rely on arbitration agreements for the express purpose of shielding themselves from class action liability.[95]

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.[96]

*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

[94] 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 class arbitration can move forward. *See* AAA, "Supplementary Rules for Class Arbitrations," at 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," at 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.").

[95] *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 . . . .").

[96] 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* https://www.citizen.org/our-work/access-justice/arbitration-trap.

NAF, which was the most widely used arbitration administrator for debt collection.[97] 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.[98] 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.[99] 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.[100] 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.[101]

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.[102] Specifically, shortly after the NAF settlement, the AAA offered testimony to Congress that – independent of the NAF

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[97] *See* Mollenkamp, *supra* note 96. 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., No. 1409 (S.D.N.Y. Dec. 13, 2011).

[98] *California* v. *National Arbitration Forum, Inc.*, No. 473-569 (S.F. Sup. Ct. Mar. 2009).

[99] *See* Complaint at 2, State of Minnesota v. National Arbitration Forum, Inc. No. 09-18550 (4th Jud. Dist. Minn. July 14, 2009), *available at* https://www.nclc.org/images/pdf/unreported/naf_complaint.pdf.

[100] 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. Press Release, City Attorney Dennis Herrera, "Herrera Secures $5 Million Settlement, Consumer Safeguards Against BofA Credit Card Subsidiary," (Aug. 22, 2011), *available at* https://www.sfcityattorney.org/2011/08/22/herrera-secures-5-million-settlement-consumer-safeguards-against-bofa-credit-card-subsidiary/.

[101] Memorandum and Order, In re National Arbitration Forum Trade Practices Litig., No. 10-02122 (D. Minn. Aug. 8, 2011), ECF 120.

[102] *See* Press Release, AAA, "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* AAA, "Consumer Debt Collection Due Process Protocol Statement of Principles," (2010), *available at* 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. 81 FR 32830, 32836 n.97 (May 24, 2016).

settlement – AAA "had independently reviewed areas of the process and concluded that it had some weaknesses" in its own debt collection arbitration program, and noted that generally that "areas needing attention . . . include[d] consumer notification, arbitrator neutrality, pleading and evidentiary standards, respondents' defenses and counterclaims, and arbitrator training and recruitment."[103]

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,[104] 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.[105] Initially, these challenges yielded conflicting results. Some courts held that class arbitration waivers were not unconscionable.[106] Other courts held that such waivers were unenforceable on unconscionability grounds.[107] Some of these decisions also held that the FAA did not preempt application of a State's unconscionability doctrine.[108]

Before 2011, courts were divided on whether arbitration agreements that bar class proceedings were unenforceable because they violated a particular State's laws. Then, in 2011, the Supreme Court held in *AT&T Mobility* v. *Concepcion* that the FAA preempted application of

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[103] *See* Press Release, AAA, *supra* note 102.
[104] 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.").
[105] *See, e.g.*, Opening Brief on the Merits at 5, Discover Bank v. Superior Court, No. S113725, 2003 WL 26111906, (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.").
[106] *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).
[107] *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).
[108] *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.

California's unconscionability doctrine to the extent it would have precluded enforcement of a 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."[109] 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).[110] 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.[111] 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.[112]

*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 National Association of Securities Dealers – now known as the Financial Industry Regulatory

[109] *AT&T Mobility LLC* v. *Concepcion*, 563 U.S. 333, 344 (2011).
[110] *Id.* at 348-51.
[111] *See* Robert Buchanan Jr., "The U.S. Supreme Court's Landmark Decision in AT&T Mobility v. Concepcion: One Year Later," Bloomberg Legal News, 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.
[112] *American Express Co.* v. *Italian Colors Restaurant*, 133 S. Ct. 2304, 2309 (2013).

Authority (FINRA) – the self-regulating body for the securities industry that also administers arbitrations between member companies and their customers.[113] 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.[114] 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.[115] In addition, since 1976, the regulations of the Commodity Futures Trading Commission (CFTC) implementing the Commodity Exchange Act (CEA) have required that arbitration agreements in commodities contracts be voluntary.[116] 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.[117]

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.[118] Some courts in the late 1990s disagreed with the FTC's

[113] *See* FINRA, "Arbitration and Mediation," https://www.finra.org/arbitration-and-mediation (last visited Feb. 8, 2017).
[114] FINRA, "Class Action Claims," at Rule 12204(d). For individual disputes between brokers and customers, FINRA requires individual arbitration.
[115] *See* Self-Regulatory Organizations; National Ass'n of Securities Dealers, Inc.; Order Approving Proposed Rule Change Relating to the Exclusion of Class Actions from Arbitration Proceedings, Exchange Act Release No. 31371, 1992 WL 324491, (Oct. 28, 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.
[116] Arbitration or Other Dispute Settlement Procedures, 41 FR 42942, 42946 (Sept. 29, 1976); 17 CFR 166.5(b).
[117] *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.
[118] 16 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 only 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

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."[119] 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.[120]

More recently, the Department of Labor finalized a rule addressing conflicts of interest in retirement advice.[121] To be eligible for an exemption from part of that rule, a covered entity cannot employ an arbitration agreement that can be used to block a class action, although agreements mandating arbitration of individual disputes will continue to be permitted.[122] Other agencies are reevaluating their arbitration initiatives. The Department of Education recently sought to postpone implementation of a rule that was intended to limit the impact of arbitration agreements in certain college enrollment agreements by addressing the use of arbitration agreements to bar students from bringing group claims.[123] The Centers for Medicare and Medicaid Services (CMS) have proposed revisions to a rule finalized in late 2016 regarding the requirements that long-term health care facilities must meet to participate in the Medicare and Medicaid programs.[124]

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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, at 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 and 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).

[119] *See* 80 FR 42710, 42719 (July 20, 2015).

[120] *See id.*

[121] Best Interest Contract Exemption, 81 FR 21002 (Apr. 8, 2016).

[122] 81 FR 21002, 21020 (Apr. 8, 2016).

[123] *See* Student Assistance General Provisions, 82 FR 27621 (June 16, 2017); *see also* Student Assistance General Provisions, 81 FR 75926, 76021-31 (Nov. 1, 2016).

[124] The recent proposal seeks to amend the 2016 rule's required terms for the use of arbitration agreements between long-term care facilities and residents of those facilities. 82 FR 26649 (June 5, 2017); *see also* Centers for Medicare & Medicaid Services, Medicare and Medicaid Programs, Reform of Requirements for Long-Term Care Facilities, 81 FR 68688 (Oct. 4, 2016).

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.[125] 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.[126] 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."[127] In July 2015, DoD promulgated a final rule that significantly expanded that definition of "consumer credit" to cover 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.[128] 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.[129]

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

[125] 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).
[126] John Warner National Defense Authorization Act for Fiscal Year 2007, Public Law 109-364, 120 Stat. 2083 (2006).
[127] Limitations on Terms of Consumer Credit Extended to Service Members and Dependents, 72 FR 50580 (Aug. 31, 2007) (codified at 32 CFR 232).
[128] *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 to 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.
[129] 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).

contracts, which the Bureau implemented in its Regulation Z.[130] 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.[131] Section 922 of the Act invalidated the use of arbitration agreements in connection with certain whistleblower proceedings.[132] 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 this rulemaking.[133] 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.[134] However, States are constrained in their ability to regulate arbitration because the FAA preempts conflicting State law.[135]

*Arbitration Today*

Today, the AAA is the primary administrator of consumer financial arbitrations.[136] 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

[130] *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).
[131] Dodd-Frank section 921(b).
[132] Dodd-Frank section 922(c)(2).
[133] Dodd-Frank section 1028(a).
[134] Cal. Civ. Proc. Code sec. 1281.96 (amended effective Jan. 1, 2015); D.C. Code sec. 16-4430; Md. Comm. L. Code, secs. 14-3901-05; 10 M.R.S.A. sec. 1394 (Maine).
[135] *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] sec. 2.").
[136] *See infra* Part III.D.

consumers.[137] 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."[138] A second entity, JAMS, administers consumer financial arbitrations pursuant to the JAMS Streamlined Arbitration Rules & Procedures[139] and the JAMS Consumer Minimum Standards.[140] These administrators' procedures for arbitration both 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.[141] 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

[137] AAA, "Consumer Arbitration Rules," (effective Sept. 1, 2014), *available at* https://adr.org/sites/default/files/Consumer%20Rules.pdf.
[138] AAA, "Consumer Due Process Protocol Statement of Principles," at Principle 1, *available at* http://info.adr.org/consumer-arbitration/. 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.
[139] JAMS, "Streamline 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.* at Rule 1(a).
[140] *See* JAMS, "JAMS Policy on Consumer Arbitrations Pursuant to Pre-Dispute Clauses: Minimum Standards on Procedural Fairness," (effective July 15, 2009), *available at* https://www.jamsadr.com/consumer-minimum-standards/ (setting forth 10 standards). This policy explains that "JAMS will administer arbitrations pursuant to mandatory pre-dispute arbitration clauses between companies and consumers1 only if the contract arbitration clause and specified applicable rules comply with the following minimum standards of fairness." *Id.*
[141] *See* AAA, "Class Arbitration Case Docket," https://www.adr.org/casedockets (last visited Feb. 9, 2017).

only three.[142] Industry has criticized class arbitration on the ground that it lacks procedural 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.[143]

## 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)*.[144]

This Part describes the process the Bureau used to carry out the Study and summarizes the Study's results. Where relevant, this Part then sets forth comments received in response to the proposal that were specific to the Study and its results. The Bureau generally addresses the outcome of its Study, including analyses of the results of the Study, in Part VI, Findings, below. In some instances, the Bureau has elected to address issues related to both the Study and the Findings in Part VI.

[142] Study, *supra* note 3, 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.

[143] 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." Brief of the Chamber of Commerce of the United States of America as Amicus Curiae in Support of Plaintiff-Appellants at 9, Marriott Ownership Resorts, Inc. v. Sterman, No. 15-10627 (11th Cir. Apr. 1, 2015).

[144] Study, *supra* note 3.

*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.[145] 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 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 incorporated an extensive analysis of consumer financial litigation – both individual litigation and class actions.[146] 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

[145] Arbitration Study RFI, *supra* note 16.
[146] *See generally* Study, *supra* note 3, sections 6 and 8.

lack of relationship of these cases to private class litigation.[147] 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 included a "difference-in-differences" regression analysis using a representative random sample of the Bureau's Credit Card Database, to look for price impacts associated with changes relating to arbitration agreements for credit cards, an analysis that had never before been conducted.[148]

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.[149]

*B. December 2013 Preliminary Results*

In December 2013, the Bureau issued a 168-page report summarizing its preliminary results on a number of topics (Preliminary Results).[150] 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

[147] *Id.* at section 9.
[148] *Id.* section 10 at 7-14.
[149] *See* Myriam Gilles, "The End of Doctrine: Private Arbitration Public Law and the Anti-Lawsuit Movement," (Benjamin N. Cardozo Sch. of L. Faculty Res. Paper No. 436, 2014) (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").
[150] Bureau of Consumer Fin. Prot., "Arbitration Study Preliminary Results," (Dec. 12, 2013), *available at* http://files.consumerfinance.gov/f/201312_cfpb_arbitration-study-preliminary-results.pdf.

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.[151]

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 stakeholders, including industry associations and consumer advocates, 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.[152] Pursuant to the Paperwork Reduction Act (PRA), 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.[153] 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

[151] *Id.* at 129-131.
[152] *Id.* at 129.
[153] The survey was assigned OMB control number 3170-0046.

published a second *Federal Register* notice in May 2014, which generated an additional seven comments.

*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.[154] 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.[155]

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 in Federal and selected State courts; and all of the 562 consumer finance class actions identified in Federal and selected State courts of the same time period. The Study also

[154] Study, *supra* note 3, section 5 at 19-68.
[155] *See generally id.* section 2.

included over 40,000 filings in State small claims courts 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 Federal courts over a five-year period and more than 1,100 State and Federal public enforcement actions in the consumer finance area.[156] The Study also included 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, summarize the main results of each section, and then summarizes and addresses criticisms of the Study results.[157]

Before doing so, one preliminary observation is in order. With rare exception, the commenters did not criticize the methodologies the Bureau used to assemble the various data sets used in the Study or the analyses the Bureau conducted of these data. Rather, to the extent commenters addressed the Study itself – as distinguished from the interpretation or significance of the Study's findings – in the main the commenters suggested that the Bureau should have engaged in additional analyses.

As explained in more detail below, in many instances the analyses that commenters suggested were not feasible given the limitations on the data available to the Bureau. For example, as discussed below, the Bureau did not have a feasible way of studying the actual costs that financial service providers incur in defending class actions or studying the outcomes of

[156] 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.

[157] 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 3, 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.

arbitration or individual litigation cases that were settled (or resolved in a manner consistent with a settlement) unless the case records reflected the settlement terms. In other instances, the analyses the commenters suggested – such as studying the satisfaction of the small number of consumers who file arbitration cases – were not, in the Bureau's judgment, relevant to determining whether limitations on arbitration agreements are in the public interest and for the protection of consumers. And, in other instances, resource limitations required the Bureau to deploy random sampling techniques or to limit the number of years under study while still obtaining representative data.

Beyond that, it is worth noting that it is the case with any research – even research as extensive and painstaking as the Study – that it is always possible, ex post, to think of additional questions that could have been asked, additional data that could have been procured, or additional analyses that could have been performed. The Bureau does not interpret section 1028's direction to study the use of arbitration agreements in consumer finance to require the Bureau to research every conceivably relevant question or to exhaust every conceivable data source as a precondition to exercising the regulatory authority contained in that section. As discussed in substantial detail below in Part VI, the Bureau believes that its extensive research provides ample evidence that the restrictions on the use of arbitration agreements contained in this Rule are in the public interest and for the protection of consumers.

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

Section 2 of the Study addressed 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.[158] Previous 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.[159] 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.[160] 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-sized 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 GPR 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

[158] *Id.* section 2 at 3.
[159] *Id.* section 2 at 4-6.
[160] 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).

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.[161] 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 payday lenders in California, Texas, and Florida.[162] 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.[163] For the mobile wireless market, the Bureau reviewed the wireless contracts of the eight largest facilities-based providers of mobile wireless services[164] which also govern third-party billing services.[165]

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.[166] In the credit card market, the Study found that small bank issuers were less likely to include arbitration agreements than large bank issuers.[167] Likewise, only 3.3 percent of credit unions in the credit card sample used arbitration agreements.[168] As a result, while 15.8 percent of credit card issuers included such agreements in

[161] Study, *supra* note 3, section 2 at 18.
[162] *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.
[163] *Id.* section 2 at 24.
[164] 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.
[165] Study, *supra* note 3, 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.
[166] *Id.* section 1 at 9.
[167] *Id.* section 2 at 10.
[168] *Id.*

their contracts, 53 percent of credit card loans outstanding were subject to such agreements.[169] 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).[170] In contrast, only 7.1 percent of small- and mid-sized banks and 8.2 percent of credit unions used arbitration agreements.[171] In the GPR 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.[172] 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.[173]

In addition to examining the prevalence of arbitration agreements, Section 2 of the Study reviewed 13 features sometimes included in such agreements.[174] 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 agreements; 85.5 percent of the storefront payday loan contracts with arbitration agreements; and

[169] *Id.* As the Study noted, the *Ross* settlement – a 2009 settlement of an antitrust case in which four of the 10 largest credit card issuers agreed to remove their arbitration agreements – likely impacted these results. Had the settling defendants in *Ross* continued to use arbitration agreements, 93.6 percent of credit card loans outstanding would be subject to arbitration agreements. *Id.* section 2 at 11.
[170] *Id.* section 2 at 14.
[171] *Id.*
[172] *Id.* section 2 at 19, 22.
[173] *Id.* section 2 at 24, 26.
[174] *Id.* section 2 at 30.

66.7 percent of private student loan contracts with arbitration agreements.[175] 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.[176]

In contrast, JAMS is specified in relatively fewer arbitration agreements. The Study found that the contracts 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.[177]

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

[175] *Id.* section 2 at 38.
[176] *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.
[177] *Id.*

agreements – covering over 99 percent of market share subject to arbitration in the six product markets studied – included such no-class-arbitration provisions.[178] 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.[179]

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.[180] 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.[181]

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 an award; and provisions addressing the award of attorney's fees.[182] Most arbitration agreements reviewed in the Study contained provisions that had the effect of capping consumers' upfront arbitration costs at or below the AAA's maximum consumer fee thresholds. These same

[178] *Id.* section 2 at 44-47.
[179] *Id.* section 2 at 46-47.
[180] *Id.* section 2 at 33-34.
[181] *Id.* section 2 at 31-32.
[182] *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.

arbitration agreements took noticeably different approaches to the reallocation of arbitration fees in the arbitrator's award, with approximately one-fifth of the arbitration agreements in credit card, checking account, and storefront payday loan markets permitting shifting company fees to consumers.[183] The Study also found that only a small number of agreements representing negligible shares of the relevant markets directed or permitted arbitrators to award attorney's fees to prevailing companies.[184] A significant share of arbitration agreements across almost all markets did not address attorney's fees.[185]

Aside from costs more generally, 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 attorney's fees to the consumer.[186] However, as the Study pointed out, the AAA's consumer arbitration fee schedule, which became effective March 1, 2013, restricts such reallocation.[187] 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 requiring or permitting hearings to take place in locations close to the consumer's place of residence.[188]

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

[183] *Id.* section 2 at 62-66.
[184] *Id.* section 2 at 67.
[185] *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.
[186] *Id.* section 2 at 62-66.
[187] *Id.* section 2 at 61-62.
[188] *Id.* section 2 at 53.

that the consumer could not be a party to a class action in court.[189] 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.[190] The Study found that this language was often capitalized or in boldfaced type.[191]

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; GPR prepaid card contracts, almost all of which included such limitations; and mobile wireless contracts, all of which included such limitations. A review of consumer agreements *without* arbitration agreements revealed a similar pattern, albeit with damages limitations being somewhat less common.[192]

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,

[189] *Id.* section 2 at 72.
[190] *Id.* section 2 at 72-79.
[191] *Id.* section 2 at 72 and n.144.
[192] *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, one-third of GPR 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.*

respectively.[193] 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.[194] No storefront payday loan, private student loan, or mobile wireless contracts in the sample without arbitration agreements had such time limits.[195]

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.[196]

Comments received regarding the scope of Section 2 are addressed in Part III.E below.

*2. 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.[197] 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

[193] *Id.* section 2 at 50.
[194] *Id.* section 2 at 51.
[195] *Id.*
[196] *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).
[197] 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.

against their credit card issuers. In late 2014, the Bureau's contractor completed telephone surveys with 1,007 respondents who had credit cards.[198]

The consumer survey found that when presented with a hypothetical situation in which the respondents' 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.[199] Almost the same proportion of respondents stated that they would simply pay for the improperly assessed fee (1.7 percent).[200] A majority of respondents (57.2 percent) said that they would cancel their cards.[201]

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 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.[202] 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.[203]

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

[198] 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.
[199] *Id.* section 3 at 18.
[200] *Id.*
[201] *Id.*
[202] *Id.* section 3 at 15.
[203] *Id.*

consumers generally lacked 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.[204] 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."[205] 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 answered "No," and 54.4 percent answered "Don't Know."[206] 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.[207] 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).[208]

[204] *Id.* section 3 at 18.
[205] *Id.* section 3 at 18-20.
[206] *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 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.
[207] *Id.* section 3 at 18-20.
[208] *Id.* section 3 at 25.

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.[209]

*Comments Received on Section 3 of the Study*

An industry commenter suggested that the Bureau should conduct further analyses to gain a better understanding of consumer comprehension with respect to arbitration agreements. The commenter asserted that this was appropriate given statements from the Bureau that many consumers do not even know that they are bound by an arbitration agreement. A different industry commenter thought the Bureau should have asked consumers if they would decline to file a class action against their credit card issuer because the presence of an arbitration agreement would substantially lower their likelihood of classwide relief. This commenter also said that, rather than asking consumers hypothetical questions about what they would do if an improper charge appeared on their account in the future, the Bureau should have asked whether such a charge had appeared on a consumer's account in the past and, if so, what the consumer did about it. Relatedly, an industry commenter suggested that the Bureau should have surveyed consumers about their baseline level of understanding of other key provisions of their card agreements. With such a baseline, the commenter said that the Bureau could have evaluated whether consumers pay greater, less, or the same attention to dispute resolution clauses as to other clauses important to them – and why that might be so. Absent such data, the commenter said that the survey is meaningless.

[209] *Id.* section 3 at 21 and 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.

A law firm commenter writing on behalf of an industry participant suggested that the Study's consumer survey was flawed because the Bureau only surveyed credit card consumers and that the Bureau should not draw general conclusions about consumers' understanding of dispute resolution systems from survey results in a single market in part because credit card agreements are often provided simultaneously with an access device rather than when a consumer applies for a card. This is because, the commenter suggested, that credit card contracts are unique, because consumers do not receive the complete loan agreement until they receive the card itself.

*Response to Comments Received on Section 3*

The Bureau disagrees with the commenter that suggested that the Bureau should have conducted further analyses of consumer comprehension. The Bureau, in Section 3 of the Study, explored in detail consumer comprehension issues with respect to arbitration agreements using a nationally representative telephone survey. As is discussed in the Study, among other findings, the Bureau determined that a majority of respondents whose credit cards include pre-dispute arbitration agreements did not know if they could sue their issuers in court. Nor does the Bureau agree that asking consumers about their likelihood to file a class action given an arbitration agreement would result in useful information. As the Study showed, the proposal and this final rule discuss, and several industry commenters acknowledged, regardless of the level of individual consumer awareness, arbitration agreements do in fact have the effect of blocking class actions that are filed and suppressing the filing of many more cases, consumers' awareness of this fact does not seem relevant. Insofar as cases are blocked, further focus on consumers' comprehension of this fact is unnecessary.

The Bureau acknowledges it did not develop a baseline of understanding of other key credit card agreement terms. However, the Bureau disagrees that the failure to do so renders the survey "meaningless." The survey found that consumers do not shop for credit cards based on the type of dispute resolution process provided in the credit card agreement and that consumers do not understand the consequences of choosing a card with an arbitration provision. Whether consumers have greater or lesser understanding of other provisions of credit card agreements does not seem to the Bureau to be relevant in assessing whether limitations on the use of arbitration agreements is for the protection of consumers and in the public interest.[210]

Regarding the commenter that suggested that the survey of credit card customers cannot be extrapolated to other markets because credit card agreements are often provided simultaneously with an access device (and not at the time of application), the Bureau disagrees that this is a relevant reason not to extrapolate the results of the survey. Even if consumers do not receive the terms at the time of application, they do receive them before they activate a credit card. At that point, they are free to reject the credit card and its terms. The survey showed that few make that choice; the Bureau has no reason to believe that such a decision is different in other markets. Nor has this or any other commenter provided evidence to the contrary.

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

While the Study generally focused on empirical analysis of dispute resolution, Section 4 of the Study provided a brief qualitative comparison between 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.

[210] As is noted in Section 2 at 72 of the Study, many arbitration agreements are already printed in bolded text or with all capital letters.

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.[211] 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.[212] Prior to March 1, 2013, arbitrators in AAA consumer arbitrations had discretion to reallocate fees in the final award. After March 1, 2013, arbitrators can only reallocate arbitration fees in the award if required by applicable law or if the claim "was filed for purposes of harassment or is patently frivolous."[213]

Parties in court generally bear their own attorney's fees, unless a statute or contract

[211] Study, *supra* note 3, 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)).
[212] *Id.* section 4 at 11-12.
[213] *Id.*

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.[214] For example, 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."[215]

*Representation*. The Study noted that in most courts, individuals can either represent themselves or hire an attorney as their representative.[216] In arbitration, the rules are more flexible than in many courts about the identity of party representatives. 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."[217] Some States, however, prohibit non-attorneys to represent parties in arbitration.[218]

*Selecting the Decisionmaker*. The Study noted that court rules generally do not permit parties to reject the judge assigned to hear their case.[219] 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 the parties cannot agree on the arbitrator, the arbitrator is selected following the procedure specified in their contract or in the governing arbitration rules.[220]

[214] *See, e.g.*, 15 U.S.C. 1640(a)(3) (TILA).
[215] Study, *supra* note 3, section 4 at 12.
[216] *Id.* section 4 at 13.
[217] *Id.* section 4 at 13-14.
[218] *Id.* section 4 at 14.
[219] *Id.*
[220] *Id.* section 4 at 15.

*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.[221]

*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.[222]

*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.[223] The Study further noted that the AAA and JAMS have adopted rules, derived from Federal Rule 23, for administering arbitrations on a class basis.[224]

*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 record generally available for public review; by comparison, arbitration is a private process in that there is no particular mechanism for public transparency. Absent an agreement by the parties, however, it is not by law required to be confidential.[225]

*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

[221] 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 3, 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 3, 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.*
[222] Study, *supra* note 3, section 4 at 18.
[223] *Id.* section 4 at 18-20.
[224] *Id.* section 4 at 20.
[225] *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.

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.[226]

*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.[227]

*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.[228]

*Comments Received on Section 4 of the Study*

A nonprofit commenter criticized the Bureau's analysis of arbitration procedures by noting that it is the shortest section of the Study and that the Bureau did not attempt to estimate the actual transaction cost for consumers in pursuing claims in court as compared to arbitration. A research center commenter suggested that the Bureau should have performed a more detailed analysis of how judges supervise arbitration and how many businesses have adopted provisions similar to that at issue in the *Concepcion* case[229] because this information would aid the Bureau's analysis of the effectiveness of arbitration clauses for consumers.

*Response to Comments Received on Section 4*

[226] *Id.* section 4 at 22-24.
[227] *Id.* section 4 at 24.
[228] Courts may vacate arbitration awards under the FAA only in limited circumstances. 9 U.S.C. 10 (arbitration awards can be vacated (1) where the award was procured by corruption; the arbitrator is partial or corrupt, the arbitrator was guilty of misconduct in certain specified ways, the arbitrator exceeded his powers or the arbitrator so imperfectly executed his powers that an award was not made). *Cf. supra* notes 104-112 and accompanying text (identifying the narrow grounds upon which a court may determine an arbitration agreement to be unenforceable).
[229] The arbitration provision at issue in *Concepcion* provided that the company would pay all costs of the arbitration for the consumer; that the arbitration would take place in the county where the consumer resided or could take place by telephone or document submission; that the arbitrator was not limited in the damages it could award the consumer; that if the consumer received an award that was higher than the company's last written settlement offer, the company would have to pay $7,500 in addition to the award; and that if the consumer prevailed he could seek double the amount of his attorney's fees. *AT&T Mobility LLC* v. *Concepcion*, 563 U.S. 333, 337 (2011).

While the review of arbitration procedures was shorter than other chapters that report on the results of empirical analyses undertaken for the Study, the Bureau believes its analysis to be fulsome; the commenter – other than offering the transaction cost criticism as discussed in the rest of this paragraph – did not explain what more the Bureau's analysis could have done nor did it identify other specific topics for analysis. With regard to the comparison of costs, the Bureau notes that the Study provided a detailed discussion of the fees a consumer would need to pay in (a) Federal court; (b) small claims court, using Philadelphia Municipal Court as an example; and (c) arbitration, using the AAA and JAMS as examples.[230] The Bureau notes that the Study included a discussion regarding available fee waivers for indigent plaintiffs, as well as the ability of the arbitrator to reallocate the initial fee distribution.[231] The Study also assessed the frequency with which consumers proceeded without counsel in arbitration proceedings in and court proceedings.

As for the commenter that suggested that the Bureau should have looked at how judges supervise arbitration, the commenter did not explain what additional insights could be gained from such an analysis. As for the commenter's contentions regarding *Concepcion*-like clauses, the Bureau notes that Section 2 found such clauses to be rare in consumer finance.[232]

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

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

[230] *See* Study, *supra* note 3, section 4 at 10.
[231] *See id.* section 4 at 10 n.40 (citing 28 U.S.C. 1915(a)).
[232] Study, *supra* note 3, section 2 at 70-71 and tbl. 15.

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 automobile purchase loans. To conduct this analysis, the Bureau used electronic case files from the AAA.[233] 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.[234] Because the AAA provided the Bureau with case records for all disputes filed in arbitration during this period, Section 5 of the Study provided a reasonably complete picture of the frequency and typology of claims that consumers and companies file in arbitration.[235]

The Study identified about 1,847 filings in total – about 616 per year – with the AAA for the six product markets combined.[236] 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 submissions by both the consumer and the company.[237] 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

[233] *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); Christopher R. Drahozal & Samantha 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).

[234] Study, *supra* note 3, section 5 at 17.

[235] While the analysis did 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.

[236] *Id.* section 5 at 9.

[237] *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.

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.[238]

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.[239] In debt disputes, the average disputed debt amount was approximately $15,700; the median was approximately $11,000.[240] Across all six product markets, about 25 cases per year involved affirmative claims of $1,000 or less.[241]

Overall, consumers were represented by counsel in 63.2 percent of arbitration cases.[242] 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 filed.[243]

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.[244] Among other issues, settlement terms were rarely known in cases in which the parties settled their disputes. Indeed, 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.[245] Accordingly, on the one hand, an incomplete file could indicate a settlement, or, on the other hand, that the proceeding was still

[238] *Id.* section 1 at 11.
[239] *Id.* section 5 at 10.
[240] *Id.*
[241] *Id.*
[242] *Id.* section 5 at 29.
[243] *Id.* section 5 at 28-32.
[244] *Id.* section 5 at 4-7. As a result, the Bureau was only able to determine a substantive outcome in 341 cases.
[245] *Id.* section 5 at 6.

in progress but relatively dormant. Because parties settled claims strategically, disputes that *did* reach an arbitrator's decision on the merits were not a representative sample of the disputes that were filed.[246] 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 showed that the parties settled. In 34.2 percent of disputes (362 disputes), the available AAA case record ended in a manner that was 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 ended in a manner that suggested 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.[247]

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.[248] Of these 341 cases, 161 disputes involved an arbitrator decision on a consumer's affirmative claim. Of the cases in which the Bureau determined the results,

[246] *Id.* section 5 at 7 (noted 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 noted 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.*
[247] *Id.* section 5 at 11.
[248] *Id.* section 5 at 13.

consumers obtained relief on their affirmative claims in 32 disputes (20.3 percent).[249] 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).[250] The total amount of affirmative relief awarded in all cases was $172,433 and total debt forbearance was $189,107.[251] 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.[252] With respect to disputes that involved company claims in 2010 and 2011, the Bureau determined the terms of arbitrator awards relating to company claims in 244 of the 421 disputes.[253] 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.[254]

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.[255]

The Study also found that very few class arbitrations were filed. The Study identified only two filed with AAA 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

[249] *Id.*
[250] *Id.*
[251] *Id.* section 5 at 41, 43.
[252] *Id.* section 5 at 13.
[253] This includes cases filed by companies as well as cases in which companies asserted counterclaims in consumer-initiated disputes. *Id.* section 5 at 14.
[254] Of the 244 cases in which companies made claims or counterclaims that the Bureau determined 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 43-44.
[255] *Id.* section 5 at 85.

that followed a State court decision granting the company's motion seeking arbitration.[256]

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.[257] Further, the Study found that more than half of the filings that reached a decision were resolved by "desk arbitrations," meaning that the 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.[258] 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.[259]

*Comments Received on Section 5 of the Study*

An industry commenter criticized the Study's review of arbitration processes for its failure to assess whether the AAA due process protocol was effective in ensuring arbitrator neutrality. The commenter suggested that the Bureau could have reviewed decisions of individual arbitrators to see if they had a pattern of favoring the companies over consumers. This commenter further criticized the Bureau for making no effort to evaluate whether arbitrators' decisions were properly decided.

Similarly, a Congressional commenter expressed concern that the Study failed to thoroughly analyze and compare arbitration programs and program features. The commenter

[256] *Id.* section 5 at 86-87. The Study's analysis of class action filings identified a third class action arbitration filed with JAMS following the dismissal or stay of a class litigation. *Id.* section 6 at 59.
[257] *Id.* section 5 at 71-73.
[258] *Id.* section 5 at 69-70.
[259] *Id.* section 5 at 70-71.

suggested that the Bureau should have reviewed whether certain features of arbitration programs produce better consumer outcomes and enhance the consumer experience as compared to others, but did not identify specifically which features warranted additional analysis.

An industry commenter took issue with the Bureau's assertion that the disputes it reviewed involving AAA represent substantially all consumer finance arbitration disputes that were filed during the Study period, noting that JAMS was named as the administrator at least 50 percent as often as AAA in the agreements reviewed by the Bureau.

Another industry commenter suggested that the Study's data regarding disputes reached on the merits were not representative of the sample because only 32 percent of cases had a judgment on the merits, while the rest remained dormant or settled on unknown terms.

*Response to Comments on Section 5 of the Study*

With respect to the commenter that criticized the Bureau for not evaluating whether certain arbitration programs (such as those that limit consumer costs, allow for "bonus" awards,[260] or other benefits) provide better consumer outcomes, the Bureau notes that the case records available for the Study did not necessarily include the terms of the arbitration agreement and that, except for the cases that were decided by an arbitrator, the case records also did not include the terms of the outcomes. Thus, the analysis of arbitration programs (as expressed in arbitration agreements) suggested by this commenter was not feasible and, in any event, would not have impacted the central finding, discussed below, that an extremely small number of consumers avail themselves of any arbitration process under any scheme.

[260] An example "bonus" provision in an arbitration agreement would require a company to pay a consumer double or triple the company's highest settlement offer if the consumer wins on his or her arbitration claim in an amount that exceeds that settlement offer.

As to the commenter that criticized the Bureau for not evaluating whether arbitrators deciding AAA consumer cases were biased, the Bureau notes that, for those cases that were resolved with a written opinion, the Study reported whether the decision favored the consumer or the financial institution and the amount of the award, if any. The Study also explored whether arbitrators favored parties that were repeat players before them.[261] As the Study noted, commentators have long raised concerns that such a repeat player bias may occur given incentives some arbitrators may have to curry favor while seeking future appointments.[262] The Bureau could not evaluate outcomes in cases that settled or cases that were resolved in a manner consistent with a settlement. The Bureau also did not evaluate whether arbitrators' decisions were "properly decided" as the Bureau does not believe it would have a basis for making such a determination. As discussed in Part VI below, this rulemaking does not rely on a finding that arbitration proceedings are fair (or not) but rather that consumers do not use arbitration to resolve disputes in any meaningful volume.

With respect to the industry commenter that suggested the Study undercounted individual arbitration because it studied only those filed with the AAA and not JAMS, the Bureau noted in the Study and the proposal that JAMS appears to handle a relatively small number of consumer finance arbitrations per year. For example, it reported to the Bureau that it handled 115 consumer finance arbitrations in 2015 (an unknown number of which were filed by consumers as opposed to providers),[263] significantly fewer than the approximately 600 per year the Bureau found filed with the AAA in the Study. Thus, the Bureau believes that the relevant data supports a conclusion that the AAA cases represent a substantial majority of consumer finance

[261] *Id.* section 5 at 56-68.
[262] *Id.*
[263] *See* 81 FR 32830, 32856 (May 24, 2016); Study, *supra* note 3, section 5 at 9.

arbitrations that occur. Further, even if the Bureau were to assume that JAMS handled a consumer finance caseload equal to half of the AAA caseload (based on the fact that JAMS was named as an administrator about 50 percent as often as AAA), that would still suggest that there are fewer than 900 consumer financial services cases per year as between the two largest administrators.

As for the commenter that contended that the decisions reached on the merits are not representative of the whole, the Bureau notes that it does not contend otherwise. It noted in the Study that a merits-decision occurred less frequently than other forms of resolution, such as settlement.[264]

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

The Study's review of consumer financial litigation in court represented, 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.[265] 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.[266] 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

[264] Study, *supra* note 3, section 5 at 11-12.
[265] *See, e.g.*, Thomas E. Willging et al., "Empirical Study of Class Actions in Four Federal District Courts: Final Report to the Advisory Committee on Civil Rules," (Fed. Jud. 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), *cited in* Study, *supra* note 3, section 6 at 19 n.19.
[266] Due to resource constraints, the Bureau did not examine individual automobile purchase loans. *See* Study, *supra* note 3, section 6 at 11 n.22.

analogue to the years for which electronic AAA records were available, and captured outcomes reflected on dockets through February 28, 2014.

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.[267] The Bureau also reviewed Federal multi-district 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 large counties that had a public electronic database in which complaints were regularly available.[268] 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.[269] Collectively, this State court sample accounted for 18.1 percent of the U.S. population as of 2010.[270]

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.[271] 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

[267] LexisNexis, "Courtlink,", http://www.lexisnexis.com/en-us/products/courtlink-for-corporate-or-professionals.page (last visited Feb. 10, 2017).
[268] To determine what counties to include in the data set, the Bureau started with the Census Bureau's list of the 10 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.
[269] Study, *supra* note 3, appendix L at 71.
[270] *Id.* section 6 at 15; *see generally id.* appendix L.
[271] *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.[272] In Federal court class cases, the most common claims were under the FDCPA and State statutes prohibiting unfair and deceptive acts and practices.[273] In State court class cases, State law claims predominated.[274] 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 for purposes of comparison 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.[275] The Bureau was able to determine, however, that more than one-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). Only about 10 percent of the 562 class cases sought statutory damages under Federal statutes that do not cap damages available in class proceedings.[276]

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.[277] 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 typically unavailable from the court record unless the settlement was on a class basis. The bulk of cases, therefore, including individual cases and cases filed as a class action but that settled on an individual basis only,

[272] *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.* section 6 at 14-15.
[273] *Id.* section 6 at 6.
[274] *Id.*
[275] *Id.* section 5 at 10.
[276] *Id.* section 6 at 22-26. The "capped" claims arose from five statutory schemes: the Expedited Funds Availability Act, the EFTA, the FDCPA, the TILA (including the Consumer Leasing Act and the Fair Credit Billing Act), and the 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.
[277] *Id.* section 6 at 2-5.

resulted in unknown substantive outcomes.[278] 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.[279] 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.[280] In addition, while the Bureau believed that its data set of State court complaints is the most robust available, the Bureau noted the dataset's limitations. For example, the three States and seven additional counties from which the Bureau collected complaints filed in State court may not be representative of the consumer financial litigation filed in State courts nationwide.[281]

In addition to the limitations on comparing case outcomes, the Study also noted that even comparing frequency or process across litigation and arbitration proceedings was of limited utility.[282] 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 basis; and whether to seek arbitration of cases filed in court.[283] 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

[278] *Id.* section 6 at 3.
[279] *Id.*
[280] *Id.* section 6 at 3-4.
[281] *Id.* section 6 at 15 n.34. *See also id.* appendix L.
[282] *Id.* section 6 at 4.
[283] *Id.*

by February 28, 2014.[284] 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.[285] 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.[286] 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.[287]

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.[288] 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.[289]

The Bureau reviewed outcomes in all of the individual cases from four of the five markets studied and a random sample of the cases filed in the fifth market, resulting in an analysis of 1,205 cases.[290] 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

[284] *Id.* section 6 at 7.
[285] *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.
[286] *Id.*
[287] *Id.*
[288] *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.
[289] *Id.* section 6 at 7.
[290] 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.

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.[291]

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.[292] Aside from a handful of individual cases transferred to MDL proceedings, individual Federal cases closed in a median of approximately 127 days.[293]

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

[291] *Id.* section 6 at 48.
[292] *Id.* section 6 at 9.
[293] *Id.*

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.[294] In a comparable set of 140 individual disputes, motions seeking arbitration were filed one-tenth as often, in only 5.7 percent of proceedings.[295] 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.[296]

*Comments Received on Section 6 of the Study*

One industry lawyer commenter criticized the Bureau's review of class action filings for failing to evaluate the underlying merits of the class actions and whether they asserted substantive claims or instead alleged what the commenter considered technical violations, such as improperly worded disclosures. This commenter similarly suggested that the Bureau should have evaluated whether class action claims were meritorious or whether plaintiffs made frivolous claims to attract nuisance value settlements.

An industry commenter took issue with the fact that the Bureau studied 1,800 arbitrations but only a sample of the individual litigation cases and asserted that extrapolating from the latter

[294] *Id.* section 6 at 60-61. The court granted motions seeking arbitration in 61.5 percent of these disputes.
[295] *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).
[296] *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.* section 6 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).

but not the former provided an inaccurate picture of the individual litigation landscape. The commenter similarly opined that the State court class actions studied by the Bureau cannot be relied upon to be representative of such litigation nationwide because the Bureau, in the Study, acknowledged that they may not be representative of the entire country.

An industry commenter took issue with the small number of instances documented in the Study (12) where a dismissed class claim was re-filed in arbitration, contending that the Bureau did not research whether claims were filed in any arbitration forum other than the AAA.

Relatedly, an industry commenter expressed concern that the number of individual Federal court lawsuits reported in the Study was too low. Specifically, the commenter cited records of the Transactional Records Access Clearinghouse (TRAC), which is a data gathering and research organization at Syracuse University. The commenter asserted, based on the TRAC data, that there were 890 consumer credit lawsuits filed in Federal district court in May 2012 and 723 such suits filed in September 2012.[297] The commenter also referenced data from a commercial litigation monitoring website called WebRecon that similarly stated that more than 1,000 consumers per month filed suits in Federal courts in the years 2010, 2011, and 2012 for violations of the TCPA, FCRA, or the FDCPA.[298] Taken together, the commenter asserted these figures as a basis to question the accuracy of the Bureau's data.

*Response to Comments Received on Section 6*

Regarding the industry lawyer commenter that criticized the Study's failure to explore whether class actions assert substantive or technical claims, the Bureau notes that the Study did

[297] TRAC Reports Inc., "Consumer Credit Civil Findings For May 2012," (July 12, 2012), *available at* http://trac.syr.edu/tracreports/civil/285/; TRAC Reports Inc., "Consumer Credit Card Civil Lawsuits Starting to Fall," (Nov. 6, 2012), *available at* http://trac.syr.edu/tracreports/civil/298/. According to TRAC, there were 890 new "consumer credit" lawsuits filed during May 2012, most of which asserted claims under FDCPA or FCRA.

[298] WebRecon LLC, "Out Like a Lion…Debt Collection Litigation and CFPB Complaint Statistics, Dec. 2015 and Year in Review," *available at* https://webrecon.com/out-like-a-lion-debtcollection-litigation-cfpb-complaint-statistics-dec-2015-year-in-review/.

report on the types of claims asserted in Federal class actions by statute.[299] The Bureau does not believe that it would be appropriate for it to classify claims alleging violations of Federal or State law as "technical" or not "substantive." Nor does the Bureau believe that it would be feasible, given notice pleading requirements, or appropriate for the Bureau to assess the merits of the claims asserted in these complaints. The Bureau notes that the Federal Rules of Civil Procedure provide means of securing dismissal of complaints which, on their face, fail to state a valid cause of action and of obtaining summary judgments for cases in which there are no genuine issues of material fact and the defendant is entitled to judgment as a matter of law. As discussed below in connection with Section 8 of the Study, the Bureau reported statistics on such dispositive motions in the context of Federal class action settlements. The Bureau discusses further judicial safeguards on such cases in Part VI Findings below, including by noting legislative and judicial safeguards that limit frivolous litigation. The Bureau also disagrees with the commenter that said the Study only looked for claims re-filed in arbitration in its AAA data. As is explained in Section 6 of the Study, the Bureau located nine of the 12 re-filings in its review of court filings.[300] Four of these cases were filed with JAMS and five with AAA. The remaining three cases that the Bureau identified came from its review of AAA data.[301]

As for the assertions that the Bureau's analysis undercounted the number of individual cases filed in Federal court, the Bureau does not believe that the figures cited by the commenters provide a basis on which to question the accuracy of the Bureau's data. As is explained in detail in Appendix L of the Study, the Bureau completed its analysis by first crafting a deliberately

[299] Study, *supra* note 3, section 6 at 20 fig. 1 (which shows the various legal claims, including Federal statutory, State common law, and State statutory claims, asserted in 562 class cases filed in Federal and State Court); *id.* section 6 at 21 fig. 2 (which shows the legal claims asserted in the 470 Federal class cases).
[300] *Id.* section 6 at 59.
[301] *Id.*

overbroad text search in the Courtlink database and then manually sorting through that data for cases that fit the relevant parameters. The Bureau filtered this data so that it could analyze individual claims filed in Federal court with respect to five consumer financial products (credit cards, GPR prepaid cards, checking accounts/debit cards, payday loans, and private student loans) and found approximately 1,200 per year. The TRAC and WebRecon sources referenced by the commenter did not, as the Bureau did, analyze each case to see whether it fell into one of the five product categories analyzed in that part of Section 6. Both databases appear to be based on initial case designations made upon filing by a plaintiff. Thus, many cases designated as "consumer credit" fall outside both the parameters of Section 6 and the Bureau's proposed rulemaking. For example, not every case filed under the FCRA or the FDCPA and reported by TRAC as a consumer credit case concerns a consumer financial product or service, and thus TRAC overstates the number of Federal individual claims concerning such products. Similarly and as the Bureau noted in the proposal, an unknown number of the cases reported by WebRecon also would not be covered by the Study or by the proposal rule because that database similarly includes all claims under FDCPA, FCRA and TCPA and have not been analyzed further. As evidence of the overbroad nature of these results, a separate study explained that more than 3,000 TCPA claims were filed in 2015 but many of these concerned marketing communications unrelated to consumer finance, such as those against a merchant or a company with whom the consumer has no relationship (contractual or otherwise).

As for the commenter concerned about the Bureau having extrapolating data on individual litigation, the Bureau notes that the Study did not purport to analyze all claims about consumer financial products filed in Federal court. Thus it agrees that the number of individual Federal lawsuits about all of the consumer financial products that would be covered by this rule

is necessarily higher than 1,200. The Bureau knows of no reason to view the studied markets as materially different than other financial services markets, however, with regard to the level of Federal litigation overall, nor does the commenter suggest otherwise. As for extrapolating from Federal individual lawsuits, the Bureau disagrees that extrapolating data is inappropriate. Extrapolation is standard technique used in studies like the Bureau's and is typically only inappropriate if there is a reason that the data collected is unique. The Bureau does not believe such a reason exists regarding its Federal individual court records, nor did the commenter identify one.[302] As for the State court class action data, which was drawn from courts representing 18.1 percent of the population, the Bureau stated in the Study that the data from the State courts analyzed may not be representative of the consumer financial litigation filed in State courts nationwide.[303] Despite the cautious language in the Study, the Bureau is not aware of any reason why this data are not representative of parts of the country not studied. Below, in Part VI, the Bureau discusses the extent to which it relies on this data.

*6. 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.

[302] The Bureau collected State court data from parts of New York, California, Florida, Utah, Oregon, and Oklahoma. *See* Study, *supra* note 3, section 6 at 14-15.
[303] Study, supra note 3, section 6 at 15 n.34.

The Bureau believes that the Study's review of small claims court filings is 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.[304] The Study, however, was the first that the Bureau has been able to identify 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.[305] The Bureau identified 12 State databases that purport to provide Statewide data and that can be searched by year and party name, plus a comparable database for the District of Columbia and a database for New York State that did not include New York City. This "State-level sample" covered approximately 52 million people. The Bureau also identified 17 counties with small claims court databases that met the same criteria (purporting to provide countywide 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" covered approximately 35 million people and largely avoided overlap with the State-level sample.[306] The Bureau searched each of these 31 jurisdictions' databases for cases involving a set of 10 large credit card issuers that the Bureau estimated to cover approximately 80 percent of credit card balances outstanding

[304] 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 Mass., Dist. Ct. Dep't of the Trial Ct., "Report of the Small Claims Working Group," at 3 (Aug. 1, 2007), *available at* http://www.mass.gov/courts/docs/lawlib/docs/smallclaimreport.pdf.
[305] Study, *supra* note 3, section 7 at 5.
[306] *Id.* section 7 at 6.

nationwide.[307] 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.[308]

The Study estimated that, in the jurisdictions the Bureau studied – with a combined population of approximately 87 million people – consumers filed no more than 870 disputes in 2012 against these 10 institutions[309] (including the three largest retail banks in the United States).[310] This figure included 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: 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 10 issuers, and none of the four Philadelphia cases were situations where individuals were filing credit card claims against one of the 10 issuers. This additional analysis shows that the Bureau's broad methodology likely significantly overstated the actual number of

[307] *Id.*
[308] Preliminary Results, *supra* note 150, at 155 and 156 tbl. 10.
[309] Study, *supra* note 3, section 7 at 9. Due to a typographical error in the Study, the combined population of these jurisdictions was incorrectly reported as 85 million.
[310] *Id.* appendix Q at 120-21.

small claims court cases filed by consumers against credit card issuers.[311]

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.[312] Based on the available data, it is likely that nearly all these cases were debt collection claims.[313]

*Comments Received on Section 7 of the Study*

One industry commenter asserted that the Bureau had only evaluated whether arbitration agreements contained small claims court carve-outs and requested that the Bureau re-conduct its Study to, among other things, critically analyze the use of small claims court as compared to arbitration or class action litigation. The commenter did not specifically address the Bureau's analysis in Section 7 of the Study or otherwise specify what further type of critical analysis would have been appropriate.

Another industry commenter asserted that the sample size used by the Bureau in its analysis of small claims court was too small and that this demonstrates a weakness of the Study that undermines the credibility of any assertion that consumers rarely proceed individually to obtain relief from legal violations. This commenter focused on the fact that the Bureau's review was limited to what it considered a small number of jurisdictions and only looked at claims against 10 large credit card issuers in 2012, asserting that the Bureau thus understated the total number of small claims cases. Relatedly, another industry commenter expressed concern about the Bureau's limited analysis of small claims court cases, emphasizing that the Bureau was able to review case documents in only two jurisdictions out of the thousands of counties in the United

[311] *Id.* section 7 at 8-9.
[312] *Id.* section 1 at 16.
[313] *Id.*

States. However, unlike the prior commenter, this commenter was concerned that the data reflected by the Bureau's methodology may overstate the number of small claims cases filed by consumers against credit card issuers.

*Response to Comments on Section 7 of the Study*

The Bureau disagrees that its Study of small claims court was limited to an analysis of whether arbitration agreements contain class action carve-outs. As is discussed in detail above, the Bureau conducted the most fulsome analysis it could practicably conduct of consumers' use of small claims court to resolve disputes with their providers.[314] As stated above, the Bureau believes that this is the only Study with such a broad scope of jurisdictional coverage that analyzes the incidence and typology of consumer financial disputes in small claims court to date. This was in addition to – and distinct from – Section 2's analysis of companies' use of small-claims court carve-outs in their arbitration agreements.

The Bureau disagrees with the commenter that asserted that the size of the sample and the nature of its review of small claims court data undermine the Bureau's conclusion that consumers rarely proceed in this venue. The commenter did not explain why, given that the Bureau analyzed small claims courts in jurisdictions with a combined population of approximately 87 million people and found only 870 suits in 2012 against these 10 largest credit card issuers, it should be expected to find a substantially higher incidence of suits in the other portions of the country or against other providers. As is explained in the Study's Appendix Q,[315] no one had previously conducted a sample as large as the Bureau's, and the 10 credit card issuers

[314] *See id.* section 7 at 5-7. Specifically, the Bureau analyzed the small claims court cases involving credit card issuers with a number of different contractual provisions; some issuers analyzed had no arbitration clauses, some had arbitration clauses with mutual small claims carve-outs (meaning that both the consumer and company had the right to maintain a case in small claims court), some had arbitration clauses with a non-mutual small claims carve-out (meaning that only the consumer had the right to maintain an action in small claims court), and one had arbitration provisions with no small claims carve-outs. *Id.*

[315] *Id.* appendix Q at 117-18.

studied accounted for 84 percent of credit card outstandings in the Bureau's credit card contract sample.[316] Given the modest number of consumer-filed claims found, the Bureau does not believe that it is likely that a large number of cases were filed in regular State courts or small claims courts against providers of consumer financial products or services.[317]

With regard to the other commenter's concern that the Bureau has overstated the number of small claims court cases in the jurisdictions it studied, the Bureau pointed out that the 870 cases identified in Section 7 constituted a likely upper limit to the number of consumer-filed small claims court cases against the identified credit card issuers.[318] Indeed, as the Bureau notes in Part VI Findings below, the commenter expressed concern at the potential over-counting of consumer claims tends to support the Bureau's belief that the number of small claims court cases involving credit cards indicates that these claims may go unaddressed but for class actions.

*7. Class Action Settlements (Section 8 of Study)*

Section 8 of the Study contained the results of the Bureau's quantitative assessment of consumer financial class action settlements. As described above, Section 6 of the Study, which analyzed consumer financial litigation, included findings about the frequency with which consumer financial class actions are filed and the types of outcomes reached in such cases. 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 settlements, for Section 8, the Bureau conducted a search of class action settlements through an

[316] *See id.* section 3 and section 7 at 6 n.19.
[317] For example, in collecting data for Section 6 of the Study concerning litigation in court, the Bureau's preliminary research suggested that the number of consumer-filed consumer finance cases in State court would not be high. *Id.* appendix L at 70-71 (explaining that the Bureau considered searching for State cases using a contract "nature of suit" but ultimately determined that the total number of cases in this category would be high while the number of consumer-filed cases concerning the products we covered would not be).
[318] *Id.* section 7 at 9 (noting that the detailed analysis of consumer-filed cases in two jurisdictions led the Bureau to the conclusion that "our broad methodology may well overstate the actual number of small claims court cases filed by credit card consumers against our sample of issuers.").

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.[319] 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.[320]

The set of consumer financial class action settlements overlapped 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 was larger because it encompassed a wider time period (settlements finalized from 2008 through 2012), which, among other benefits, decreased the variance across years that could be created by unusually large settlements and allowed the Bureau to account for the impact of such events as the April 2011 Supreme Court decision in *Concepcion*, which is

[319] 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.*at 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.* at appendix L.

[320] *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 and appendix S.

discussed above.[321] 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 was the first to comprehensively catalogue and analyze class action settlements specific to consumer financial markets.[322]

As the Study noted, there were limitations to the Bureau's analysis. The Study understated 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.[323]) 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 even if claims numbers are not yet final.[324] In addition, not every settlement document contained information on every data point or metric that the Bureau sought to analyze; the Study accounted for this by referencing, for every metric reported on, the number of settlements that provided the relevant number or estimate.[325]

The Bureau identified 422 Federal consumer financial class settlements that were approved between 2008 and 2012, resulting in an average of approximately 85 approved

[321] *Concepcion*, 563 U.S. at 344.
[322] *See* Study, *supra* note 3, section 8 at 8-9.
[323] *Id.* section 8 at 10.
[324] *Id.* section 8 at 11.
[325] *Id.* section 8 at 10.

settlements per year.[326] The bulk of these settlements (89 percent) concerned debt collection, credit cards, checking accounts, or credit reporting.[327] Of these 422 settlements, the Bureau was able to analyze 419.[328] 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*),[329] these settlements included 160 million class members.[330]

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.[331] This estimate included cash relief of about $2.05 billion and in-kind relief of about $644 million.[332] 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.[333] 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 beyond simply to comply with the law.

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

[326] *Id.* section 8 at 9.
[327] *Id.* section 8 at 11.
[328] *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.*
[329] *Id.* section 8 at 3.
[330] *Id.*
[331] *Id.* section 8 at 4. 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.*
[332] *Id.*
[333] *Id.* 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.

cash payments to class members was $1.1 billion. Again, this excludes payment of in-kind relief and any valuation of behavioral relief.[334]

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.[335] 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.[336]

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 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.[337] 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

[334] *Id.* section 8 at 28.
[335] *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 U. (Dec. 9, 2015). 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.
[336] 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 3, section 8 at 19.
[337] *Id.* section 8 at 30.

the cases providing for automatic relief, was 4 percent including the large *TransUnion* settlement, and 11 percent excluding that settlement.[338]

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 the 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.[339]

In addition, the Study included a case study of *In re Checking Account Overdraft Litigation*, MDL No. 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 11 cases, the banks' deposit agreements did not include 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.[340] Another four defendants moved to seek arbitration, but ultimately settled; in those cases 8.8

[338] *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.
[339] *Id.* section 8 at 36 tbl. 13. 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.
[340] *Id.* section 8 at 44 tbl. 20. 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.

million consumers obtained $180.5 million in relief.[341] Five companies, in contrast, successfully invoked arbitration agreements, resulting in the dismissal of the cases against them.[342]

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 noted, 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.[343]

*Comments Received on Section 8 of the Study*

Several commenters, including industry commenters and a nonprofit commenter, criticized the Bureau's analysis of class action settlements. These commenters cited a working paper by one research center that critiqued use of what it called "aggregate averages" to evaluate the effectiveness of class action cases.[344] The result, according to the nonprofit commenter, was that the Study tended to overweight data from a handful of very large settlements in a way that

[341] *Id.* section 8 at 45 tbl. 21.
[342] *Id.* section 8 at 42 tbl. 18.
[343] *Id.* section 8 at 39-46. The case record did not reveal how many consumers received informal relief of some form. It is likely that many other class action settlements account for similar set-offs for consumers that received relief in informal dispute resolution, as settling defendants would have economic incentives to avoid double-compensating such plaintiffs.
[344] By aggregate averages, the academic paper suggests that the Bureau had computed these averages by counting the number of class members paid, and the total amount paid in attorney's fees, and dividing those numbers by, respectively, the total number of class members and the class payment.

overstates the importance of class actions. Relatedly, an industry commenter contended that the Study gave undue weight to a few large class action settlements. This commenter, several industry commenters, and a research center commenter also took issue with the Bureau's decision to exclude certain settlements from the Study because the settlements did not involve contractual relationships and thus could not be blocked by invoking an arbitration agreement (*e.g.*, cases involving out-of-network ATM notices) while including debt collection class actions which, according to the commenters, also do not typically involve a contractual relationship between the debt collector and the consumer. Along similar lines, an industry trade association commenter took issue with the Bureau's use and analysis of the Overdraft MDL case study. According to the commenter, the overdraft cases were atypical because, among other things, they settled, they involved automatic payouts to class members rather than requiring the submission of claims, and they resulted in abnormally large settlements. The commenter stated that the Bureau should therefore have excluded the cases from its analysis. Furthermore, the commenter asserted that the Bureau failed to address critical questions about the overdraft cases, including the time spent in litigation before settlement, the net present value to consumers of the settlements, and the plaintiff's attorney fees. Finally, the research center commenter also contended that the Bureau's approach biased the Study by skewing data on attorney's fees.

A nonprofit commenter, a research center commenter and several industry commenters also criticized the Study for not attempting to assess the underlying merit of consumer class actions that result in settlements and one of these industry commenters criticized the Bureau for not also analyzing the merits of all class actions, not just those that settled. The nonprofit commenter noted that the Study did not present data regarding which companies were more likely to settle nor did the Bureau offer details on what the commenter identified as key measures

of class action performance. Without this information, contended the commenter, readers are unable to know if allowing more class actions would actually resolve a societal problem or instead would be used to extort settlements from companies for minor violations that do not harm anyone. One industry commenter focused on the fact that the Bureau did not calculate any actual injury to consumers belonging to a class and instead assumed that settlements reflect redress for legal violations even though most settlements do not include a finding of wrongdoing and some may be settlements to resolve nuisance suits. This commenter further expressed concern for, in its view, the Bureau's failure to determine if class action claims were meritless or frivolous. Relatedly, one of the industry commenters said that the Bureau should have evaluated whether class actions were brought to address consumer harm as opposed to being motivated by attorneys' desire to earn fees (and thus benefits to consumers were secondary).

An industry commenter suggested that Section 8 exceeded the Bureau's authority, noting that section 1028(a) required the Bureau to study pre-dispute arbitration agreements and did not expressly require the Bureau to study class actions and the use of arbitration agreements to block class actions.

Another industry commenter noted that the data set considered in this section was for a five-year period and not three years as was used in some of the other sections and asserted that this distorted the relative importance of class actions. The commenter further noted that the data was not restricted to specific consumer financial products and services. The commenter also stated that it was difficult to analyze unequal or dissimilar data sets and come to an accurate portrait of how they compare.

A research center commenter and an industry trade association both expressed concern that the analysis in this section of the Study excluded the sums that companies paid attorneys to

defend class action claims and class actions that did not report payments to class members; in other words, they asserted that the Bureau did not present the "net cost" of class actions in the Study. The commenters argued that the Study accordingly substantially underestimated costs incurred by companies in connection with class actions. The research center commenter further asserted that the Bureau either systematically excluded or overstated the benefit of many claims-made settlements.[345]

Finally, an industry commenter suggested that the Bureau's method for calculating attorney's fees artificially deflated the average amount of attorney's fees reported per case.

*Response to Comments Received on Section 8*

In response to the commenters that were concerned with the Bureau's use of aggregate averages, the Bureau notes that it did present Section 8's analyses of class action settlements in a number of different segments. This allows the public to avoid any confusion that could be caused by aggregating the entire set, and commenters to focus on whatever segments they believe to be most relevant. The Study also directly addressed potential confusion on aggregate averages by providing data on the number of settlements within various ranges of gross relief.[346] Further, the Study included tables that provided specific information for, among other variables: year and type of relief (table 7) and 11 different product types (table 8). Regarding the comment that suggested that the Study overweights large settlements such as the Overdraft MDL, the Bureau believes that rather than indicating a problem with the Study, this simply reflects the fact that the distribution of class action settlement amounts is right-skewed. Commenters suggest no

[345] Relatedly, an industry commenter argued that the Bureau's methodology for calculating the percentage of settlement payments going to attorney's fees artificially deflated the average amount of attorney's fees by lumping large settlements with smaller ones. Insofar as the commenter was primarily disputing the Bureau's characterization of this data in its analysis, this argument is addressed in Part VI.B.3 below.

[346] Study, *supra* note 3, section 8 at 26 fig. 4 (noting that 7 settlements provided over $100 million in gross relief; 23 settlements provided between $10 million and $100 million in gross relief; 58 settlements provided between $1 million and $10 million in gross relief; 127 settlements provided between $100,000 and $1 million; and 204 settlements provided less than $100,000 in relief).

reason why this distribution is unusual. As is noted below in Part VI.B.3, there continue to be large class action settlements in consumer finance.

As for the related concern about the Bureau's inclusion of certain class actions that commenters thought should have been excluded, the Bureau similarly provided data in different forms to allow interested persons to tally the figures and omit cases as they see fit.[347] In other words, if an interested person was concerned about the Bureau's inclusion of a particular category, such as the overdraft or debt collection cases, the data were presented in a way that allowed that person to consider the data without those cases. Also, as suggested in Part VI.B.3, below, the Bureau believes that even if these categories of class action settlements were excluded from the data, the Bureau's conclusion as to the efficacy of class settlements generally would not change. In any event, the Bureau chose to include debt collection cases because a debt collector normally seeks to collect a debt based on a contract and may be able to invoke an arbitration clause if one is contained in the original credit agreement.[348] By contrast, the cases involving ATM disclosures involved no contract between the merchant and consumer, and thus no arbitration agreement could be used to block cases filed by customers.

In response to the commenter that took issue with the Bureau's use and analysis of the Overdraft MDL case study, the Bureau believes that overdraft cases were not atypical in offering automatic payouts to class members.[349] Nor were the overdraft settlements abnormally large –

[347] For example, if this commenter wanted to analyze consumers' recovery without including debt collection cases, the Study makes that possible. *See* Study, *supra* note 3, section 8 at 25 tbl. 8 (noting that debt collection cases resulted in $96.82 million in total relief). Doing so would reduce the total payout to consumers by $97 million to $2.6 billion. *Id.*

[348] *See id.*, section 6 at 56 n.96; SBREFA Report, *infra* note 419, at 17 n.23 (noting that debt collector small entity representatives informed the Bureau that, in certain cases, if the underlying credit agreement contains an arbitration clause, a debt collector may be able to compel arbitration).

[349] Study, *supra* note 3, section 8 at 20 (identifying 140 settlements that provided automatic relief, or 37 percent of settlements); *id.* section 8 at 22 (noting that nearly 24 million class members received automatic relief); *id.* section 8 at 28 n.46 (noting that $709 million was paid out to class members in automatic cash distribution cases).

just two of the seven largest settlements identified in the Study were Overdraft MDL cases.[350] The Bureau also believes that the commenter did not explain why its litany of other questions on the overdraft cases warranted these cases' exclusion from the Study. In any event, the data the commenter sought for the overdraft cases are within the normal range of values set out in the Study.[351]

As for the commenters that asserted that the Bureau did not review the merits of all class actions or just those that resulted in settlements, as noted above in connection with Section 6 of the Study, the Bureau notes that the Study analyzed the closest proxies for merit possible – the filing and disposition of summary judgment motions and motions to dismiss preceding final class action settlements.[352] The commenters were correct to the extent that the Bureau did not attempt to evaluate the merits of claims resolved in class action settlements. The Bureau did not believe it possessed any greater ability to do so than the parties that had agreed to settlements or the courts that reviewed them. In any event, as with all litigation settlements, parties made their own judgments about the case in assessing and agreeing to a settlement. The relationship between merit and settlements is discussed further in Part VI, below.

With respect to the industry commenter concerned that the Bureau's Study was too expansive and exceeded its section 1028(a) authority – by studying class actions in addition to arbitration – the Bureau believes that its analysis is relevant to performance of its charge under section 1028(a) and notes that a number of responses by industry and consumer commenters alike to the Bureau's initial request for information strongly urged the Bureau to study class

[350] *Id.* section 8 at 28 n.47 (*citing* Order of Final Approval of Settlement, Tornes v. Bank of America NA (In re Checking Account Overdraft Litig.), No. 08-23323 (S.D. Fla. Nov. 22, 2011) and Order of Final Approval of Settlement, Lopez v. JP Morgan Chase NA (In re Checking Account Overdraft Litig.), No. 09-23127 (S.D. Fla. Dec. 19, 2012).
[351] *Id.* section 8 at 36-37 (measuring days elapsed from complaint to final settlement); *Id.* section 8 at 32-35 (providing a range of attorneys fee percentages by settlement relief size and product type).
[352] *See id.* section 8 at 38 tbls. 15 and 16.

action litigation.[353] One of the commenters that responded to the original request for information, a coalition of industry trade associations, specifically requested that the Bureau study whether class actions provided meaningful benefit to individual consumers as compared with individual arbitration. The Bureau agreed with this commenter because, in its view, the only way to assess whether arbitration agreements adequately protect consumers is to evaluate others means of consumer protection. This includes class actions, the blocking of which is a motivator for and key result of companies' use of arbitration agreements.

Regarding the Bureau's selection of a five-year period review of class actions, the Bureau studied the longest time periods practicable for the various individual components of the Study consistent with electronic data availability and other Bureau resource limitations. As it explained in the Study and the proposal, the fact that it was practicable to study a broader time range for Section 8 of the Study had a number of advantages, including the ability to account for significant background shocks such as the financial crisis and the Supreme Court's decision in *Concepcion* in 2011, as well as for the fact that the results of settlements may not be reported to courts for some time.[354] Also, a longer time period decreased the variance across years that could be created by unusually large settlements. Further, the Study set forth data by year and by claim in numerous tables and figures, so that outside parties could analyze specific data sets, particularly if they wanted to focus on or exclude specific financial products and services.[355]

With regard to concerns raised by the research center commenter, as discussed further below in Part III.E, the Bureau notes that data about defense attorney costs is not publicly available. The Bureau further determined that it would be too difficult or impossible to gather

[353] *See supra* Part III.A.
[354] *See* Study, *supra* note 3, section 8 at 37 tbl. 14 (reporting that average time to final settlement after initial filing was 690 days and median time was 560 days).
[355] *See, e.g.*, *id.* section 8 at 12 tbl. 1 (setting forth settlement incidence by product and by year).

additional information on any uniform basis about defense costs, given that at least some of this information may be considered subject to attorney-client privilege. The Bureau made clear that it was seeking to study "transaction costs in consumer class actions," and firms that had been involved in defending class actions could have produced data on their transaction costs during the Bureau's Study process but did not. Nor has any such data been provided to the Bureau in response to the notice of proposed rulemaking.[356] As for not studying class actions for which data was unavailable, this limitation was noted in the Study; the Bureau was only able to study cases for which data could be located.[357] For cases the Bureau could find, the data gathered, at minimum, establishes a floor for the amount of money recovered by consumers in class actions.

Finally, with regard to the concern related to the method used to report attorney's fees, the Bureau notes that the Study reported data regarding attorney's fees in a number of different ways – including by comparing them to cash relief, to gross relief, and by product type. To the extent that the commenter suggested that the Bureau is drawing the wrong conclusion from this data, the Bureau addresses that argument below in Part VI.

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

Section 9 of the Study explored the relationship between private consumer financial class actions and public (governmental) enforcement actions. As Section 9 noted, 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

[356] The Bureau's Section 1022(b)(2) Analysis attempts to address this issue, below. *See also* Study, *supra* note 3, section 8 at 24 tbl. 7.
[357] Study, *supra* note 3, section 8 at 10-11; *see generally id.* appendices R and S.

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 analyzed the extent to which private class actions overlapped with government enforcement activity and, when they did overlap, which types of actions came 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.[358] The Bureau did this by reviewing websites for all Federal regulatory agencies with jurisdiction over consumer finance matters, for the State regulatory and enforcement agencies in the 10 largest and 10 smallest States, and for four county agencies in those States to identify reports on public enforcement activity over a period of five years from 2008 through 2012.[359] 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

[358] *Id.* section 9 at 5 and appendix U at 141.

[359] The analysis included review of enforcement activity conducted by the Bureau, the Federal Trade Commission, 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 3, appendix U at 141-142. *See supra* note 156 (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).

(including cases filed before 2008 and after 2012) and searched the pleadings in those cases.[360]

Second, the Bureau essentially performed a similar search over the same period, 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 plaintiff's 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.[361]

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 identified, the Bureau did not find an overlapping private class action.[362] The Study similarly found that, where private parties brought a class action, an overlapping government enforcement action existed in only a minority of cases, and rarely existed 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.[363]

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

[360] Study, *supra* note 3, section 9 at 7.
[361] *Id.* section 9 at 8-10.
[362] *Id.* section 9 at 4.
[363] *Id.*

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.[364]

*Comments Received on Section 9 of the Study*

Several industry commenters stated that, in their view, the Study was flawed because the Bureau did not properly consider the impacts its own enforcement activities have on providers. For example, one of these commenters stated that the Bureau only reviewed AAA arbitrations resolved during what it termed the Bureau's "formative stage" and asserted that the Study was therefore skewed because it did not take into account the Bureau's enforcement actions in later years. Another commenter criticized the Bureau for failing to account for the impact that other Bureau activities – interim final and other finalized rulemakings, amicus briefs, etc. – would have on providers, and asserted that further study of these impacts is warranted.

An industry commenter took issue with what it believed to be an overly narrow focus in this Section 9 of the Study that overlooked several key points. For example, this commenter said that the Bureau should have evaluated how many class actions are a result of other disclosures of wrongdoing (*e.g.*, news reports) and thus the filing of a class action did not function as a disclosure mechanism informing the company of its potential wrongdoing. In addition, the commenter said the Bureau should have evaluated how many class actions followed government investigations or other disclosures of claimed wrongdoing, rather than focusing only on how many class actions overlapped with public enforcement actions. The commenter noted that in some instances government enforcement agencies declined to bring an action even where they identified wrongdoing.

[364] *Id.*

*Response to Comments on Section 9 of the Study*

As to the comments that criticized the scope of the Bureau's analysis of its own enforcement actions, noting that the Bureau increased its enforcement activity after 2012, such comments assume that the purpose of the analysis was to assess the overall level of public enforcement and compare it to the volume of class action activity. To the extent that there has been, and will continue to be, an increase in Bureau enforcement actions relative to the Study period, the Bureau knows of no reason to believe that the relationship between public and private enforcement will change, nor did any commenter suggest a basis for so believing.[365] As is discussed in greater detail in Part VI below, Section 9 demonstrated that there was generally little overlap between these two spheres, and to the extent there is, private activity generally precedes public activity. As was discussed in that section, the Bureau believes that these data indicated – as supported by the comments from a group of State attorneys general and the Bureau's experience and expertise – that private class actions are a useful complement to public enforcement actions, especially given the resource limitations faced by regulators or that may be faced by regulators in the future. With respect to whether the Bureau considered other of its undertakings, the Bureau does not believe that there is an adequate means to do so and, more importantly, that such an undertaking would not be relevant to this rulemaking.[366]

*9. Arbitration Agreements and Pricing (Section 10 of Study)*

Section 10 of the Study contained the results of a quantitative analysis which explored

[365] The Bureau notes that it did not in fact limit its data to public enforcement cases announced or filed prior to December 31, 2012. As the methodology to the Study set out, the public enforcement data started with two different sets of cases as a starting point to analyze overlap. The Bureau analyzed a set of public enforcement cases between 2008 and 2012 for overlapping private cases that may have occurred before or after 2012. The Bureau also analyzed a set of private class actions from 2008 through 2012 for overlapping public enforcement cases that may have been filed or announced before 2008 or after 2012. As such, in this second set, any public enforcement cases filed or announced after December 31, 2012 would have been included in the data. *See* Study *supra* note 3, appendix U at 145-146.

[366] To the extent the commenter asserted that the Bureau should have looked at the magnitude of its enforcement efforts in later years after the Bureau was more established as opposed to earlier years in support of an argument that class actions are superfluous given the Bureau's activities, that argument is addressed below in Part VI.

whether arbitration agreements affected 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 through" at least some cost savings to consumers in the form of lower prices, while others reject this notion.[367] However, as the Study noted, there is little empirical evidence to support either position.[368]

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.[369] In these *Ross* settlements, which were negotiated separately from settlements in the case 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 a half years.[370] Using data from the Bureau's Credit Card Database,[371] the Bureau examined whether it could find statistically significant evidence, at a standard confidence level (95 percent), that companies that removed their arbitration agreements raised their prices as measured by total cost of credit in a manner that was different from that of comparable companies that did not remove their agreements. The Bureau was unable to identify any such

[367] *Compare, e.g.*, Amy J. Schmitz, "Building Bridges to Remedies for Consumers in International eConflicts," 34 U. Ark. L. Rev. 779, at 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, Unconscionablility, and Equilibrium, The Return of Unconscionability Analysis as a Counterweight to Arbitration," 19 Ohio St. J. on Disp. Resol. 757, at 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.").
[368] Study, *supra* note 3, section 10 at 5.
[369] *See* First Amended Class Action Complaint, In re Currency Conversion Antitrust Litig., No. 1409 (S.D.N.Y. June 4, 2009).
[370] Study, *supra* note 3, section 10 at 6.
[371] The Bureau's Credit Card Database 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 7-8.

evidence from the data.[372]

The Bureau performed a similar inquiry into whether the 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 noted 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.[373] 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.[374]

*Comments Received on Section 10 of the Study*

An industry commenter and a trade association dismissed the Bureau's findings in Section 10, asserting that the *Ross* case did not provide an appropriate case study because changes in bank pricing are slow to occur and because credit cards issuers would not be expected to shift their pricing in response to a temporary ban on arbitration agreements in any event. The trade association commenter contended that the Bureau understated the problems with its difference-in-difference analysis of pricing changes. For example, the commenter questioned the Bureau's selection of a control group due to its admission that it did not know if all members of the control group used arbitration agreements. Also, citing two academics, the commenter stated that the lack of evidence of a price change was unsurprising given the temporary nature of the moratorium and, as noted above, that large institutions like the *Ross* settlers typically change prices slowly. A research center commenter expressed a similar concern.

[372] *See id.* section 10 at 5-6. 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 15-16.
[373] *Id.* section 10 at 17.
[374] *Id.* section 10 at 6.

A nonprofit commenter, citing to an academic working paper, contended that the Study failed to indicate whether the Bureau checked to ensure the validity of the econometric technique it used in evaluating price changes. This commenter also criticized the Bureau's method as valid only if prices had been changing at the same rate prior to the settlement in *Ross*.

An individual commenter criticized the conclusions that the Bureau drew from its analysis, and asserted that footnote 34 in Section 10 of the Study demonstrated that the *Ross* settlement did in fact prompt differential pricing responses from the banks involved and that such a result comports with economic expectation. The commenter further asserted that the Bureau improperly dismissed this result as statistical noise that disappeared once costs were collapsed into a single total cost of credit (TCC) variable. In reality, the commenter asserted, the Bureau's analysis implied that the banks increased other costs charged to consumers as evidenced by the separate regression analyses with respect to APR and fees. This commenter also suggested that a number of other events that happened around the same time as the *Ross* settlement – *e.g.*, the enactment of the CARD Act and the Dodd-Frank Act, Supreme Court litigation regarding the applicability of the FAA, and other ongoing class action lawsuits – may have also had varying effects on companies' use of arbitration agreements and pricing decisions. The commenter asserted that consumers who did not trigger the currency conversion fees that were specifically at issue in *Ross* suffered as a result of these differential changes, and that such consumers were more likely to be low-income, unmarried, and members of racial and ethnic minorities. Accordingly, the commenter asserted that the Bureau's analysis in fact suggested that dropping the arbitration agreements led to more expensive credit for certain groups of consumers.

An industry commenter noted that the Bureau's analysis in this section focused only on large banks and did not account for small institutions' practices, which the commenter suggested

may be different. The commenter noted that the Study more generally found that larger institutions were more likely to use arbitration agreements and asserted that there may be a relationship between using arbitration and providing credit to many more consumers, especially those with poor credit (as large institutions may be more likely to do). The commenter concluded that this might mean that the class proposal could harm credit access for poorer consumers. A research center made a similar point, stating that empirical evidence shows that consumer finance companies do pass on changes in their costs but that banks are unlikely to adjust their deposit and loan rates quickly or fully to reflect only temporary changes in market interest rates. This commenter also suggested that firms in the consumer services sector adjust prices much more slowly in response to cost changes than do firms in the manufacturing sector, and large firms adjust prices more slowly than do small firms.

Another industry commenter stated that, in its view, there was not statistically significant empirical support to generalize the findings in this section beyond the specific *Ross* case. This commenter accused the Bureau of using what it labeled as a bizarre methodology and of inappropriately extrapolating results from the behavior of an arbitrary and small group of providers. The commenter concluded that the results in Section 10 were overly handicapped by caveats and other uncertainties that did not extend across all providers in all markets. Relatedly, an industry commenter suggested that the conclusions of this section ignored case study evidence that shows consumers would choose a lower priced product that includes an arbitration clause as opposed to a higher priced one that lacked an arbitration clause.

*Response to Comments on Section 10 of the Study*

The purpose of Section 10 was to explore the suggestion by some that companies' use of arbitration agreements lowers prices for consumers. The analysis then conducted found no

evidence to support that claim. As the Bureau explained in the Study, analyzing whether pre-dispute arbitration agreements lower the price of consumer financial products or services is extremely difficult. The Bureau continues to believe that it made sense to analyze the *Ross* case as a potential natural experiment, although it could not provide a complete answer to the underlying question. The Bureau continues to believe that it used an appropriate methodology in analyzing those results and concluding that it did not demonstrate statistically significant evidence that the issuers increased prices or reduced access to credit. Nevertheless, the Bureau notes that Section 10 does not form the basis for any of the Bureau's significant findings, which are discussed in greater detail in Part VI below. Instead, the Bureau finds that there is some amount (although the specific amount is unknown) of costs from the class rule that will be passed on to consumers. *See also* Section 1022(b)(2) Analysis, below.

With regard to criticism of the methodology, the Bureau notes that its regression analysis was designed to control for effects that could have impacted pricing if the credit card companies had changed their prices for any number of external factors.[375] This is because the analysis did not just evaluate whether there was a change in pricing, but rather looked instead to see if the change in pricing of the *Ross* settlers sample differed from the change in pricing of the other banks that were subject to the same external background factors. The Bureau's analysis also looked at multiple time periods spanning 2008 through 2011, in part to account for the possibility that any price adjustments by the *Ross* settlers may have taken place over a relatively long period of time.[376] The Bureau acknowledged in both the Study and the proposal that the *Ross* settlement was time limited and that it is possible that the banks who were subjected to the

[375] *See id.* section 10 at 12.
[376] *Id.* section 10 at 14 (setting forth the time frames used in the analysis). The Bureau does not necessarily agree, however, that credit card pricing is slow moving; to the contrary, in the Bureau's experience the pricing offered in credit card solicitations is quite dynamic and at least some large card issuers make frequent adjustments of their fees to the extent permitted by law.

settlement might have taken that fact into account in deciding their pricing strategy going forward.[377] This is an inherent limitation in the data.

As to the commenter that expressed concern that the Bureau had never ensured the validity of its econometric technique, the Bureau believes that the commenter misunderstood the nature of the difference-in-difference analysis used. In the analysis, the control group was neither companies with arbitration clauses nor was it companies that did not have arbitration clauses. Rather, the control group was companies that did not change their use of arbitration provisions, either because they used arbitration provisions through the entire period or they did not use arbitration provisions through the entire period. The treatment group was the *Ross* settlers who did change their use of arbitration provisions. The Bureau believes that this comparison was effective because it was not comparing the absolute pricing of the different issuers but instead was comparing the rate at which they changed their pricing during the time period. The Bureau further notes that nothing indicated that the treatment group – the issuers that changed their use of arbitration provisions – changed their pricing in a statistically significant way vis-a-vis the control group.[378] Consequently, the Study did not find evidence that the companies that had to stop using arbitration provisions changed their pricing in any meaningful way as compared to people that did not have to do so.

As to the nonprofit commenter's point that the Bureau's technique in this analysis was valid only if prices had been changing at the same rate prior to the settlement in *Ross*, the Bureau notes that the technique used does assume that the two groups of companies changed pricing at

[377] *See id.* section 10 at 15-16.
[378] *See id.* section 10 at 15.

the same rate before the imposition of the moratorium (controlling for a number of variables).[379] Thus, the Bureau's analysis assumed that banks changed pricing at the same rate notwithstanding the items controlled for.

As to the individual commenter that expressed concern about other impacts on pricing and arbitration agreements beyond the *Ross* settlement, the Bureau's analysis attempted to control for a number of variables. Specifically, the benefit of conducting a difference-in-differences analysis is that it should account for background effects like the CARD Act, the Dodd-Frank Act, the development of law over time, and pending litigation. The Bureau notes that it did not state that the analysis was "problematic," but simply set out limitations of the analysis, as it did with regard to each section of the Study.[380]

In response to this commenter's assertion that the Bureau did find a difference and buried it in footnote 34, the Bureau believes that the commenter was really disagreeing with the use of TCC as the appropriate metric.[381] As the Bureau explained, pricing involves numerous components that work together to represent total cost. For example, a provider can raise interest rates but lower fees and still have the same TCC. All that footnote 34 stated was that given the number of regressions run, it was likely that at least one of the trials would produce statistically significant coefficients on the various dependent variables simply by chance. Nevertheless, the Bureau continues to believe that TCC was the appropriate metric because it represents

[379] *See* list of factors set out in Appendix V of the Study at page 148.
[380] *Id.* section 10 at 18-19. The latter analysis accounts for the possibility that initial changes in credit output would begin with subprime accounts.
[381] As was stated in the Study, the TCC "metric incorporates all fees and interest charges the consumer pays to the issuer. It excludes revenue generated through separate agreements between other businesses and the issuer, such as interchange fees paid by merchants and marketing fees or commissions paid by companies offering add-on products to an issuer's customer base. This TCC metric thus capture all of the component costs that consumers pay." *Id.* section 10 at 9 (quoting "CARD Act Report," (2013)), *available at* http://files.consumerfinance.gov/f/201309_cfpb_card-act-report.pdf.

everything that consumers pay to keep and use their credit cards.[382] Finally, as to the individual commenter concerned that the Study did not account for higher interest rates that disproportionately impact, among others, low-income households, the Bureau notes that its analysis in Section 10 controlled for credit score and refreshed credit score (both square and log terms for each) as well as for borrower income but did not find statistically significant results for TCC overall.[383] Similarly, when the Bureau studied whether there were limitations on credit issuance, it used two measures – initial credit line and subprime account issuance – and still did not find any statistically significant changes.[384]

The Bureau agrees, as an industry commenter noted, that its analysis in this section was limited to very large banks. The Bureau addresses cost concerns specific to small entities below. Regarding the commenter's theory regarding access to credit for those with poor credit, the Bureau reiterates, as is noted above, that it had a number of controls for consumer credit that would have detected a particular effect on subprime consumers. The Bureau also acknowledges that there are a number of factors, as one commenter identified, that impact when and how banks decide to adjust pricing mechanisms.

The Bureau disagrees with the contention that its definition of the control group was invalid. As was explained in the Study, the control group contained entities that had no change in their use of arbitration agreements; whether they did or did not use such an agreement was not relevant. This group was then compared to those entities required to withdraw arbitration agreements as a result of the *Ross* settlement in order to diagnose whether this required change resulted in a price shock. The Bureau disagrees with the industry commenter regarding

[382] *See* Study, *supra* note 3, section 10 at 9.
[383] *See generally id.* at appendix V. The Bureau did find some differences for subcomponents of TCC, but none were found to contradict the overall price effect. *See id.* section 10 at 15 n.34.
[384] *Id.* section 10 at 18-19.

extrapolation from the results of Section 10; the Bureau did not engage in such extrapolation. In any event, the Bureau acknowledges the caveats it made in the Study and, notwithstanding those caveats, stands by the results.

Finally, regarding the commenter that said that the conclusion of this section was at odds with other available evidence, the Bureau explains below in Part VI the relevance of this part of the Study to its overall findings in this rulemaking.

*E. Additional Comments Received Regarding the Study and Responses Regarding the Study*

The Bureau notes that it received numerous comments from members of Congress, consumers, consumer advocates, academics, nonprofits, consumer lawyers and law firms, public-interest consumer lawyers, State legislators, State attorneys general, and others that expressed confidence in the Study and the Bureau's methods. Many of these commenters noted the Study's comprehensiveness; a few noted that it appeared to be the most comprehensive study of dispute resolution in connection with consumer financial services completed to date.

One nonprofit commenter challenged the Bureau's Study for its alleged failure to comply with the requirements of the Information Quality Act[385] and a related OMB bulletin,[386] asserting that the Study should have undergone a rigorous, transparent peer review process to ensure the quality of the disseminated information. Similarly this commenter and a trade association representing credit unions, expressed concern about the Bureau's lack of a peer review process and about the fact that no entity other than the Bureau attempted to replicate the Study. The trade association commenter also expressed concern that the Bureau had not conducted a study

[385] Information Quality Act, Public Law 106-554, § 515, 114 Stat. 2763, 2763A-153-154 (2000); *see* Office of Mgmt. & Budget, "Information Management: Information Quality Guidelines," *available at* https://www.opm.gov/information-management/information-quality-guidelines/.
[386] Memorandum from Joshua B. Bolten, Dir., Office of Mgmt. & Budget, to Heads of Departments and Agencies concerning Issuance of OMB's "Final Information Quality Bulletin for Peer Review," *OMB Bulletin* No. M-05-03 (Dec. 16, 2004), *available at* https://obamawhitehouse.archives.gov/omb/memoranda_fy2005_m05-03/.

of general consumer satisfaction with consumer financial products and services.

Several other industry commenters criticized the Bureau for not soliciting public comments during the course of the Study process. In the view of one commenter, such a process could have enabled the Bureau to address defects and other problems with the Study before its conclusion. The industry commenters stated that the Bureau had never informed the public of the topics it had decided to study, never sought public comment on them, and never convened a public roundtable discussion on key issues. These commenters concluded that having not undertaken these steps, the Study was flawed and does not support the proposal.

Several industry commenters stated that the Bureau should have studied consumer satisfaction with the arbitration process through, for example, interviews of consumers who have arbitrated claims and who had been involved in class actions. One of these commenters also stated that the Bureau should have evaluated consumer experience with arbitration in other areas, such as employment, where it has existed longer.[387] Several industry commenters asserted that the Bureau's intentional refusal to study consumers' experience with arbitration was perplexing because both logic and common sense dictated that understanding consumer satisfaction with arbitration is essential to a complete understanding of whether mandating consumer arbitration was in the public interest. In support of this viewpoint, one commenter cited a 2005 Harris Interactive online poll that found that consumers found arbitration to be faster, simpler and cheaper than proceeding in court and that they would use arbitration again.

One industry commenter suggested that the Bureau should have also studied the impact on consumers and society if companies abandon arbitration as well as the costs to consumers and

[387] Relatedly, an industry commenter expressed concern that the Bureau did not explain in the proposal why contracts for consumer financial products and services differed from other markets where arbitration would still be permitted to block class actions. The Bureau expresses no opinion on the role of arbitration agreements in markets beyond the scope of its authority.

society of the additional 6,042 class actions that the proposal's Section 1022(b)(2) Analysis projected would be filed every five years. This commenter further noted that the Bureau did not study whether class actions are necessary as a deterrent given the impact of modern social media, explaining that in modern society providers have enormous incentive to ensure that their customers are satisfied and any disputes resolved fairly because dissatisfaction can be amplified on social media.

Another industry commenter challenged the Bureau's failure to survey market participants regarding their views on the deterrent effect of class action litigation.

A letter from some members of Congress urged the Bureau to gather more data on consumer outcomes.[388] Other comments expressed similar concerns. For example, one industry lawyer commenter suggested that the Study should have evaluated arbitration as a dispute resolution mechanism as compared to litigation for individual claims that are inappropriate for class action treatment. This commenter noted that the Bureau did not appear to consider the FTC's 2010 Study entitled "Repairing a Broken System: Protecting Consumers in Debt Collection Litigation and Arbitration."[389] The FTC's 2010 Study, suggested the commenter, criticized litigation as a dispute resolution mechanism and suggested that the Bureau consider this criticism in any regulatory effort that results in an increase in litigation. This same commenter also suggested that the Bureau should have examined a number of other items. Specifically, this commenter (along with another industry commenter) suggested that the Bureau should have studied whether there is any difference in the level of compliance between financial

[388] In explaining this request, the authors of this letter referred to a June 2015 letter that stated that, in the authors' view, the Bureau did not study transaction costs associated with pursuing a claim in Federal court as compared to arbitration or the ability of a consumer to pursue a claim in Federal court or arbitration without an attorney.

[389] Fed. Trade Comm'n, "Repairing a Broken System: Protection Consumers in Debt Collection Litigation," (July 2010), *available at* https://www.ftc.gov/reports/repairing-broken-system-protecting-consumers-debt-collection-litigation.

services companies with and without provisions in their contracts that can block class actions. The industry commenter suggested that the Bureau should have studied the effectiveness of its complaint process as a means of resolving consumers' issues. The industry lawyer commenter suggested that data to evaluate this might be reflected in the number or type of complaints received by the Bureau regarding each type of company. Similarly, the commenter also suggested that the Bureau should have studied whether class actions are the most efficient method of enforcing the law as compared to enforcement actions, although the commenter did not address how the Bureau should have gone farther than it did in Section 9.

Another industry commenter stated that, in its view, the Study could have been more comprehensive. This commenter listed a number of additional items that it contended the Bureau should have studied, including the evaluation of what it said were the advantages of arbitration in handling the most typical types of consumer complaints (which the commenter asserted were overcharges, duplicative charges, and other errors); in providing a less formal and more accessible forum to consumers; in the speedy resolution of claims; in actual monetary awards to claimants; and in aggregate cost to participants and related cost-savings; resolution of arbitrations without the involvement of counsel; and in consumer satisfaction. This commenter further criticized the Bureau for not making similar inquiries regarding class actions.

Several commenters, including an industry lawyer, a nonprofit, a group of State attorneys general, and two industry trade associations, criticized the Study (and the proposal) for drawing comparisons between *settlements* of class actions and *decisions* in arbitrations. These commenters all suggested that the Bureau could have drawn a more accurate comparison by comparing arbitration settlements with class action settlements. One of these commenters, a group of State attorneys general, noted that the Bureau had acknowledged that 57.4 percent of

arbitrations were known or likely to have settled and asserted that it was reasonable to assume that the cases that settled were stronger claims. Some of these commenters also suggested that the Bureau should have evaluated class arbitration. The group of State attorneys general also noted that the Bureau's data on arbitration outcomes and class actions settlements was incomplete because the Bureau only had data for 20.3 percent of arbitrations and 60 percent of settlements. Relatedly, an industry commenter criticized the Bureau for focusing only on filed and adjudicated arbitrations, rather than those that settled or that were never filed in the first instance because a consumer achieved relief as a result of informal dispute resolution. A Congressional commenter also asked why the Bureau had not considered arbitration settlements in its Study.

Several industry commenters criticized the Study for comparing data regarding arbitration awards for a two-year period (2010 through 2011) to class action settlements over a five-year period (2008 through 2012). One commenter noted that the Bureau compared the fact that 34 million consumer class members received $1.1 billion in compensation over those five years to only 32 arbitration awards to consumers (that the Bureau could verify) for a total of only $172,433. This comparison is misleading, suggested the commenter, because it omitted arbitrations that resulted in a confidential settlement. This commenter further asserted that the Study was misleading because it reported the percentage recovery received by consumers who succeeded in arbitration (57 cents for every dollar), but did not report similar figures for payouts to consumers in class actions.

The Bureau received comments from several specific industry groups that variously asserted that the Study had omitted a fulsome analysis of their particular market or provider type. For example, a trade association commenter representing credit unions asserted that the Bureau

studied only a small number of credit unions and criticized it for not engaging in more fulsome analyses of small entities more generally in its Study. A credit union commenter also expressed concern that most of the Bureau's analysis in Section 2 (prevalence) did not adequately represent products offered by credit unions and that there was limited evidence that credit unions use arbitration agreements. Relatedly, a trade association representing online lenders noted that its members were excluded from Section 2, although it acknowledged that its members almost uniformly used arbitration agreements and several installment lenders noted that both online and installment lenders were missing from Section 2.

A Tribal commenter asserted that the Bureau should have consulted with Tribal entities in order to understand how the Tribal governments resolve disputes and that the Bureau should have focused on Tribal businesses in various sections of the Study. Relatedly, a different Tribal commenter asserted that the Bureau did not examine Tribal dispute resolution and procedures or Tribal regulations that protect consumers.

Additionally, an industry trade association representing companies that are consumer reporting agencies (CRAs) said that the Bureau should have more fulsomely included CRAs in the Study in general and credit monitoring cases against CRAs and litigation pursuant to the Credit Repair Organizations Act (CROA) in particular. Although the commenter noted that the Bureau's analyses of class actions (in Section 8) included CRAs, it focused on the Bureau's failure to analyze individual disputes involving CRAs. The commenter further noted that credit reporting constituted one of the four largest product areas for class action relief but the Bureau did not define the scope of credit reporting class actions, and the Bureau only mentioned credit monitoring twice in its Study.

An industry trade association representing automobile dealers, asserted that the Bureau's

Study contained virtually no information on automotive financing, and that what little evidence there was suggested that the Bureau did not understand the automotive finance industry. The commenter concluded that the Study's findings as to the automotive finance market were, at best, "murky."

An industry commenter suggested that the Bureau should have, but did not, conduct an analysis of how arbitration and class actions operate in the "real world" and what the relative trade-offs are for consumers between each dispute resolution mechanism. Relatedly, the commenter expressed concern that the Study failed to balance adequately the actual benefits of the arbitration process against the costs of class-action lawsuits and the likely impacts of the proposal. An industry commenter criticized the Bureau for failing to study the impact of the proposal on online dispute resolution services and other methods of informal dispute resolution.[390] This commenter said that the Bureau overlooked what is potentially a large universe of consumer disputes that are addressed outside the courtroom, a universe far broader than what was addressed in the Study. Relatedly, an industry commenter suggested that the Bureau should have studied informal dispute resolution in addition to formal dispute resolution and a research center suggested that the Bureau's survey should have asked questions about informal dispute resolution. An industry commenter took issue with the Bureau's failure to study defense costs incurred by companies in defending class actions. The commenter asserted that the Dodd-Frank Act requires such an analysis. The commenter further asserted that the Bureau's assumptions in the Study regarding defense costs – that they are about 75 percent of the amounts awarded to plaintiff's attorneys in settled class actions and 40 percent in other cases –

[390] This commenter specifically referenced Modria. Modria is a company that offers online customer response and dispute resolution services and purports to handle more than 60 million disputes a year. *See* Modria, "The Modria Platform," http://modria.com/product/ (last visited March 13, 2017).

were ill-conceived.

An industry commenter asserted that the Study did not adequately assess the role of consumer choice – presumably for products with or without arbitration agreements. This commenter also stated that the Study should be re-conducted to evaluate the economic impact on providers and consumers of regulations that prohibit the use of class action waivers.

*Response to General Comments on Study*

In response to concerns about the Bureau's compliance with the Information Quality Act, the Bureau did comply with the IQA's standards for quality, utility, and integrity under the IQA Guidelines.[391] Moreover, the Study did not fall within the requirements of the OMB's bulletin on peer review, contrary to what the commenter suggested. The bulletin applies to scientific information, not the "financial" or "statistical" information contained in the Study.[392] The Federal financial regulators, including the Bureau, have consistently stated that the information they produce is not subject to the bulletin.[393]

Although the Bureau did not engage in formal peer review, it did include with its report detailed descriptions of its methodology for assembling the data sets and its methodology for analyzing and coding the data so that the Study could be replicated by outside parties. The Bureau is not aware of any entity that has attempted to replicate elements of the Study; to the extent that the Bureau's analysis has been reviewed by academics and stakeholders those individual critiques are addressed above. The Bureau has monitored academic commentary in addition to the comments submitted and continues to do so.

[391] *See* Bureau of Consumer Fin. Prot., "(Bureau) Information Quality Guidelines are Issued in Accordance with the Provisions of the Treasury and General Government Appropriations Act for Fiscal Year 2001, Pub. L. No. 106-554 (the "Act") and OMB Government-wide Guidance," https://www.consumerfinance.gov/open-government/information-quality-guidelines/ (last visited May 19, 2017).
[392] *See* OMB Bulletin, *supra* note 386.
[393] *See* Bureau Information Quality Guidelines, *supra* note 385.

With respect to the claim that the Bureau did not provide notice of the scope of the Study, the Bureau notes that, although not required to do so by Dodd-Frank section 1028(a), the Bureau did, in fact, issue a request for information before commencing the Study to solicit public input with respect to its scope and the sources of data to which the Bureau should look.[394] Moreover, the Bureau released the Preliminary Results in late 2013, and at that time the Bureau listed the remaining topics it intended to study, thus providing clear public visibility into the Study's eventual scope. Furthermore, the Bureau held periodic meetings with stakeholders before, during, and after the Study (as discussed further in Part IV below) and received ongoing input regarding the appropriate Study scope.

As for the commenters concerned that the Bureau did not conduct a study of consumer satisfaction with their consumer financial products and services, the Bureau believes that even if it were to find very high levels of satisfaction, that would not affect the assessment of the various alternative dispute resolution mechanisms, especially given the potential for claims to go undiscovered by consumers. With respect to the concern that the Bureau did not evaluate consumer satisfaction with the arbitration process, the Bureau notes that it did not do so for several reasons. First, given the small number of consumers who participated in arbitration proceedings, it would have been difficult and costly to construct a sample of such consumers and obtain statistically reliable results. Second, it would have been difficult to distinguish consumer satisfaction with the process from consumer satisfaction with the outcome in particular cases. Thus, if a consumer received a poor or no settlement or award in an arbitration, he or she might view the process unfavorably even if the underlying claim was objectively poor and merited little

[394] *See* Arbitration Study RFI, *supra* note 16.

relief. The opposite would also be true.[395] Third, given the finding that so few consumers brought individual claims in arbitration, the satisfaction of that small number of consumers who ultimately did use the process (assuming enough could be located to make a study of their satisfaction reliable) would not answer the question of whether all consumers should be limited to using arbitration to resolve disputes.

With respect to the related argument that the Bureau should have conducted a survey comparing consumers' experiences in arbitration as compared to class actions, the Bureau believes that it would have been exceedingly difficult to find consumers who had experienced arbitration, and any comparison in consumer experiences with arbitration and a class action would have suffered from selection bias (*i.e.*, consumers who prevailed using one of the dispute resolution mechanisms would be more likely to express satisfaction with that mechanism). In any event, as is discussed further below in Part VI, the Bureau does not believe that consumers' relative satisfaction with a dispute resolution mechanism that they use quite infrequently should be afforded as much weight as the fact that the Study showed, and many commenters agreed, that arbitration agreements can preemptively limit consumers' ability to resolve disputes in class actions. Nor does the Bureau believe that other things that commenters suggested the Bureau should have studied were relevant or feasible (or both). As for studying the impacts on society of additional class actions and the potential loss of arbitration as a means of dispute resolution, these impacts are addressed in the Bureau's Section 1022(b)(2) Analysis.

[395] The Bureau also finds the Harris Interactive poll cited by this commenter to be irrelevant because over 80 percent of respondents were individuals who chose to arbitrate claims rather than being compelled to litigate. *See* Study, *supra* note 3, section 3 at 5 n.5. *See* Harris Interactive Mkt Res., "Arbitration: Simpler, Cheaper, and Faster than Litigation, A Harris Interactive Survey," (Apr. 2005) (conducted for U.S. Chamber Institute for Legal Reform), *available at* HarrisInteractiveSurveyforUSChamberofCommerce.pdf. Nor did this survey ask respondents their opinions about being blocked from filing or participating in a class action.

As to those comments that criticized the Study for failing to compare dispute resolution outcomes, the Bureau carefully explained why such a comparison was neither feasible (because of the large volume of settlements or potential settlements where the outcome could not be determined) nor meaningful (because of potential selection bias in the choice of forum and in the cases that did not settle.)

In response to the industry lawyer commenter's criticism that the Bureau did not consider the FTC's 2010 Study of debt collectors' use of arbitration and litigation, the Bureau did review the FTC's 2010 Study in the course of analyzing materials for the 2015 Arbitration Study and, in any case, the Bureau believes the FTC's 2010 Study to be relevant to this rulemaking in offering background information on the use of arbitration in debt collection disputes brought against consumers.[396] The focus of the Bureau's Study and subsequent rulemaking, in contrast, is on the ability of consumers to seek affirmative relief for claims relating to consumer products and services – in other words, claims brought by consumers against their providers.

With respect to the claim that the Bureau should have further studied the value or necessity of class actions in deterring misconduct, the Bureau does not believe that a survey of companies or their representatives on this issue would have produced reliable information.

The Bureau believes that the review it undertook of how companies and their representatives respond to the filing and settlement of class actions, as discussed further below in Part VI, is much more probative than self-serving survey results. And, as set out below in Part VI.B, the Bureau believes that social media are insufficient to force companies to change company practices – because, among other reasons, many consumers do not know that they have

[396] Fed. Trade Comm'n, "Repairing a Broken System: Protection Consumers in Debt Collection Litigation," (July 2010), *available at* https://www.ftc.gov/reports/repairing-broken-system-protecting-consumers-debt-collection-litigation.

valid complaints or how to raise their claims through social media. Further, in at least one study, companies ignored nearly half of the social media complaints consumers submitted, and when companies did respond, consumers were dissatisfied in roughly 60 percent of the cases.[397]

Regarding the commenter that suggested that the Bureau should have evaluated whether there is a different level of compliance for companies that use arbitration versus those that can be sued in a class action and that such an analysis can be conducted by review of the Bureau's complaint database, the Bureau disagrees with the premise of the comment; simple comparisons across companies that use arbitration versus those that do not, cannot be made using complaint data. The Bureau also notes that the largest volume of complaints concerns debt collectors, whose ability to invoke arbitration agreements is derivative of the clients they serve; credit reporting companies, which may not have contracts or arbitration agreements with consumers; and mortgage lenders and servicers, who generally are not covered by arbitration agreements. Additionally, the Study found that in certain markets – including GPR prepaid cards, payday loans, private student lending, and mobile wireless third-party billing – arbitration agreements are so common that it would be all but impossible to make the comparisons suggested. In response to the dual suggestions that the Bureau's consumer complaints database could be used to benchmark the compliance of providers with consumer laws or that the Bureau's complaints mechanism itself could be used as a form of dispute resolution instead of class actions, the Bureau observes that some industry commenters had opposed the Bureau's publication of

[397] Sabine A. Einwiller & Sarah Steilen, "Handling Complaints on Social Network Sites – An Analysis of Complaints and Complaint Responses on Facebook and Twitter Pages of Large US Companies," 41 Pub. Rel. Rev. 195, at 197-200 (2015).

consumer complaint narratives on the grounds that the Bureau's consumer complaint database contained unrepresentative data.[398]

As to whether class actions are superior methods of enforcing the law as compared to government enforcement, the Bureau does not believe this is a necessary subject of study. The more relevant question is the relative overlap between the two mechanisms and the extent to which class action cases pursue harms not otherwise addressed by government enforcement. Moreover, regardless of the outcome of this rulemaking, government enforcement will continue. The Bureau believes it more appropriate to compare, as the Study did, consumers' ability to achieve relief individually and as part of a class action. The question, analyzed in detail below, is whether government enforcement remedies all harms in the relevant markets or if class actions supplement government enforcement.[399]

In response to comments that criticized the Bureau for comparing outcomes in arbitration obtained through arbitral decisions (but not settlements) to class action settlements, the Bureau notes that the Study specifically cautioned that the two types of data were derived from different sources and should not be compared as apples to apples.[400] The Bureau conducted a fulsome analysis of all data that it could obtain but had no way to measure settlements of arbitrations that were not reported to the administrator. The Bureau notes that commenters did not suggest any way to overcome this limitation in the underlying record. Regarding the State attorneys general that commented on the incomplete nature of the Bureau's data on arbitration and class action

[398] Bureau of Consumer Fin. Prot., Disclosure of Consumer Complaint Narrative Data, Final Policy Statement, 80 FR 15572, 15576 (Mar. 24, 2015) ("Industry commenters, by contrast, asserted that the publication of narratives in the Database would mislead consumers because the data is, in the commenters' words, unverified and unrepresentative."). While the Bureau did not agree that such data was unverified, the Bureau in response focused on the impact the Bureau's complaints database would have on customer service and helping companies improve their compliance mechanisms generally. *See id.* ("In general, the Bureau believes that greater transparency of information does tend to improve customer service and identify patterns in the treatment of 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.").

[399] See Consumer Financial Class Actions and Public Enforcement (Sections 8 and 9 of Study) discussion above.

[400] *See* Study, *supra* note 3, section 5 at 6-7.

outcomes, the Bureau notes that it expressly acknowledged the limitations of these data in the Study.[401]

The Bureau also disagrees that it overlooked the role of online dispute resolution. The Bureau had no direct way of studying the extent to which consumers were able to resolve disputes informally, and the Study specifically acknowledged that this is a means by which consumers may seek relief.[402] The Bureau did, however, use its case study of the Overdraft MDL to evaluate the extent to which informal dispute resolution obviated the need for a class action mechanism.[403] As this case study showed, even after deductions were made for previously-provided informal relief, there was still nearly $1 billion in relief provided to more than 28 million consumers in the class. This indicated that even if every consumer who sought informal relief was successful, most consumers were still without a remedy until they received a share of the class action settlement. For further discussion of individualized resolution of consumer disputes, see Part VI.B below.

As to the commenters that said that the Bureau should not have compared two years of arbitration data to five years of class action data, the Bureau studied arbitration records for the longest period practical given electronic data limitations. Although the Bureau could have similarly confined its study of class actions, the Bureau believed that studying settlements over a longer time period would provide more robust data to support firmer findings. The differences between the number of consumers involved in arbitration actions and individual actions of any type as compared to the number of consumers that benefited from class actions and the damages awarded in each were so stark as to mitigate any concerns about the difference in the time

[401] *See, e.g.*, *id.* section 5 at 4-8.
[402] The online dispute resolution service referenced by the commenter purports to offer services to "ecommerce" companies, *i.e.*, merchants, which are excluded from the Bureau's authority. *See* Modria.com, Inc., "About Us," http://modria.com/about-us/ (last visited March 10, 2017).
[403] *See* Study, *supra* note 3, section 8 at 39-46

periods studied.[404] As a more technical point, the Bureau also notes that the commenter was not correct that the Bureau looked at only two years of arbitration data. The Bureau studied three years of arbitration filings, from 2010 to 2012, and two years of available arbitration outcomes for cases that were filed in 2010 and 2011 (*i.e.*, the cases may not have been resolved in those years). As is explained in the Study, that window was chosen because 2010 was the first year that electronic records were available from the AAA.[405] As is further explained, when the Bureau conducted an analysis of the arbitration records (in 2013) complete records for many of the disputes that had been filed in 2012 were unavailable because those cases had not yet been resolved.[406]

Regarding the commenter that said that the Bureau was misleading by reporting percentage recovery in arbitration but not in class actions, the Bureau notes that it was only able to do the former because the AAA requires that the filing party specify the dollar amount of his or her claim in an arbitration.[407] Similar disclosures are typically not required by Federal or State court rules and are rarely included in class action complaints.[408] Accordingly, the Bureau was unable to calculate recovery rates for court proceedings.[409]

Regarding the focus of the Bureau on providers in specific categories, such as Tribal lenders, credit unions, online lenders, providers of automobile financing, and CRAs (including credit monitoring), the Bureau included in the Study those products and services offered by these providers to the extent that data was available and that these providers were relevant to each

[404] Doubling the number of consumers successful in AAA arbitrations filed in 2010 and 2011 would raise the number of successful consumers 32 to 64.
[405] Study, *supra* note 3, section 5 at 17 n.30.
[406] *Id.* section 5 at 11 n.17.
[407] *Id.* section 5 at 20-28.
[408] *Id.* section 6 at 3, 33-54.
[409] The Bureau did attempt to do this analysis. Of 78 Federal individual cases where there was a result for the consumer, we could identify information about a monetary award in 75 cases. Of those 75 cases, the complaint included an allegation with a claim amount in only four cases. *See id.* section 6 at 49.

section of the Study. For example, to the extent a credit monitoring class action settlement occurred during the Study period, it is included in the analysis in Section 8. With respect to the Study's approach to credit unions, the Bureau notes that its review of credit cards in Section 2 included agreements offered by credit unions to the extent that credit unions are represented in the credit card agreement database mandated under the CARD Act.[410] The Bureau's review of deposit account agreements included agreements from the 50 largest credit unions. As is discussed in the Section 1022(b)(2) Analysis below, the Bureau notes that to the extent that the commenter was correct in its assertion that credit unions do not offer many products with arbitration agreements, the impact of this rule will be minimal.[411] As for online lenders, while the Bureau agrees that it did not specifically analyze this category in Section 2, it notes that the trade association commenter acknowledged in its letter that its members have arbitration agreements that can be used to block class actions. To state this another way, the Bureau did not specifically exclude any products or services because of the entity that offered it – whether Tribal, governmental or otherwise – although in some cases data were not specifically available for specific types of providers. As for Tribal regulations concerning dispute resolution, the Bureau focused its description on AAA and JAMS standards as the two largest arbitration administrators. As for the suggestion that the Bureau should have studied Tribal consumer protection laws, the Bureau did not study any particular jurisdiction's consumer protection laws and in any case, the commenter did not suggest the specific ways in which such Tribal laws would be meaningfully different from laws in other jurisdictions.

[410] *Id.* section 5 at 13

[411] The SBREFA Report further details the potential impact of this rule on small entities, including credit unions that are small. *See* SBREFA Report, *infra* note 419, at 23-32.

Regarding the comment that the Bureau should have conducted a "real world" analysis of arbitration and class actions and tradeoffs of each, the Bureau believes that the Study did attempt such an analysis. Specifically, it attempted to catalogue the cost, benefits, and efficacy (in terms of consumers involved) of each mechanism. Further, as is discussed in greater detail in the Section 1022(b)(2) Analysis below, the Bureau has considered the impacts on consumers and providers of the final rule it is adopting. To the extent that the commenter was concerned that the Study did not evaluate the relative merits of each mechanism, the Bureau believes that such an evaluation is better suited to the rulemaking process where it can consider the impacts of potential policy options. *See* Part VI Findings, below.

The Bureau does not agree, as one industry commenter suggested, that Dodd-Frank section 1028(a) required it to study defense costs. In any event, as set out above in Section III.D, above, the Bureau determined that it would be too difficult to gather additional information on any uniform basis about defense costs, given that at least some of this information may be considered privileged by companies. Further, as set out above, the Bureau made clear that it sought "transaction costs in consumer class actions," but the Bureau received no such data from firms during the Bureau's Study process or in response to the proposal.

The Bureau did attempt to project such costs based on the best data available to it, and discussed their significance in the sections of the proposal analyzing whether it was in the public interest and for the protection of consumers and the proposal's potential impacts on covered persons and consumers under section 1022 of the Dodd-Frank Act. To the extent that the

commenter's primary objection was to the significance that the Bureau accorded defense costs in its analyses, those are discussed in Part VI.C below.[412]

As to the commenter that urged the Bureau to study class arbitration, the Bureau notes that the Study addressed class arbitration in several ways. First, Section 2 addressed the percentage of arbitration agreements that allowed for class arbitration in the six product markets studied (the vast majority prohibit it).[413] Second, Section 4 reviewed AAA's and JAMS' class arbitration procedures.[414] Third, Section 5 reviewed the few consumer finance class arbitrations that did occur.[415]

As for the commenters that suggested that the Bureau should have studied informal dispute resolution, the Bureau notes that the Study did address informal dispute resolution in a number of contexts. For example, as noted above in the discussion of Section 8, the Bureau noted the impact of previously-resolved informal disputes on the overall amount paid out by the settling banks in the MDL overdraft litigation. The Bureau also considered the significance of the availability of informal dispute resolution mechanisms in both the proposal's Section 1028 proposed findings and Section 1022(b)(2) Analysis, and in their counterparts for the final rule below. In any event, the commenters did not specify what about informal dispute resolution the Bureau should have studied.

As for the commenter that asserted that the Bureau should have studied the role of consumer choice, the Bureau notes that the Study's consumer survey *did* address this question. Whether this should impact the rulemaking is addressed below in Part VI. Regarding the

[412] During the Study process, the Bureau sought comment on whether a study of defense costs could be undertaken, but the Bureau received no useful comment on this point. Arbitration Study RFI, *supra* note 16.
[413] *See* Study, *supra* note 3, section 2 at 46 tbl. 7.
[414] *See id.* section 4 at 20.
[415] *See id.* section 5 at 86.

commenter's contention that the Bureau should have studied the economic impact of its proposal, the Bureau notes that Section 10 did attempt to analyze the likelihood that class action costs would be passed on to consumers. The Bureau also refers the commenter to the proposal's and this rule's Section 1022(b)(2) Analysis.

## IV. The Rulemaking Process

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

As noted, the Bureau released the 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.[416] 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 final rule.

### *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).[417] 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.[418] Working with stakeholders and the agencies, the

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

[417] 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).

[418] Bureau of Consumer Fin. Prot., "Small Business Advisory Review Panel for Potential Rulemaking on Arbitration Agreements: Outline of Proposals Under Consideration and Alternatives Considered," (Oct. 7, 2015), *available at* http://files.consumerfinance.gov/f/201510_cfpb_small-

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 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 proposal on those entities. Those findings and recommendations are set forth in the Small Business Review Panel Report (SBREFA Report), which is being made part of the administrative record in this rulemaking.[419] 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

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business-review-panel-packet-explaining-the-proposal-under-consideration.pdf; Press Release, Bureau of Consumer Fin. Prot., "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/.

[419] Bureau 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.

consumer advocates. Bureau staff also presented an overview of the SBREFA Outline at a public meeting of the Bureau's Consumer Advisory Board (CAB) and solicited feedback from the CAB on the proposals under consideration.[420]

*D. The Bureau's Proposal*

In May 2016, in accordance with its authority u section 1028 and consistent with its Study, the Bureau proposed regulations that would govern agreements that provide for the arbitration of any future disputes between consumers and providers of certain consumer financial products and services. The comment period on the proposal ended on August 22, 2016.

The proposal would have imposed two sets of limitations on the use of pre-dispute arbitration agreements by covered providers of consumer financial products and services. First, it would have prohibited providers from using a pre-dispute arbitration agreement to block consumer class actions in court and would have required providers to insert language into their arbitration agreements reflecting this limitation. This proposal was based on the Bureau's preliminary findings – which the Bureau stated were 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, that consumers rarely file individual lawsuits or arbitration cases to obtain such relief, and that as a result pre-dispute arbitration agreements lowered incentives for financial service providers to assure that their conduct comported with legal requirements and interfered with the ability of consumers to obtain relief where violations of law occurred.

Second, the proposal would have required providers that use pre-dispute arbitration agreements to submit certain records relating to arbitral proceedings to the Bureau. The Bureau

[420] *See* Bureau of Consumer Fin. Prot., "Advisory Groups," http://www.consumerfinance.gov/advisory-groups/advisory-groups-meeting-details/ (last visited May 17, 2017); *see also* Bureau of Consumer Fin. Prot., "Washington, DC: CAB Meeting," YouTube (Oct. 23, 2015), https://www.youtube.com/watch?v=V11Xbp9z2KQ.

stated that it intended to use the information it would have collected to continue monitoring arbitral proceedings to determine whether there are developments that raise consumer protection concerns that would warrant further Bureau action. The Bureau stated that it intended 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 have applied 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. Consistent with the Dodd-Frank Act, the proposal would have applied only to agreements entered into after the end of the 180-day period beginning on the regulation's effective date. The Bureau proposed an effective date of 30 days after a final rule is published in the *Federal Register*. To facilitate implementation and ensure compliance, the Bureau proposed language that providers would be required to insert into such arbitration agreements to explain the effect of the rule. The proposal would have also permitted providers of general-purpose reloadable prepaid cards to continue selling packages that contain non-compliant arbitration agreements, if they gave consumers a compliant agreement as soon as consumers register their cards and the providers complied with the proposal's requirement not to use arbitration agreements to block class actions.

*E. Feedback Provided to the Bureau*

The Bureau received over 110,000 comments on the proposal during the comment period. These commenters included consumer advocates; consumer lawyers and law firms; public-interest consumer lawyers; national and regional industry trade associations; industry members including issuing banks and credit unions, and non-bank providers of consumer financial products and services; nonprofit research and advocacy organizations; members of Congress and

State legislatures; Federal, State, local, and Tribal government entities and agencies; Tribal governments; academics; State attorneys general; and individual consumers. In addition to letters addressing particular points raised by the Bureau in its preliminary findings, the Bureau received tens of thousands of form letters and signatures on petitions from individuals both supporting and disapproving of the proposal. As is discussed in greater detail in Part VI below, many thousands of consumers submitted comments generally disapproving of the Bureau's proposal (many of these comments were form comments) while many consumers submitted comments generally approving of the Bureau's proposal and, in many instances, urging a broader rule that prohibited arbitration agreements altogether in contracts for consumer financial products and services (many of these comments were form comments or petition signatures as well).

Since the issuance of the proposal, the Bureau has engaged in additional outreach. The Bureau held a field hearing to discuss the proposal and its potential impact on consumers and providers in Albuquerque, New Mexico.[421] The Bureau engaged in an in-person consultation with Indian Tribes in Phoenix, Arizona in August 2016 pursuant to its Policy for Consultation with Tribal Governments after the release of this notice of proposed rulemaking.[422] In addition, the Bureau received input on its proposal from its Consumer Advisory Board and its Credit Union Advisory Council. Finally, interested parties also made *ex parte* presentations to Bureau staff, summaries of which can be found on the docket for this rulemaking.[423]

[421] Bureau of Consumer Fin. Prot., "Field Hearing on Arbitration in Albuquerque, NM," (May 5, 2016), (video, transcript, and remarks by Director Cordray), *available at* https://www.consumerfinance.gov/about-us/events/archive-past-events/field-hearing-arbitration-albuquerque-nm/.
[422] 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.
[423] Regulations.gov, "Arbitration Agreements," No. CFPB-2016-0020, https://www.regulations.gov/docket?D=CFPB-2016-0020 (last visited June 21, 2017)

## V. Legal Authority

As discussed more fully below, there are two components to this final rule: a rule prohibiting providers from the use of arbitration agreements to block class actions (as set forth in § 1040.4(a)) and a rule requiring the submission to the Bureau of certain arbitral records and arbitration-related court records (as set forth in § 1040.4(b)). The Bureau is issuing the first component of this rule pursuant to its authority under section 1028(b) of the Dodd-Frank Act and is issuing the second component of this rule pursuant to its authority both under section 1028(b) and section 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 rule relating to pre-dispute arbitration agreements

fulfills all these statutory requirements and is in the public interest, for the protection of consumers, and consistent with the Bureau's Study.

*B. Section 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.[424] Accordingly, in issuing this, the Bureau is exercising 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).[425]

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.[426] 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 activities of covered persons and service providers. The Bureau finalizes § 1040.4(b) pursuant to

[424] *See* Dodd-Frank section 1002(14) (defining "Federal consumer financial law" to include the provisions of title X of the Dodd-Frank Act).
[425] *See* Section 1022(b)(2) Analysis, *infra* Part VIII.B. (discussing the Bureau's standards for rulemaking under section 1022(b)(2) of the Dodd-Frank Act).
[426] Dodd-Frank section 1022(c)(3)(B).

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 Findings That the Final Rule is in the Public Interest and for the Protection of Consumers

The Bureau notes that commenters on the proposal made extensive comments on the Bureau's preliminary findings related to Dodd-Frank Act Section 1028(b), including its factual findings, its findings that the proposal would be for the protection of consumers, and its findings that the proposal would be for the protection of consumers. The bulk of these commenters did not identify whether their comments on particular topics were related to the preliminary factual findings (discussed below in Part VI.B), to the preliminary findings that the proposed rule would be for the protection of consumers (discussed below in Parts VI.C.1 and VI.D.1), or to the preliminary findings that it would be in the public interest (discussed below in Parts VI.C.2 and VI.D.2). Accordingly, for this final rule, the Bureau addresses each comment in the context of the finding it believes the comment was most likely addressing. There is significant overlap between the topics addressed in the final factual findings, the findings that the rule would be for the protection of consumers, and the finding that the rule would be in the public interest. The Bureau therefore incorporates each of its findings into the others, to the extent that commenters may have intended their comments to respond to a different preliminary finding or to more than one.

### *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 Part sets forth the Bureau's interpretation of this standard including a summary of its proposed standard and a review of comments received on it.

*The Bureau's Proposal*

As noted in the proposal, the Bureau can read this requirement 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 in order to determine which reading best effectuates the purposes of the statute, the Bureau exercises its expertise. The Bureau proposed to interpret the two phrases as related but conceptually distinct.

As discussed in the proposal, 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 the Securities Act and the Securities 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."[427] The SEC has routinely applied this language without delineating separate tests or definitions for the two phrases.[428] There is an underlying logic to such an approach since investors make up a substantial portion of "the public" whose interests the SEC is

[427] *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).

[428] *See, e.g.*, *Bravo Enterprises Ltd.*, Securities Exchange Act 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* Notice of Commission Conclusions and Rule-Making Proposals, Securities Act Release No. 5627 [1975-1976 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 7 (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.").

charged with advancing. This is even more the case for section 1028, since nearly every member of the public is a consumer of financial products and services under Dodd-Frank. Furthermore, in exercising its roles and responsibilities as the Consumer Financial Protection Bureau, the Bureau ordinarily approaches consumer protection holistically. In other words, the Bureau approaches consumer protection in accordance with the broad range of factors it generally analyzes under title X of Dodd-Frank, which include systemic impacts and other public concerns as discussed further below. Therefore, the proposal explained that 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 would be informed by the Bureau's particular expertise in the protection of consumers.

But the proposal further explained that the Bureau believed that treating the two phrases as separate tests would ensure a fuller consideration of 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.[429] Under this framework, the proposal explained, the Bureau would be required to exercise its expertise to outline a standard for each phrase because both phrases are ambiguous. In doing so, and as described in more detail below, the Bureau would look to, using its expertise, the purposes and objectives of title X to inform the "public interest" prong,[430] and rely on its expertise in consumer protection to define the "consumer protection" prong.

[429] *See Hibbs* v. *Winn*, 542 U.S. 88, 101 (2004); *Bailey* v. *United States*, 516 U.S. 137, 146 (1995).
[430] 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).

The proposal explained that under this approach the Bureau believed 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, the proposal explained, 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 other relevant elements of the public. These interests 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. The other relevant elements of the public interest include impacts on providers, markets, and the rule of law, in the form of accountability and transparent application of the law to providers, as well as other related general systemic considerations.[431] The Bureau proposed to adopt this interpretation, giving the two phrases independent meaning.[432]

The proposal also explained that the Bureau's proposed interpretations of each phrase standing alone were 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 therefore would be 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

[431] 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).
[432] The proposal explained that the Bureau believes that findings sufficient to meet the two tests explained in the proposal 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.

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."[433] Similarly, section 1022 of the Act authorizes the Bureau to prescribe rules to "carry out the purposes and objectives of the 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.[434] In light of these purposes and requirements, as set forth in the proposal, the Bureau understands its responsibilities with respect to the administration of Federal consumer financial laws to be integrated with the advancement of a range of other public goals such as fair competition, innovation, financial stability, and the rule of law.

Accordingly, the Bureau proposed 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, as well as the

[433] 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.
[434] Dodd-Frank section 1022(b)(2)(B) and (C).

impact of any change in those markets on the broader economy, and the promotion of the rule of law.[435]

With respect to "the protection of consumers," as explained above and in the proposal, 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 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 proposed to interpret to include the full range of considerations encompassed in title X, the proposal explained that the Bureau believed, based on its expertise, that "for the protection of consumers" should not be interpreted in the broad manner in which it is ordinarily understood in the Bureau's work.

The Bureau instead proposed to interpret the phrase "for the protection of consumers" as used in section 1028(b) 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 proposed to interpret it, would be exclusively on the impacts of a proposed regulation on the level of compliance with relevant laws, including deterring violations of those laws, and on consumers' ability to obtain redress or relief. 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

[435] The Bureau uses its expertise to balance competing interests, including how much weight to assign each policy factor or outcome.

and practices and from discrimination."[436] Under this proposed interpretation, the Bureau would not consider more general or systemic concerns with respect to the functioning of the markets for consumer financial products or services or the broader economy as part of section 1028's requirement that the rule be "for the protection of consumers."[437] Rather, the Bureau would consider these factors under the public interest prong.

The proposal stated that the Bureau provisionally believed that giving separate meaning and consideration to the two prongs would best ensure effectuation of the purpose of the statute. 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.[438]

*Comments Received*

Several commenters – a nonprofit, an industry trade association, two industry commenters, and an individual – supported the Bureau's proposal to interpret the legal standard as including two separate but related tests. A trade association of consumer lawyers argued for treating the legal standard as a single test given that other similar standards have traditionally been treated as unitary and that the Bureau's two proposed tests would have significant overlap.

One nonprofit commenter acknowledged that the phrase "public interest" is susceptible to multiple interpretations, but also stated that the Bureau's proposed interpretation of the legal

[436] Dodd-Frank section 1021(b)(1) and (2).
[437] *See Whitman* v. *Am. Trucking Ass'ns, Inc.*, 531 U.S. 457, 465 (2001).
[438] As noted above, the proposal explained that if the Bureau were to treat the standard as a single, unitary test, the test would involve the same considerations as described above, while allowing for a more flexible balancing of the various considerations. The Bureau accordingly believed that findings sufficient to meet the two tests explained in the proposal would also be sufficient to meet a unitary test, because any set of findings that met each of two independent criteria would necessarily meet a more flexible single test combining them.

standard includes factors that should not be considered. This commenter explained that, in its view, the Bureau should interpret the phrase in the context of the FAA and the longstanding Federal policy that encourages use of arbitration as an efficient means of resolving disputes. The commenter further suggested that section 1028 requires the Bureau to find that a regulation is in the public interest for reasons uniquely applicable to consumer financial products or services rather than for reasons that could apply to other types of products or services. Furthermore, this commenter contended that in enacting section 1028, Congress was not concerned with under-enforcement of laws because there is no specific reference to such considerations in that section of the statute or its brief legislative history. The commenter therefore asserted that the Bureau should not consider increased deterrence or enforcement in determining whether a regulation is "in the public interest and for the protection of consumers."

Several commenters identified additional specific factors that, in their view, the Bureau should consider in its determination of whether the rule is in the public interest and for the protection of consumers. A group of State attorneys general and an industry commenter suggested that the legal standard should include the public's interest in the freedom of contract. The industry commenter also stated that the public interest standard should consider individuals' ability to choose whether to participate in class action litigation or to be bound by class action judgments. A group of State legislators argued that the Bureau should consider States' rights as a factor in its determination of whether the rule is in the public interest. The group stated that class waivers in arbitration clauses undermine States' ability to pass laws that will be privately enforced, measure the efficacy of those laws, or observe their development, and that the legal standard should account for such effects.

A group of State attorneys general argued that the proposed "protection of consumers" standard is incomplete because it is limited to providers' compliance with the law and consumers' ability to obtain relief. The commenters maintained that the Bureau should also consider consumers' interest in a "vibrant and flourishing financial market" as part of the standard.

*Response to Comments*

The Bureau is not persuaded by the nonprofit commenter that the standard should be treated as a single test on the ground that other similar standards have been treated as unitary and the Bureau's two proposed tests will have significant overlap. As explained in the proposal, the statutory standard is ambiguous, and while it is useful and relevant for the Bureau to consider how other similar standards have been applied, there are persuasive reasons, as set forth in the proposal, for the Bureau to adopt a different interpretation here in the context of section 1028.[439] The Bureau recognizes that the two tests will have significant overlap, but that in and of itself is not a reason to adopt a unitary test. Instead, the Bureau continues to believe that treating the two phrases as separate tests is more consistent with canons of statutory construction and may ensure a fuller consideration of relevant factors.[440]

The Bureau also disagrees with the nonprofit commenter that stated that the proposed interpretation includes factors that should not be considered. With regard to the commenter's contention that section 1028 requires the Bureau to find that a regulation is in the public interest for reasons uniquely applicable to consumer financial products or services rather than for reasons

[439] Note that similar standards have not been exclusively applied as unitary. *See Verizon* v. *FCC*, 770 F.3d 961, 964 (D.C. Cir. 2014) ("protection of consumers" and "public interest" separate "conjunctive" factors). And while other agencies have applied similar, but not identical language, as a unitary standard in some contexts, they have for the most part done so without discussion as to their reasons for doing so.

[440] Furthermore, the Bureau continues to believe that if it were to treat the standard as a single, unitary test, the test would involve the same considerations, while allowing for a more flexible balancing of the various considerations. Therefore findings sufficient to meet the two tests would also be sufficient to meet a unitary test, because any set of findings that met each of two independent criteria would necessarily meet a more flexible single test combining them.

that could apply to other types of products or services, the Bureau notes that section 1028 contains no such limitation. As explained above, the proposed interpretation of the legal standard is guided by the Bureau's purposes and objectives as laid out in title X of the Dodd-Frank Act. The commenter did not identify a basis in the text of title X or the statute's underlying purposes for excluding factors derived from title X simply because they could apply to other products and services. In any event, the Bureau's findings are specific to consumer financial products and services and are based on an empirical study required by Congress that is specific to consumer financial products and services.[441]

Further, as noted above, the Bureau looks to the purposes and objectives of title X to inform the section 1028 standard, and the FAA is not referenced in those purposes and objectives. To the extent that Federal law encourages arbitration through the FAA, the Bureau notes that, as Congress has limited pre-dispute arbitration agreements in other contexts, Congress, through Section 1028, has granted the Bureau express authority to prohibit or otherwise limit the use of such agreements.[442] Thus, rather than incorporate the FAA per se into its public interest analysis, the Bureau conducted a robust analysis of the advantages and disadvantages of pre-dispute arbitration agreements as currently enforced (under the FAA) in markets for consumer financial products and services. This included whether consumers are able to meaningfully pursue their rights and obtain redress or relief in light of pre-dispute arbitration agreements with class waivers enforceable under the FAA, as discussed in Section VI.B.

[441] The Bureau notes that its Study and this rulemaking focused almost exclusively on the use of arbitration agreements on contracts for consumer financial products and services. Whether the findings of this rulemaking may apply in other markets is not relevant and beyond the scope of this process.

[442] *See CompuCredit Corp.* v. *Greenwood*, 565 U.S. 95, 103-04 (2012) (listing statutes where Congress has "restricted the use of arbitration" as well as section 1028); *see also* Dodd-Frank section 1414(a) ("No residential mortgage loan…may include terms which require arbitration…as the method for resolving any controversy or settling any claims arising out of the transaction.").

The Bureau also disagrees with the commenter's contention that increased deterrence or enforcement should not be considered because section 1028 and its brief legislative history[443] do not specifically mention deterrence. As explained above, the Bureau looks to the purposes and objectives of title X to inform the "public interest" inquiry, and these statutory purposes and objectives evince a goal of enforcing the law and deterring illegal behavior as well as a mandate for the Bureau to do so.[444] Similarly, based on its expertise in consumer protection, the Bureau believes that deterring illegal behavior and enforcing the law are core aspects of the "protection of consumers." The absence of a specific mention of deterrence or enforcement in section 1028 or its legislative history does nothing to undercut these conclusions. In fact, the Bureau believes that while the phrase "in the public interest and for the protection of consumers" is ambiguous it would be unreasonable not to consider deterrence as part of the standard.

A variety of commenters identified additional factors that they thought should be considered in the legal standard. The Bureau notes that the standard already encompasses the types of considerations suggested by these commenters, and thus, disagrees that it should specifically list these factors as a part of the legal standard. As the Bureau explained in the proposal, it interprets the public interest standard to include consideration of "benefits and costs to consumers and firms." The standard thus accounts for impacts that a rule may have on consumers' "freedom of contract" and their ability to determine whether or not to participate in class actions. Likewise, both the public interest standard and the protection of consumers

[443] *See* S. Rept. 111-176, at 171 (2010).
[444] *See, e.g.*, Dodd-Frank sections 1021(a) ("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."); 1021(b)(2) ("…consumers are protected from unfair, deceptive, or abuse acts and practices and from discrimination"); 1021(b)(3) ("…Federal consumer financial law is enforced consistently….").

standard account for the extent to which laws are actually enforced. This includes the extent to which State laws that States intend to be privately enforced are actually enforced in this manner.

Finally, the Bureau also disagrees with the State attorneys general that suggested that the "protection of consumers" specifically (as opposed to the section 1028 standard generally or "the public interest" prong) should include consideration of a rule's impact on the general flourishing of the economy. As explained in the proposal, the Bureau generally views consumer protection holistically in its approach to fulfilling its mandate in accordance with the broad range of factors it considers under title X of Dodd-Frank. But in the context of section 1028, which pairs "the protection of consumers" with "the public interest," the Bureau continues to believe that systemic impacts should be considered under the public interest standard rather than the protection of consumers standard. As such, the Bureau considers a variety of factors related to competition and the flourishing of the economy under the public interest standard rather than the protection of consumers standard. Such systemic impacts implicate benefits to consumers, including consumers' interests in "access to a vibrant and flourishing financial market" as noted by the commenter, and the Bureau considers those benefits in its public interest analysis.

*The Final Legal Standard*

For these reasons and those stated in the proposal, the Bureau is adopting the interpretation of the section 1028 standard largely as proposed, with minor wording changes for clarification, as restated below.

The phrase "in the public interest and for the protection of consumers" in section 1028 is ambiguous. The Bureau interprets it as comprising two separate but related standards.

The Bureau interprets the phrase "in the public interest" to condition any regulation under section 1028 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 requires the Bureau to consider the benefits and costs to consumers and firms, including the more direct factors considered under the protection of consumers standard, and general or systemic concerns with respect to the functioning of markets for consumer financial products or services, as well as the impact of any changes in those markets on the broader economy and the promotion of the rule of law, in the form of accountability and transparent application of the law to providers.[445]

The Bureau interprets the phrase "for the protection of consumers" as used in section 1028 to condition any regulation on a finding that such regulation will 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 is exclusively on the impacts of a regulation on the level of compliance with relevant laws, including deterring violations of those laws, and on consumers' ability to obtain redress or relief. Under the Bureau's interpretation, the Bureau does not consider more general or systemic concerns with respect to the functioning of the markets for consumer financial products or services or the broader economy as part of section 1028's requirement that the rule be "for the protection of consumers." Rather, the Bureau considers these factors under the public interest prong.

*B. The Bureau's Factual Findings Consistent With the Study and 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 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

[445] The Bureau uses its expertise to balance competing interests, including how much weight to assign each policy factor or outcome.

products and services. The Bureau finds that all of the factual findings in this Part VI.B are consistent with the Study.

As noted in Part IV.E, above, the Bureau received many comments on the class proposal. In addition to letters addressing particular points raised by the Bureau in its preliminary findings, the Bureau received tens of thousands of letters and signatures on petitions from individuals both supporting and disapproving of the class proposal.[446]

The Bureau received letters from industry, including banks, credit unions, non-bank providers of consumer financial product and services, trade associations, academics, members of Congress, nonprofits, consumers, and others expressing disapproval of the Bureau's class proposal. The specifics of these letters are discussed in relevant part below. The majority of the letters criticizing the proposal expressed general disapproval rather than specific concerns with provisions of the proposed regulation. Many of these letters recited facts derived from the Study, such as the amount of payments received per consumer in class action settlements, the amount of relief received by consumers who obtained arbitral awards in their favor, the amount of fees paid to plaintiff's attorneys in class actions, and the proportion of class cases that do not result in classwide relief. Many of these comments expressed concerns that the proposal would raise the cost to consumers of financial services and that only plaintiff's attorneys would benefit from the class proposal because of the large fees that plaintiff's attorneys often receive when class action cases are settled. These urged the Bureau not to adopt the proposal.

The Bureau also received many comments from consumers, consumer advocates, nonprofits, public-interest consumer lawyers, consumer lawyers and law firms, academics,

[446] The Bureau received a number of letters that did not appear to address the proposal at all and instead expressed general favor or displeasure with the Bureau or the Federal government. The Bureau views these comments as beyond the scope of the proposed rule.

members of Congress, State attorneys general, State legislators, local government representatives, and others that expressed broad support for the class proposal. The specifics of these letters are also discussed in relevant part below. These commenters explained that, in their view, the proposal is in the public interest, for the protection of consumers and, if finalized, would be consistent with the Study. Many of these letters recited facts derived from the Study and cited by the Bureau in the proposal that support these findings. For example, many emphasized the need for class actions by comparing the benefits provided to consumers in individual arbitration and litigation with those provided in class actions. These letters also stated that forcing arbitration on consumers by means of form contracts is not in the public interest. Many asserted that consumers should never have to give up constitutional protections, such as the right to bring a case in court. A petition signed by many thousands of consumers asked the Bureau to restore consumers' right to join together to take companies to court. Other commenters urged the Bureau to adopt the class proposal because it would generally enhance consumer rights vis-à-vis financial institutions.

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

As explained in the proposal, the benefits and drawbacks of arbitration as a means of resolving consumer disputes have long been contested. The Bureau stated there that it did not believe that, based on the evidence currently available to the Bureau as of the time of the proposal, it could 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.[447] Accordingly, the Bureau preliminarily found that a comparison of the relative fairness and efficiency of individual arbitration and individual litigation was inconclusive and thus that a total ban on the use of pre-dispute arbitration agreements in consumer finance contracts was not warranted at that time.

*Comments Received*

Numerous industry, research center, and State attorneys general commenters disagreed with the Bureau's preliminary assessment that a comparison of the relative fairness and efficiency of individual arbitration and individual litigation is inconclusive. Instead, many of these commenters stated their belief that arbitration is a superior form of dispute resolution than individual litigation for consumers because it is less expensive, faster, and does not require the consumer to retain an attorney. For example, commenters stated that the informal nature of arbitration allows for a more streamlined process; that overburdened courts slow resolution of individual litigation; that arbitration hearings can be held via telephone or other convenient means, and that the lack of procedural complexity in arbitration minimizes the need for a consumer to have an attorney.[448] These commenters further stated that the class rule would cause providers to remove arbitration agreements from their consumer contracts altogether, thereby depriving consumers of arbitration as a forum for hearing their individual disputes and forcing them to proceed in court; the Bureau's response to these comments is addressed below in Part VI.C.1, because they relate to whether the class rule protects consumers and not these

[447] *See* Study, *supra* note 3, section 6 at 4 (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.
[448] Among commenters that favored arbitration in consumer contracts were a number of automobile dealers and their advocates. In response, a consumer lawyer commenter noted that the automobile dealers' opinion might be hypocritical insofar as they advocate for including arbitration agreements in their contracts with consumers while advocating for their removal in dealers' contracts with manufacturers.

factual findings regarding a comparison of the relative fairness and efficiency of individual arbitration and individual litigation.

A group of State attorneys general commenters, a nonprofit commenter, many individual commenters, and Congressional, consumer advocate, academic, and consumer law firm commenters also disagreed with the Bureau's preliminary findings about the relative fairness of individual arbitration and individual litigation, but for reasons opposite those described above. Instead, these commenters stated that individual arbitration was so unfair relative to individual litigation that the Bureau should have protected individual consumers by banning outright the use of pre-dispute arbitration agreements. For example, several consumer advocate commenters and many individual commenters (including thousands of individuals who had signed petitions) argued that any arbitration proceeding that occurs pursuant to a pre-dispute arbitration agreement is "forced" and therefore unfair, and that arbitration agreements are contracts of adhesion that should not be permitted in any context. Other commenters argued that consumer arbitration cannot be neutral because it naturally favors repeat players – the providers who repeatedly hire arbitrators and select administrators – over consumers, who may only be involved in an arbitration once. One public-interest consumer lawyer commenter argued that only a complete ban on pre-dispute arbitration agreements would help consumers because consumers cannot find legal representation for arbitrations and few consumers file arbitrations in any case. Academic commenters stated that consumers should never be deprived of the right to go to court. A Congressional commenter noted that arbitral filing fees can be tens of thousands of dollars and thus are unaffordable to many consumers, particularly when compared to filing fees in court which vary but in some courts are as low as a few hundred dollars. Finally, another public-interest consumer lawyer commenter observed that many resources exist to help individual

litigants use the court system – such as volunteer attorneys, offices that offer legal advice, publications, standardized pro se forms, videos, etc. – but that comparable resources do not exist to help individuals navigate arbitration proceedings.

*Response to Comments and Findings*

As noted in the proposal and explained in the Study, 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. Commenters did not disagree with this preliminary finding. The Study showed that AAA arbitrations proceeded relatively expeditiously relative to litigation, that companies often advance consumer filing fees in arbitration, which does not occur in litigation, and that at least some consumers proceeded without an attorney. The Study also showed that those consumers who did prevail in arbitration obtained substantial individual awards – the average recovery by the 32 consumers who won judgments on their affirmative claims was nearly $5,400.[449]

At the same time, the Study showed that a large percentage of the relatively small number of AAA individual arbitration cases were 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 prevailed more frequently on their claims than consumers[450] and that companies were almost always represented by attorneys (90 percent of the claims

[449] *See* Study, *supra* note 3, section 5 at 13.

[450] *Id.* section 5 at 13-14 (finding that consumers prevailed on 25 of 92 claims in which a consumer asserted affirmative claims only and an arbitrator reached a decision on the merits in seven of 69 claims in which a consumer brought an affirmative claim and also disputed debts they were alleged to owe (finding that companies prevailed in 227 out of 250 cases in which companies asserted counterclaims against consumers). The Study did not explain why companies prevailed more often than consumers. While some stakeholders have suggested that arbitrators are biased – citing, for example, that companies were repeat players or often the party effectively chose the arbitrator – other stakeholders and research suggested that companies prevailed more often than consumers because of a difference in the relative merits of such cases.

analyzed) while consumers were represented significantly less (60 percent).[451] Finally, the Study showed that companies were awarded payment of their attorney's fees by consumers in 14.1 percent of 341 disputes resolved by arbitrators in companies favor' and consumers were awarded payment of their attorney's fees in 14.6 percent of the 341 disputes in which consumers prevailed and were represented by an attorney.[452]

In light of these results and in consideration of the comments received, the Bureau continues to believe that the results of the Study were inconclusive as to the benefits to consumers of individual arbitration versus individual litigation during the Study period. Nevertheless, because arbitration procedures are privately determined, the Bureau finds that they can under certain circumstances pose risks to consumers. For example, as discussed above in Part II.C and in the proposal, until it was effectively shut down by the Minnesota Attorney General, the National Arbitration Forum (NAF) was the predominant administrator for certain types of arbitrations. NAF stopped conducting consumer arbitrations in response to allegations that its ownership structure gave rise to an institutional conflict of interest. The Study also showed isolated instances of arbitration agreements containing provisions that, on their face, raised significant concerns about fairness to consumers similar to those raised by NAF, such as an agreement that designated a Tribal administrator that does not appear to exist and agreements that specified NAF as a provider even though NAF no longer handled consumer finance arbitration, making it difficult for consumers to resolve their claims.[453]

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[451] *Id.* section 5 at 29.
[452] *Id.* section 5 at 12. Note that the number of attorney's fee requests was not recorded.
[453] *Id.* section 2 at 37 tbl. 4. 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").

As first stated in the proposal, the Bureau remains concerned about the potential for consumer harm in the use of arbitration agreements in the resolution of individual disputes. 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 Bureau is therefore, as set out below at length in Part VI.D and the section-by-section analysis of section 1040.4(b), adopting a system that will allow it and the public, to review certain arbitration materials in order to monitor the fairness of such proceedings over time.

However, the Bureau disagrees with the consumer advocate and individual commenters that any arbitration proceeding pursuant to a pre-dispute arbitration agreement is necessarily "forced" and unfair, and that arbitration is not neutral. The Bureau recognizes that, with rare exception, contracts for consumer financial services are contracts of adhesion offered on a take-it-or-leave-it basis. In some markets, consumers may, in theory, be able to choose a provider that does not require pre-dispute arbitration but the Study found that credit card consumers generally do not understand the consequences of entering into a pre-dispute agreement or shop on that basis and the Bureau has no reason to believe that consumers in other markets are any different.[454] Furthermore, the Study found that there are markets for certain consumer financial services where pre-dispute arbitration agreements are nearly ubiquitous; consumers in those markets have little choice.[455] Thus, the Bureau generally agrees that consumers rarely affirmatively and knowingly elect to enter into pre-dispute arbitration agreements.

[454] *See generally* Study, *supra* note 3, section 3.
[455] *See generally id.* section 2.

Nonetheless, the Bureau does not agree that the fact that consumers are largely unaware of these agreements means that the resulting arbitration proceedings are inherently unfair. As is discussed above, the Bureau finds that the Study did not provide any basis for evaluating whether individual arbitration proceedings resulted in demonstrably worse outcomes than individual litigation proceedings in a manner that warrants a more substantial intervention. The Bureau also disagrees with the comment that the Study identified a clear-cut repeat-player effect favoring of industry participants over consumer participants. As noted above, the Study showed that arbitration cases proceeded relatively expeditiously relative to individual litigation because companies often advance filing fees, the cost to consumers of arbitral filing fees was modest relative to individual litigation and at least some consumers proceeded without an attorney. The Study also showed that those 32 consumers who did prevail in arbitration obtained substantial individual awards.[456] For all of these reasons, the Bureau disagrees, at this time, with those commenters that recommended that it should completely ban the use of pre-dispute arbitration agreements.

The Bureau acknowledges that an arbitration agreement, by definition, deprives consumers of the right to bring disputes to court since an arbitration agreement permits a company to force any dispute it does not wish to litigate in court to an arbitral forum. On the other hand, an arbitration agreement gives consumers a new right – the right to force a company to resolve a dispute in arbitration. Absent such an agreement, consumers could proceed to arbitration only if the company is willing to arbitrate a particular dispute. Given the inconclusive nature of the evidence concerning the relative fairness or efficacy of individual litigation and

[456] *Id.* section 5 at 13-15.

arbitration in resolving consumer disputes, the Bureau is not prepared at this time to ban arbitration agreements.

*2. 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 concluded in the proposal, based upon the results of the Study, that individual dispute resolution mechanisms are an insufficient means of ensuring that consumer financial protection laws and consumer financial product or service contracts are enforced.

The Study showed that consumers rarely pursued individual claims against companies they dealt with 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.[457] Second, the Study showed that relatively few consumers filed claims against companies in small claims courts even though most arbitration agreements contained 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 87 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

[457] *Id.* section 6 at 28 tbl. 6.

United States.[458] Extrapolating those results to the population of the United States suggests that, at most, a few thousand cases are filed per year in small claims court by consumers concerning consumer financial products or services.[459]

As discussed in the proposal's preliminary findings, a similarly small number of consumers filed consumer financial claims in arbitration. The Study showed 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.[460] Given that the AAA was the predominant administrator identified in the arbitration agreements studied, the Bureau believes that this represents most consumer finance arbitration disputes that were filed during the Study period. Indeed, as noted in the proposal, JAMS (the second largest provider of consumer finance arbitration) reported to Bureau staff that it handled about 115 consumer finance arbitrations in 2015.[461]

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 was 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.[462] As stated in the proposal's

[458] The figure of 870 claims included 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 id.* appendix Q at 113-114.

[459] As explained in the Study and above at Part III.D.5, other than its sample of filings in small claims court, the Bureau did not collect individual claims filed in State courts of general jurisdiction because doing so was infeasible. *Id.* appendix L at 71.

[460] *See id.* appendix Q at 113-114 and section 5 at 19-20. 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 tbl. 6. 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.* section 5 at 21-22 tbl. 2. 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*. section 5 at 31 n.64. Another 175 were mutually filed by consumers and companies. *Id.* section 5 at 19.

[461] *Id.* section 4 at 2; 81 FR 32830, 32836 n.97 (May 24, 2016).

[462] 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:

preliminary findings, the Bureau believes that the relatively low numbers of formal individual claims (either in judicial or arbitral fora) may be explained, at least in part, by the fact that legal harms are often difficult for consumers to detect without the assistance of an attorney who understands the relevant laws and whether to pursue facts unknown to the consumer that may support a claim. 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.[463] Individual dispute resolution therefore generally 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 preliminarily concluded 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.[464] 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

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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 3, section 8 at 40 and 41-42 tbl. 17.

[463] 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.").

[464] 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), 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.

lunatic or a fanatic sues for $30."[465] 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 an attorney. 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."[466] 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.[467]

The Study's survey of consumers in the credit card market reflected 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.[468]

As stated in the proposal, 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.[469] A consumer must pay his or her attorney in advance or as the 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

[465] *Carnegie* v. *Household Int'l, Inc.*, 376 F.3d 656, 661 (7th Cir. 2004).
[466] 28 U.S.C. App. 161 (1966).
[467] *Amchem Prod.*, 521 U.S. at 617 (*citing Mace* v. *Van Ru Credit Corp*., 109 F.3d 338, 344 (7th Cir. 1997)).
[468] 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 3, section 3 at 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 was not worth their time and expense given the small amounts at issue and their low likelihood of recovery.
[469] For instance, in the Study's analysis of individual arbitrations, the average and median recoveries by consumers who won awards on their affirmative claims were $5,505 and $2,578, respectively. *Id.* 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 fee 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.*

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.[470]

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

As discussed in the proposal, some stakeholders claimed that the low total volume of individual claims found by the Study in litigation or arbitration was attributable not to inherent deficiencies in the individual formal dispute resolution systems but rather to the success of informal dispute resolution mechanisms in resolving consumers' complaints. Under this theory, the cases that actually are litigated or arbitrated are outliers – consumer disputes in which the consumer either bypassed the informal dispute resolution system or the system somehow failed to produce a resolution. The Bureau preliminarily explained why it did not find this argument persuasive. As stated in the proposal, the Bureau preliminarily found that informal dispute resolution was not sufficient because – as with pursuing claims through more formal

[470] 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.").

mechanisms – consumers may not know that their provider is acting in a way that harms them or that violates the law. Moreover, even when consumers recognize problematic behavior and decide to complain to their providers informally, companies exercise their discretion about whether they provide relief to particular consumers. The Bureau pointed out, for example, that a company could decide whether to provide relief to a consumer based on the customer's profitability, rather than based on the merit of the complaint. And in the Bureau's experience, even if companies resolve some disputes in favor of customers who complain, companies do not generally volunteer to provide relief to other affected customers who do not themselves complain.

*Comments Received*

*Number of individual claims.* Numerous industry, research center, and State attorneys general commenters challenged the Bureau's preliminary finding that consumers rarely pursued individual claims against their providers of consumer financial products or services. To the extent these comments relate primarily to the Study's data regarding this preliminary finding, they are summarized above in Part III.D. Various consumer advocate, public-interest consumer lawyers, nonprofit, and consumer lawyer commenters agreed with the Bureau's preliminary finding that consumers rarely pursued individual claims against providers of consumer financial products or services with whom they dealt. These commenters generally cited to the Bureau's Study and how it confirmed their own experiences concerning the relative rarity of individual cases across both arbitration and litigation. For example, a consumer advocate commenter highlighted data from the Study that indicated that borrowers of payday loans are particularly unlikely to pursue individual claims despite what the commenter asserted was evidence of broad misconduct by payday lenders. A law professor noted that there are also low numbers of

consumer arbitrations in the cellular telephone industry, noting that one large company averaged less than 30 arbitrations a year despite having over 85 million customers.[471] An industry commenter asserted that the Bureau has no data on individual lawsuits filed in State court and, therefore, the Bureau has no basis for finding that consumers rarely file individual lawsuits.

*Explanations for low number of individual claims.* Few industry commenters addressed the Bureau's preliminary finding that consumers often are not aware that they are injured or do not fully understand their potential claims without legal advice. However, many industry, State attorneys general, and research center commenters disputed the relevance of the Study's consumer survey, which found that only 2 percent of respondents were likely to seek an attorney or file formal claims if they found an unexplained fee on their credit card bill.

On the other hand, numerous consumer advocate, public-interest consumer lawyer, and consumer lawyer and law firm commenters validated the Bureau's preliminary finding in this regard. Among the reasons given, one consumer advocate explained that consumers often do not know they are injured in the first place given the complexity of consumer finance products and the Federal and State laws and regulations governing those products. Similarly, a consumer law firm explained that their clients were often unaware of claims that they might be able to bring. Even when they are harmed, the commenter stated that consumers may not know that they may be entitled to a remedy, particularly when statutory damages are available. For example, a consumer may be frustrated by telephone calls from a debt collector but not know that the calls violate the Telephone Consumer Protection Act and that he or she is entitled to statutory damages. On the other hand, some industry commenters suggested that there are few individual

[471] A recent media report similarly found, regarding a different cellular telephone company, "that – out of nearly 150 million customers – only 18 went through arbitration for small claims in the past two years." CBS Evening News, "AT&T and DirecTV Face Thousands of Complaints Linked to Overcharging Promotions," (May 16, 2017), *available at* http://www.cbsnews.com/news/complaints-att-directv-bundled-services-directv-customers-promotions-overcharging/.

consumer finance claims because public enforcement sufficiently remedies all violations of consumer finance laws.[472]

With respect to the Bureau's preliminary findings that consumers may not pursue individual claims because they are small, at least one industry commenter and one research center commenter agreed with the Bureau that consumer finance claims are often for small amounts and that it would not be rational for a consumer to pursue a very small claim, such as one for less than $200. Consumer advocates and other nonprofits commenters similarly agreed. However, other industry and research center commenters disagreed, asserting that consumer finance claims under laws that provide for statutory damages (sometimes as much as $1,000 or $1,500 per violation) or double or treble actual damages are not small. In one industry commenter's view, when consumers can receive statutory damages or double or treble damages, these damages create sufficient incentives for consumers to bring such claims. The commenter also suggested there may be some particular barrier to bringing small consumer finance claims in arbitration as compared to other types of small claims, because other types of small claims are more commonly filed in arbitration based on publicly available data. This commenter noted that claims under $1,000 amounted to approximately 2 percent of the consumer finance arbitrations in the Study, but that small claims generally amounted to 3.5 percent of all AAA consumer arbitrations (not limited to consumer finance) between 2009 and 2014. Another industry commenter asserted that consumers are particularly incentivized in California to pursue individual remedies because of the availability of rescission, restitution, injunctive relief, actual damages and attorney's fees under many California consumer protection statutes.

[472] For example, commenters cited enforcement activities by the Bureau and State attorneys general.

Numerous consumer advocate, individual consumer, consumer protection clinic law professors, academic, nonprofit, public-interest consumer lawyer, and consumer lawyer and law firm commenters agreed with the Bureau's preliminary finding that consumers do not pursue individual claims for many reasons, including their relative size and the difficulties inherent in bringing such claims on an individual basis. In support of the Bureau's findings in this regard, many consumer lawyers, individual consumers, and public-interest consumer lawyer commenters cited to specific examples from their own experiences with clients who were unable to pursue claims against providers of consumer financial products and services because of lack of time relative to the potential size of the claim. Similarly, a group of academic commenters concluded, based on their experience and expertise, that individual arbitrations are not and realistically never will be a sufficient substitute for consumer class actions because individual claims are worth small amounts of money and it is not worth consumers' time (or an attorney's time) to pursue them. In these commenters' view, even when consumers are motivated to do so it is hard to find legal representation, and individual consumers are often unaware of the claim in any event.

The same group of academic commenters further cited to a study looking at a broader array of consumer arbitration claims that found less than 4 percent of the claims were brought for $1,000 or less, which in their view confirms that consumers rarely bring small claims in arbitration.[473] A consumer lawyer noted that circumstances in consumers' lives can make bringing a claim difficult. This commenter explained that, in his view, consumers are busy working and providing for their families. Even assuming that arbitration is a streamlined process

[473] *See* David Horton & Andrea Cann Chandrasekher, "After the Revolution: An Empirical Study of Consumer Arbitration," 104 Geo. L. J. 57, at 117 (2015).

as compared to litigation in court, it can still involve time in drafting and filing a claim, researching and gathering documents, and other activities. In this commenter's opinion, lower-income people are less likely to make such an investment of time and resources.

An organization of public-interest lawyers also commented that in its experience, low-income consumers often have claims of no more than a few hundred dollars. While that money may be critical for low-income consumers, they are unable to invest the time and money necessary to pursue an uncertain recovery (*e.g.*, taking time off of work, finding child care, etc.). A public-interest consumer lawyer relatedly commented that arbitration rules (citing AAA's 44-page consumer rules document) are incomprehensible to the average consumer. Similarly, a nonprofit commenter representing servicemembers commented that servicemembers and their families might find it particularly difficult to pursue individual claims against providers due to deployment, frequent moves, and other logistical challenges.

One consumer advocate commenter noted that the threat of extensive litigation prior to receiving a hearing on the merits of a claim discourages legitimate claims. This same commenter also noted that filing fees could discourage some claims. Relatedly, a consumer law firm commenter stated that, in its view, most consumers find the prospect of litigating (in small claims court or arbitration) pro se against a well-represented corporate entity to be far too intimidating and risky to be considered a legitimate avenue.[474] This commenter cited the small number of claims documented by the Bureau in the Study as evidence of these dynamics. A law professor commenter stated that, in her opinion, consumers rarely use arbitration because of the

[474] An industry commenter made a similar point, but limited it to pro se representation in court. A consumer law firm commenter disagreed that court is harder for pro se litigants. It asserted that arbitration rules are complex for pro se litigants, that courts are more accustomed to working with those who proceed pro se and that more resources are available for these litigants in court.

minimal oversight of arbitration's fairness and lawfulness, the failure to require a comprehensive system of fee waivers, and the limited access accorded third parties.

One public-interest consumer law firm commenter explained that, in its experience, it is hard to bring claims of fraud, unfair, or deceptive practices in individual consumer financial services cases because the value of such claims is small. A consumer law firm commenter stated that, in its experience, individual actions are inefficient because damages can be low or hard to quantify and that these challenges impact consumers' and attorneys' risk-reward calculus. Another consumer lawyer commented that the laws underlying consumer finance are complicated and often impenetrable to laypersons. As an example, this commenter cited to complicated judicial interpretations of New York's usury law that are based on precedents over one hundred years old.[475] A consumer advocate commenter explained that, in its opinion, consumers will take lower settlements when they do not have an attorney or if they fear not getting a fair decision from an arbitrator due to the arbitrator's potential bias.

A nonprofit commenter provided the Bureau with data from its own survey of consumers that found that most consumers know it is not practical to take legal action when the harm against them is relatively small.[476] A different nonprofit commenter suggested that the reason the Bureau's Study showed that most individual claims that reach a judgment in arbitration were of relatively high value was that these were the only cases most consumers wanted to pursue. A consumer advocate commenter agreed that individuals are likely to pursue only relatively high-

[475] *See, e.g.*, *Ford Motor Credit Co. LLC* v. *Black*, 910 N.Y.S.2d 404 (N.Y. Civ. Ct. Apr. 14, 2010) (noting the long, complex history of New York's usury law). The commenter noted that the Third Circuit made a similar observation. *Homa* v. *American Express Co.*, 494 Fed Appx 191 (3d Cir. 2012) ("Furthermore, in view of the complexity of the issues pertaining to the merits of [the plaintiff's] claim, it would be very difficult for him to prosecute the case without the aid of an attorney whether in a judicial proceeding or in arbitration.").

[476] Pew Charitable Trusts, "Consumers Want the Right to Resolve Bank Disputes in Court: An Update to the Arbitration Findings in 2015 Checks and Balances," (Aug. 17, 2016), *available at* http://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2016/08/consumers-want-the-right-to-resolve-bank-disputes-in-court. An industry commenter noted that the Bureau should not conclude that this survey supports a finding that consumers prefer court to arbitration because survey participants were not asked about arbitration. This commenter also noted that only 23 percent of respondents would take legal action.

dollar claims. On the other hand, a comment letter from a group of academics noted that while consumers may be discouraged from pursuing claims on an individual basis, consumers are motivated to pursue actions that can protect other consumers from being similarly injured; put another way, they are emboldened to pursue actions that will force providers to change their conduct.

With respect to the Bureau's preliminary finding that it is difficult for consumers to find attorneys to file small claims, few commenters disagreed. However, an industry commenter and a research center commenter stated their belief that consumers should be able to find attorneys for small claims asserting violations of statutes that provide for recovery of attorney's fees. On the other hand, several industry, consumer advocate, public-interest consumer lawyer, and consumer lawyer and law firm commenters agreed with the Bureau's preliminary findings that it is difficult for consumers to find attorneys for small individual claims. One industry commenter cited a study that showed that attorneys are unlikely to accept contingency fee cases for claims below $60,000.[477] The consumer lawyer and law firm commenters stated that only in rare cases did they find it economically sensible to bring individual small dollar claims regardless of the availability of statutory attorney's fees or contingent recoveries. For example, several public-interest consumer lawyer commenters explained that they lacked resources to handle all of the small-dollar claims that are brought to them by consumers on an individual basis and that, as a result, these consumers frequently abandoned these claims because they could not find other legal help. These commenters also noted that a typical attorney's hourly rate – were a consumer to decide on a fee-based arrangement with an attorney – would quickly eclipse the value of any

[477] Elizabeth Hill, "Due Process at Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association," 18 Ohio St. J. on Disp. Resol. 777, at 783 (2003).

such claim. In addition, even when attorney's fees are available under a statute (*e.g.*, ECOA and TILA[478]), commenters asserted that the uncertainty behind any legal claim and the ability to actually recover fees made both consumers and attorneys unwilling, in most cases, to bear that risk. A consumer lawyer discussed a particular case that the court sent to arbitration on an individual basis after it had been originally filed as a class action. The lawyer explained that it quickly became apparent that the client would not recover a fraction of the amount necessary to cover the time the lawyer had invested in the case by proceeding individually in arbitration, and the case was thus abandoned. Another public-interest consumer lawyer commenter suggested that, based on its experience, there are not enough legal services programs or private attorneys to pursue individually the claims of all victims.

*Consumer attitudes regarding arbitration.* Industry, research center, and government commenters suggested alternative reasons for why the Bureau found relatively few individual arbitration claims. Instead of the Bureau's explanations, these commenters stated that consumers are either unaware of arbitration or do not understand it which discourages them from bringing individual claims, and that such factors could be mitigated either by the Bureau or by the market. For example, one industry commenter suggested that consumers would file more claims in arbitration if they were more educated about the benefits of arbitration or if arbitration agreements were required to include consumer-friendly provisions, such as no-cost filing or "bonuses" for consumers who win claims in certain circumstances.[479] Another industry commenter suggested that consumers might not use arbitration because it is relatively new to consumer finance and that consumers may not yet know about how it can help them achieve

[478] ECOA, 15 U.S.C. 1691e(d); TILA, 15 U.S.C. 1640(a)(3).
[479] An example "bonus" provision included in an arbitration agreement would require a company to pay a consumer double or triple the company's highest settlement offer if the consumer wins on his or her arbitration claim in an amount that exceeds that settlement offer.

relief for their claims. This commenter, who appeared to acknowledge that the number of consumers using arbitration is quite low, predicted that consumers would become more accustomed to using arbitration to resolve disputes given time. This same commenter suggested that the opponents of arbitration and the Bureau itself have helped create a negative public perception of arbitration that has discouraged consumers from pursuing it.

*Informal dispute resolution.* Many industry and research center commenters and a group of State attorneys general commenters suggested that there were relatively few individual claims because consumer harms were sufficiently remedied through informal dispute resolution. In so doing, these commenters disagreed with the Bureau's preliminary finding that informal dispute resolution is not sufficient to enforce the relevant laws, pointing to evidence in some court cases that large numbers of consumer complaints are resolved by informal dispute resolution. Some credit union commenters stated that there were particularly strong informal dispute resolution procedures in that market. One such commenter contended that the Study was flawed in failing to analyze informal resolution of disputes between companies and consumers. This commenter stated that the evidentiary record in *AT&T* v. *Concepcion* established that AT&T had awarded more than $1.3 billion to consumers in informal relief during a 12-month period. The same industry commenter noted that the Bureau's consumer complaint process facilitates informal resolution of consumer claims; the commenter emphasized in particular that over four years of the existence of the process, consumers had submitted more than 500,000 complaints and consumers had not disputed the company's response in more than two-thirds of the cases in which companies filed such a response.[480] One research center commenter asserted that in the

[480] Consumer Response Annual Report, *supra* note 464, at 46-47 (stating that 65 percent of consumers "did not dispute the response during the feedback period" and another 14 percent were pending review of the company response).

Overdraft MDL case at least $15 million was refunded to consumers through informal dispute resolution, supporting the claim that consumers received significant relief from that process.

This research center commenter also cited studies showing that companies do provide informal relief to some consumers who complain. For example, the commenter cited a 2014 survey of 983 credit card users, in which 86 percent of consumers who asked their credit card company to reverse a late fee were successful and further asserted that success is likely not correlated to socioeconomic status because unemployed customers had about the same rate of success as those who were employed.[481] That commenter cited another study – referenced by the Bureau in the proposal – showing that almost two-thirds of consumer complaints to a mid-sized regional bank in Texas were voluntarily resolved in favor of the customer in the form of a full refund.[482] The commenter stated that that study further showed that the number of consumers who received full refunds varied based on the city in which the consumer lived or the type of complaint the consumer raised, but ranged from 56 percent to 94 percent.[483] Other commenters asserted that consumers can close their accounts and move to new financial service providers if they do not like how their providers handle informal disputes. Relatedly, an industry commenter asserted that the Bureau had overlooked complaints that consumers file with State attorneys general or other State agencies.

In contrast, many commenters agreed with the Bureau's preliminary findings as to the role of informal dispute resolution. A consumer advocate and a public-interest consumer lawyer commenter both explained that low-income consumers are significantly less likely to raise

[481] Keri Anne Renzulli, "The Crazy Easy Trick to Getting a Credit Card Fee Waived or Your Rate Lowered," Money (Sept. 25, 2014), *available at* http://time.com/money/3425668/how-to-get-credit-card-fee-waived-rate-lowered/. The Study did not appear to examine whether the disputed fees were in fact improper.
[482] Jason S. Johnston & Todd Zywicki, "Arbitration Study: A Summary and Critique," at 31 (Mercatus Ctr. at Geo. Mason U., Working Paper, 2015).
[483] *Id.*

concerns directly with a company because they have limited time, resources, or confidence in their rights. Relatedly, a public-interest consumer lawyer commenter stated that it is much easier for low-income consumers to access justice through the courts than it is arbitration because arbitration lacks many of the procedural safeguards available in court. A different public-interest consumer lawyer commenter asserted that profitability models impact companies' treatment of consumers and thus low-income consumers who may be less profitable are less likely to be treated favorably.

Like the public-interest consumer lawyer commenter referred to above, a consumer law firm commenter agreed with the Bureau's preliminary finding that consumers may experience varied amounts of success through informal dispute resolution even when similarly situated. This commenter suggested that a particular consumer's sophistication, language skills, socioeconomic status, and tenacity all play important roles in determining whether the company will remedy the problem. Several commenters suggested that low-income consumers particularly benefit from class actions because these consumers are less likely than others to pursue relief individually. According to one consumer advocate, limited time, resources, or confidence may explain why low-income consumers are substantially less likely to advocate for their interests by complaining informally to a company or by pursuing formal relief. A public-interest consumer lawyer commenter suggested that low-income and vulnerable consumers may not realize that they have been the victim of unlawful predatory practices. Thus, the commenter asserted, class actions represent the only reasonable, private means for such consumers to obtain relief. Two commenters suggested that the specific characteristics of consumer financial services class action settlements make them favorably structured to provide consumers with meaningful relief. For example, one of these commenters noted that damages usually can be

calculated with precision (*e.g.*, if based on an improperly charged fee) and that classes are often readily ascertainable because providers typically have accurate records of their customers.[484]

With respect to the Bureau's preliminary finding that informal dispute resolution is not sufficient because a company can choose to respond (or not) to any consumer complaint, industry, research center, and a group of State attorneys general commenters asserted that companies with arbitration agreements have stronger incentives to provide relief to consumers who complain. For example, an industry and a research center commenter both asserted that companies have strong incentives to resolve complaints informally because companies' arbitration agreements typically require them to pay all of the filing fees for arbitration, which can be as high as $1,500, plus all expenses, and that this is a feature unique to arbitration. Therefore, these commenters contended that companies would rationally settle any claim raised by a consumer that was under $5,000, which the commenters asserted is the approximate cost to the company of any single arbitration. These commenters further noted that there is even greater incentive for companies to resolve claims informally when the arbitration agreements include "bonus provisions" requiring companies to pay consumers double or triple the company's highest settlement offer if the consumer wins on his or her arbitration claim in an amount that exceeds that settlement offer.

At least one research center commenter agreed with the Bureau's assertion that a consumer's profitability could factor into the provider's decision on how to resolve a dispute with that consumer, citing data that credit scores can influence whether providers decide to waive fees for particular consumers while also asserting that the Bureau cited faulty or

[484] To support these claims, this commenter cited a paper that says that in consumer financial services cases, most consumers were compensated. Brian T. Fitzpatrick & Robert C. Gilbert, "An Empirical Look at Compensation in Consumer Class Actions," 11 N.Y.U. J. of L. & Bus. 767, at 788 (2011).

incomplete data to support the theory that providers decide how to handle complaints based on consumer profitability.[485] This commenter contended, however, that profitability would be an appropriate standard for a provider to use in determining whether to resolve a dispute with a consumer because it is in the interest of consumers for the provider to keep only profitable customers. To the extent that providers retain unprofitable customers, the commenter asserted that fees become higher for all customers.

Other industry commenters and a research center commenter stated that there is sufficient incentive for providers to change general practices in response to informal complaints because it is time-consuming for providers to respond to complaints one by one, and thus they would prefer to change their practices wholesale with respect to all consumers for the sake of efficiency. For this reason, these commenters disagreed with the Bureau's assertion that companies are unlikely to globally change practices for all consumers when only a fraction of consumers complain. Offering a different opinion, a consumer law firm commenter stated that, in its experience, only hard-fought litigation can get a company to change its underlying practices; piecemeal, informal, individual complaints are too small and too easily ignored by most companies.

Additionally, several commenters, including industry, research center, and State attorneys general commenters, contended that consumers do not file formal individual claims because they prefer instead to move their business to other companies. The State attorneys general commenters and an industry commenter cited data from the Bureau's consumer survey that they contend shows a small number of consumers would pursue a legal remedy as opposed to a market-based one. Thus, to keep customers happy, companies maintain positive policies and

[485] The commenter further asserted that an article that the Bureau relied upon in its preliminary finding in this regard was an editorial. *See* 81 FR 32830, 32857 n.370 (May 24, 2016) (citation omitted).

comply with the law regardless of the availability of private enforcement. Similarly, a few industry commenters suggested that there was no need for consumers to file claims in arbitration or litigation or to pursue informal dispute resolution because consumers can use social media to address business practices that consumers believe to harm them. In one commenter's view, a consumer's social media complaint about their provider can quickly attract support from many other consumers and cause a company to change its practices.

*Response to Comments and Findings*

*Number of individual claims.* Comments that asserted that the Study methodology undercounted the number of individual claims filed in court or arbitration are addressed above in Part III.D. Beyond the debates about specific sources and counting methodologies, the Bureau emphasizes that it did not purport to provide a comprehensive report of the entire universe of individual consumer financial claims but instead offered data that is indicative of the larger market. Taken together, the total number of individual consumer financial claims identified in the Study was approximately 2,400 per year.[486] Even multiplying those 2,400 claims by 10 or 100 to account for the markets and jurisdictions the Study did not analyze would amount to less than 250,000 individual claims. The result would still be a low number of individual claims in relation to the hundreds of millions of individual consumer financial products and services. The Bureau believes this supports the finding that a small number of consumers seek individual redress either through arbitration or the courts.[487] Accordingly, the Bureau finds, in accordance

[486] 1,200 in Federal court, 800 in small claims court, and 400 in arbitration.

[487] 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 3, section 8 at 40.

with the preliminary findings, that the number of individual filings is low in comparison to the relative size of the market for consumer financial products and services.

*Explanations for number of individual claims.* Many industry commenters disagreed with the Bureau's preliminary findings as to why consumers do not file many individual claims. For example, one research center commenter stated that claims under certain of the consumer financial laws that provide for statutory damages or double or treble actual damages if the consumer prevails are necessarily large enough to incentivize consumers and attorneys to pursue the claims. The Bureau disagrees. First, as a matter of logic and as supported by examples provided by several public-interest consumer lawyer and consumer lawyer and law firm commenters, statutory damages cannot incentivize a consumer to bring a claim about which he or she is unaware. For example, consumers who do not receive the disclosures to which they are entitled may not know that something was missing. Consumers who are subject to discrimination may not know that others are being treated more favorably. Consumers who are charged a fee disallowed by State law or contract may not know that the fee was impermissible. In some cases, consumers may not even be aware that any action has been taken with respect to them. For example, the Bureau recently settled an enforcement action with a large bank related to its widespread practice of opening consumer accounts without their knowledge.[488] Because most of the victims of this conduct were unaware that the accounts were being opened, those customers could not have complained about those accounts to the bank through either formal or informal mechanisms.

[488] Press Release, Bureau of Consumer Fin. Prot., "Consumer Financial Protection Bureau Fines Wells Fargo $100 Million for Widespread Illegal Practice of Secretly Opening Unauthorized Accounts," (Sept. 8, 2016), *available at* http://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-fines-wells-fargo-100-million-widespread-illegal-practice-secretly-opening-unauthorized-accounts/.

Second, even if a consumer is aware that he or she was harmed, the availability of statutory damages and attorney's fees (or even particularized types of relief like restitution and rescission available under certain State's laws, as one commenter suggested) could only incentivize filing a claim over a small harm if the consumer were aware of those statutory provisions. While there may be some well-informed consumers who are aware and thus seek out an attorney to pursue such claims, the Bureau believes – based on its expertise and experience with consumer financial markets and as was noted by several commenters – that those consumers are likely in the minority. Indeed, the consumer survey conducted as part of the Study, as well as the nonprofit's survey noted above, is indicative of how unlikely consumers are to pursue claims even when they are confident they have been wronged and contradicts industry comments suggesting otherwise.[489]

Third, even if a consumer is both aware of a wrong and aware of the availability of statutory damages and attorney's fees, the statutory damages or attorney's fees may be insufficient motivation for the consumer or his or her attorney given the uncertainty of recovery and the potential size of such recovery relative to the time required to pursue the claim even if the potential value of that claim is larger than the consumer's actual damages.[490] Notably, most industry commenters did not disagree with the Bureau's preliminary finding that it is difficult for consumers to find attorneys for small claims; indeed, one industry commenter cited a study finding that attorneys will not take a claim valued at less than $60,000 – much higher than the $1,000 or $1,500 in statutory damages provided by many of the consumer financial statutes.

[489] *See* Pew study, *supra* note 476. As an industry commenter noted, 23 percent of wronged consumers in the nonprofit's survey would pursue a legal remedy.

[490] In other words, an attorney considering a TILA case that allows for recovery of attorney's fees must discount his or her fee by the likelihood that the consumer will not prevail or will accept a settlement that compensates that attorney for less than all of the attorney's incurred fees and costs in the case. It is this calculus that makes many such cases undesirable for plaintiff's attorneys.

Thus, even if, as one commenter suggests, most claims are above $1,000, they may still be too small to be worth the time for most consumers to find an attorney to pursue them. And as discussed further below, even if individual arbitration reduces the amount of time and need for attorney representation relative to individual litigation, the Bureau believes that the time required to pursue small claims is still sufficient to discourage many consumers from doing so. Moreover, there are many claims concerning consumer financial products or services for which statutory damages are not available, including common law tort and contract claims.

A research center commenter also suggested that small claims are more commonly filed in arbitration with respect to non-consumer financial products and services than for consumer finance claims, which the commenter believes may reflect something particular about consumer finance claims. While a small claims filing rate of 3.5 percent for all types of claims is higher than a small claims filing rate of 2 percent for consumer finance claims, both are low rates of filing. Indeed, even if the number of consumer finance arbitration cases involving small claims were to double, to 4 percent, that would mean only an additional 25 cases per year, still a very low figure.[491] With respect to commenters that suggested that consumers do not file individual claims because their disputes are adequately resolved through public enforcement, the Bureau will respond to that argument in depth below in Part VI.B.5.

*Consumer attitudes regarding arbitration*. With respect to the comments that suggested that consumers' current attitudes and awareness levels about arbitration tend to suppress the number of individual arbitrations but could be shifted over time, the Bureau views those suggestions as speculative and not persuasive. Arbitration agreements have existed in consumer

[491] Study, *supra* note 3, section 5 at 10 (finding 25 AAA disputes per year which involved consumer affirmative claims under $1,000 across six markets studied).

finance contracts since the early 1990s, meaning consumer have had more than 20 years to become aware of arbitration and yet the Study found that consumers file only a few hundred arbitrations a year. Thus, arbitration is hardly novel and the Bureau doubts that novelty is depressing consumer filings in arbitration. Indeed, the availability of individual litigation is not novel, yet consumers rarely bring individual cases in court either.

Even assuming for the sake of argument that the low use of arbitration were attributable to awareness levels, the Bureau is skeptical as to whether it is realistic to believe that all or most consumers could be educated about the terms of arbitration agreements to significantly improve consumer attitudes or awareness. Indeed, even if every consumer subject to an arbitration agreement received education about arbitration, understood the agreement's terms and had a positive attitude toward arbitration – and even if every arbitration agreement provided for company-paid filing fees and minimum award amounts – it still would be the case that use of the arbitration system would be limited by consumers' lack of awareness of potential legal violations, reluctance to pursue formal claims, and the low value of their claims relative to the time required to pursue their claims.

For all these reasons, the Bureau finds that there are structural and behavioral factors that prevent individual dispute resolution systems – including both arbitration and litigation – from providing an adequate or effective means of assuring that harms to consumers are redressed.

*Informal dispute resolution.* As for the industry commenters that disagreed with the Bureau's preliminary finding that informal dispute resolution cannot explain the low volume of individual cases observed, the Bureau is not persuaded. The Bureau acknowledges that informal dispute resolution provides at least some relief to some consumers who are harmed by and complain to their consumer financial service providers. The Bureau stated in the proposal that it

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. Indeed, the Bureau cited such evidence in the proposal arising out of the Overdraft MDL (approximately $15 million in informal relief had been provided by defendants in those cases), and commenters provided evidence of studies reflecting that companies sometimes provide informal relief to consumers.[492] The Bureau's consumer complaint function is specifically designed to facilitate informal dispute resolution and has been successful in doing so for many thousands of consumers. The Bureau's concern, however, is not with those complaints that are resolved, but with those situations in which consumers are unaware of harm in the first instance or are aware of harm but do not advocate for informal resolution as effectively as other complainants, as well as with those complaints that are resolved in ways that do not affect the financial institution's future behavior.

As noted in the proposal and discussed further above, for a variety of reasons, many consumers may not be aware of whether a company they deal with is complying with the law or not. Furthermore, consumers may not even think about a company's customer service function as a way of seeking redress for certain types of wrongs. For example, the Bureau believes, based on its experience and expertise, that consumers are unlikely to know when they have received inadequate disclosures and, even if they do, they are unlikely to call a customer service

[492] With respect to the commenter that cited $1.3 billion in consumer relief provided by AT&T as established by the record in the *Concepcion* litigation, the record in that case is not fully developed and does not provide enough detail for the Bureau to be able to establish that all of the $1.3 billion in manual credits reflects relief provided to customers who complained to AT&T. *See* Berinhout Declaration at ¶ 17, Trujillo v. Apple Computer, Inc., No. 07-4946 (N.D. Ill. Oct. 16, 2007), ECF No. 40. The record does not explain, for example, how the $1.3 billion was calculated, how the $1.3 billion compares to the amount actually requested by consumers, nor how much of the consumer relief was necessarily the result of a consumer complaint or the resolution of such complaint. *Laster* v. *T-Mobile USA, Inc.*, 2008 WL 5216255, *15 (S.D. Cal. Aug. 11, 2008). Furthermore, assuming this figure is accurate, the Bureau cannot evaluate the revenue generated by AT&T from other consumers who did not complain or whose complaints were rejected by AT&T and received no part of the amount that AT&T refunded.

department over such an issue. Similarly, the Bureau is not aware of informal dispute resolution successfully resolving complaints of discrimination, systematic miscalculations of interest rates, certain types of deceptive advertising,[493] improper furnishing of credit information about which the consumer was unaware, and other common harms that are largely imperceptible to the average consumer. Consumers are more likely to use a customer service function, for example, to question charges that appear on their bill, including fees assessed by the financial institution. Even in those cases, the consumer first must notice the charge and, in some instances, further recognize that there is some basis to challenge or question the charge if the initial request is rebuffed. Based on its experience, the Bureau does not believe that even a majority of consumers have such an awareness. Thus, an informal dispute resolution system is unlikely to be used by most or all consumers who are adversely affected by a particular illegal practice. For example, one survey cited by a commenter showed that only 28 percent of consumers surveyed had ever asked to have such fees waived and not all of these were successful.[494] In other words, most consumers simply do not seek informal resolution of wrongful actions. Moreover, commenters noted and studies have found that poorer and less educated consumers are less likely to seek resolution of disputes through informal means because they lack sufficient information to pursue claims informally, are unfamiliar with the process, or do not have the time to pursue it.[495] As to commenters who suggested that the Bureau overlooked that consumers can pursue claims informally by contacting their State attorneys general or other regulators, the Bureau does not

[493] For example, the Bureau entered into a settlement in 2014 with a mortgage company for deceptive advertising about which most individual consumers likely were not aware. Press Release, Bureau of Consumer Fin. Prot., "CFPB Orders Amerisave to Pay $19.3 Million for Bait-And-Switch Mortgage Scheme," (Aug. 12, 2014), *available at* https://www.consumerfinance.gov/about-us/newsroom/cfpb-orders-amerisave-to-pay-19-3-million-for-bait-and-switch-mortgage-scheme/.

[494] Martin Merzer, "Poll: Asking for Better Credit Card Terms Pays Off," CreditCards.com (Sept. 24, 2014), *available at* http://www.creditcards.com/credit-card-news/poll-ask-better-terms.php.

[495] Rory Van Loo, "The Corporation as Courthouse," 33 Yale J. Reg. 547, at 579 (2016) ("Studies have shown for decades that wealthy and better educated consumers are more likely to complain to corporations and more successful than are low-income consumers."); Amy J. Schmitz, "Remedy Realities in Business-To-Consumer Contracting," 58 Ariz. L. Rev. 213, at 231 (2016) ("the proactive consumers who obtain remedies tend to be of higher income and education").

believe that it overlooked a substantial number of complaints that consumers file with State attorneys general or other State regulators. To the extent that they do, the Bureau addresses the ability of State enforcement agencies to remedy harms in section VI.B.5 below

Further, none of the evidence cited by commenters refuted the Bureau's preliminary finding that companies can and do choose – for any reason – *not* to resolve complaints informally, and that the outcome of these disputes may be unrelated to the underlying merits of the complaint.[496] As noted in the proposal, 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 had not raised their dispute to a company. Regardless of the merits or similarities between the complaints, the company retains discretion to decide how to resolve them. This is true even with respect to providers that are member-owned, like credit unions. 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.[497] Indeed, as the Bureau stated in the proposal, 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

[496] Some 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 Mktg. Res. 337, at 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 et al., "Complaint Handling: Principles and Best Practice," at 6 (Univ. of Leicester, Centre for Util. Consumer L. April 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/Complainthandling-PrinciplesandBestPractice-April2007_000.pdf.

[497] 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, "Arbitration Study: A Summary and Critique," at 31 (Mercatus Ctr. at Geo. Mason U., Working Paper, 2015) (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 did 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.

discretion of customer service representatives to make adjustments for complaining consumers based on such scores.[498] For example, in the study of a midsize bank in Texas cited by some commenters, 44 percent of consumers who complained about one type of fee were not offered a refund in one city in which the bank operated.[499] While there is no way to know whether the complaints that consumers made in that study reflect violations of the law, it shows the differential treatment that can occur. Furthermore, in some markets, consumers have no choice as to their provider, and thus companies need not worry about losing the consumer's business if complaints are left unresolved. This is most obviously true with respect to servicing markets, such as student loan servicing and debt collection.

One research center commenter agreed with the Bureau's preliminary findings in this regard and stated its belief that a company should deny informal relief to less profitable consumers in order to maintain reasonable fees for other more profitable consumers. The Bureau agrees that in the context of informal complaint handling systems – which do not adjudicate the merits of claims but rather exist to enhance a company's business interests – it is rational for a company to forgive a fee charged to a profitable consumer and not to do so for an unprofitable consumer. But that is precisely the point: in the eyes of the law, wrongful fees should be reimbursed without regard to the profitability of the customer incurring the fee. This commenter's argument thus illustrated one of the limitations of informal dispute resolution as a

[498] *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). The Bureau notes that this article is not an editorial as suggested by one industry commenter. *See also* Amy J. Schmitz, "Remedy Realities in Business-To-Consumer Contracting," 58 Ariz. L. Rev. 213, at 230 (2016) (explaining why various groups, such as minorities, women and low-income consumers are less likely to complain and to achieve a positive resolution).

[499] In a preliminary draft of his research paper, one commenter addressed this issue and suggested that banks look at whether the investment in resolving a consumer's concern is worth it when compared to the likelihood that the bank will make a profit off of that customer in the future. *See* Jason Scott Johnston, "Preliminary Report: Class Actions and the Economics of Internal Dispute Resolution and Financial Fee Forgiveness," (Manhattan Inst. Rept. 2016), *available at* https://www.manhattan-institute.org/html/class-actions-and-economics-internal-dispute-resolution-and-financial-fee.

method of enforcing the consumer protection laws. In this realm, a company can choose which complaints it wishes to resolve for which consumers, and that choice is likely to be very different than the decision made by a neutral judge after a consumer has filed a claim alleging violations of the law.

As noted in the proposal, the Study's discussion of the Overdraft MDL provided an example of the limitations of informal dispute resolution and the important role of class litigation in more effectively resolving consumers' disputes.[500] In the cases included in the Overdraft MDL, certain customers lodged informal complaints with banks about the overdraft fees. The subsequent litigation revealed that banks had been ordering transactions based on the size of the transaction from highest to lowest amount to maximize the number 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, nearly 29 million bank customers received cash relief in court settlements over and above relief through informal dispute resolution processes.[501] Furthermore, the litigation resulted in fundamental changes in the banks' transaction ordering processes that had not previously occurred as a result of the informal complaints and informal relief. While industry commenters cited this example as an instance where informal dispute resolution provided significant relief, it also supports the Bureau's conclusion that informal dispute resolution does not provide systemic relief of consumer harms.

[500] Study, *supra* note 3, section 8 at 39-46.

[501] In total, 18 banks paid $1 billion in settlement relief to nearly 29 million consumers. *Id.* (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 n.61 and 46 n.63.

As to commenters' arguments that companies with arbitration agreements have strong incentives to resolve complaints in consumers' favor in order to avoid the cost of arbitral fees and the risk of paying a "bonus" award, the Bureau acknowledges that companies with arbitration agreements have at least some incentive to resolve informal disputes with consumers especially when the company suspects that the consumer, if unsatisfied, will file an arbitration case and cause the company to incur filing fees. It is also true that companies without arbitration agreements have an incentive to resolve informal disputes with consumers when they suspect that litigation will otherwise result, since litigation can result in defense costs which exceed the costs of arbitral fees or of arbitral defense. It is unclear, at best, whether arbitration agreements create greater incentives to resolve a complaint informally than the risk of litigation and commenters did not provide data or evidence to show otherwise.[502] Indeed, one recent news article about AT&T – a company that includes a "bonus" provision in its arbitration agreements – reports that only 18 of its approximately 150 million customers filed claims in arbitration against the company over a two-year period.[503] In any event, whatever the source of the incentives that might encourage a company to settle a consumer dispute informally, these incentives only go so far, particularly when the company knows that the vast majority of consumers who complain will not formally pursue the matter and that individual complaints can be resolved informally without systemic change. For example, as discussed above in this Part VI.B.2 with respect to the explanation for the low number of individual claims consumers file, the Bureau recently settled an enforcement action with a large bank concerning its employees'

[502] One commenter, a research center, suggested that the Bureau should have analyzed the historical evolution of such bonus provisions. The Preliminary Results did analyze their prevalence and found them to be rarely used. *See* Preliminary Results, *supra* note 150, at 51.
[503] Anna Werner and Megan Towey, "AT&T and DirecTV Face Thousands of Complaints Linked to Overcharging, Promotions," CBS Evening News (May 16, 2017), *available at* http://www.cbsnews.com/news/complaints-att-directv-bundled-services-directv-customers-promotions-overcharging/. *See also Concepcion*, 563 U.S. at 337 (describing AT&T's "bonus" provision which, in the event that a customer receives an arbitration award greater than the company's last written settlement offer, requires it to pay a $7,500 minimum recovery and twice the amount of the claimant's attorney's fees.).

practices of opening unauthorized accounts on behalf of customers that had pre-existing accounts with the bank.[504] During the Bureau's investigation of that bank, it uncovered that some individual consumers had discovered the unauthorized accounts and complained about them; but the bank's employees nevertheless continued the widespread practice with respect to many other customers. Similarly, the Bureau settled another enforcement case with a buy-here, pay-here automobile dealer concerning violations of the FDCPA and the FCRA in which the Bureau discovered that several customers had disputed the improper credit reporting information with the dealer without the dealer taking any corrective action.[505] In some instances, the dealer informed the customers in writing that the account information had been corrected when it had not been.[506]

With respect to the comments that suggested that there were few individual claims because companies will change practices that harm consumers when consumers complain on social media, the Bureau believes that social media are insufficient to force companies to change company practices and, by extension, to enforce the consumer protection laws for the same primary reason that informal dispute resolution is insufficient – because many consumers do not know that they have valid complaints or how to raise their claims through social media. Further, companies can choose either to ignore or resolve such complaints at their own option especially in markets where consumers cannot take their business elsewhere; and companies can resolve complaints on a one-off basis with the individual complainant. Indeed, as discussed above in

[504] *See* Press Release, Bureau of Consumer Fin. Prot., "Consumer Financial Protection Bureau Fines Wells Fargo $100 Million for Widespread Illegal Practice of Secretly Opening Unauthorized Accounts," (Sept. 8, 2016), *available at* http://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-fines-wells-fargo-100-million-widespread-illegal-practice-secretly-opening-unauthorized-accounts/.
[505] Press Release, Bureau of Consumer Fin. Prot., "CFPB Takes First Action Against 'Buy-Here, Pay-Here' Auto Dealer," (Nov. 9, 2014), *available at* https://www.consumerfinance.gov/about-us/newsroom/cfpb-takes-first-action-against-buy-here-pay-here-auto-dealer/.
[506] DriveTime Automotive Group, Inc., CFPB No. 2014-CFPB-0017, Consent Order at ¶¶ 42, 43 (Nov. 19, 2014), *available at* http://files.consumerfinance.gov/f/201411_cfpb_consent-order_drivetime.pdf.

Part II.E, at least one study of social media complaints found that companies ignored nearly half of the complaints consumers submitted and that when companies did respond, consumers were dissatisfied in roughly 60 percent of the cases.[507]

Thus, while informal dispute resolution systems may provide some relief to some consumers, the Bureau finds that these systems alone are inadequate mechanisms to resolve potential violations of the law that broadly apply to many customers of a particular company for a given product or service. The Bureau further finds that the prevalence of these systems cannot and does not explain the low volume of individual cases pursued through arbitration, small claims courts, and in Federal court.

*3. Class Actions Provide a More Effective Means of Securing Significant Consumer Relief for Large Numbers of Consumers and Changing Companies' Illegal and Potentially Illegal Behavior*

The Bureau preliminarily found, based on the results of the Study and its further analysis, that the class action procedure provides an important mechanism to remedy consumer harm. More specifically, the Bureau preliminarily found, consistent with the Study, that class action settlements are a more effective means than individual arbitration (or litigation) for assuring that large numbers of consumers are able to obtain monetary and injunctive relief for wrongful conduct, especially for claims over small amounts.

As noted in the preliminary findings, in the five-year period studied, the Bureau was able to analyze the results of 419 Federal consumer finance class actions that reached final class settlements. These settlements involved, conservatively, about 160 million consumers and about

[507] Sabine A. Einwiller & Sarah Steilen, "Handling Complaints on Social Network Sites – An Analysis of Complaints and Complaint Responses on Facebook and Twitter Pages of Large US Companies," 41 Pub. Rel. Rev. 195, at 197-200 (2015).

$2.7 billion in gross relief of which, after subtracting fees and costs, made $2.2 billion available to be paid to consumers in cash relief or in-kind relief.[508] Further, as set out in the Study, nearly 24 million class members in 137 settlements received automatic distributions, meaning they received payments without having to file claims.[509] In the five years of class settlements studied, at least 34 million consumers received $1.1 billion in payments.[510] 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 beyond simply to comply with the law. The Bureau further preliminarily found that 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, both because putative class members may still be able to obtain relief on a classwide basis after those individual outcomes and because the cost of defending a putative class case that ends in this manner is relatively low in comparison to the cases that provide class relief.

Based on its experience and expertise – including its review and monitoring of these settlements and its enforcement of Federal consumer financial law through both enforcement and supervisory actions – the Bureau also preliminarily found that behavioral relief could be, when

[508] These figures exclude *cy pres* relief that is distributed to a third party (often a charity) on behalf of consumers, instead of to consumers directly, in cases where making payments to consumers directly is difficult or impossible. 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 3, 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 automobile 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.

[509] *Id.* section 8 at 27.

[510] As noted above, *see* Johnston & Zywicki, *supra* note 335 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 3, 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.

provided, at least as important for consumers as monetary relief. Indeed, prospective relief can provide more relief to more affected consumers, and for a longer period, than retrospective relief because a settlement period is limited (and provides a fixed amount of cash relief to a fixed number of consumers), whereas injunctive relief lasts for years or may be permanent and may apply to more than just the defined class.

In the discussion that follows, the Bureau reviews comments on these two preliminary findings, addresses concerns raised in those comments, and makes its final findings on these issues. At the outset, the Bureau notes that the bulk of the critical comments it received on these preliminary findings concern the actual cash compensation to consumers in class action settlements and other related concerns commenters have about class actions, with far fewer commenters addressing behavioral relief despite its relative importance to the Bureau's preliminary findings. Thus, while the bulk of the discussion focuses on the former preliminary finding, the Bureau emphasizes below the non-monetary benefits of class actions.[511]

*Comments Received*

*Monetary Relief Provided by Class Actions.* Many industry and research center commenters disagreed with the Bureau's preliminary finding that class actions provide significant monetary relief to consumers who have been harmed; instead, these commenters highlighted the fact that the Study showed that individuals received, on average, only $32 per person from the class action settlements studied.[512] Some of these industry and research center commenters further pointed out that the average recovery of $32 is particularly low if compared

[511] An additional important benefit of the rule is the general deterrent effect of class actions. That is addressed below in Part VI.C.1, insofar as this part focuses on the benefits of class actions as documented in the Study and Part VI.C.1 focuses on the benefits the Bureau expects consumers to derive from the rule.

[512] The Bureau notes that $32 is an approximation derived from data in the Study, *supra* note 3, section 8. The Bureau believes that this $32-per-class-member recovery figure is a reasonable estimate.

to the Study's finding that consumers who win claims in arbitration recover an average of nearly $5,000 per claim. One commenter provided examples of specific cases involving low payouts. A group of automobile dealers and a law firm representing automobile dealers in California similarly commented that in the class actions studied concerning automobile loans, the average relief provided was $337 per consumer, less than a typical consumer's monthly car payment. In this commenter's view, that average recovery is very low in light of the value of the claims asserted in a typical case concerning automobile loans. Relatedly, the same group of automobile dealers and another group of trade associations representing automobile dealers criticized class action settlements as unnecessary for cases in which consumers have claims worth higher dollar amounts, such as, in the commenter's view, claims concerning automobile purchase loans. These commenters asserted that individual consumers have sufficient incentive to bring individual claims concerning these products, which the commenter asserted were typically for $1,000 or more (though it cited no data in support of this figure).[513]

Numerous consumer advocates, academics, consumer law firms and research center commenters agreed with the Bureau's preliminary finding that class actions provide substantial monetary relief to consumers. Many of these commenters highlighted the sums reported by the Bureau in the Study – that at least 160 million class members were eligible for relief via class action settlements over the five-year period studied; that those settlements totaled $2.7 billion in cash, in-kind relief, and attorney's fees and expenses; and that consumers actually received at least $1.1 billion in those cases. The commenters stated that, in their view, these are substantial sums and that if many providers had not used pre-dispute arbitration agreements, these sums

[513] Another automobile dealer commenter pointed out that arbitration agreements between automobile dealers and consumers are different than arbitration agreements concerning other products or services because the automobile dealers provide their arbitration agreements as a separate document, rather than as part of the purchase contract.

would have been substantially higher. The academic commenters, citing the Study, concluded that class actions are a powerful tool that can help consumers vindicate their rights under Federal and State law. They cited both funds returned to consumer and the deterrent effect of class actions.

Numerous consumer advocates, public-interest consumer lawyer, and consumer lawyers and law firms provided specific examples from their own experiences where class actions caused defendants to stop harmful practices and consumers received substantial monetary amounts as a result of class action settlements. One of the consumer law firms reported that it had obtained millions in relief for consumers via class actions. Another consumer law firm commenter noted that, in its experience, these cases frequently involved automatic payouts to class members, who did not need to submit a form or other documentation to receive the benefit of the settlement. Another commenter noted that class actions provide a practical and efficient way to allow consumers to recover for relatively low-value abuses. Similarly, several commenters suggested that by allowing class actions, the Bureau would make it possible for consumers to achieve relief when they largely would be unable to do so if arbitration agreements continue to be used as they are now. A public-interest consumer lawyer and a consumer advocate commenter each stated that the very nature of class action claims – that they are often low value – emphasizes their overall importance because consumers will not otherwise receive relief for those claims. The commenter further asserted that, when multiplied out, the practices at issue in those cases often generate substantial profits to providers. A consumer law firm commenter noted that class actions require the settling company to repay all consumers who are members of the affected class, not just those individuals who take the time to assert a claim.

Other industry and research center commenters suggested that consumers do not obtain significant relief from class actions because settlements often require consumers to file claims to

obtain relief, which most consumers do not do. For example, many industry commenters noted that in settlements requiring consumers to file a claim to obtain relief, the Study showed that only 4 percent of consumers filed a claim.[514] Thus, these commenters contended that class action settlements do not serve their compensatory purpose. Further, a few industry commenters contended that taking into account both the 4 percent claims rate in class settlements where consumers were required to submit a claim and the fact that the Study found that only 12 percent of putative class cases in the six selected markets resulted in a classwide settlement as of the Study cutoff date, there is a very low likelihood that a consumer in a putative class case actually receives any compensation from any case filed as a class action. One industry commenter cited a study of class action settlements concerning claims under certain consumer protection statutes that estimated that only 9 percent of the total monetary award in those cases actually went to the plaintiffs as further support for its positions that class actions do not provide significant relief to consumers.[515] Expressing a related concern, an industry commenter stated that it did not find data in the Study of how consumers fared in class action settlements. This commenter stated that the 4 percent claims rate indicated that awards were so small as to not be worth the effort required to make a claim. The commenter asserted that the Study did not contain enough detail on the nature of the settlements or explain how the Bureau was able to conclude that class actions were preferable to arbitration (where 32 consumers recovered over $5,000). A research center commenter further stated its belief that low-income consumers are less likely to file claims and thus such settlements function as a regressive tax on low-income consumers in favor of plaintiff's attorneys. Relatedly, an industry commenter asserted that the Bureau overstates the

[514] Study, *supra* note 3, section 8 at 30.
[515] Joanna Shepherd, "An Empirical Survey of No-Inquiry Class Actions," at 2 (Emory U. Sch. of L., Res. Paper No. 16-402, 2016) (these "no injury" class actions were not limited to cases concerning consumer financial products, as discussed in more detail below in this Part VI.B.3 where the Bureau responds to these comments).

benefit provided by most class actions – gross relief in almost half of the settlements was $100,000 or less and the gross relief in 79 percent was $1 million or less.

Several industry and research center commenters further criticized the Bureau's reliance on the Study to support its findings that class actions provide significant relief to consumers on the basis that certain cases should have been excluded from the analysis. For example, one research center commenter asserted that a large settlement involving a credit reporting agency should have been excluded as distorting the overall effect because it provided $575 million of "in-kind" relief rather than actual cash relief. A number of others commented that the Study's findings on the overall amount of relief provided in class actions was not representative of consumer finance class actions generally because the Overdraft MDL class-action settlements included in the Study were atypically large and unlikely to recur. A research center commenter also noted that if those large settlements were excluded from the Study's data, the average payment to an individual consumer from a class action settlement analyzed in the Study would be $14, a significant reduction from the $32 per consumer average payment for the Study as a whole.[516] In these commenters' view, the overdraft settlements distorted the Study to make it seem that consumers get much more relief than class actions typically provide. Further, one industry commenter asserted that the overdraft settlements may not have been as large had the overdraft activity occurred later because the practices could have been the subject of a Bureau enforcement action. That same industry commenter suggested that the Bureau failed to assess the extent to which consumers' overdraft complaints were resolved through informal channels before the class actions commenced. The commenter also suggested that the conduct at issue was not actually illegal.

[516] Study, *supra* note 3, section 8 at 18 tbl. 3.

One research center commenter contended that the value of the overdraft settlements should be discounted because the settlements do not make customers of those providers better off, overall. This commenter hypothesized that most of the overdraft fee refunds went to low-income consumers and that the defendant banks likely perceived those customers as less profitable following the settlements (since they could no longer assess as many overdraft fees). The commenter posited that, in the event such customers become unprofitable, the settling banks will screen those low-income customers from their customer base in the future, resulting in higher fees for the customers who remain. This commenter stated that after the Overdraft MDL settlements, minimum balance requirements to avoid checking account fees have generally increased and asserted that this may be linked to class action liability, though that link has not been empirically established.

*Behavioral and In-Kind Relief in Class Actions*. Several industry and research center commenters disagreed with the Bureau's preliminary findings that class settlements benefit non-class members because they cause companies to change their harmful practices with respect to all consumers, asserting that companies agreed to behavioral relief in only 13 percent of the class action settlements analyzed. Many industry and research center commenters further stated their belief that class actions do not provide significant relief to consumers because of the prevalence of non-cash and coupon relief in lieu of providing cash directly to consumers in class action settlements.[517] For example, one industry commenter noted that the Study found relief other than direct cash payments, including coupon settlements, are provided nearly 10 times as often (for 316 million consumers) as cash relief (for 34 million consumers). The same commenter

[517] A coupon settlement is one in which a company provides class members with a "coupon" or other discount of the purchase of a future product or service.

criticized class actions settlements generally but cited only to examples that did not involve consumer finance that provided consumers with "worthless" coupons for future service from the defendant company, rather than with cash.

In contrast, many consumer advocate, consumer law firm and nonprofit commenters agreed with the Bureau's assertion that companies often change their behavior in ways that benefit consumers as the result of class action settlements. One such commenter emphasized the fact that many class action settlements include injunctive relief, such as requiring companies to stop harmful practices that led to the class action, to agree to outside monitoring to ensure that further misconduct does not occur, or to provide increased training or other safeguards to improve future compliance with the law. As an example, one nonprofit commenter cited a class action settlement involving two money transmission companies that agreed to not only compensate consumers but also to halt their use of unfavorable exchange rates, provide better disclosures, and develop a community fund. As another example, a consumer law firm commenter explained how a class action was able to provide complete relief to all affected consumers. This relief included not only cash compensation for their injuries but also injunctive relief that was able to resolve the problem permanently and for all affected in a way that an individual action would not have been able to do. Other commenters provided similar examples.

*Proportion of Cases Filed as Class Actions That Ultimately Provide Classwide Relief.* Many industry and research center commenters criticized the Bureau's preliminary finding that class actions provide significant relief to consumers based on a contention that the majority of cases filed as class actions do not, in fact, result in class settlement. The commenters asserted that such cases do not provide any relief to consumers other than the named plaintiff when the case settles on an individual basis, while imposing significant costs on providers. As noted

above, numerous such commenters noted that only 12 percent of the putative class action filings analyzed in the Bureau's Study resulted in a class action settlement as of the Study cutoff date, while the remainder of the cases filed as class actions resulted in no classwide relief at all.[518] These commenters pointed out that just over 60 percent of the cases filed as putative class actions resulted in either an individual settlement between the defendant(s) and the named plaintiff or a voluntary withdrawal of the case by the named plaintiff (which could also signal that the parties reached an individual settlement). Some commenters further contended that when putative class cases end in a settlement or potential settlement with only the named plaintiff, that outcome may indicate that the case lacked merit.

One industry commenter cited further studies indicating that only a fraction of cases filed as class actions ultimately result in classwide relief to consumers.[519] One such study found that around one-third of the putative class cases resulted in classwide settlement, while another found that 20 percent to 40 percent resulted in such relief.[520] A credit union commenter provided an example of a putative class action case in which the credit union was a defendant; a settlement was reached with the named plaintiff on an individual basis for a few thousand dollars, but the case cost the credit union tens of thousands in defense costs. The credit union commenter asserted that the plaintiff's attorney in that case privately admitted in oral conversation that the claims filed were meritless; the commenter did not explain why it chose to settle a case it knew to be meritless.

[518] Study, *supra* note 3, section 6 at 37.
[519] Mayer Brown LLP, "Do Class Actions Benefit Class Members? An Empirical Analysis of Class Actions," (Dec. 11, 2013), *available at* www.instituteforlegalreform.com/uploads/sites/1/Class_Action_Study.pdf.
[520] *Id.*; Jason S. Johnston, "High Cost, Little Compensation, No Harm to Deter: New Evidence on Class Actions Under Federal Consumer Protection Statutes," (U. Va. Sch. of L., Res. Paper Series 2016-12, 2016).

Some industry commenters challenged the Bureau's preliminary finding that non-class settlements in putative class action cases do not undermine the benefits of those cases that do result in classwide settlements. For example, one commenter disagreed with the Bureau's finding that putative class members could pursue subsequent claims after a case was settled on a non-class basis because the putative class members would not be bound by the non-class settlement. In this commenter's view, there is no evidence that such follow-on claims are actually brought and, in any event, the commenter asserted that such claims would likely lack merit and thus that it would be difficult for putative class members to find attorneys to assert them on a class basis.

*Merits of Claims Resolved by Class Action Settlements.* Many industry commenters disagreed that class actions benefit consumers because they contended the Bureau erroneously assumed that a class action settlement necessarily redresses a violation of the law. For example, some industry commenters contended that companies agree to class action settlements when they have not violated the law or where the claims asserted are frivolous to avoid the significant expense of litigating and to avoid the risk of a much higher payout if the case were to survive certain stages of court review. In cases like these, the commenters contended that the settlement represents a failure of the litigation system because the company felt forced to settle claims that lacked merit, rather than a benefit to consumers or a redress of harm. One industry commenter supported this point by citing court decisions recognizing the pressure on companies to settle in class action cases. Some Tribal commenters stated their view that Tribal treasuries are at risk from the prospect of frivolous class action settlements which contradicts longstanding Federal

law that provides that protecting the Tribal treasury against legal liability is essential to the protection of Tribal sovereignty.[521]

Another industry commenter contended that the Study's data that dispositive motions were granted before class settlement in 10 percent of the class actions studied is not relevant to whether the allegations in those cases were meritorious because defendants may choose to settle a case even after winning a dispositive motion to avoid the costs of litigation and appeal. The commenter stated that the low frequency of classwide judgments for consumers and plaintiffs who prevailed on dispositive motions suggests that the underlying claims in putative class cases lack merit or are frivolous. Some industry commenters expressed their view that class action litigation is inferior to other forms of dispute resolution, such as arbitration, because class action cases do not reach decisions "on the merits" given that class actions almost never go to trial, although they did not explain why the lack of a decision at trial necessarily makes class action litigation inferior. A few industry commenters pointed out that none of the cases identified in the Bureau's analysis of settlements went to trial and therefore that the class members in those putative class action cases never got a "day in court."

A State attorney general commenter noted that, in his State, class action plaintiffs seeking to pursue a claim of consumer fraud were required to get approval from his office that the putative claim was not frivolous before it could be filed in court.[522] His office has concluded that not a single one of these complaints was frivolous as alleged. This commenter made a similar point regarding a provision in CAFA that permits State attorneys general to review

[521] *E.g.*, *Allen* v. *Gold Country Casino*, 464 F.3d 1044, 1047 (9th Cir. 2006).
[522] *See* Iowa Code ch. 714H.

settlements.[523] This review (done by a team of State attorneys general) has seldom found a settlement that was abusive or unfair.

*Other Concerns Regarding Class Actions.* A few industry commenters noted that class actions proceed slowly and asserted that the value of the relief that they do provide is diminished by the length of time it takes to receive that relief. One industry commenter further noted that class actions proceed much more slowly than individual arbitration and asserted thus that individual arbitration is therefore a superior forum than class litigation.

Several industry commenters noted that the Study found that consumers filed more individual arbitrations per year (411) than they did Federal class actions (187) and asserted that the Bureau should not have counted putative class members in those class actions as supporting its finding that class actions benefited more consumers than individual arbitration or litigation.

*Response to Comments and Bureau Findings*

*Monetary Relief Provided by Class Actions*. Many industry commenters disagreed with the Bureau's preliminary findings that class actions provide significant monetary relief to consumers because they concluded that class action settlements provide, on average, small amounts of relief per consumer (what many commenters calculated as $32 per consumer as shown by the Study) and that, as a result, they provide no meaningful benefit to consumers. For several reasons, the Bureau does not agree that the fact that class actions sometimes provide a small amount of relief per consumer compels a finding that they do not provide significant relief to consumers in the aggregate or detracts from the Bureau's preliminary finding that class actions provide a more effective mechanism of securing relief than individual litigation or arbitration. The Bureau was not surprised to find average individualized monetary recoveries in class actions

[523] *See* 28 U.S.C. 1715(a).

in such amounts, given that the class action procedure is designed to aggregate claims for small damages precisely because rational consumers do not spend the time or the money to litigate them on their own.

First, in assessing the relevance of the small size of the average relief obtained, it is important to compare that to the alternative in which these consumers obtain no relief at all – because, as discussed above in Part VI.B.2, virtually none of them will pursue their individual claims. The Bureau finds that relief of $32 (or even $14, as some commenters suggest is a more accurate figure reflecting their attempts to exclude the overdraft settlements from the Bureau's data) is a better result for harmed consumers than no relief at all. As noted above, there were only about 25 disputes a year involving affirmative claims in arbitration by consumers for $1,000 or less.[524] Second, companies are less likely to harm consumers when they face the threat of class action liability (this "deterrent effect" is discussed in more detail below at Part VI.C.1). While a single harm may be small, that amount of that harm (and the value of claims concerning that harm) multiplied by thousands or millions of consumers is substantial.[525] Yet the single harm remains much less than the amounts for which consumers will choose to challenge or the amounts attorneys typically will take individual cases on contingency; as cited by industry commenters and discussed above, studies have shown that attorneys generally will not accept individual claims worth less than $60,000 on contingency.[526]

Further, the Bureau agrees with some consumer advocate commenters that stated that consumers who are unaware that they have been harmed nonetheless can benefit from a class

[524] Study, *supra* note 3, section 5 at 10. Similarly, few consumers filed claims in small claims court.
[525] This finding is no less true in cases concerning automobile loans for which the average relief is $337 – that amount is likely still too small of an amount for a rational consumer to invest the time and expenses necessary to file an individual claim. In the automobile loan class action settlements analyzed in the Study, consumers received over $202 million in cash relief. *Id.* section 8 at 25 tbl 8.
[526] Hill, *supra* note 477, at 783. Indeed, no commenter suggested that attorneys would bring most of these smaller dollar value claims on an individual basis. Nor would it make economic sense for a consumer to pay a typical attorney's hourly rate to bring a small dollar claim.

action. For these reasons, the Bureau finds that consumers who fall victim to legally risky practices are better protected by receiving relatively small amounts from a class action settlement than being relegated to a system in which their only alternative is to pursue relief individually which, in practice, will result in most of them receiving nothing. This is especially true given that class members invest little (and in many cases none) of their own time or money to receive relief in a class action. The Bureau finds that the overall relief provided by class actions, coupled with the large number of consumers that receive payments as part of this relief, are the correct measure of their efficacy and that overall relief is not undermined by the fact that each of these individuals may receive relatively small monetary amounts.

The Bureau also finds that commenters' comparison between the average payment to consumers in a class action (around $32) to the average individual consumer award in arbitration (around $5,000) is not apt. Many commenters have made this comparison to contend that consumers fare better in individual arbitration than in class litigation and, by extension, that class actions do not provide significant relief to consumers. This is an apples-to-oranges comparison. As discussed above, there is not much money at stake in the typical claim of a putative member of a class action, and thus there is little incentive for an individual to devote time and money to litigating the claim. In contrast, the Study found the average claim amount demanded in an arbitration to be $29,308, and the median to be $17,008.[527] No commenters adduced evidence suggesting that the amounts at stake in most consumer class actions are even approaching this magnitude on a per consumer basis. Thus, arbitration claims are not the same magnitude as claims that are brought in class actions. Not surprisingly, the Study found that individual arbitration filings for amounts less than $1,000 were quite rare – only 25 per year. In other

[527] Study, *supra* note 3, appendix J at 62 tbl. 16.

words, individuals rarely file claims in individual arbitration over small amounts, whereas class actions more often provide recovery to consumers for those claims.[528] Thus, the disparity between the recoveries of an individual consumer in class actions and those in individual arbitration is unsurprising.

With respect to the view asserted by an automobile industry commenter that class actions are not necessary for claims related to that industry because claims are typically for $1,000 or more, the Bureau does not find it to be supported that claims in that industry are typically for $1,000 or more (*i.e.*, that small claims generally do not exist in that market). The commenter asserted that because the principal balance of an automobile loan is higher than the amount of credit extended for other consumer financial products and services, the frequency of small claims is therefore substantially reduced. The Bureau disagrees, however, that the principal balance of a loan is the primary indicator of the likelihood of small claims.[529] Regardless of the size of the loan, claims can arise with respect to, for example the assessment of late fees or other ancillary fees, the application of individual payments, or the failure to provide required disclosures. Even claims of discriminatory pricing may not be for more than $100 on average, as has been true in certain enforcement actions the Bureau has brought involving automobile lending.

Furthermore, even if it were true that automobile loans claims are typically for $1,000, the Bureau does not believe that the existence of a $1,000 claim is sufficient incentive to encourage large numbers of consumers to file individual claims, for all of the reasons discussed above in Part VI.B.2, nor did the commenter cite evidence to the contrary. Indeed, multiple consumer lawyer and law firm commenters noted that it is economically unfeasible for them to

[528] As noted above in Part VI.B.2, the Study showed that consumers rarely pursue low value claims in other fora, nor are many such claims resolved informally.
[529] Indeed, the Bureau notes that Congress has prohibited arbitration clauses in mortgages, where the typical size of the loan is much larger than the typical automobile loan.

represent consumers who have claims of this magnitude on an individual basis; such claims are only viable when they can be aggregated. For these reasons, the Bureau finds that the availability of class actions concerning automobile financing benefits consumers notwithstanding the possibility that the average claims amount in those cases in the Study may be higher than in some other markets.[530]

Many industry and research center commenters criticized the efficacy of class actions because the settlements often require consumers to submit claims to obtain relief and consumers frequently do not do so. The Bureau disagrees that the low claims rate in claims-made settlements undermines the conclusion that significant relief is provided to consumers from class actions generally. Most of the commenters ignored the fact that in many consumer finance class actions, the company's records make it possible to identify the class members entitled to relief and the amount of relief to which they are entitled, thus obviating the need for a claims process. The Study identified 24 million consumers who received automatic payouts in the 133 class settlements that identified the number of class members paid.[531] Moreover, for the 251 settlements where the Bureau had data on the amount consumers were paid, the Study found as many cases that provided automatic relief as provided claims-made relief.[532] In total, the Study found that consumers received $709 million through automatic payment settlements, $322 million by submitting claims, and another $63 million in cases involving both automatic and claims-made relief.[533] No commenters disputed these amounts. The combined total of $1.1 billion in actual payments to consumers represents about half of the total $2.0 billion in cash

[530] With respect to the automobile dealer commenter that noted that dealers provide arbitration agreements to consumers as a separate document, the manner in which the arbitration agreement is provided to consumers is not relevant to the Bureau's findings that the class rule is for the protection of consumers or in the public interest. Indeed, for reasons discussed more fully in the Section 1022(b)(2) Analysis below in Part VIII, consumer awareness of arbitration is not the market failure that this rule intends to address.
[531] Study, *supra* note 3, section 8 at 22 tbl. 6.
[532] *Id.* section 8 at 28 n.46.
[533] *Id.*

relief awarded through the settlements analyzed. Further, the actual amounts paid to consumers from the settlements analyzed in the Study are almost certainly higher than what was reported because the Bureau was unable to obtain payments data for 79 of the 208 class settlements it analyzed that required consumers to make claims in order to receive monetary relief.[534] Thus, the class settlements in the Study showed that a substantial portion of the relief awarded was paid, which is contrary to the suggestions of commenters that very little of the settlement amounts is delivered to consumers. Numerous comments from consumer advocates, nonprofits, public-interest consumer lawyers, and consumer lawyer and law firms confirmed this through their own experiences regarding class actions that provided substantial benefits to class members.

The Bureau acknowledges that, in the 105 class settlements analyzed in the Study requiring claims where there was data on the potential class size and claims rates, the unweighted average claims rate was 21 percent and the weighted average was 4 percent. While these figures may understate the percentage of consumers actually eligible for relief who submitted claims (since the claims rate is sometimes calculated based on the number of potential members of a class, and since additional class members may have submitted claims after the Study's release), the figures do indicate that a large majority of consumers potentially entitled to claim relief from class actions do not file a claim when one is required.[535] Nevertheless, the Bureau finds that, even taking into account the fact that many consumers do not file claims in class settlements that require them to do so, a system which enabled 4 percent of consumers to obtain relief for small claims still would be more effective in providing redress than one in which the only alternative is

[534] *Id.* section 8 at 27. In addition, there were 56 class settlements that provided injunctive relief that covered 106 million class members (as well as future consumers who were not class members) regardless of whether they submitted a claim. Many of the class settlements that required consumers to submit a claim included such injunctive relief. *Id.* section 8 at 20-21 and tbl. 5.
[535] *Id.* section 8 at 5.

for individuals to pursue their claims individually. Moreover, given the important role that automatic payment settlements play in consumer finance class actions, such actions can deliver relief to far more than 4 percent of class members. Simply stated, the over $200 million in relief provided per year on average to an average of almost 7 million consumers through a combination of automatic payments and claims made by consumers is significant relief to consumers.

With respect to the paper that commenters cited for the proposition that consumers receive only about 9 percent of the settlement amounts in class actions, the paper cited does not state the number of settlements that it analyzed that required consumers to submit claims as compared to the number of settlements that provided automatic relief, if any. Instead, the paper reached that 9 percent conclusion by estimating a 15 percent claims rate rather than through any substantive analysis.[536] Indeed, the author stated that she did not actually obtain the claims rates in the settlements analyzed (by contrast, the Bureau's Study did so). Thus, the Bureau does not believe that the author's 9 percent estimated figure is representative of consumer finance class actions overall because, as discussed above, consumer finance class actions are often particularly amenable to automatic payments.

Further, the paper's author limited the settlements analyzed to a subset of class action cases under particular statutes the author classified as "no-injury."[537] As that paper acknowledges, there is no generally accepted definition of a "no-injury" case, and the Bureau does not agree, for reasons discussed below at Part VI.C.1 discussing deterrence, with the characterization of claims under these statutes as "no injury."[538] In addition, the bulk of those

[536] Shepherd, *supra* note 515, at 21. The author determined, based on citation to other studies, that claims rates are always 15 percent or less. She then multiplied that by the 60 percent of total awards that go to consumers to reach the 9 percent conclusion.
[537] Shepherd, *supra* note 515, at 9.
[538] In any event, the Supreme Court's recent decision in *Spokeo, Inc.* v. *Robbins* reaffirmed that class members must have an actual injury. 136 S. Ct. 1540 (2016).

cases involved claims under the FDCPA, TCPA, FCRA, and EFTA, each of which cover activity that extends beyond the scope of the Study and this rulemaking, to include claims involving nonfinancial goods or services that were not covered in the Study, that are not subject to the final rule, and that are more likely to involve claims-made settlements.[539] For example, FCRA class actions can involve merchants and employers and thus would not be consumer financial in nature, while EFTA class actions in this period were often ATM "sticker" claims that no longer violate EFTA and, in any event, involve individuals who did not have contractual relationships with the provider and thus could not involve an arbitration agreement. As the proposal noted, and as finalized, the rule would have no impact on such cases. Similarly, FDCPA class actions cover collection of all types of debt, including debt that does not arise from a consumer financial product or service (such as taxes, penalties and fines), whereas the Study and the rule only cover collection of debt to the extent it is collection on a consumer financial product or service. Finally, TCPA class actions often involve marketing communications unrelated to consumer finance. Such claims are often brought against a merchant or a company with whom the consumer otherwise has no relationship, contractual or otherwise.[540] It may well be that claims rates in TCPA cases could be low, perhaps in some part because there is no contractual relationship between the harmed consumer and the company and thus it is more difficult to reach those consumers.

Many commenters pointed to the fact that in the Study, a small number of settlements – specifically, those that occurred as part of the Overdraft MDL litigation – accounted for a large portion of the relief obtained and a large portion of the consumers obtaining relief. The Bureau

[539] Shepherd, *supra* note 515, at 2, 13.
[540] For example, a different study that analyzed TCPA filings in one Federal district court over two years found that 58 percent of the claims asserting violations of that statute related to unauthorized marketing faxes, calls, texts, or emails. Johnston, *supra* note 520 at 32.

notes that, rather than indicating a problem with the Study, this simply reflects the fact that the distribution of class action settlement amounts is right-skewed. Such distributions are commonplace in business and finance: for instance, a small number of banks represent a large fraction of all depository accounts, and a relatively small proportion of individuals hold a majority of household wealth.[541] Similarly, as shown in the Study, smaller settlements are more common than larger ones, even setting aside the overdraft settlements.[542] Mathematically, the inevitable result of very small settlements being common and very large settlements being somewhat uncommon is that the large settlements will represent the bulk of the total dollars.

Insofar as these commenters have suggested that this makes the results observed in the Study unrepresentative of the benefits that class actions can provide in other time periods, the Bureau does not agree. The Bureau believes that the large overdraft settlements reflect, in part, that there was an industry-wide practice in a very large market that harmed many consumers. While class actions concerning such industry-wide practices may not occur every year, they do occur from time to time and can provide significant relief for consumers.[543] Similarly, multidistrict litigations involving many millions of affected consumers come along regularly.

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[541] *E.g.*, Alina Comoreanu, "Bank Market Share by Deposits and Assets," WalletHub (Feb. 9, 2017) (noting that the five largest depository banks, based on total assets, hold 47 percent of total bank assets in the United States); Congressional Budget Office, "Trends in Family Wealth, 1989 to 2013," (2016) (indicating that, in the United States, families in the top 10 percent of the wealth distribution held 76 percent of wealth); Bureau of Consumer Fin. Prot., "Monthly Complaint Report: Vol. 21," (Mar. 2017) at 3, 10 (indicating that complaints against the top 10 most-complained-about companies constituted about 30 percent of all complaints).

[542] Study, *supra* note 3, section 8 at 26 fig. 4.

[543] For example, between 2003 and 2006, 11 automobile lenders settled class action lawsuits alleging that the lenders' credit pricing policies had a disparate impact on minority borrowers under ECOA. Mark Cohen, "Imperfect Competition in Auto Lending Subjective Markup, Racial Disparity, and Class Action Litigation," 1 R. L. Econ. 22, at 49 (2012) (noting that value of 11 settlements included $63 million in direct monetary benefits to consumers plus hundreds of millions of dollars more in savings to consumers from the companies' agreements as part of the settlement to restrict markups). Another example is a series of settlements concerning allegations that mortgage companies forced consumers to purchase unnecessary or excessive insurance that provided hundreds of millions of dollars in relief for consumers. *See, e.g.*, Order Granting Final Approval to Class Action Settlement, Hall v. Bank of Am., N.A., No. 12-22700, 2014 WL 7184039 (S.D. Fla. Dec. 17, 2014) ($228 million settlement); Order Granting Final Approval to Class Action Settlement, Diaz v. HSBC USA, N.A., No. 13-21104, 2014 WL 5488161 (S.D. Fla. Oct. 29, 2014) ($32 million settlement); Order Granting Plaintiff's Motion for Final Approval of Class Action Settlement, Saccoccio v. JP Morgan Chase Bank, N.A., 297 F.R.D. 683 (S.D. Fla. Feb. 28, 2014) ($300 million settlement); Stipulation and Settlement Agreement, Fladell v. Wells Fargo Bank, N.A., No. 13-60721, 2014 WL 10017434, *1 (S.D. Fla. Mar. 17, 2014) ($19.5 million settlement); *see also* Order Granting Final Approval to Class Action Settlement, Lee v. Ocwen, et al., 2015 WL 5449813 (S.D. Fla 2015) (granting final approval to $140 million settlement with multiple defendants); Opinion and Order, Arnett v. Bank of Am., N.A., 2014 WL 4672458 (D. Or. 2014) (granting final approval to $34 million settlement with one defendant).

And even class actions against a single institution can produce large numbers depending on the scope of the practice and customer base; for instance, one class action against a large bank whose employees routinely opened unauthorized accounts for existing customers recently reached a preliminary settlement of $142 million.[544]

The Bureau thus finds that the body of class actions, when taking into account their overall results, including both the large and small settlements, provides significant relief to consumers. Some commenters suggested that given the existence of the Bureau, in the future public enforcement can be expected to substitute for large class action settlements so that settlements of the magnitude of those that occurred in the Overdraft MDL litigation are unlikely to occur. However, an analysis of the complaints in the overdraft cases indicates that many of the claims were predicated on State law and on the terms of the consumers' contracts, and thus may not have been claims that the Bureau could have brought. Moreover, while it may seem easy, in hindsight, to identify "big" cases and assert that these are cases that public authorities like the Bureau would have brought, the view in real time is far murkier. The Bureau certainly hopes that, given the resources available to it and the limitations on its enforcement authority, it will succeed in identifying instances in which large numbers of consumers are subject to harm and will seek and obtain redress. The Bureau acknowledges that, to the extent this occurs, the impact of the rule could be marginally reduced as consumers and class action attorneys might be less likely to pursue class actions with respect to that harm. However, as discussed further below in Part VI.B.5, given both resource and authorities constraints, the Bureau cannot be certain that

[544] Motion and Memorandum in Support of Motion for Preliminary Approval of Class Action Settlement and for Certification of a Settlement Class, Jabbari v. Well Fargo & Co. et al., No. 15-2159 (N.D. Cal. Apr. 20, 2017) ECF No. 111. As of the date of this Final Rule, the settlement has received preliminary approval by the district court in which the case is pending.

it or other regulators can or will identify and redress all instances of large-scale consumer harm and thereby displace all large class action settlements.

Moreover, even if it were appropriate to disregard the overdraft cases in assessing the Study's findings, the relief provided to consumers by the class action settlements analyzed in the Study that was unrelated to overdraft is itself significant. Indeed, the Study breaks out the relief provided to consumers through class settlements by product and that relief includes at least four large settlements of more than $50 million in markets other than checking and savings accounts (where the settlements concerning overdraft occurred).[545] Setting aside all of the cash relief provided by cases related to checking and savings accounts, which includes cases beyond the overdraft cases, the payments actually made to consumers totaled $622.8 million, or an average of overage $130 million per year.[546] Many of these cases also resulted in significant behavioral relief as well.

Further, many of the settlements analyzed in the Study were for cases alleging violations of statutes for which the recovery in a single case is capped, such as the FDCPA which is capped at the smaller of $500,000 or 1 percent of the defendant's net worth.[547] It is therefore not possible for there to be settlements of tens or hundreds of millions of dollars under the FDCPA, but the Bureau believes that those smaller settlements, in aggregate, continue to provide significant relief for consumers and deter wrongdoing by debt collectors. The Bureau finds consumers were eligible to receive and did receive substantial relief from class action settlements separate and apart from the overdraft settlements. Again, the Bureau received numerous

[545] The settlements resulting in total payments to class members over $50 million were: Final Approval Order, In re Currency Conversion Fee Litigation, No. 01-01409 (S.D.N.Y. Sept. 17, 2008); Final Approval Order, Faloney v. Wachovia, No. 07-01455 (E.D. Pa. Jan. 22, 2009); Final Approval Order, Holman v. Student Loan Xpress, Inc., No. 08-00305 (M.D. Fla. Jan. 4, 2011); and Final Approval Order and Judgment, In re Chase Bank USA N.A. Check Loan Contract Litig., No. 09-02032 (N.D. Cal. Nov. 11, 2012). Study, *supra* note 3, section 8 at 28 n.47.
[546] Study, *supra* note 3, section 8 at 36 tbl. 13.
[547] 15 U.S.C. 1692k(a)(2)(B).

comments from consumer lawyers and law firms, consumer advocates, and public-interest consumer lawyers regarding their own experiences within which companies provided substantial payouts to consumers. Most of these examples did not concern the overdraft cases, but nonetheless they all involved large sums provided to consumers.[548]

As to commenters' criticisms of the Bureau's inclusion of the overdraft settlements in the Study because the Bureau did not attempt to assess the extent to which companies in those settlements provided informal relief to consumers, the Bureau did in fact address that issue in the Study and in the proposal, and discussed above in Part VI.B.2.[549] In fact, as noted in the Study, the settlement amounts in those cases nearly all took into account the amount of informal relief that companies had provided to consumers prior to the settlement.[550] More precisely, in 17 of the 18 Overdraft MDL settlements, the settlement amounts and class members were 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. 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.[551] These results are consistent with the Bureau's more general concerns that, as discussed above at Part VI.B.2, consumers are often unable to pursue informal dispute resolution and, when they do, experience varying amounts of success.

With respect to the contention that consumers were not made better off by the overdraft settlements because the effect of the agreements to cease maximizing overdraft revenue through

[548] *See, e.g.*, *Wells* v. *Chevy Chase Bank*, 768 A. 2d 620 (Md. 2001) ($16 million settlement for raising interest rates above advertised amount). Several commenters cited to an example, discussed in the Bureau's Preliminary Results, involving settlement of three cases against payday lenders in North Carolina. The three cases settled for $45 million, with payments sent to over 200,000 consumers. Another commenter cited a $38.6 million settlement involving LVNV Funding. *See Finch* v. *LVNV Funding, LLC*, 71 A.3d 193 (Md. Ct. Spec. App. 2013).
[549] 81 FR 32830, 32850 (May 24, 2016).
[550] Study, *supra* note 3, section 8 at 45.
[551] *Id.* section 8 at 46 and n.63.

reordering drove up the price on all consumer checking accounts, the Bureau acknowledges that to the extent class actions succeed in curtailing unlawful practices that generate revenue for financial institutions, the institutions may respond by changing their pricing structures. Even if the effect of the overdraft litigation was to cause banks to substitute transparent, upfront fees on checking accounts for back-end fees paid by a small percentage of vulnerable consumers,[552] the Bureau does not agree that it would follow that consumer welfare was unchanged or negatively impacted, especially since up-front fees are more likely to generate competition and shopping than more shrouded elements of pricing. In any event, the Bureau believes that consumers generally are made better off when companies follow the law even if in a particular case the effect of doing so is to eliminate a subsidy that one group of consumers is effectively providing to another. For this reason, too, the overdraft settlements made consumers better off in that those banks provided a remedy to consumers for the banks' violations of the law.

*Behavioral and In-Kind Relief in Class Actions.* In addition to preliminarily finding that class actions were a relatively effective means for securing monetary relief for consumers victimized by unlawful practices, the Bureau also preliminarily found that class actions were effective as a means of providing other forms of relief as well. With respect to behavioral relief, the Study found that behavioral relief was provided for in about 13 percent of the settlements analyzed. That relief inures to the benefit of all consumers, whether the consumers were part of the settlement class or not. Further, as is discussed below in the Section 1022(b)(2) Analysis in Part VIII, the Study's definition of "behavioral relief" was quite narrow and referred 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

[552] The Bureau is not aware of any evidence demonstrating the extent to which the overdraft litigation had such an effect.

compliance programs.[553] The Bureau did not count as behavioral relief a defendant's agreement simply to comply with the law, even though such a commitment often does, in fact, result in material changes in the company's behavior.[554] There were many class action settlements in which companies agreed to stop violating the law, behavior that inures to the benefit of all consumers, which are not reflected in the number of cases reporting behavioral relief in the Study.[555] And neither type of behavioral relief was accounted for in the Study's monetary calculations.

No commenters took significant issue with any of these findings; to the extent that some industry commenters were dismissive of behavioral relief based on the Study's stating that it occurred in only 13 percent of cases, they appeared to overlook the fact that the Bureau was using a very narrow definition for this determination. Accordingly, in addition to cash relief provided, the Bureau finds that the behavioral relief – understood broadly – provided by class action settlements is a significant component of the relief provided to consumers. Indeed, as the Bureau noted in the proposal, the Bureau believes that this form of relief is often more meaningful to consumers than monetary recovery in individual class actions, an opinion echoed by several consumer advocate commenters. 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

[553] Study, *supra* note 3, section 8 at 4 n.7.
[554] *Id.* appendix S at 135.
[555] *See, e.g.*, Settlement Agreement at 14, Murphy v. Capital One Bank, No. 08-00801 (N.D. Ill. Jan. 12, 2010) ECF No. 76-2 (requiring defendant to continue to "add[]to its periodic billing statements a message warning customers that, where appropriate, payment of the minimum payment due shown on their statement may not be sufficient to avoid an overlimit fee" and to "use its best efforts to maintain its policy for a period of not less than eighteen (18) months following the entry of the Final Judgment") (cited at 81 FR 32830, 32932 (May 24, 2016); Settlement Agreement at 13-14, Nobles v. MBNA Corp., No. 06-03723 (N.D. Cal. Dec. 5, 2008) ECF 179-3 (requiring defendant to continue to include language in credit agreements compliant with California law) (*cited* at 81 FR 32830, 32932 (May 24, 2016)); Joint Motion for Preliminary Approval of Class Action Settlement at 3, Peterson v. Resurgent Capital Services L.P., No. 07-251 (N.D. Ind. Oct. 21, 2008) ECF 47 ("for all members of this class with a known address in Wisconsin, whose debt is time barred, Defendants will cease all efforts to collect the debt and not sell the debt") (*cited* at 81 FR 32830, 32932 (May 24, 2016)).

the conduct in question. Any consumer affected by that practice – whether or not the consumer is in a particular class – benefits from the 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. The Study found 53 class settlements in which defendants agreed to change their behavior to the benefit of at least the 106 million class members, including, for example agreeing to improve disclosures or stop charging certain fees.[556]

One example of this appears to have occurred with respect to overdraft practices. In *Gutierrez* v. *Wells Fargo*, the court ruled that the defendant bank's overdraft practices were illegal.[557] Although that judgment was limited to a California class of the bank's consumers, the bank thereafter appears to have also changed its overdraft practices in other jurisdictions in the United States, presumably out of concern regarding other State's laws.[558] Similarly, the Bureau bases this 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 values of these behavioral

[556] Study, *supra* note 3, section 8 at 22 and appendix S at 134.
[557] 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).
[558] *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.").

changes are typically not quantified in case records, the Bureau believes, based on its experience and expertise, that their value to consumers is significant.[559]

With respect to commenters' criticisms of coupon settlements that they contended provide little tangible relief to consumers and to one commenter's criticism of a large settlement included in the Study, the Bureau notes that its analysis of class action settlements in the Study specifically separated such "in-kind" or "coupon" relief from cash relief and that the data discussed above regarding cash relief provided to consumers does not include the value of in-kind relief.[560] Only slightly more than 2 percent of the class settlements analyzed in the Study provided for only in-kind relief (as opposed to cash relief by itself or in combination with other kinds of relief).[561] Moreover, most of the examples cited by commenters of "worthless" coupon settlements are in cases that do not concern consumer financial products and thus are outside the scope of this rule, such as a case involving a ticket broker. As used in the Study, the term "in-kind relief" refers to class settlements in which consumers were provided with free or discounted access to a service, such as credit monitoring. The Bureau believes that in-kind relief can, in appropriate cases, provide additional benefits to class members. The Bureau valued such relief in the Study based upon the difference between the market price of a service given to class members and the price the class members were required to pay.[562] The Bureau recognizes, that Congress, through CAFA, has provided for the courts to apply heightened scrutiny on in-kind

[559] Relatedly, as is noted below in this part, the Overdraft MDL cases provide substantially more relief in perpetuity, to future customers not part of the class, than they did in cash settlements.
[560] The cash relief provided by settlements analyzed in the Study was $1.1 billion. Study, *supra* note 3, section 8 at 29.
[561] *Id.* section 8 at 19.
[562] *Id.* section 8 at 4 n.6 and n.8. Most often, in-kind relief entailed free access to a service.

relief, and the Bureau does not believe that such relief is, by itself, generally the primary benefit that consumers receive from class actions.[563]

*Proportion of cases filed as class actions that ultimately provide classwide relief.* The Bureau has considered commenters' criticism that only a fraction of the cases brought as putative class actions reach a class settlement that provides relief for consumers in the class. While many of these commenters focused on the fact that the Study reported that 12 percent of the cases had resulted in class relief as of 2012, the proposal reported that the percentage of cases in which a final class settlement was approved or pending approval had increased to 18.1 percent as of April 2016.[564] Approximately 60 percent of the putative class actions analyzed either were settled on an individual basis or resolved in a manner consistent with an individual settlement.

The Bureau believes, as it stated in the proposal, that the best measure of the effectiveness of class actions for all consumers is the absolute relief they provide in light of the number of consumers who receive this relief, and not the proportion of putative class cases that result in other outcomes. 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 in court or arbitration, including by filing their own class actions. 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

[563] *See, e.g.*, Kara L. McCall, "Coupon Settlements Play a Continuing Role in Class Litigation After CAFA," ABA Section of Litigation (2012), *available at* http://www.americanbar.org/content/dam/aba/administrative/litigation/materials/sac2013/sac_2013/46_buy_this_all_natural.authcheckdam.pdf.
[564] 81 FR 32830, 32847 (May 24, 2016).

appropriate to evaluate class actions based on the number of consumers who obtain relief and the magnitude of relief that these cases collectively (including the many that do result in class settlements) deliver to consumers.[565] Thus, even if, as one commenter noted, the likelihood that any case filed as a putative class action results in actual cash relief to a consumer is low, the amount ultimately provided in those cases that do is large enough to compel a finding that class actions provide significant relief to consumers.

The Bureau acknowledges that when a case is filed as a putative class action and settled individually, the defendant may incur higher defense costs than if the case had been filed individually. Further, while the purpose of the class rule is to preserve the ability for there to be class mechanisms to compensate consumers when they are harmed, the prospect of which deters companies from further harming consumers as discussed in more detail below in Part VI.C.1, the Bureau agrees that the putative class cases that do not end in class settlement may not themselves further this purpose. Nevertheless, it would not be possible for a rule to allow the filing of only such cases that would ultimately end in class settlement or favorable judgments for consumers because the purpose of litigation is to sort such outcomes. Accordingly, while the Bureau considers the prevalence of these outcomes and the cost of defending these cases further below in discussing whether the proposed rule is for the benefit of consumers and in the public interest (and in its Section 1022(b)(2) Analysis below in Part VIII as well), it does not believe these outcomes detract from the Bureau's finding that class actions provide an effective means of providing consumer relief.

[565] Stakeholders similarly asserted that class actions were 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.

Many of the commenters also suggested that the high proportion of putative class cases that resulted in individual settlements or potential individual settlements (around 60 percent) demonstrates that the underlying claims were not meritorious. Even if that were true, it still would not suggest that the class action mechanism as a whole is ineffective as a means of redressing harm to consumers for the reasons discussed above. But the Bureau also notes that there is no way to know with certainty whether the putative class cases settled on an individual basis had merit or involved potentially classable claims; the commenters did not provide evidence to support their assertions that those cases are, on the whole, meritless. Settlement between parties to a lawsuit is an everyday occurrence. Parties may choose to settle a putative class case on an individual basis for any number of reasons, such as because the defendant threatened to move the case to arbitration or offered the named plaintiff full relief on his or her individual claim, which a company may do in litigation in an effort to avoid defense costs or to avoid providing broader relief to other affected consumers. Indeed, there are numerous factors that go into any defendant's decision to settle, including the legal framework of the claims asserted, the facts underlying the allegations, and the costs of defense. When a consumer files an action in court alleging the consumer's individual claims affect a class of other consumers, the rules of civil procedure generally allow that consumer to conclude the action by resolving their individual claims before a court certifies the case is a class action. Sometimes, a consumer who has filed a putative class action may be unwilling to pursue that case if the company decides to make the consumer whole, while in other cases, the law may not have allowed the class claims to proceed if the company offered full relief to the named plaintiffs.[566] This outcome is available at

[566] During the period covered by the Study which analyzed cases filed in the years 2010 through 2012, a majority of Federal circuits had held that an offer of judgment to the named plaintiff renders a class action moot. *Diaz* v. *First American Home Buyers Protection Corp.*, 732 F.3d 948,

the election of the parties and generally not subject to approval by the court. Therefore, the Bureau does not agree that there is a valid basis to draw inferences about the quality of the claims alleged in these cases based solely on how the parties chose, as a voluntary matter, to resolve them.

In addition, the Bureau finds that individual settlements in putative class cases, when they occur, typically occur relatively early in the class action process. The Study's data on time to resolution of putative class cases suggested that defense costs are likely much lower for putative class cases that result in individual settlement than for a putative class case that reaches classwide settlement. The Study obtained information on the amount of time to resolution for the cases it analyzed and the Bureau expects that a company's defense costs likely increase as the time to resolution of the case increases. This data showed that the median number of days to close for a case filed as a class case but that resulted in a known individual settlement was 193 days; for such a case that resulted in a potential individual settlement, the median days to close was 130 days.[567] In contrast, the median number of days to close when a case was settled on a classwide basis was 670 days.[568] In other words, cases filed as class actions that settled on a classwide basis typically closed more than a year after similar cases that resulted in an individual settlement or a potential individual settlement. These cases settled on an individual basis therefore involved less litigation and thus likely lower defense costs. The relevance of these findings is discussed further below in Part VI.C.2 in the discussion of whether the class rule is in the public interest.

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953 n.5 (9th Cir. 2013) (citing precedent in six Federal appellate circuits under which offers of complete relief were held to moot a class action). The Supreme Court recently held, however, that an unaccepted settlement offer to the named plaintiff does not render a class action moot. *Campbell-Ewald Co.* v. *Gomez*, 136 S. Ct. 663, 670 (Jan. 20, 2016).

[566] Study, *supra* note 3, section 6 at 46 tbl. 7.

[567] *Id.*

[568] *Id.*

*Merits of Claims Resolved by Class Actions.* With respect to commenters that contend that class action settlements do not benefit consumers because they often occur in cases where the defendant may have agreed to settle the case but did not actually violate the law or where the claims were frivolous, the Bureau does not dispute that there is some pressure to settle contested matters of all kinds, whether individual suits or class actions, to avoid defense costs or the risk of a judgment. Nevertheless, the Bureau does not agree that the existence of this pressure means that a settlement has no correlation with merit or violations of the law. To the contrary, a defendant's assessment of the merits of the plaintiff's claim – specifically, the plaintiff's likelihood of succeeding at trial – is a key factor influencing a defendant's decision to settle.[569] The central role that the merits of a plaintiff's claim plays in this framework is reflected in the fact that it is among the primary factors courts assess when reviewing proposed class settlements.[570]

Further, the Study showed that certification in a class case almost invariably occurs coincident with a settlement, and thus that certification is not typically the force that drives settlement. The Study further found that, not infrequently, settlements follow a decision by a

[569] Key factors affecting the expected cost of litigation, and thus a defendant's settlement amount, include the exposure to the class, the plaintiff's likelihood of success at trial (a reasonable proxy for the merits of the plaintiff's claim), and the defendant's litigation costs. *E.g.*, Richard A. Posner, "An Economic Approach to Legal Procedure and Judicial Administration," 2 J. Legal Stud. 399, at 418 (1973); Jennifer K. Robbennolt, "Litigation and Settlement, in The Oxford Handbook of Behavioral Economics and the Law," at 623 (Eyal Zamir and Doron Teichman, eds. 2014).

[570] *E.g.*, 7A Charles Alan Wright & Arthur R. Miller, "Federal Practice and Procedure: Civil §1797.1" at 82-88 (3d ed. 2002) (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"); Federal Judicial Center, "Manual for Complex Litigation," at § 21.62 (4th ed. 2004) (listing "the advantages of the proposed settlement versus the probable outcome of a trial on the merits" as a factor that may bear on review of a settlement). *See also 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"); *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"); *Schneider* v. *Citicorp Mortgage, Inc.*, 324 F. Supp. 2d 372, 376 (E.D.N.Y. 2004) ("[W]hen considering whether to approve a proposed class action settlement, 'the most important factor is the strength of the case for plaintiffs on the merits, balanced against the amount offered in settlement.'"), citing *City of Detroit* v. *Grinnell Corp.*, 495 F.2d 448, 455 (2d Cir. 1974); *In re Microsoft Corp. Antitrust Litig.*, 185 F. Supp. 2d 519, 526-27 (D. Md. 2002) (denying approval of proposed class settlement in part because record was not "sufficiently developed on various damages issues" or the probability of plaintiff's success at trial); *Lachance* v. *Harrington*, 965 F. Supp. 630 (E.D. Pa. 1997) (approving proposed class settlement where parties adequately estimated outcomes and risks of trial as well as value of settlement to proposed class members).

court rejecting a dispositive motion (*e.g.*, a motion to dismiss) filed by the defendants. Such motions provide some evidence as to the merit of the legal theories underlying the complaint and, in the case of summary judgment motions, of the factual allegations as well. In particular, court decisions granting such motions would suggest that the claims lack merit. Yet the data show that courts grant dispositive motions relatively infrequently, indicating that they rarely find that these cases are devoid of legal merit as pled.[571]

The Study analyzed these data in two different case sets: class action filings in State and Federal courts in six consumer finance markets, and cases with Federal class action settlements across consumer finance markets more generally. Among class action filings in the six markets, the Study found that companies filed dispositive motions in 37.9 percent of the 562 cases analyzed, and that courts granted such a dispositive motion and dismissed at least one company party entirely from the case in only 10 percent of the same cases.[572] Among Federal class action settlements analyzed in the Study, 40.3 percent were approved by courts only after a defendant filed dispositive motions and the court denied at least one such motion.[573] In short, in both case sets, the Bureau found that companies regularly sought to challenge the legal or factual basis for claims asserted in the litigation, and that courts infrequently granted these challenges. The Bureau does not believe that the Study's finding that few class cases conclude with a court granting a defendant's dispositive motions or a trial verdict in favor of the plaintiff is consistent with a lack of merit in the underlying allegations.[574]

[571] The Bureau acknowledges, as some commenters suggested, that survival of a dispositive motion is not always indicative of the merits of the underlying claim, given that courts typically take allegations as true (in reviewing a motion to dismiss) or most favorably to the non-movant (in reviewing a summary judgment motion). Nevertheless, if most class actions truly were devoid of any merit as many commenters suggested they are, the Bureau would have expected defendants to succeed more often in defeating such claims before entering into a settlement.
[572] Study, *supra* note 3, section 6 at 38 n.68.
[573] *Id.* section 8 at 38-39.
[574] While trial verdicts in consumer financial class action cases are rare, they do occur. A bench trial in *Gutierrez* v. *Wells Fargo Bank, N.A.*, led to a judgment on the merits in favor of the plaintiff class. 730 F. Supp. 2d 1080, 1082 (N.D. Cal. 2010). This case was not included in the

With respect to commenters that hypothesized that defendants could nevertheless agree to enter into a class action settlement after winning a dispositive motion, the Bureau notes that these commenters cited no examples, and this did not happen in the class action filings analyzed in the Study.[575] Regardless, if a defendant settles on a classwide basis after winning a motion to dismiss, the Bureau believes that the settlement amount is likely to be lower than it would have been if the defendant had lost the motion to dismiss.[576] This is because among the factors a court considers in reviewing a settlement is likelihood of success on the merits, and if the court has already found a claim to lack merit, that will naturally affect its view of the likelihood of success of such a claim on appeal.[577]

Given the mechanisms within the litigation process for testing the relative merit of allegations short of trial, the Bureau does not agree with commenters that suggested that the dearth of trials in class action cases suggests that the merit of these cases go untested.[578] As discussed, short of verdicts, courts have and use mechanisms to test the merit of and dispose of claims that cannot succeed as pled. Courts dismiss claims that fail to state a plausible claim for relief[579] and can sanction attorneys that file frivolous claims without evidentiary support for the

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Study's analysis of consumer financial litigation in court because it was filed in 2007 and the Study analyzed cases filed from 2010 through 2012. Study, *supra* note 3, section 6.

[575] *See id.* at appendix O.

[576] *See* J. Maria Glover, *The Federal Rules of Civil Settlement*, 87 N.Y.U. L. Rev. 1713, at 1730–31 (2012) ("In general, access to discovery is granted without limitation once a motion to dismiss is denied, enabling claimants to impose significant, asymmetric production costs on the opposing party. . . . Accordingly, a claimant will obtain a 'motion to dismiss premium' in proportion to any temporal or absolute asymmetrical cost imposition in the discovery stage.").

[577] *See, e.g.*, *Shane Group, Inc.* v. *Blue Cross Blue Shield of Michigan*, 825 F.3d 299, 309 (6th Cir. 2016) ("[T]he district court must specifically examine what the unnamed class members would give up in the proposed settlement, and then explain why—given their likelihood of success on the merits—the tradeoff embodied in the settlement is fair to unnamed members of the class."); *In the Matter of Synthroid Marketing Litigation*, 264 F.3d 712, 716 (7th Cir. 2001) (determining that a settlement "is generous in light of the difficulties facing the class" in proving their case on the merits); *TBK Partners, Ltd.* v. *Western Union Corp.*, 675 F.2d 456, 464 (2d Cir. 1982) ("[I]n light of the substantial risks inherent in further litigation and the limited potential amount of a possible successful recovery, we find no reason to overturn the District Court's evaluation of the settlement as manifestly reasonable.").

[578] The Bureau notes that one consumer lawyer commenter stated that he had been involved in multiple class actions that reached a verdict in favor of the class.

[579] Fed. R. Civ. P. 12(b)(6). *See also Bell Atlantic Corp.* v. *Twombly*, 550 U.S. 544 (2007), and *Ashcroft* v. *Iqbal*, 556 U.S. 662 (2009) (both elaborating on the requirement that a complaint must dismissed if it does not state a claim upon which relief can be granted).

allegations.[580] In addition, Congress, through amendments to the Federal Rules of Civil Procedure and enactment of CAFA, has and continues to consider further adjustments to class action procedures.[581] The Supreme Court has also rendered a series of decisions making clear that Federal Rule 23 "does not set forth a mere pleading standard" and establishing a number of requirements to subject putative class claims to close scrutiny.[582] Thus as noted above in Part II.B, the law expects courts to act to limit frivolous litigation. Further, the Bureau understands that class action attorneys will typically earn nothing for the time invested in developing, filing, and litigating a class case that is dismissed on a dispositive motion. The Bureau believes this may serve as an incentive not to bring cases that would be dismissed for lacking merit.

With respect to Tribal commenters that asserted that frivolous class action settlements threaten Tribal treasuries, the Bureau notes that Tribal governments are generally immune from private lawsuits and therefore that class actions should not affect their Tribal coffers, as discussed in detail below in the section-by-section analysis of § 1040.3(b)(2) in Part VII. Further, the Bureau clarifies in § 1040.3(b)(2) of this Final Rule that any Tribal government or an arm of such government that is immune from private suit is exempt from the class rule.

*Other Concerns Regarding Class Actions*. With respect to comments that criticized the value to consumers of class action settlements because they proceed slowly and it takes a long time for consumers to obtain relief, the Bureau recognizes that class actions can proceed slowly. As discussed above in this Part VI.B.3 with respect to the monetary relief provided by class actions, however, the Bureau believes that most consumers who obtain relief in class actions

[580] Fed. R. Civ. P. 11.
[581] *See, e.g.*, Class Action Fairness Act (CAFA), Public Law 109-2, 119 Stat 4 (2005); Fairness in Class Action Litigation Act, H.R. 985, 115th Cong. (2017); Fairness in Class Action Litigation and Furthering Asbestos Claim Transparency Act of 2016, H.R. 1927, 114th Cong. (2016); State of Class Actions Ten Years After the Enactment of the Class Action Fairness Act, Hearing before the H. Comm. on the Judiciary, 113th Cong. 114-10 (2015);
[582] *See, e.g., Wal-Mart Stores, Inc.* v. *Dukes*, 564 U.S. 338, 350 (2011).

likely would not have pursued relief through other individual litigation or arbitration. For this reason, the Bureau finds that the relief provided to these consumers through class actions, even if slow to arrive, benefits these consumers relative to a system which proceeds faster but only handles individual cases and thus provides relief to few consumers. In an economic sense, if a consumer receives $32 three years from now, instead of immediately, the present value of the later income may be about $8 less (approximately $24), but it is more than zero.[583] Similarly, the Bureau does not believe that it is instructive to compare the duration of an individual arbitration proceeding to the duration of a class action case that ends in a settlement. Very few individuals pursue claims in individual arbitration, and those who do typically do so because they have a claim worth a significant amount of money. As commenters seem to agree, those claims are not the types of claims typically redressed in a class action. In addition, as one consumer advocate suggested, if all consumers harmed by a provider's widespread practice actually did bring their claims individually, or if even a significant portion of them did, the time and expense for consumers and providers alike would likely far exceed what would occur if the claims could be addressed in a single class action.

With respect to one industry commenter's argument that each class action lawsuit should be counted as one filing (despite covering claims of many consumers) and compared to single individual filings in either litigation or arbitration, the Bureau disagrees that that is the relevant comparison. Instead, the Bureau maintains that because there are thousands or even millions of consumers who benefit from class action settlements, the relevant comparison when analyzing

[583] For example, assuming a 10 percent discount rate, net present value of $32 drops to $24 in three years. By contrast, the value of a company's agreement to change its behavior does not diminish over time and may increase.

individual and class action suits is the number of consumers who ultimately benefit from the suit, rather than the number of consumers who file the suit.

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

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

In the proposal, the Bureau made a number of preliminary findings regarding the impact that arbitration agreements have on consumers and, in particular, consumers' ability to pursue relief on a classwide basis. Specifically, the Bureau preliminarily found, based upon the Study, that arbitration agreements are frequently used by providers of consumer financial products and services, that the agreements have the effect of blocking a significant portion of class action claims that are filed. Indeed, the Study found nearly 100 putative class action cases that were blocked by arbitration agreements.[584] The Bureau further preliminarily found that consumers rarely filed claims on an individual basis once a class action was blocked by an arbitration agreement, citing to the Study. The Bureau further cited to its case study of opt-outs from settlements in the Preliminary Results of the Study further demonstrates that consumers who opt of receiving cash relief in a class settlement rarely take the opportunity to file a claim in 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

[584] Study, *supra* note 3, section 6 at 7.

court dockets or the AAA Case Data, only two of which the Study determined were filed as putative class arbitrations.[585]

The Bureau also preliminarily found that the existence of arbitration agreements suppresses the filing of class action claims in the first place, citing in support of this proposition a survey of consumer lawyers who had declined to file class cases concerning products covered by an arbitration agreement. [586]

*Comments Received*

*Frequency of use of arbitration agreements to block class actions.* Several industry commenters disagreed that arbitration agreements are frequently used to block class actions. One such commenter noted that in the 562 Federal class actions analyzed by the Study, companies filed motions to compel in only 17 percent of the cases and those motions were successful in only 8 percent of the 562 cases. Accordingly, this commenter suggested that arbitration agreements were not widely used to block class actions and that few class actions were actually blocked. The same industry commenter noted that the Study showed that arbitration agreements were used rarely to block individual cases – motions to compel arbitration were filed in only 1 percent of the 1,200 individual Federal cases analyzed. This commenter disputed the Bureau's assertion that there were "large" numbers of individuals in the putative classes that were compelled to arbitration on the basis of arbitration agreements because there was no way to know class size if the case was not certified before the motion to compel was granted.

[585] *See id.* section 6 at 57-58.
[586] *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.

On the other hand, consumer advocates, public-interest consumer lawyers, consumer lawyers and law firms, and several nonprofits asserted that arbitration clauses frequently block and chill the filing of class action cases. In many instances, commenters proffered examples from their personal experiences. For example, one consumer law firm commenter provided two examples of class actions that could not proceed due to the existence of an arbitration agreement – one case was voluntarily dismissed (and thus would not be counted in the Bureau's Study) and one in which arbitration was compelled upon appeal. Another stated that he had turned away over 100 cases involving arbitration agreements. A different consumer lawyer contrasted her experience with a series of automobile finance class actions involving what she characterized as plainly unlawful behavior; the commenter noted three cases that defendants had successfully blocked by invoking an arbitration agreement and contrasted those to others in which she had successfully recovered damages for a class where there was no arbitration agreement. Another consumer law firm commenter stated that it had turned away 27 cases in the prior year because it lacked the resources to try each of these cases individually, although it would have had the resources and an interest in pursuing them as class actions if there had not been arbitration agreements prohibiting class proceedings. Several public-interest consumer lawyer commenters said that one of the first questions they ask is whether consumers have disputes that may be governed by arbitration agreements and, if so, that they turn down those clients.

A group of Congressional commenters cited the example of a large bank whose employees opened millions of unauthorized accounts in the names of the bank's existing customers over a period of years. The bank successfully used arbitration agreements in its agreements with customers for the authorized accounts to block lawsuits by customer's asserting

violations of the law with respect to the unauthorized accounts.[587] In the view of these Congressional commenters, the bank's use of arbitration agreements to block those lawsuits allowed the bank to continue its illegal practices for significantly longer than it would have been able to had the lawsuits been allowed to proceed in court when they were filed. One public-interest consumer lawyer commenter noted several instances in which companies have said informally to him that they maintained arbitration agreements in order to block class actions.

*Pursuit of individual claims after class actions blocked.* Some industry commenters further challenged the Bureau's preliminary finding that consumers rarely pursued a claim on an individual basis after a putative class claim was dismissed or stayed on the basis of an arbitration agreement. For example, one industry commenter challenged findings in a case study presented in the Bureau's Preliminary Results indicating that only three of the 3,605 individuals who opted out of class action settlements analyzed (comprising approximately 13 million consumers) filed individual claims in AAA arbitration. The commenter contended that the Bureau's data is too limited to support its conclusion because the consumers who opted out could have filed individual claims with JAMS or in court, but the Bureau had data only concerning AAA arbitrations.

Several consumer advocates, nonprofits, and consumer law firms and lawyers agreed with the Bureau's finding. Specifically, one consumer lawyer stated that in his experience individual claims are never filed when class claims are stayed or dismissed. Two public-interest consumer lawyer commenters explained that, in most cases, only the named plaintiff even knows that a claim exists, and even that individual might not have an incentive to pursue the claim in

[587] *E.g.*, *Douglas* v. *Wells Fargo*, BC521016 (Ca. Super. Ct. 2013); *Jabbari* v. *Wells Fargo*¸ (N.D. Cal. 2015).

arbitration if there is no promise of benefitting others who are similarly situated given the relative size of the claim and the costs of pursuing it further.

*Suppression of claims.* With respect to the Bureau's preliminary finding that arbitration agreements suppress the filing of class claims, several industry commenters stated that the survey of consumer lawyers on which the Bureau relied to support this conclusion is flawed because it did not examine whether a case turned down by one attorney was later filed by another nor does it purport to show the total number of cases not filed. Other consumer lawyer and law firm commenters disagreed, asserting that the survey was accurate and, as noted above, in accordance with their own experiences. Specifically, consumer lawyers and law firms stated in their comments examples from their own experiences of not bringing cases due to the existence of an arbitration agreement that a defendant could use to block the case from proceeding. For example, one consumer lawyer explained how, after a case where it was apparent that his fee would take a large portion of his client's potential recovery, he concluded that it was economically impossible for him to continue to handle such individual cases and thus decided to no longer take them at all.

*Response to Comments and Findings*

*Frequency of use of arbitration agreements to block class actions.* As noted above in Part III.D.1, 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 an arbitration agreement, a defendant can seek a dismissal or stay of the

litigation in favor of arbitration.[588] If the court grants such a dismissal or stay in favor of arbitration, the class case could potentially be refiled as a class arbitration.[589] 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.[590] The Study did not identify any contracts with arbitration agreements that explicitly permitted class arbitration, nor did any commenters indicate that such agreements exist. 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. No commenters disagreed with any of the Bureau's findings in this regard.

As set out above in Part II.C, the public filings of some companies confirmed that the effect – indeed, often the purpose – of arbitration agreements is to allow companies to shield themselves from class liability.[591] Further, companies have stated both to the Bureau and in public news reports after the proposal was released, that they adopted arbitration agreements for the primary purpose of blocking private class action filings.[592] Commenters did not dispute this. Indeed, many industry commenters stated that the class action waiver is integral to their offering of individual arbitration; they asserted that the cost of arbitrating individual claims is too great to

[588] *See Concepcion*, 563 U.S. 333 (2011).
[589] 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 3, section 5 at 86-87.
[590] *Id.* section 2 at 44-46.
[591] *See* Discover Financial (Form 10-K), *supra* note 95.
[592] *See* SBREFA Report, *supra* note 419, at 16-17; *see also* James Rufus Koren, "Agency Targets Ban on Class Actions," L.A. Times (May 5, 2016) ("'What made arbitration clauses attractive was their impact on class-action litigation,' [financial services attorney Alan Kaplinsky] said. 'Most banks and companies using it now will conclude it's no longer worth it.'"); Kate Berry, "CFPB's Arbitration Plan Delivers Sharp Blow to Financial Industry," American Banker (May 5, 2016) ("For 30 years, financial institutions have used arbitration agreements with so-called class-action waivers to effectively prevent consumers from banding together in class actions to pursue similar claims. 'Under the CFPB's proposal, that shield would no longer be available,' said Walter Zalenski, a partner at the law firm BuckleySandler.").

bear when they must also defend class action litigation. (This argument is addressed below in Part VI.C.1.)

The Study showed that defendants were not reluctant to invoke arbitration agreements to block putative class actions and were successful in many cases.[593] With respect to industry comments that suggested that arbitration agreements were not widely used to block class actions because companies filed motions to compel arbitration in only 16.7 percent of the class cases analyzed in the Study, the 16.7 percent figure is correct but reflects only one of two data sources in the Study on motions to compel arbitration. The Study cited 92 cases out of 562 putative class cases analyzed in Section 6 of the Study in which motions to compel arbitration were filed (16.7 percent) and in 46 of those cases, the motions were granted and the case was dismissed or stayed. The Study also found an additional 50 putative class cases that were filed outside of the period analyzed in the Bureau's review of filings in court and were dismissed on the basis of an arbitration agreement.[594] Thus, over a period of approximately five years, nearly 100 Federal and State putative consumer class actions were dismissed or stayed because companies invoked arbitration agreements in motions to compel arbitration.[595] While it is true, as one industry commenter noted, that every putative class case blocked by an arbitration agreement might not have been certified or ultimately provided relief to any consumers, it is reasonable to expect that at least some of those 100 cases would have done so. Because one settled class action case can provide relief to many consumers, the Bureau finds that arbitration agreements blocking nearly

[593] Study, *supra* note 3, section 6 at 57.
[594] These putative class cases pertained to consumer financial products or services (including more than the initial six markets studied) and were dismissed pursuant to a motion to compel arbitration that cited the *Concepcion* case. *Id.* section 6 at 58-59.
[595] In any event, if the commenters that argued that arbitration agreements are not actually used to block class actions were correct, then it seems unlikely that industry commenters would so uniformly oppose the likely result of this rule – additional class actions filed against providers that will result in settlements.

100 putative class cases indicates that use of arbitration agreements affects large numbers of consumers.

As just one example, the Bureau notes that in the matter discussed above in Part VI.B.3 involving a large bank that opened unauthorized accounts on behalf of millions of customers in violation of the law, that bank relied on arbitration agreements in its contracts with customers for the authorized accounts to block many of those customers from pursuing classwide relief in court with respect to the unauthorized accounts. Plaintiffs filed two putative class action lawsuits in 2015 against the bank for opening unauthorized accounts, and both lawsuits were later dismissed in response to the bank's motions pursuant to its arbitration agreements.[596] Because those lawsuits were blocked, those consumers were not able to pursue relief in court for the bank's violations of the law. The parties in the latter case later agreed voluntarily to withdraw an appeal of the arbitration dismissal and have recently come to agreement on a proposed class settlement, nearly two years after the class action was first filed.[597]

Moreover, while the Bureau was unable to determine in what percentage of all class action cases analyzed defendants had arbitration agreements and were in a position to invoke an arbitration agreement, 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.[598] This is strong evidence that companies that do include arbitration agreements in their consumer contracts are very likely to

[596] *Jabbari* v. *Wells Fargo*, (N.D. Cal. 2015); *Heffelfinger* v. *Wells Fargo.*, (N.D. Cal. 2015). Individuals filed at least two lawsuits in California State court in 2013 against the bank for opening unauthorized accounts, and both lawsuits were dismissed or stayed on the basis of arbitration agreements; one ultimately settled and the other was withdrawn, indicating a possible non-class settlement. *Douglas* v. *Wells Fargo*, BC521016 (Ca. Super. Ct. 2013); *Mokhtari* v. *Wells Fargo*, BC530202, (CA. Super Ct. 2013).
[597] Motion and Memorandum in Support of Motion for Preliminary Approval of Class Action Settlement and for Certification of a Settlement Class, Jabbari v. Well Fargo & Co. et al., No. 15-2159 (N.D. Cal. Apr. 20, 2017) ECF No. 111. *See also* Part VI.B.3 above (discussing this proposed class action settlement) and Part VI.B.2 (discussing the Bureau's enforcement action concerning the same conduct).
[598] Study, *supra* note 3, section 6 at 61.

use them to block class actions filed against the company. As noted, the experiences of many public-interest consumer lawyer and consumer lawyer and law firm commenters buttress this finding, as does the evidence with respect to companies' articulated reasons for including arbitration agreements in their consumer finance contracts.

The Study further indicated that companies were at least 10 times more likely to move to compel arbitration in a case filed as a class action than in a non-class case.[599] Put another way, companies used arbitration agreements far more frequently to block class actions than to move individual court cases to arbitration. While some industry commenters disputed the relevance of this comparison because they contended the overall frequency of class actions blocked by arbitration agreements is low, the Bureau finds that this data showed that most companies are more concerned with stopping putative class actions from proceeding than they are with determining in what forum (court or arbitration) individual disputes are resolved. Indeed, this data confirmed the direct evidence 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 some industry and research center commenters have touted the benefits of arbitration as a forum of individual dispute resolution because it is, for example, quicker and simpler than litigation, as discussed below in Part VI.C.1, for many providers, those benefits seem ancillary to their ability to limit class actions. Indeed, many industry commenters stated that they would no longer include arbitration agreements in their consumer contracts if the class rule were finalized, indicating that the primary purpose of those arbitration agreements is in fact to block class actions.

[599] *Id.* section 6 at 57-58.

*Pursuit of individual claims after class actions blocked.* The Bureau further finds that when courts grant a motion to dismiss class claims based on arbitration agreements, most consumers who would have constituted the putative class are unlikely to pursue the claims on an individual basis in any forum 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 individual arbitration filings in the court dockets or AAA case data, only two of which the Study determined were filed as putative class arbitrations.[600] 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 Bureau's case study of opt-outs from settlements in the Preliminary Results of the Study further demonstrated this.[601] 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 AAA as the arbitration administrator. In these settlements, 3,605 of the 13 million class members chose to opt out of receiving cash relief.[602] Nevertheless, just three out of these 3,605 individuals appear to have taken the opportunity to file arbitrations in AAA against the same settling defendants.[603] Although the case study is a limited sample, the Bureau has little reason to believe (nor have commenters put forth evidence to the contrary) that consumers in putative class cases that never even go through certification and opt-out processes would be more likely to refile in arbitration.

[600] *Id.* section 6 at 59. The record reflects that the arbitrator denied class status to one of the arbitrations filed on a class basis; the Bureau does not have information on the second arbitration.
[601] *See* Preliminary Results, *supra* note 150, at 86-87.
[602] *See id.* at 104.
[603] 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. *Id.* at 104 n.225.

Indeed, as two consumer law firm commenters noted, most members of putative classes do not even know they have a potential claim. With respect to the industry commenter that criticized this data as too limited because the Bureau searched only for arbitrations filed before AAA and did not search for whether those consumers who opted out filed in a JAMS arbitration or in a case filed in court, as noted in the proposal, the Bureau obtained data from JAMS – not disputed by any commenter – indicating that the number of consumer arbitrations filed in that forum in 2015 was 115 or approximately one-quarter the number filed with AAA.[604] Thus, even if every single arbitration filed with JAMS involved a consumer that opted out of a class action, that number would be small in comparison to the number of consumers for consumer financial products and services. With respect to the commenter's argument that cases may have been re-filed in court, the Study found that individuals file very few cases in Federal court in comparison to the size of the consumer financial marketplace, as discussed in detail above in Part VI.B.2.

*Suppression of claims.* In addition to blocking class actions that are actually filed, the Bureau finds that arbitration agreements inhibit putative class action claims from being filed at all for several reasons. Numerous public-interest consumer lawyers and consumer lawyer and law firm commenters indicated that – based on their own experiences – they did not file class actions when they knew that a class claim might be blocked by an arbitration agreement. These commenters explained that plaintiffs and their attorneys frequently choose not to file such claims because arbitration agreements substantially lower the possibility of classwide relief. Given this evidence and the fact that attorneys incur costs in preparing and litigating a case under a contingency pricing structure, attorneys 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 an

[604] 81 FR 32830, 32856 (May 24, 2016).

attorney 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.

The Bureau admittedly cannot quantify this effect because there are no records of cases that were never filed in the first instance. Nevertheless, stakeholders that surveyed attorneys found that respondents reported frequently turning away cases – both individual and class – when arbitration agreements were present.[605] The consumer lawyer and law firm commenters that provided details on their personal experiences with cases they declined to pursue support these surveys. While industry commenters criticized that data as anecdotal and not taking into account whether a case rejected by one attorney was taken up by another, these commenters produced no evidence, anecdotal or otherwise, to suggest that the existence of an arbitration agreement does not have a bearing on whether an attorney would pursue a class claim against a company.

For all of these reasons, the Bureau finds that arbitration agreements block class actions and suppress the filing of others.

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

In the proposal, the Bureau preliminarily concluded, based upon the results of the Study and its own experience and expertise, that public enforcement is not itself a sufficient means to

[605] In response to the Bureau's Request for Information in connection with the Study, one trade association of consumer lawyers 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. 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 10. *Id.* 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.

enforce consumer protection laws and consumer finance contracts. This conclusion was based upon several findings: consumer protection statutes explicitly provide for both public and private enforcement; the market for consumer financial products and services is enormous and public enforcement resources are limited; the Study results supported a conclusion that private class actions complement public enforcement; and there are some claims concerning consumer financial products and services for which there is no public enforcement.

*Comments Received*

*Statutes provide for class actions.* Few commenters disagreed with the Bureau's preliminary findings that consumer protection statutes explicitly provide for both public and private enforcement and that when Congress and State legislatures authorized private enforcement, that generally includes private class actions.[606] Indeed, consumer advocate and nonprofit commenters emphasized the consumer protection role of specific statutes as a reason not to allow arbitration agreements to block class actions. A research center commenter opined that unfettered and meaningful access to the courts has long played a critical role in the effective functioning of the United States' system of governance. A public-interest consumer lawyer commenter highlighted the role of private litigation under fair housing laws as an example of where private litigation has provided clear benefits to class members. This commenter also noted that public regulatory bodies may also be geographically distant from sites of harm and generally have access to less information about unlawful conduct as compared to private litigants.

[606] One industry commenter noted that Utah law permits closed-end credit contracts to include class action waivers, which the Bureau discusses further below in Part VI.C.2. Another nonprofit commenter specifically asserted that Congress intended statutes that provide for statutory damages, such as EFTA, to be enforced on an individual rather than a classwide basis, and suggested the rule should only apply to laws that explicitly permit class actions. As noted in the Bureau's Section 1022(b)(2) Analysis, however, EFTA does explicitly provide for classwide damages.

*Public enforcement resources are limited.* With respect to the Bureau's assertion that public enforcement resources are limited in comparison to the size of the market for consumer financial products and services, numerous industry commenters disagreed. One such commenter noted that the Bureau has broad enforcement authority and has produced approximately $11 billion in consumer relief through the end of 2015, thus demonstrating the extent of the Bureau's resources to enforce the relevant laws. Another industry commenter stated that Bureau enforcement actions typically provide more relief to consumers than the relief provided from class actions. As compared to the approximately $32 per person that consumers received from class actions in the Study, another industry commenter reported that Bureau enforcement actions provided $440 on average in relief per consumer to more than 25 million consumers. This commenter contended that the threat of public enforcement creates sufficient deterrence to ensure that companies will comply with the relevant laws. Indeed, another industry commenter cited a survey showing that 86 percent of companies surveyed have increased their compliance spending since 2010, when the Bureau was created.[607] One industry commenter stated that public enforcement actions are preferable to private enforcement (*i.e.*, class actions) because private class action attorneys are motivated to bring cases for their own financial self-interest and care little about curtailing harmful conduct or compensating injured consumers. At least one industry commenter asserted that the preliminary findings were deficient because the Study did not prove that public enforcement alone is insufficient to enforce the consumer protection laws. One trade association commenter representing consumer reporting agencies stated its belief that the Bureau has sufficient resources to supervise and enforce consumer reporting agencies

[607] Aptean, "2015-2016 Aptean Consumer Complaints Compass: A Survey of U.S. Financial Service Executives Regarding CFPB Compliance," (2016), *available at* http://images.broadcast.aptean.com/Web/Aptean/ percent7Bd0da75db-6649-4133-bc5a-4f189f65282b percent7D_Respond_APT_CFPB_Survey_Fast_Facts_03-18-16.pdf.

because the Bureau supervises only 30 such companies pursuant to its larger participant rule for that market. According to the commenter, the Bureau should have no resource constraints with respect to supervising those 30 entities.

Consumer advocate commenters, on the other hand, agreed with the Bureau's preliminary findings regarding public enforcement. Specifically, these commenters referenced examples of strained public resources for consumer protection. One public-interest consumer lawyer commenter suggested that private enforcement of some claims saves taxpayers money because such activity allows public enforcement agencies to concentrate their resources on cases that private claims cannot reach or that are more appropriate cases for public enforcement. One consumer advocate noted that industry commenters were inconsistent in arguing that the public enforcement by the Bureau provides a sufficient deterrent given that these same commenters are asking Congress and others to substantially reduce or eliminate altogether the Bureau's enforcement powers.

*Class actions complement public enforcement.* With respect to the Bureau's preliminary finding that the Study showed that private class actions are a necessary companion to public enforcement of consumer finance injuries, several industry commenters disagreed. One commenter asserted that the Study's finding that public enforcement cases overlap with private class actions in 32 percent of the cases analyzed represents a significant amount of duplication. An industry commenter then suggested that overlap would increase because it expected the number of Bureau enforcement actions to rise. Another industry commenter disagreed with the relevance of the Bureau's preliminary finding that many private class action settlements occur without a corresponding public enforcement action. Another industry commenter stated that when a private class action is filed without a corresponding government action, the class action

could have been based on a news story or other public information, and thus may not involve situations in which the plaintiff's attorney independently discovered the wrongdoing. In addition, the commenter noted that private class actions filed in the absence of a public enforcement action could have been based on government investigations that uncovered wrongdoing but did not lead to an enforcement action, perhaps because the wrongdoing harmed only a few individuals or because there was no wrongdoing at all.

Another industry commenter criticized the Study's finding that class actions are often filed without a corresponding public enforcement action as simply wrong. The commenter suggested that most class actions are "copycats" of government enforcement actions, citing law review articles supporting this theory.[608] In addition, the commenter cited examples of settled class actions in which the FTC filed amicus briefs requesting that fees for class counsel be reduced because the settled case followed directly from an FTC investigation and enforcement action.[609]

Consumer advocates and public-interest consumer lawyers disagreed. For example, one consumer advocate asserted that companies know that public enforcers cannot police every instance of financial fraud and that companies therefore make compliance decisions accordingly. A separate nonprofit commenter stated that legislatures designed laws to have both public and private enforcement; where the latter is effectively blocked, the laws' intended effect cannot be achieved. Another nonprofit commenter contended that private class actions are a necessary supplement to public enforcement in the areas of fair lending and equal credit and that this was

[608] John H. Beisner et al., "Class Action "Cops": Public Servants or Private Entrepreneurs?," 57 Stan. L. Rev. 1441, 1453 (2005); *see also, e.g.*, Howard M. Erichson, "Coattail Class Actions: Reflections on Microsoft, Tobacco, and the Mixing of Public and Private Lawyering in Mass Litigation," 34 U.C. Davis L. Rev. 1, 2 (2000).

[609] Beisner et al, *supra* note 608, at 1453 (citing Brief of Amicus Curiae The Federal Trade Commission, In re First Databank Antitrust Litig., 209 F. Supp. 2d 96, No. 01-00870, (D.D.C. 2002); Brief of Amicus Curiae The Federal Trade Commission, In re Buspirone Patent Litig., 185 F. Supp. 2d 340, No. 1410 (S.D.N.Y. 2002). *Id.* at 1453-54.

the view of Congress in passing the nation's fair lending laws. This commenter also noted that individually, privately filed cases can spur subsequent public enforcement actions.

A group of State attorneys general charged with enforcing the laws in their States expressed similar concerns about the inability of public enforcement authorities – including themselves – to enforce all of consumer protection law. They noted that, in their experience, public enforcement is benefited when consumers can also take advantage of private enforcement. The commenters noted that many States' unfair competition and consumer protection laws expressly permit private enforcement, often through class actions. As an example, they quoted a decision by the Massachusetts Supreme Judicial Court finding that that State's law had been amended to allow private enforcement specifically because the public enforcement agency lacked capacity to handle the complaints it was receiving.[610] Another State attorney general, writing separately, made a similar point.

A nonprofit organization commented that private enforcement was important because it may advance more aggressive legal theories and seek more substantial remedies as compared to government agencies. Other public-interest consumer lawyer commenters similarly emphasized that, in their view, public enforcement is insufficient. A public-interest consumer lawyer commenter opined that public enforcement agencies are unlikely to have the resources to uncover all instances of unlawful conduct and that these agencies can be subject to political pressures and limitations by the executive or legislative branches of government.[611]

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[610] *Slaney* v. *Westwood Auto, Inc*., 366 Mass. 688, 697, 700, 322 N.E.2d 768, 775-77 (1975); *see also Grayson* v. *AT&T*, 15 A.2d 219, 240 (D.C. 2010) (Providing a private right of action in order to "allow the government to coordinate with the nonprofit and private sectors more efficiently….Public-interest organizations will be able to bring additional resources to consumer protection enforcement in the District, contributing private and donated funds that will advance public priorities without causing the expenditure of additional government resources.").

[611] In support, this commenter cited to Jason Rathod and Sandeep Vaheesan, "The Arc and Architecture of Private Enforcement Regimes in the United States and Europe: A View Across the Atlantic," 14 U. of N.H. L. Rev. 306, at 309 (2015) (noting that "[w]ith large populations and complex economies, even a team of committed public enforcers cannot be expected to catch, let alone prosecute, every violation…. And during

Academic commenters explained that, in their view, the United States legal system depends in large part on private enforcement of the laws. This comment letter contrasted the American system with those of other countries that invest more in public enforcement. They also noted, and cited the Study, that consumer class actions provide relief for injuries that are not the focus of public enforcers. An individual consumer noted in her letter that class actions, unlike increased public enforcement budgets, do not increase government bureaucracy. Relatedly, another individual consumer commenter and a nonprofit both suggested that while class actions should be generally available, they especially should be available for claims brought pursuant to statutes that expressly provide for classwide civil liability.

*Response to Comments and Findings*

*Statutes provide for class actions.* As noted by many commenters, including a group of State attorneys general, 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 public enforcement. For other laws, lawmakers have expressly decided that there should be both public and private enforcement. For example, on several occasions, Congress expressly recognized the role class actions can have in effectuating Federal consumer financial protection statutes. Commenters noted that State legislators have often done the same. As described in Part II.A, for instance, Congress amended the 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

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times of fiscal austerity, government budget cuts further diminish the ability of enforcement agencies to uncover wrongdoing") (internal citations omitted).

objectives of providing adequate deterrence while appropriately limiting awards (because it viewed potential TILA class damages as too high).[612] Two years later, when the 1976 TILA amendments increased the cap to the lesser of $500,000 or 1 percent of the creditor's net worth, the primary basis put forth for the increase was the need to adequately deter large creditors.[613] No commenters disagreed with any of these findings and several consumer advocate commenters highlighted other, similar examples from State law.[614]

*Public enforcement resources are limited.* The market for consumer financial 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 in Part VIII, this rule alone would cover about 50,000 firms. In contrast to the size of the market, the resources of public enforcement agencies are limited. For example, the Bureau enforces over 20 separate Federal consumer financial protection laws (including the Dodd-Frank Act's prohibition on unfair, deceptive and abusive practices) with respect to every depository institution with assets of more than $10 billion and non-depository institutions. Yet the Bureau has about 1,600 employees, less than half of whom work in its Division of Supervision, Enforcement, and Fair Lending, which supervises for compliance and enforces violations of these laws.[615] Furthermore, the Bureau is the only Federal agency exclusively focused on

[612] "Class Actions Under the Truth in Lending Act," 83 Yale L. J. 1410, at 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.").

[613] Consumer Leasing Act of 1976, S. Rept. 94-590, 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* Electronic Fund Transfer Act (1978), H. Rept. 95-1315, at 15.

[614] *See, e.g.*, Iowa Code ch. 714H; California Unfair Competition Law, Bus. & Prof. Code, § 17200 *et seq.;* Massachusetts Consumer Protection Law, G.L. c. 93A, § 9; N.Y. Gen. Bus. Law § 349(h); District of Columbia Consumer Protection Procedures Act, D.C. Code § 283905(k)(l)(A).

[615] Bureau of Consumer Fin. Prot., "Financial Report of the Consumer Financial Protection Bureau for Fiscal Year 2016," at 13 (Nov. 15, 2016), *available at* https://www.consumerfinance.gov/documents/1495/112016_cfpb_Final_Financial_Report_FY_2016.pdf (stating that, as of Sept. 30, 2016, the Bureau had 1,648 employees, 44 percent of whom worked in the Division of Supervision, Enforcement, and Fair Lending).

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

With respect to commenters that believe the amount of relief that the Bureau has provided to consumers through its enforcement cases demonstrates that the Bureau has sufficient resources to enforce the relevant consumer protection laws with respect to all potential wrongdoers, the Bureau acknowledges that it has provided significant relief to consumers since 2012. At the same time, the Bureau is also aware that its enforcement and supervision efforts have not been able to examine the conduct of every provider subject to its jurisdiction under every law that it enforces.[616] As noted above, excluding the mortgage market and certain other types of financial services not covered by this rule, there are at least 50,000 companies that fall within the Bureau's jurisdiction. The Bureau cannot conceivably supervise or investigate all of those firms or even necessarily take action each time it uncovers some evidence of wrongdoing. Thus, with respect to the trade association commenter's contention that the Bureau could easily supervise all 30 larger participant consumer reporting agencies, the Bureau emphasizes that its resources are spread not just among those 30 agencies but among the tens of thousands of other entities within the Bureau's jurisdiction. While the number of larger participant entities in any particular market may be small, the total number of entities for which the Bureau is tasked with enforcing the law is enormous. Indeed, the Bureau has recognized it must prioritize when it

[616] Whether that will change, as one commenter suggested, is addressed below in this Part VI.B.5

brings public enforcement actions and generally chooses to do so where the harms are most egregious and the most consumers are affected by those harms. This prioritization may leave harms that affect relatively fewer consumers, such as some harms by smaller providers, unremedied by public enforcement. As to the amount of money recovered by the Bureau, commenters did not state that it represents all (let alone a meaningful percentage) of the harm that exists in the marketplace, nor is there evidence to support such a contention. Based on its experience and expertise, the Bureau believes that the amounts it has recovered do not represent all of the harm.

Furthermore, as several consumer advocate commenters noted, the Bureau does not have jurisdiction to enforce all violations of the law pertaining to consumer finance. Specifically, the Bureau cannot enforce claims for violation of State statutes, or claims arising in tort (which includes claims sounding in fraud) or those that allege breach of contract. The Bureau also cannot pursue claims against depository institutions and credit unions with less than $10 billion in assets. For all of these reasons, the Bureau finds that its enforcement authority alone is insufficient to remedy all violations of the law and deter future violations.

With respect to the quantity of relief the Bureau has provided to consumers, for the years of 2013 through 2016, the Bureau brought 165 enforcement actions or an average about 41 enforcement actions per year. This is significantly fewer than the 85 class action consumer finance settlements on average identified in the Study per year (a figure that the Bureau's Section 1022(b)(2) Analysis predicts will be 165 per year once this rule takes effect). And while the number of Bureau enforcement cases has increased year-over-year in the near past, the number of cases that the Bureau brings every year is subject to change, as some commenters noted. Further, only some of these enforcement actions and a portion of the approximately $11 billion

in relief provided by the Bureau through its enforcement actions over the past four years concern claims that would be covered by this rule. For example, over $2.5 billion of that relief concerned mortgages, a product not covered by this rule.

The Bureau acknowledges, as several commenters noted, that the Bureau's enforcement actions provided, on average, more relief per consumer than did class action settlements. This reflects the fact that Bureau enforcement may target higher value cases. It may also reflect the fact that the Bureau may be able to pursue cases more effectively than private class actions because, for example, the Bureau has authority to issue civil investigative demands, the Bureau does not need to cover its costs out of recoveries, does not need to certify a class, and can pursue certain claims unavailable to private litigants.[617] But the fact that public enforcement may be a more effective mechanism to secure relief for some consumers on some claims does not mean that it is a sufficient mechanism in and of itself to secure relief on all claims for all consumers. Indeed, private class actions are able to pursue violations of law that the Bureau does not have the resources or enforcement authority to pursue, thereby providing additional relief to consumers and deterring companies from future violations of the law.

With respect to commenters that contended that public enforcement actions are better avenues to address violations of the law because public enforcers are not motivated by their own self-interest to bring cases, the Bureau disagrees that differing motives, if they exist, are relevant. Whatever the motivations of plaintiff's attorneys to bring cases, the Bureau has observed that public enforcers do not have the resources to bring sufficient cases to remedy all violations of the law, and thus that private enforcement of such violations is necessary. Further, as discussed more fully in Part VI.C.2, the Bureau does not agree that the motivation of private plaintiff's

[617] Of course, these figures do not include investigations and other cases abandoned by the Bureau.

attorneys determines whether class action settlements benefit consumers. Indeed, the prospect of fee awards is specifically designed to incentivize plaintiff's attorneys to bring class action cases that individuals might not otherwise pursue, and courts monitor attorney's fee awards to ensure that they are fair and reasonable.

The Bureau notes that most of the commenters critical of the Bureau's preliminary findings regarding public enforcement focused on the Bureau's own enforcement authorities and accomplishments, and to a large extent did not address enforcement by other Federal and State regulators. Most of these other regulators, as the comment letter from the group of State attorneys general noted, enforce not only consumer protection laws but also many other laws and must allocate their enforcement resources accordingly. In addition, as several commenters noted, these regulators, like the Bureau, must manage general budgetary constraints, changing legislative priorities, and limitations on jurisdiction and authorities, such as over tort or contract claims, that are more suited to private actions.

Finally, the Bureau notes that if the commenters were correct in claiming that public enforcement is sufficient to address all misconduct in the covered consumer finance markets and secure relief for those affected, the Bureau would expect to see a low incidence of class action litigation due to incentives facing plaintiff's attorneys. Further, the Bureau would expect to see small settlements given that settlements are generally a function of the expected value of the claims. As discussed above, the evidence with respect to number, size, and relief obtained in class actions belies the claim that public enforcement is sufficient to fully vindicate consumers' rights under the consumer protection laws.

*Class actions complement public enforcement.* 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.[618] 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.[619]

In response to commenters that asserted that this still left significant amounts of overlap between private and public cases, the Bureau notes that where there was overlap, private class actions appear to have preceded public enforcement actions roughly two-thirds of the time. Moreover, when there are private cases that follow public enforcement, courts can and do take the earlier public case into account when approving settlements and calculating attorney's fees. For example, one commenter noted cases where the FTC filed an amicus brief requesting that the court reduce plaintiff's attorney fees for a class action settlement that followed a public enforcement matter on the same facts.[620] Further, resources for judges who manage class actions have favorably cited this case as a model for Federal judges handling such follow-on private litigation.[621] As for the commenters that suggested that private class actions that did not overlap with public enforcement cases are somehow less valuable because they may have been based on public news reports or on evidence uncovered by public enforcers in investigations that were not pursued, the Bureau does not believe the origin of those private cases is relevant. Instead,

[618] Study, *supra* note 3, section 9 at 4.
[619] *Id.*
[620] *In re First Databank Antitrust Litig*., 209 F.Supp.2d 96 (D.D.C. 2002)
[621] Barbara J. Rothstein & Thomas E. Willging, "Managing Class Action Litigation: A Pocket Guide for Judges," Fed. Jud. Ctr., at 26 (2005), *available at* http://www.uscourts.gov/sites/default/files/classgde.pdf (citing , *e.g.*, *Swedish Hospital Corp.* v. *Shalala*, 1 F.3d 1261, 1272 (D.C. Cir. 1993) (affirming district court's decision to "bas[e] its fee calculation only on that part of the fund for which counsel was responsible" where class counsel brought a case that "rode 'piggyback'" on a previous action); *In re First Databank Antitrust Litig*., 209 F.Supp.2d 96, 98 (D.D.C. 2002)).

regardless of origin, those cases provided relief to consumers for violations of the law that public enforcers otherwise did not or were not able to pursue.

*C. The Bureau Finds that the Class Rule Is in the Public Interest and for the Protection of Consumers*

In the proposal, the Bureau preliminarily found, in light of the Study and the Bureau's experience and expertise, 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 legally risky or potentially illegal activities and reduce the likelihood that consumers would be subject to such practices in the first instance. The Bureau further preliminarily found that because of these outcomes, allowing consumers to seek class action relief was consistent with the Study and would be in the public interest and for the protection of consumers. The Bureau made this preliminary finding after considering 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 found that the statutory standard was satisfied.

The sections below discuss the bases for the preliminary findings, comments received, and the Bureau's further analyses and final findings in support of the class rule 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 incentives to comply with the law and causing companies to choose between increased risk mitigation and enhanced exposure to liability imposes certain burdens on providers. These burdens are 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 putative class actions themselves, including, in some cases, providing relief to a class and payment to its attorneys. The Bureau also recognizes that providers may pass through some or all 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 in Part VIII and, with regard in particular to burdens on small financial services providers, discussed further below in Part VII in the section-by-section analysis to proposed § 1040.4(a) and in the final Regulatory Flexibility Analysis below in Part IX.

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

In the proposal, the Bureau preliminarily found that the class rule, 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 explained in the proposal that it believed 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 materially reduced. 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 proposal's 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[622] and the courts[623] 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 was 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 financial products and services. The Bureau 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 stated that it was 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 was 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

[622] H. Rept. 94-589, Equal Credit Opportunity Act Amendments of 1976, at 14 (Jan. 21, 1976).

[623] *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.").

developments in class action litigation,[624] for instance claims pertaining to EFTA,[625] FACTA,[626] FCRA,[627] FDCPA,[628] and the TCPA.[629]

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 stated in the proposal that it had 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

[624] A brief search by the Bureau 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 LLP, "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," at 49-52 (2013) (noting a variety of compliance activities companies should consider in product design in order to mitigate class action exposure).

[625] *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.").

[626] *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 LLP, "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 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.").

[627] *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.").

[628] *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 FDCPA compliance" in order to avoid class action liability).

[629] *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.").

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 result in groups of consumers taking action."[630] Another 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.[631] Similarly, the Bureau noted that industry 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.[632]

The Bureau also stated in the proposal that while it believed 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, however, identified instances where it believed that class actions filed against one or more firms in an industry led to others changing their practices, presumably in an effort to avoid

[630] *See, e.g.*, Jones Day LLP, "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/.

[631] 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)."). *See also infra* note 670 (noting that this trend has continued with regard to the proposal itself, as law firms have advised clients to review their compliance materials given the potential that the Bureau would finalize the proposal).

[632] 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.

being sued themselves. For example, between 2003 and 2006, 11 automobile lenders settled class action lawsuits alleging that the lenders' credit pricing policies had a disparate impact on minority borrowers 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.[633] The use of caps has continued even after the consent decrees that triggered them have expired.[634]

As another example, the Bureau noted in the proposal that since 2012, 18 banks have entered into class action settlements as part of the Overdraft MDL,[635] 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

[633] *See* F&I and Showroom, "2.5 Percent Markups Becoming the Trend," (Aug. 9, 2005), *available at* 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/. 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: Fast Facts," (FFVR 35, revised Nov. 2016), *available at* https://www.dmv.ca.gov/portal/dmv/?1dmy&urile=wcm:path:/dmv_content_en/dmv/pubs/brochures/fast_facts/ffvr35.

[634] *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.").

[635] *See supra* note 501 and accompanying text.

abandoned this practice. According to a 2015 study, from 2013 to 2015, the percentage of large banks that used commingled high-to-low reordering decreased from 37 percent to 9 percent.[636]

The proposal noted a third example of companies responding to class actions by changing their practices to improve their compliance with the law that relates to foreign transaction fees and debit cards. *In re Currency Conversion Fee Antitrust Litigation* (MDL 1409) was 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.[637] 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.[638] A review of the market subsequent to the 2006 settlement indicated 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.[639]

As the proposal explained, these are a few examples of industry-wide change in response to class actions that the Bureau believed support its preliminary finding that exposure to consumer financial class actions creates incentives that encourage companies to change

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[636] *See* Pew Charitable Trusts, "Checks and Balances: 2015 Update," at 12 fig. 11 (May 2015), *available at* 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. Independent Community Banks of America, "The ICBA Overdraft Payment Services Study," at 40 (June 2012), *available at* http://www.icba.org/docs/default-source/icba/solutions-documents/knowledge-vault/icba-surveys-whitepapers/2012overdraftstudyfinalreport.pdf. Only 8.8 percent of community banks reordered transactions from high to low dollar amount. *Id.* at 42 and 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.*

[637] Third Consolidated Amended Class Action Complaint, In Re Currency Conversion Fee Antitrust Litig., 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 percent 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").

[638] Stipulation & Agreement of Settlement at 27-30, In re Currency Conversion Fee Antitrust Litig., No. 1409 (S.D.N.Y. July 20, 2006).

[639] 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. Karen Bruno, "Foreign transaction fees: Hidden credit card 'currency conversion fees' may be returned – if you file soon," CreditCards.com (May 23, 2007), *available at* 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.").

potentially illegal practices and to invest more resources in compliance in order to avoid being sued.[640] 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 stated in the proposal that it 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 proposal's Section 1022(b)(2) Analysis, the Bureau did not believe it possible to quantify the benefits to consumers from the increased compliance incentives attributable to the class proposal due in part to the difficulty of measuring the value of deterrence in a systematic way. Nonetheless, the Bureau preliminarily found that increasing compliance incentives would be for the protection of consumers.

The Bureau recognized 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 unlawful. Other companies may seek to mitigate their risk but may miscalibrate and underinvest or under comply. To the extent that this happens, the Bureau preliminarily found that the class proposal would enable many more consumers to obtain redress for violations than do so now while companies can use arbitration agreements to block class actions. As set out in the proposal'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

[640] 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 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 in many cases can (and should) do more to ensure that their conduct is compliant and that the presence of class action exposure will affect companies' incentives to comply.

of arbitration agreements in those individual markets – but is substantial nonetheless and in most markets represents a considerable increase.[641]

Furthermore, the Bureau preliminarily found that through such litigation consumers would be better able to cause providers to cease engaging in unlawful or legally risky 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 Bureau offered the Overdraft MDL as an example to help illustrate the potential ongoing value of such prospective relief. A 2015 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 for the value of prospective relief. The analysis reviewed settlement documents and found that 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.[642] 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

[641] 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.

[642] Fitzpatrick & Gilbert, *supra* note 484, at 785, ("[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.*

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.[643] 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 class period) 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.[644] 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 showed, prospective relief – because it can continue in perpetuity – can have wide-ranging benefits for consumers over and above the value of

[643] *See id.* at 786 and 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.

[644] 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 does the benefit include 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.

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 stated in the proposal that it believed 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, deceptive, and abusive debt collection practices proscribed by the FDCPA and the discriminatory practices proscribed by ECOA.[645] In those States that provide for private enforcement of their unfair 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.

The Bureau also discussed in the proposal that some stakeholders had predicted during the SBREFA phase and other early outreach that pursuing a class rule would lead them to remove arbitration agreements, either because arbitration agreements served no purpose if they did not operate to block class actions or because the costs of individual arbitration to providers were substantial enough that providers would want to eliminate that dispute resolution channel in

[645] *See generally* Study, *supra* note 3, section 8 at 13 and fig. 1 (noting the number of class settlements by frequency of claim type).

the absence of offsetting benefits from blocking class actions.[646] The Bureau acknowledged in the proposal that it was possible that providers would not maintain their arbitration agreements if they concluded that individual arbitration provides no benefit to themselves or their customers, but was not persuaded that such an outcome was certain simply because the rule would change the outcome on class proceedings. In particular, the Bureau noted that because providers would still face some individual disputes in any event, it was not entirely clear how providers would evaluate the tradeoffs between different channels for resolving those disputes in isolation, if class proceedings were subject to the proposed rule.

For example, the Bureau noted that 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).[647] Moreover, the costs of the upfront 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. Indeed, as explained in the proposal's Section 1022(b)(2) Analysis, providers generally already maintain two systems to the extent that most arbitration agreements allow for litigation in small claims courts. Thus, the Bureau did not understand why the costs of resolving a few cases in arbitration, even if somewhat greater than resolving these cases in litigation, would alone cause companies to withdraw an option that they often asserted benefits both themselves and consumers. Further,

[646] The Bureau addressed this concern in the proposal in the context of its preliminary findings that the class proposal was in the public interest. In this final rule, however, the Bureau addresses this concern in the context of its finding that the class rule is for the protection of consumers, because many commenters raised concerns that the loss of individual arbitration as a forum would harm consumers. As noted below in Part VI.C.2, however, if providers choose to remove arbitration agreements from their contracts, the loss of individual arbitration as a form of dispute resolution arguably impacts both providers and the public interest. Accordingly, the Bureau incorporates this discussion with respect to its public interest findings as well.

[647] *See* Study, supra note 3, section 5 at 75-76.

the Bureau stated that it did not believe that any resulting constraints on individual dispute resolution would be so severe as to outweigh the broader benefits of the class rule to consumers.

*Comments Received*

*Deterrence.* Many industry, research center, State attorneys general, and individual commenters took issue with the Bureau's preliminary finding that the threat of private class actions deters companies from violating the law. However, these commenters generally did not disagree with the Bureau's basic premise that a system that provides for liability for violations of law promotes deterrence; instead they asserted that while deterrence in general may exist in such a system, class actions themselves either do not achieve increased deterrence or to the extent that they do increase deterrence, that increase is unnecessary or even harmful to consumers.

Many of these industry, research center, and individual commenters contended that class actions do not deter violations of the law because they exert pressure on companies to settle whether or not the claims asserted have merit. The commenters asserted that such risk is unavoidable regardless of an entity's compliance efforts, and that companies will therefore not in fact increase such efforts. The pressure to settle exists in part, the commenters asserted, because defendant companies must bear high discovery and defense attorney costs and must consider the risk, no matter how small, of a large judgment in a case that is certified as a class action. The commenters asserted that providers are not willing to tolerate the risk that such a judgment would involve substantial payouts to each member of the class, even if the likelihood of the judgment occurring is low. These commenters contended that the pressure to settle regardless of the merit of the claims means that class actions do not deter wrongdoing, they are simply a "cost of doing business."

One trade association commenter representing defense lawyers held the opposite view: class actions do deter violations of the law and in fact, they create "over-deterrence." In this commenter's view, many class actions in the financial services market involve ambiguities and uncertainties in the law, rather than clear violations. Thus, when companies settle class actions without final adjudication of these uncertain legal issues and change their behavior to cease the conduct at issue, the commenter asserted that the companies may be avoiding behavior that is lawful, creating over-deterrence. Relatedly, another industry commenter stated its view that class action settlements are unfair when the law is ambiguous or uncertain and thus companies cannot predict that their conduct may violate the law and subject them to a class action. A nonprofit commenter also agreed that class actions deter wrongdoing, but contended that compliant providers are more likely to be sued in class actions than "bad actor" providers because the latter are likely judgment proof. In the commenter's view, this fact creates an imbalance wherein compliant providers are more deterred from bad behavior than non-compliant ones.

In the Study, the Bureau found that class action settlements typically occur in conjunction with class certification, which the Bureau stated in the proposal suggests that class certification does not itself pressure defendants to settle.[648] Some industry commenters disagreed with the significance of this finding, contending that there is pressure to settle class actions at every stage of litigation, not just after class certification. Many industry and research center commenters further contended that the pressure to settle non-meritorious class actions is particularly acute in cases asserting claims under statutes that provide for statutory damages, such as FACTA, FCRA, and FDCPA, because the statutory damages multiplied by hundreds or thousands of potential

[648] Study, *supra* note 3, section 6 at 7.

class members can create potential liability of hundreds of millions or even billions of dollars.[649] In these commenters' view, statutory damages were designed to incentivize individual claims, and when claims pursuant to those statutes are pursued using the class action device, they can create the potential for ruinous liability that creates massive pressure for companies to settle.

Some industry commenters agreed that the threat of class action liability deters at least some violations of the law, but contended that its deterrent effect is imprecise and inefficient because of statutes that provide for recovery of attorney's fees and double or treble damages. In these commenters' view, these remedy features incentivize attorneys to bring claims under statutes that have them (as opposed to bringing claims under other statutes or common law without those features) in order to maximize their own profit. One commenter asserted that the lawsuits themselves therefore bear no relation to the merit of the claims and thus do not deter wrongdoing.[650] This inefficiency is compounded, according to the commenters, by the fact that statutory damages often provide for significant liability for technical violations of the law even where there has been no actual harm to consumers. For example, another commenter pointed out that companies can face massive liability class actions against merchants under FACTA for accidentally printing credit card expiration dates on a receipt, activity which the commenter contends does not harm consumers. A law firm commenter representing individual automobile dealers in California stated that the remedy for violations of certain State disclosure requirements for automobile purchases is restitution of the vehicle purchase price, resulting in enormous pressure for those dealers to settle cases alleging violations of those laws. As another example, a trade association representing consumer reporting agencies that offer credit monitoring products

[649] The Bureau notes that the FDCPA caps damages in a class action at the lesser of $500,000 or 1 percent of net worth of defendant; capped amount is in addition to any actual damages; punitive damages are not expressly authorized. 15 U.S.C. 1692k(a)(2)(B).
[650] Shepherd, *supra* note 515, at 2.

directly to consumers identified the penalty of disgorgement of all fees paid for the service for violations of CROA as disproportionate. In the view of the commenter, the prospect of such catastrophic damages does not deter wrongdoing; instead the commenter contends that compliance with CROA for its products is impossible, for reasons discussed below in this Part VI.C.1 and in the section-by-section analysis of § 1040.3(b) below in Part VII.

On the other hand, a consumer advocate commenter, quoting Judge Richard Posner, contended that this is precisely the point:

> Society may gain from the deterrent effect of financial awards. The practical alternative to class litigation is punitive damages, not a fusillade of small-stakes claims. The deterrent objective of [EFTA] is apparent in the provision of statutory damages, since if only actual damages could be awarded, the providers of ATM services … might have little incentive to comply with the law.[651]

One research center commenter cited the Overdraft MDL settlements as an example of massive liability where consumers were not actually harmed and thus disagreed with the Bureau's reliance in the preliminary findings on those settlements as evidence of deterrence. The commenter asserted that banks lose money on free checking accounts and that overdraft fees were therefore necessary in order for banks to subsidize free checking accounts for consumers. The commenter therefore believed that the overdraft settlements did not remedy harm to consumers, but actually caused harm by decreasing the likelihood that banks will offer free checking accounts going forward. The same commenter criticized the Bureau's inclusion of the overdraft settlements as an example of litigation that prompted companies to change behavior because some banks continue to reorder consumer overdrafts in such a way as to maximize the fees charged to the consumer, despite that settlement. The commenter agreed, however, that the

[651] *Hughes* v. *Kore of Ind. Enter.*, 731 F.3d 672, 677 (7th Cir. 2013) (citations omitted) (further noting that "The smaller the stakes to each victim of unlawful conduct, the greater the economies of class action treatment and the likelier that the class members will receive some money rather than (without a class action) probably nothing, given the difficulty of interesting a lawyer in handling a suit for such modest statutory damages as provided for in the [EFTA]."). As the Bureau notes above, Congress amended EFTA to remove ATM sticker provisions.

percentage of banks that employ this practice has diminished since the overdraft class action litigation began. An industry commenter asserted that the Bureau's examples of deterrence were misplaced because they concerned settlements, not actual findings or admissions that the defendants had broken the law and thus the Bureau lacked examples of illegal conduct being deterred. Asserting a similar concern, another industry commenter contended that to the extent that the class actions affect change in business practices, private class action settlements are not an efficient policymaking tool. One industry commenter further contended that because it views class actions as inefficient, the Bureau could more efficiently deter violations of the law by deciding which practices are unfair or deceptive and then informing companies of them.

Several industry commenters disagreed with the Bureau's preliminary finding that class actions deter wrongdoing because they believe that the threat of public enforcement from the Bureau, other Federal agencies, or State attorneys general is more likely to deter companies from violating the law than any class action could. A group of State attorneys general similarly asserted that State consumer protection laws and the threat of State public enforcement are sufficient to deter violations of the law. Other industry commenters contended that companies are more likely to be deterred from violating the law by the threat of individual lawsuits or the threat that consumers will take their business elsewhere once they learn of the companies' violations; one of these commenters cited the Study's survey data on the likelihood of this occurring. A Tribal commenter stated its belief that consumers who obtain products or services from Tribes are sufficiently protected through Tribal regulation and enforcement of those regulations and thus there is no need for the deterrent effect of class actions with respect to Tribes.

Several industry commenters asserted that even if class actions do deter wrongdoing, the deterrence they provide is not necessary because companies already comply fully with the law. In support, a credit union commenter provided data on the amount credit unions already spend to comply with regulations ($6.2 billion) and what it asserted was a similar additional financial impact of those regulation to its business practices. Separately, one industry commenter rejected what it characterized as an assertion by the Bureau that companies are "scofflaws." Such commenters cited data noting that companies have significantly increased their spending on compliance since the Bureau was established. Other industry, research center, and State regulator commenters contended that there is no empirical evidence that compliance with the law is currently under-incentivized and that there is nothing in the Study that supports the Bureau's contentions to the contrary. Similarly, one industry commenter criticized the preliminary finding regarding deterrence because the Bureau did not study compliance rates of companies with and without arbitration agreements, arguing that the Bureau thus had no empirical evidence that companies with arbitration agreements have lower levels of compliance. Relatedly, an industry commenter asserted that the rulemaking record, including the SBREFA Report, indicates that companies do not intend to spend more on compliance and thus it has no deterrent effect. One State regulator commenter also urged the Bureau to do a thorough quantitative analysis to determine whether companies currently comply with the consumer financial laws at less than optimal levels. Relatedly, a comment from a group of State attorneys general asserted that market forces sufficiently encourage firms to comply with the law because they do not want to be perceived as "bad actors" relative to their competitors such that they might lose customers.[652]

[652] This comment also asserted that the savings clause in section 2 of the FAA, which permits arbitration agreements to be invalidated by generally applicable contract defenses such as "fraud, duress or unconscionability" (*Concepcion*, 131 S.Ct. at 1746), also protect consumers from

Similarly, a nonprofit commenter stated its belief that individual lawsuits sufficiently deter violations of the law because an individual lawsuit can alert a company to its violation of the law as well as a class action lawsuit can. Accordingly, this commenter contended that class actions are not necessary to deter violations of the law.

Some industry commenters stated their belief that class actions were not necessary to deter violations of the law with respect to providers of certain products or services because the markets for these products or services have particular features which, in their view, encouraged full compliance by providers.[653] A trade association representing debt collectors stated that because arbitration agreements may not always be written in such a way that the class action prohibition can be relied upon by a debt collector, whether a debt collector may be subject to class action liability is typically uncertain. Because of this uncertainty with respect to the arbitration agreements, the commenter stated that debt collectors fully comply with the law and thus that the threat of class actions does not serve to deter debt collectors. Several credit union and credit union association commenters asserted that their member-owned, not-for-profit cooperative structure provides adequate accountability incentives to fully comply with the law, such that the prospect of class actions are not necessary to deter them from violations of the law. Similarly, a community bank commenter stated that community banks are relationship-oriented, and the need to develop customer relationships and retain customers provide an adequate incentive for them to comply with the law.

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bad conduct. The Bureau is not aware of any evidence to suggest that such defenses are widely available to consumers or that they address most harms that befall them and thus does not believe that exception to the FAA has any significant impact on its Findings with respect to whether the class rule is for the protection of consumers.

[653] A few of these commenters requested that they be excluded from the rule's coverage for this reason. These requests for exclusion are discussed below in Part VII in the section by section analysis to § 1040.3.

A few commenters challenged the examples the Bureau cited in the proposal (and summarized above in this Part VI.C.1) of companies that monitor class action lawsuits and adjust their conduct accordingly as supporting the Bureau's preliminary finding that class actions deter violation of the law. However, none of the commenters disagreed with the general observation that companies monitor class action litigation to minimize their class action exposure and at least one industry commenter agreed that doing so is a prudent business practice. One commenter criticized the Bureau's consideration of law firm alerts about class action cases concerning ATM fee notices pursuant to EFTA as evidence that class actions create deterrence because those cases were not analyzed as part of the class action litigation filings in the Study and because Congress has since amended EFTA such that the conduct at issue in those cases is no longer unlawful. That same commenter criticized the Bureau's citation to foreign currency litigation, contending that the only behavioral change companies made in response to that litigation was to add more consumer disclosure, which, in the commenter's view did not benefit consumers because disclosure is ineffective.

In contrast, numerous individuals, consumer advocates, public-interest consumer lawyers, nonprofits, and consumer lawyers and law firms agreed with the Bureau's findings that class action exposure deters wrongdoing and encourages others to comply with the law. One of these consumer advocate commenters suggested, as the Bureau preliminarily found, that the deterrent effect of class actions is their most potent benefit. Several of these commenters remarked that the public nature of class actions and class settlements deter wrongdoing. One consumer law firm commenter noted that companies often require notification to upper management and boards of directors about class actions because of their potentially large liability, emphasizing that such senior leaders are capable of changing the underlying policies at issue. By contrast, the

commenter stated that individual actions are often resolved at lower levels of the company and that upper management may not be made aware of the problem. Academic commenters suggested that many named plaintiffs pursue classwide relief not so that they can be compensated but to prevent the company from harming similarly situated consumers in the future. Similarly, a public-interest consumer lawyer and consumer advocate suggested that class action exposure deters bad behavior and prevents harm to victims other than the named plaintiff. A consumer law firm commenter explained that class actions deter misconduct in ways that individual actions cannot. Similarly, a consumer advocate commenter stated that class actions are critically important not only for compensating victims of corporate law-breaking but also for the deterrent effect of civil litigation.

Commenters also provided specific examples, from their personal experience, of deterrence. For example, two public-interest consumer lawyer commenters described class actions involving automobile dealer markups that resulted in an industry-wide agreement to put in place caps on compensation so as to avoid future litigation over this issue. A consumer advocate commenter cited examples of deterrence in the auto-lending, payday loan, deposit account, and credit card industries.

Commenters offered various explanations for why, in their view, class actions deter violations of the law. For example, a consumer advocate asserted that the risk of damages and reputational harm from a class action helps deter wrongdoing. Similarly, a consumer law firm commenter suggested that the public nature of class actions provides an important deterrent effect against wrongdoing. Another consumer advocate stated that the civil justice system reinforces the efforts of regulatory programs aimed at preventing such harms before they can occur, and that the threat of incurring civil liability adds a complementary deterrent factor that

can discourage individuals and businesses from breaking the law and engaging in other kinds of harmful behavior. A public-interest consumer lawyer commenter asserted that, if a company could block class actions, it may have a powerful incentive to engage in widespread violations of law that result in small, but significant, individual harms while benefiting the company significantly in the aggregate. The commenter further suggested that this incentive has led companies to act deceptively in small ways to reap additional profits.

A consumer law firm cited to the *Gutierrez* overdraft case cited in the proposal and described above, asserting that it demonstrates how defrauding consumers over small amounts can increase a company's profits. The commenter noted that there was little risk to the company that adopted those practices because it had an arbitration agreement in its customers' contracts and few consumers noticed the fee practices at issue. When companies know consumers can sue in class actions regarding such conduct, the commenter said that they are deterred. A local government commenter explained that, in its experience, class actions have the potential of changing corporate policy. Two consumer advocate commenters asserted that deterrence works because of the risk of damages and reputational harm from a class action; when this risk is low, unfair or deceptive practices become easier to adopt. Similarly, another consumer advocate commenter stated that without the deterrent effect of class actions, companies' worse instincts are unleashed – they become more driven to maximize profits and executive compensation at the expense of protecting consumers. One public-interest consumer lawyer commenter provided examples specific to civil rights class actions, explaining that it viewed private class actions as critical to protect civil rights in the financial markets and that civil rights consumer class actions provide relief beyond the named plaintiff by remedying and deterring civil rights violations and systemic discrimination. Members of Congress cited to a fact sheet written by a consumer

advocate regarding discrimination class actions. This fact sheet, which summarized others' work on the topic, asserted that individual discrimination cases are an unrealistic option for remedying discrimination because, among other reasons, it is expensive to prove institutional discrimination, and that class actions may be the only way to prove and remedy a pattern or practice of discrimination.[654] Without class actions deterring companies, stated one consumer advocate commenter, financial services companies would be able to go on enriching themselves by breaking the law at the expense of their largely unsuspecting customers. A consumer law firm commenter stated that class actions force corporate decisionmakers to think twice before inflicting harms that would otherwise escape review if consumers could only proceed on an individual basis.

With respect to the Bureau's preliminary finding that precluding providers from using arbitration agreements to block class actions would better enable consumers to enforce their rights and obtain redress when their rights are violated by providers, many consumer advocate and consumer law firm commenters agreed. By contrast, many industry commenters asserted that the rule would lead companies to remove arbitration agreements from their contracts which would make it more difficult for consumers to obtain relief in arbitration, a forum that the commenters viewed as superior to litigation. As discussed above, however, some industry, research center, and State government and State attorneys general commenters asserted that consumers have adequate alternative means of obtaining relief, whether through the informal dispute resolution channel, pursuing individual disputes via litigation or arbitration or enforcement. Consumer advocate and nonprofit commenters disagreed with these assertions.

[654] *See* Center for Justice & Democracy, "Fact Sheet: Civil Rights Class Actions: A Singularly Effective Tool to Combat Discrimination," (Jan. 6, 2014), *available at* https://centerjd.org/content/fact-sheet-civil-rights-class-actions-singularly-effective-tool-combat-discrimination.

*Whether the rule will cause providers to remove arbitration agreements.* With regard to the debate over whether adopting the class proposal would harm consumers by prompting providers to remove arbitration agreements from their contracts entirely, many industry commenters and a comment from a group of State attorneys general contended that providers would, in fact, remove arbitration agreements from their contracts and that depriving consumers of access to individual arbitration would harm them.[655] With regard to the first point, these commenters asserted that providers incur significant costs in connection with providing arbitration to their customers. As examples, commenters cited the filing fees, hearing fees, and arbitrator compensation that providers often agree to pay when consumers file arbitrations against them. These commenters suggested that providers are not willing to pay these costs for individual arbitration unless they can use arbitration agreements to block class actions and thereby avoid class action defense costs. A few industry commenters argued that it is inevitable that companies would remove their arbitration agreements because it is economically impossible for companies to pay arbitration costs related to individual arbitration and also pay class action defense costs. Nevertheless, no commenter provided a specific accounting of providers' costs or any other concrete evidence to buttress these assertions.

This lack of evidence is particularly important because the Bureau stated in the proposal that it was skeptical that the class rule would cause providers to incur significant additional costs by maintaining "two tracks" of dispute resolution (arbitration and court) given that many providers already maintain two tracks for dispute resolution in small claims court and arbitration and that few companies compel arbitration when an individual consumer first files in court.

[655] Separately, one industry commenter asserted that the combined effect of the class proposal and monitoring proposal would cause providers to drop their arbitration agreements. The impact of the monitoring proposal is discussed below in Part VI.D.

Several industry commenters explained why, in their view, the class rule would impose significant additional costs and why providers currently permit small claims court filings and rarely move to compel arbitration in individual litigation. A few industry commenters asserted that litigating disputes in both arbitration and small claims court is not substantially more burdensome for providers than litigating disputes only in arbitration, because small claims courts have many of the same streamlined procedures as arbitration, such as limits on discovery and individualized proceedings. Consequently, in the commenter's view, the fact that businesses litigate disputes in both arbitration and small claims court does not indicate that they can afford to "subsidize" arbitration while paying class action defense costs (and therefore continue to maintain two tracks if the Bureau finalized the class rule). The commenter also disagreed that the Study showed that companies already maintain two tracks of litigation because they move to compel arbitration in only about 1 percent of individual cases filed in Federal court and about 5 percent of the 140 cases against companies known to have an arbitration agreement. The commenter asserted that the Bureau's sample size of 140 cases is too small to draw the conclusion that companies rarely invoke arbitration agreements in individual litigation, although no commenter cited any evidence to the contrary. The commenter also argued that companies' low rate of invocation is not evidence of companies' willingness to litigate in both arbitration and court, because there are many reasons why a provider may not move to compel arbitration despite its preference for litigating disputes in arbitration, such as the consumer opting out of the arbitration agreement, a provider's offer of settlement, or the consumer's failure to prosecute the case.

In response to the Bureau's skepticism in the proposal as to whether the costs of individual arbitration will cause providers to remove arbitration agreements if the class rule is

finalized, other industry commenters noted that many arbitration agreements include "anti-severability provisions," which state that if the agreement's no-class provision is held unenforceable, the entire arbitration agreement is unenforceable as well.[656] The commenters stated that through these anti-severability provisions, providers have already effectively chosen to eliminate their arbitration agreements if the no-class provision is not available and thus the Bureau's skepticism is unfounded.

*Whether loss of individual arbitration harms consumers.* Numerous Congressional, industry, and research center commenters, as well as a group of State attorneys general asserted that arbitration is a superior form of dispute resolution for consumers relative to individual litigation and that consumers would therefore be harmed if the class rule causes providers to remove arbitration agreements from their consumer contracts. These commenters cited several factors in support of their argument. Many stated that arbitration is a superior forum for resolving individual disputes because filing fees are less expensive for consumers than comparable fees in court. For example, these commenters noted that the AAA's consumer arbitration rules require consumers to pay no more than $200 in costs for arbitration, and that many providers use arbitration agreements that require the provider to pay the consumer's entire filing fees in certain circumstances. In contrast, commenters noted that filing fees for individual suits in Federal court are $400, and that State court filing fees vary but are often more than $200. A research center noted that arbitration saves money for both consumers and businesses.

Many of these same industry, research center, and State attorneys general commenters noted that individual disputes filed in arbitration are, on average, resolved more quickly than those filed in individual litigation. One industry commenter noted that arbitrations analyzed in

[656] Study, *supra* note 3, section 2 at 46-47.

the Study were resolved in a median of four to seven months, depending on whether the consumer appeared at the hearing and whether that hearing was in person or by telephone. By contrast, the commenter noted that the average time to reach trial for an individual suit filed in Federal court was 26.7 months.[657] Several of these industry commenters further stated that many State courts have significant backlogs, thus increasing the time to resolution in those courts.

Many industry and research center commenters also stated their belief that arbitration is a better forum for consumers to resolve their disputes with consumer finance companies than individual litigation in court because consumers may proceed without an attorney in arbitration. These commenters believe that arbitration's streamlined process, which does not typically include motions or discovery practice common to litigation and has simpler pleading requirements, allows consumers to pursue their own claims without an attorney and are far lower than what one industry commenter asserted is the astronomical cost of litigation. Indeed, these commenters noted that the Study showed that unrepresented consumers more often received favorable decisions from arbitrators than did consumers represented by attorneys. On the other hand, one industry commenter asserted that when consumers do have an attorney in an arbitration, that attorney is likely to have prior arbitration experience. Some industry commenters and a group of State attorneys general noted that arbitration hearings were typically held in locations that were convenient for consumers and often occurred via telephone, Skype or email without the consumer having to appear in person. In contrast, these commenters noted that litigation typically requires consumers to appear in person and often during the day, requiring them to miss work. An industry and research center commenter and a group of State attorneys

[657] U.S Courts, "Federal Judicial Caseload Statistics 2016," (June 2016) *available at* http://www.uscourts.gov/statistics-reports/federal-judicial-caseload-statistics-2016.

general noted that the arbitration process is simpler than litigation and therefore easier for consumers to navigate. Relatedly, an industry commenter noted that fees are modest and disclosed in arbitrations and that arbitrators may waive or reduce them further. An industry commenter asserted that arbitration is better than litigation because consumers can play a role in choosing their arbitrator, while they cannot choose a judge. An industry commenter and several State attorneys general asserted that arbitration benefits consumers because they are more likely to receive a decisions on the merits as compared to class actions, where the Study showed no trials occurred in class actions.

Many of the industry and research center commenters noted that the Study showed that consumers prevailed on their claims in arbitration at least as much as they did in litigation. They noted, for example, that the Study showed that consumers received a favorable decision from an arbitrator 6 percent of the time and settled with companies 57 percent of the time in arbitration (appearing to reflect data from the Study that identified known and likely settlements), while consumers received a favorable judgment in 7 percent of their claims in individual litigation and settled 48 percent of claims filed in court (appearing to reflect data from the Study that identified known settlements only). Many industry commenters and a group of State attorneys general further contended that successful consumers won significant amounts in arbitration; according to the Study, the average consumer who received a favorable award received more than $5,000 and a group of State attorneys general noted that arbitration agreements rarely limit consumers' recovery.

Several of these same commenters also asserted that arbitration is at least as fair for consumers as litigation because the major arbitration administrators, AAA and JAMS, each have due process standards that require arbitrators to handle claims fairly. An industry commenter

and a research center both further noted that courts have authority under the FAA to invalidate arbitration agreements that impose unfair terms on consumers, such as those that limit consumers' right to recovery in ways not permitted by Federal or State law. In addition, these commenters noted that the Study found that few arbitration agreements contained provisions that these commenters thought were unfair to consumers on their face, such as those that required arbitration to occur in an inconvenient forum or that required the consumer to pay for all arbitration fees if the consumer failed to win the claim. Commenters additionally asserted that the majority of arbitration agreements contain provisions intended to ensure fairness for consumers, citing provisions such as those fully disclosing the arbitration process, allowing consumers to opt out of the arbitration agreement, and allowing consumers to file claims that meet the relevant claims limits in small claims court rather than be subject to arbitration. One industry commenter went further and asserted that arbitration is in fact more fair than the alternatives because disputes can be reasonably aired, considered, and resolved.

Some industry and research center commenters asserted that individual arbitration is frequently and successfully used by both consumers and companies in other areas of the law, such as in employment, securities, and medical malpractice. They further contended that, given time, consumer finance arbitration can achieve the same levels of success.[658] They did not state how much time would be required nor what should happen to consumers bound by arbitration now until that threshold is crossed. One industry commenter asserted that consumers are more satisfied but did not provide evidence supporting this claim nor did it explain what consumers were more satisfied with – their provider or arbitration.

[658] A few commenters pointed out that the Bureau requires its employees to sign pre-dispute arbitration agreements and to arbitrate employment claims against the Bureau.

Several industry and research center commenters stated that the loss of individual arbitration as an option for consumers is particularly problematic because, in their view, most injuries suffered by consumers in consumer finance cases are individualized and therefore could not be remedied through class action lawsuits, which are the focus of the Bureau's class rule. These commenters cited, as examples, cases in which an individual consumer had a deposit not properly credited at an ATM machine, was improperly charged a fee, or had incorrect interest calculations on his or her account when other consumers did not. One of these commenters stated that, in its opinion, such individualized non-classable claims are a significant majority of all consumer claims. However, the commenters did not provide any empirical evidence for their assertions that most injuries to consumers occur because of unique or individualized harms.

Many of these same industry and research center commenters noted that without arbitration, many consumer finance claims may be filed in court. Specifically, they contended that small claims courts are not an adequate forum for these claims that would have been resolved in arbitration. While small claims courts ostensibly allow consumers to pursue low-value claims more simply than in State courts of general jurisdiction or in Federal court, these commenters cited evidence suggesting that small claims courts are overcrowded or closing as a result of budget cuts in some jurisdictions (citing examples in parts of California, Alabama, and Texas). The commenters further contended that to the extent that small claims courts are over-crowded (or non-existent), they are slow in providing relief to consumers who are injured or do not provide relief at all. These commenters also pointed out that small claims courts typically

require consumers to appear in person during standard working hours, which can be difficult for many consumers who cannot take time off from their jobs.[659]

Some industry commenters stated their belief that arbitration was particularly useful, as compared to litigation, for claims concerning certain products or services. For example, a debt collection industry trade association stated that in debt collection disputes, consumers place a particularly high value on confidentiality, which it believed arbitration better preserves. It also stated that debt collection claims are simpler to adjudicate, and thus suited to a simpler process, which it believed arbitration offers.

On the other hand and as noted above in Part VI.B.2, consumer advocates, consumer lawyers, trade associations of consumer lawyers, public-interest consumer lawyers, consumer law firms, nonprofits, and many individual commenters commented at length as to why, in their view, litigation in court of individual disputes along with the availability of class actions was far preferable to pursuing the same claims in arbitration. Several of these commenters stated that industry preferred to funnel all disputes into individual arbitration not to benefit consumers but instead to insulate themselves from class actions and that they did not have consumers' best interest in mind when suggesting that arbitration was preferable.

As discussed above in Part VI.B.1, many of these commenters further stated that individual arbitration was so unfair relative to individual litigation that the Bureau should have

[659] While many commenters asserted that individual arbitration is a superior form of dispute resolution to individual litigation, a few industry commenters asserted that individual arbitration is a superior form of dispute resolution to class litigation. One industry commenter noted that individual arbitration proceeded significantly more quickly than class litigation, stating that consumer arbitration was up to 12 times faster than class action litigation when comparing resolution on the merits in arbitration to a class settlement. Another industry commenter noted that arbitration hearings occurred significantly more often than do trials in litigation and thus asserted that arbitration claims were "heard on the merits" more often than were claims in class action litigation. For example, hearings occurred in 30 percent of the arbitrations analyzed in the Bureau's Study whereas not one of the class actions analyzed in the Study went to trial (those cases ended by a plaintiff's withdrawal of claims, a settlement, or a dismissal by the court). The Bureau does not believe such a comparison is dispositive to an assessment of whether arbitration is better than litigation for resolving individual disputes. Moreover, even assuming that arbitration resolves claims more quickly than class litigation or holds hearings on the merits more often than class litigation, the Bureau believes that consumers and the public interest benefit more from the availability of class actions than from the availability of individual arbitration (for the few consumers who choose it), for all the reasons stated in this Part VI.C.1.

protected individual consumers by banning outright the use of pre-dispute arbitration agreements. For example, some commenters argued that consumer arbitration outcomes cannot be consistently fair because arbitration naturally favors providers, as repeat players, over consumers, who may only face an arbitration once. One public-interest consumer lawyer commenter argued that individual arbitration is necessarily worse for consumers than litigation because consumers cannot find legal representation and few consumers file arbitrations in any case. Accordingly, these commenters did not agree that a loss of individual arbitration, if it occurred in response to the Bureau's rule, would negatively impact consumers. Instead, many of these commenters thought that consumers would be better off without it.

One industry commenter challenged an argument it believed was raised by some consumer advocates who it claims have asserted that the widespread removal of pre-dispute arbitration agreements would not harm consumers because both sides would mutually agree to "post-dispute arbitration" (*i.e.*, a voluntary agreement to arbitrate reached after a dispute has arisen).[660] The commenter disagreed with this argument, asserting that parties are less likely to agree to post-dispute arbitration because they become invested in their positions and refuse to arbitrate and because attorneys discourage them from doing so in order to maximize attorney's fees in litigation. The commenter also asserted that post-dispute arbitration would be less attractive to consumers than pre-dispute arbitration because providers are unwilling to pay as many of the costs in such cases. In the commenter's view, post-dispute arbitration would therefore not replace pre-dispute arbitration, even where it is the most efficient option for both parties.

[660] The Bureau did not receive any comments from consumer advocates or others asserting this position, however.

*Response to Comments and Findings*

The Bureau has carefully considered the comments received on these aspects of the proposal and further analyzed the issues raised in light of the Study and the Bureau's experience and expertise. Based on all of these sources and for the reasons discussed above in Part VI.B, in the proposal, and further below, the Bureau finds that precluding providers from blocking consumer class actions through the use of arbitration agreements would substantially strengthen the incentives for companies to avoid legally risky or potentially illegal activities, thereby reducing the likelihood that consumers would be subject to such practices in the first instance. To the extent that companies nonetheless engage in unlawful conduct, permitting class actions would also 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. For these reasons and those discussed below, the Bureau finds that both of these results are for the protection of consumers.

*Deterrence*. With respect to commenters that contended that class actions do not deter wrongdoing because, in practice, companies face pressure to settle class actions whether or not they are meritorious, the Bureau does not agree that the conclusion follows from the premise. As discussed above in Part VI.B.3 and below in the Section 1022(b)(2) Analysis in Part VIII, the Bureau understands that there is some pressure to settle class action lawsuits given attorney's fees and the potential of a large verdict. At the same time, plaintiff's attorneys have an incentive to bring cases with the greatest likelihood of success since the amount they can secure in fees will be affected, at least in part, by the amount they are able to obtain for the class. Precisely because all that is true, companies that face the threat of class actions will have an incentive to avoid being sued and to reduce the expected value – and thus the likely settlement costs – of any

suits that are filed. That, in turn, means that the potential for class action litigation creates an incentive for companies to rigorously adopt compliance measures and to avoid legally risky practices. While compliance with the law may not fully insulate a company from the threat of a class action lawsuit, failing to comply with the law would almost certainly increase the likelihood that company will be sued and the value of the claims asserted. Thus, because the Bureau believes that the likelihood of being sued in a class action and the expected value of class claims are inversely proportional to the efforts a company makes to assure compliance with the law, then it necessarily follows that an increased risk of class action litigation will incentivize companies to improve compliance efforts.

An example of this deterrent effect can be found in comments from a credit reporting agency that provides credit monitoring and a consumer data trade association representing providers of credit monitoring. These commenters contended that two Federal appellate courts have improperly interpreted CROA to apply to at least one credit monitoring product.[661] As discussed in more detail in the section-by-section analysis of § 1040.3(a)(4) below in Part VII, among the requirements that CROA imposes on credit monitoring are a disclosure to potential consumers, waiting three days before commencing the services with a right of cancelation for the consumer, and prohibiting pre-payment of fees.[662] CROA further provides for statutory damages for violations of the statute that amount to disgorgement of the fees paid for the product.[663] In the view of these commenters, if they were subject to CROA, they would face significant risk of class action exposure for what the commenters referred to as "technical" violations of CROA's requirements. These companies currently offer credit monitoring services that would not meet

[661] *Stout* v. *Freescore, LLC*, 773 F.3d 680, 686 (9th Cir. 2014); *Zimmerman* v. *Puccio*, 613 F.3d 60, 72 (1st Cir. 2011).
[662] Credit Repair Organizations Act (CROA), 15 U.S.C. 1679 *et seq.*
[663] 15 U.S.C. 1679g(a)(1)(B).

CROA's requirements if they were applied to them. They contend that they would be forced to increase their prices and there is a possibility they would not be able to offer credit monitoring services if they had to comply with CROA's requirements because doing so would be infeasible both practically and financially. Further, they believe they are able to offer these services without significant risk now because they include arbitration agreements in their consumer contracts, thus insulating them from class action liability. Setting aside, for the moment, the legal question of whether CROA does apply to credit monitoring and if it did, the policy question of whether these companies *should* be able to offer credit monitoring services to consumers without complying with CROA,[664] these comments suggested that the prospect of class action liability would alter how these companies approach providing their product. In other words, their ability to insulate themselves from CROA class action liability has caused them to offer a service that the companies fear courts could hold violates CROA. Were they to lose that insulation, they say they will be deterred from offering that service.

As another example, debt collector commenters noted that debt collectors do not underinvest in compliance because the presence of class action waivers does not provide enough certainty to them that they will be always able to minimize class action liability. The Bureau believes that one corollary of this argument is that some debt collectors could be encouraged to spend less on compliance if they had more certainty about their ability to block class actions. To the extent this is true, the Bureau believes that debt collectors would be less deterred if they were more certain that they could block class actions, and conversely would be more deterred if they knew with certainty that they could not block class actions.

[664] That issue is addressed more fully below in Part VII in the section-by-section analysis of § 1040.3, in which the Bureau responds to the CRA's request for an exception to the class rule.

As for the commenter that criticized the behavioral relief in the foreign currency fee litigation as worthless because disclosures provided about these fees are ineffective, the Bureau first notes that Congress believes in the importance of timely and understandable disclosures for consumers.[665] In addition, the Bureau notes that, following settlement of the foreign currency fee cases, the number of credit cards charging fees for foreign currency transactions decreased dramatically.[666] Based on the Bureau's understanding of this industry, it believes that had companies not agreed to disclose these fees, the competitive pressure to eliminate them would have been lower. In any event, the Bureau cited the foreign currency fee class action settlements in the proposal as evidence of deterrence because those settlements caused issuers to disclose their exchange fees. The fact that other companies changed their practices is evidence of the deterrent effect, even if some commenters disagreed that disclosure of such fees is beneficial. Along the same lines, in response to the commenter that claimed the overdraft settlements did not deter such behavior because a few banks have not changed their overdraft practices following the wave of class action litigation, the commenter itself admitted that the litigation has encouraged most banks to change their overdraft practices. This bolsters the Bureau's finding that those class actions deterred banks from further violations of the law with respect to their overdraft practices, even if there are some banks that did not change their practices. Indeed, perfect compliance with the law is unlikely to be achieved through any mechanism, whether agency enforcement or class action litigation.

[665] *See* Dodd-Frank section 1021(b) ("The Bureau is authorized to exercise its authorities under Federal consumer financial law for the purposes of ensuring that… consumers are provided with timely and understandable information to make responsible decisions about financial transactions").
[666] Sienna Kossman, "Survey: More Cards Bid Farewell to Foreign Transaction Fees," CreditCards.com (March 31, 2015), *available at* http://www.creditcards.com/credit-card-news/foreign-transaction-fee-survey.php (finding that, from 2012 to 2015, "the eight issuers that charge foreign transaction fees on at least some of their consumer cards have increased the total number of fee-free cards from 21 to 38.").

With these examples, as well as the EFTA ATM "sticker" litigation example discussed in the proposal and above,[667] the Bureau disagrees with industry commenters that assessments as to the value to consumers of particular protections afforded by the law are relevant to the question of whether or not class actions have a deterrent effect.[668] Instead, these examples illustrate the broader principle that companies have altered or would alter their behavior in response to class action exposure. To the extent that the commenters were really trying to argue that the underlying laws provide no benefit to consumers, that argument is addressed separately below.

Indeed, the Bureau notes that while some industry commenters resisted the premise that potential class action liability produces deterrent effects, other industry, individual, and research center commenters agreed with the Bureau's finding and supplied additional evidence in support of it. One such individual commenter (who otherwise strongly opposed the proposal) agreed that class actions have the ability to "prompt 'enterprise-wide change'" in providers. Similarly, one of the studies cited by industry and research center commenters that analyzed the results of class action lawsuits included interviews of corporate representatives regarding class action liability in which those representatives acknowledged that "damage class action lawsuits have played a regulatory role by causing them to review their financial and employment practices."[669] Furthermore, upon issuance of the Bureau's proposal, several law firms advised their clients to

[667] In 1999, Congress amended the EFTA to require that ATM operators make disclosures about ATM fees to be charged consumers, both (1) "on or at" the ATM itself (usually a sticker on the machine) and (2) on the screen of the ATM during the transaction or on the receipt after the transaction. This EFTA amendment made ATM operators liable for actual and statutory damages in individual and class cases if consumers did not receive both disclosures. A number of class actions were filed and settled on the grounds that the ATM operator had failed to comply with the "on or at" requirement because the ATM sticker was missing. In 2012, Congress amended EFTA again to eliminate the ATM sticker requirement, and in 2013, the Bureau issued a final rule implementing this amendment.

[668] The Bureau notes that the EFTA ATM sticker requirements are no longer in place. A few commenters criticized the fact that the Bureau cited EFTA ATM sticker cases in the proposal as an example of companies changing their behavior in response to class action lawsuits because cases related to that conduct were not included in the Study. The fact that those cases were not included in the Study is irrelevant – the salient point is that companies changed their behavior in response to class action lawsuits being filed and thus that those cases deterred companies from violating EFTA in that regard.

[669] Deborah R. Hensler, et al., "Class Action Dilemmas: Pursuing Public Goals for Private Gain," at 9 (Mar. 24, 1999) (RAND Inst. for Civil Just.).

review their compliance given the possibility of the Bureau finalizing the proposal and the clients' subsequent increased risk of class actions.[670] As one firm advised:

> Affected companies should use this time, before implementation, to mitigate class action claims that previously might have been subject to arbitration. Companies should consider a review of all consumer-facing documents to confirm language complies with applicable federal and state law. Additionally, internal policies and procedures must be reviewed to ensure that product origination and servicing is consistent with all legal requirements. Likewise, vendor agreements must be reviewed in relation to applicable law—including, most importantly, principal-agency theories. It is imperative that companies anticipate ways to limit liability and manage future class action risks now—as class action defense litigation spending is anticipated to surge in every consumer finance sector.[671]

One industry commenter asserted that class actions create over-deterrence because class settlements may encourage companies to avoid behavior that is legally ambiguous but not necessarily unlawful.[672] To the extent that the comment was referring to the "over-deterrent" effect as to a company that engaged in the legally ambiguous behavior and that was sued because of it, the Bureau notes that the company was not deterred by the threat of class action liability to

[670] Jones Day LLP, "CFPB Proposes New Rule on Mandatory Consumer Arbitration Clauses," (May 2016), *available at* http://www.jonesday.com/cfpb-proposes-new-rule-on-mandatory-consumer-arbitration-clauses-05-16-2016/ (in an alert regarding the potential impact of the proposal, instructed companies subject to Bureau regulation to "[c]onduct a review of your compliance management system. Evaluate your consumer compliance management system to identify and fill any gaps in processes and procedures that inure to the detriment of consumers under standards of unfair, deceptive, and abusive acts or practices, and that could result in groups of consumers taking action."); Paul Hastings LLP, "Class (Not) Dismissed: CFPB Proposes New Rule Prohibiting Mandatory Arbitration Clauses, Encourages Consumer Class Action Law Suits," (May 12, 2016), *available at* https://www.paulhastings.com/publications-items/details/?id=8e53e969-2334-6428-811c-ff00004cbded (stating that "CFPB-regulated entities should consider the following action items," including "review[ing] customer complaint logs to identify those products and services that elicit the most frequent consumer complaints and could potentially serve as the basis for consumer class action lawsuits"); Venable LLP, "The CFPB's New Arbitration Clause Ban: How to Prepare Your Organization," (June 15, 2016), slide 31, *available at* https://tinyurl.com/l32qjdb (analyzing what the proposed rule "mean[s] for regulatory compliance" and advising entities to "assess litigation exposure," "assess recourse available to consumers," "know the terms of your contract," and "consider product and service enhancements"). These law firm alerts were preceded by others before the issuance of the proposal providing similar advice to companies to improve their compliance management and systems in anticipation of the rule. 81 FR 32830, 32862-63 (May 24, 2016). A compliance firm similarly advised its clients to "batten down the hatches" by taking steps to "mitigate the flow of class actions." *See* Treliant Risk Advisors, "Pre-dispute Arbitration Clauses: Batten Down the Hatches," *available at* https://www.treliant.com/News-and-Events/New-Coordinates-Newsletter/NC-Articles-Details/ArticleID/27227 (Summer 2016) (listing several steps firms can take to reduce risk, including that they should "analyze complaints … to identify [compliance] problems" and to "complete thorough root cause analysis for any concerning trends").

[671] Katten Muchin Rosenman LLP, "CFPB Issues Proposed Rule to Restrict Use of Mandatory Arbitration Clauses and Class Action Waivers," (May 16, 2016), *available at* https://www.kattenlaw.com/CFPB-Issues-Proposed-Rule-to-Restrict-the-Use-of-Mandatory-Arbitration-Clauses-and-Class-Action-Waivers.

[672] The Bureau adopts this definition of "over-deterrence" (*i.e.*, deterring legally ambiguous and potentially lawful behavior) solely for purposes of addressing the argument raised by the commenter. In economic terms, the existence of over-deterrence would generally imply that providers were responding to the deterrent (class actions) by taking actions where the costs (*e.g.*, foregone profits) exceed the social benefits (*e.g.*, avoided harm to consumers). That is, over-deterrence leads to more compliance than is socially optimal, regardless of the exact legal status of the conduct. As discussed in the Bureau's Section 1022(b)(2) Analysis in Part VIII below, the Bureau believes that in general the level of compliance in consumer financial products is below the optimal level, although there may be exceptions for particular firms in particular markets.

the extent that it did, in fact, engage in the behavior that was the subject of the class complaint. Accordingly, a company that takes the risk of engaging in conduct that may violate an ambiguous or uncertain law was neither deterred nor "over-deterred." To the extent that the comment was referring to an "over-deterrent" effect as to that same company once it chooses to stop engaging in the behavior that generated the class action settlement or as to other companies that become aware of the settlement and avoid similar behavior, the Bureau understands that the prospect of class action liability may, at the margins, deter some conduct that is legally ambiguous but not necessarily illegal. But, even if at the margins, the effect of the class rule would be to deter conduct that may be legal from occurring, the Bureau believes that, on balance, that would be a reasonable cost to achieve the benefits of the rule for the public and consumers. Moreover, the Bureau believes that most providers consult attorneys to assess the legal risk of engaging in particular conduct and that providers likely have different levels of tolerance for the legal risk that arises from engaging in conduct that is legally ambiguous.

Moreover, as discussed in more detail in Part VI.B.3 above, there is a relationship between the likelihood of success on class action claims and the amount of the settlement. For this reason, the Bureau believes, all else equal, that a class action that asserts legally ambiguous but not clearly unlawful claims is likely to result in a smaller settlement, if any, than a class action that asserts a clear violation of the law. As a result of a smaller settlement amount, the deterrent effect of a settlement with regard to a legally ambiguous or uncertain claim would be correspondingly smaller than the deterrent effect of a larger settlement. In other words, class action settlements involving ambiguous or uncertain violations of the law may deter some lawful conduct at the margins, but the Bureau does not believe this deterrent effect would be significant. And, even if there is some small impact from these settlements on legally ambiguous

but not unlawful behavior, the Bureau believes that, on balance, that it would be a reasonable cost to achieve the benefits of the class rule for the public and for consumers.[673] As to the research center commenter that contended that bad actors are likely not deterred from violations of the law because they are judgment proof, the commenter offered no evidence to support that most or all providers that violate the law are judgment proof. In any event, the Bureau believes for all of the reasons stated above that the prospect of class action liability deters violations of the law for providers that are not judgment proof, regardless of whether some judgment proof defendants may not be deterred.

With respect to the industry commenters that contended that statutes providing for statutory damages or double and treble damages compound the pressures to settle and thus create a deterrent effect that is imprecise or inefficient, the Bureau does not dispute that the existence of statutory damages or attorney's fee provisions may encourage lawsuits under those statutes. Some commenters contended this is "imprecise" or "inefficient." It is nevertheless a direct consequence of the statutory regime adopted by Congress and the States and, if anything, is evidence that lawmakers chose to emphasize the need for compliance with these laws. As for the commenter that suggested that class actions are an inefficient policymaking tool, the Bureau disagrees that class actions constitute policymaking themselves. Rather, the Bureau believes that class action settlements occur only because Federal and State legislatures had already adopted policy choices by enacting particular statutes or the common law had developed to reflect certain policy judgments. In response to the commenter that suggested that the Bureau should determine which conduct is unfair or deceptive because that would be more efficient than class actions, the

[673] The Bureau notes that it similarly finds below, in Part VI.C.2, that even if the class rule may ,at the margin, the deter certain innovations from occurring, the Bureau believes that, on balance, that would be a reasonable cost to achieve the benefits of the rule for the public and consumers.

Bureau's resources are limited, for all of the reasons discussed above in Part VI.B.5. For this reason, even if such a practice were more efficient than unfettered class actions, the Bureau has many competing priorities and likely would not be able to identify and communicate every type of unfair or deceptive practice for the many thousands of products or services within its jurisdiction.

As for commenters that contended that statutory damages were designed to incentivize individual claims and are misapplied when asserted in class actions, the Bureau does not agree that the class action liability that results under statutes that provide for statutory damages is unintended or accidental. Instead, and as discussed more fully in Part II.C, Congress has repeatedly enacted measures to address the interaction of statutory damages and the class action mechanism, as evidenced by its adoption of classwide damages caps for many statutes.[674] The statutory regimes enacted, including whether the statute allows for class action liability, reflect policy decisions by Congress. Commenters may disagree with those decisions, but it is Congress who makes them, not the Bureau. In any event, as discussed below in Part VI.C.2 and in the Study, most of the consumer credit protection statutes cap statutory damages.

Similarly, commenters that criticized the underlying statutes as incentivizing private lawsuits when the commenters claim there is "no harm to deter" are, in essence, either claiming that courts will allow the lawsuits to proceed despite the absence of an in injury-in-fact (which the Constitution requires for Federal court litigation[675]) or are expressing concern about the measure of damages for injuries that these commenters asserted to be minor. As to the first, Federal courts have repeatedly considered what it means for a plaintiff to establish individual,

[674] *See infra* note 740 (classwide statutory damage caps).
[675] *Lujan* v. *Defenders of Wildlife*, 504 U.S. 555, 560-61 (1992).

concrete harm in order to have standing to assert a claim for statutory damages. Indeed, the Supreme Court recently addressed the issue.[676] The judicial system can and does address whether plaintiffs must suffer harm in order to allege the violation of a statute; the Bureau is not in the position to make such assessments in the context of this rulemaking. As to the second, these commenters may be disagreeing, to some extent, with Congressional decisions about the remedies for certain harms. For example, commenters cited many statutes that they believe create violations of law and large penalties without any corresponding harm to consumers. Those statutes include FACTA requirements for printing credit card numbers on receipts that apply to merchants, a now-repealed EFTA requirement concerning ATM fee notices, TCPA restrictions concerning unsolicited telephone calls, California disclosure requirements for automobile purchases, and CROA, which concerns credit repair products and provides for the remedy of disgorgement of fees paid. While commenters may disagree that unwanted telephone calls, the printing of credit card expiration dates on receipts, or the failure to disclose certain terms of automobile purchase transactions harm consumers, Congress and the State legislatures have the authority to make those judgments and set the remedies for the harms it chooses.

With respect to CROA, as discussed below, since 2005, there have been a number of efforts in Congress to determine whether CROA could be improved by clarifying the CROA credit monitoring coverage issue that commenters raised here. No consensus has been reached to date and the FTC has twice expressed concern about the difficulty in structuring a revision to CROA to address this concern. This history suggests that the author of CROA (Congress) and its enforcer (the FTC) are not certain CROA should be revised, or how. In any event, with

[676] *Spokeo, Inc.* v. *Robbins*, 136 S. Ct. 1540, 1549 (2016) (affirming that injury to a legal interest must be "concrete" as well as "particularized" to satisfy the injury-in-fact element of standing and because Congress is "well positioned to identify intangible harms that meet minimum Article III requirements, its judgment is…instructive and important.").

respect to CROA and all statutes, it is Congress that sets the remedies and determines coverage for its statutory regimes. Further, though some providers may currently be able to block class actions under these statutes through their use of arbitration agreements, these statutes nevertheless govern providers' conduct and those providers who violate the law may be subject to individual claims. In short, to the extent that commenters believe class actions provide outsized liability under particular statutes without requiring proof of any real harm to consumers, courts, Congress, and State legislatures are presumptively the proper branches of government to address this concern.

Relatedly, one research center commenter cited the Overdraft MDL class settlements as examples of violations of the law where consumers were not harmed. In fact, in the commenter's view, consumers received a benefit from the violations, because the fees generated by those overdraft practices enabled the banks to offer free checking accounts to its customers. Whether those overdraft policies generated revenue from overdrafters that subsidized free checking accounts for consumers generally is beside the point; when companies violate the law, the consumers who are victims of the wrong are better protected and accountability is improved when there is an effective remedy, regardless of how the company may have invested the profits from those violations. If companies were excused from violating the law because doing so allowed them to charge lower prices, they could, for example, justify charging higher prices to a certain race or gender in order to subsidize lower prices to other groups. The Bureau does not believe such a result would protect consumers and likewise does not agree that the overdraft settlements harmed consumers in the way the commenter suggested. To the contrary, the Bureau believes that consumers benefitted from these aspects of the overdraft settlements, which resulted in more transparent upfront pricing that facilitates comparison shopping by consumers.

For all of the reasons stated, the Bureau finds that class action settlements are not wholly random and are sufficiently correlated to merit to deter wrongdoing. The Bureau also does not agree that the deterrence provided by class actions is limited to those cases that result in class settlements or even those that are filed at all. Mere exposure to the potential to be sued for a meritorious class action, in the Bureau's view, creates an incentive to refrain from the conduct that would give rise to that action. As one commenter noted, the exposure to potential liability based on cases filed against other companies often put upper management and boards of directors on notice of widespread misconduct in a way that individual cases are unlikely to do. To appreciate the potential for such a suit, it is not necessary for a company to be aware that another company engaged in the same conduct and was sued[677]. The Bureau therefore adopts its preliminary findings, as further elaborated here, with respect to the fact that class actions deter violation of the law.[678]

In response to commenters that contended that there is no need for the deterrence provided by class actions because companies are fully deterred from violating the law by the threat of public enforcement, the threat of individual litigation, the threat of consumers taking their business elsewhere, or by Tribal regulation and enforcement, the Bureau explained why each of these is insufficient in enforcing the law above in Part VI.B. To the extent these other mechanisms do not allow for sufficient enforcement of the law they also do not sufficiently deter companies from violating the law. As discussed there, the Bureau finds these avenues both individually and jointly insufficient to fully enforce the consumer protection laws.

[677] Although, as discussed above, the fact that providers monitor such filings in order to determine whether adjustments in their practices may be advisable demonstrates that the deterrence incentives are meaningful.

[678] The Bureau notes that one commenter requested that the Bureau commit, if the rule is finalized, to revisit the rule and determine if an increase in frivolous lawsuits occurs as a result. The Bureau notes that it regularly monitors and receives feedback from interested stakeholders on all of the rules that it administers. However, it is premature for the Bureau to decide whether it will conduct an assessment of this final rule pursuant to Dodd-Frank section 1022(d), similar to what it has announced recently regarding certain other final rules.

Moreover, the Bureau has observed, through its experience and expertise that there is not full compliance with the law. Indeed, despite the Bureau's creation and subsequent work, it continues to receive thousands of complaints per month and regularly uncovers wrongdoing that has not been deterred simply by the existence of the Bureau or the threat of individual dispute resolution, whether formal or informal. Further, the Bureau does not believe that the wrongdoing it uncovers is the only wrongdoing that exists, in part because the markets for consumer financial products and services are numerous and often large, and the Bureau's work is necessarily limited by its resources. Thus, the Bureau finds that the commenters' assertion that all providers comply fully with all applicable laws to be unsupported.

As for those commenters that suggested that specific types of providers – such as debt collectors, credit unions, and community banks – have sufficient incentives because of the nature of their particular product or service to comply fully with the law, the Bureau does not find evidence that these entities are sufficiently deterred from violation in a way that warrants their exclusion from the class rule. With respect to debt collectors, commenters noted that whether debt collectors can rely on arbitration agreements is uncertain. This, they contend, means that they already sufficiently invest in compliance. Accordingly, while debt collectors may have more incentive to comply with the law than providers that are certain that they can block class actions, debt collectors still have less incentive to comply than providers that do not include arbitration agreements in their contracts at all. In other words, while the legal uncertainty with respect to the ability of debt collectors to rely on arbitration agreements to block class actions suggests they may be somewhat more deterred from violations of the law than providers who are certain that they can do so, the Bureau believes that debt collectors will be further deterred from violations of the law once the class rule takes effect and debt collectors are certain that they may

not rely on arbitration agreements to block class actions. With respect to credit unions, the Bureau does not believe that member ownership is a sufficient compliance incentive to replace a right to enforce the relevant laws on a class basis, in part because the members of a credit union are not necessarily aware of legal harms and thus may be unable to use the membership structure to hold their credit union providers to account. Moreover, even when consumers are aware, credit union customers do not necessarily engage in active efforts to hold management of the credit union accountable, such as by attending annual meetings.[679] Just as an individual consumer is very unlikely to bring formal legal action over a small-dollar harm, a credit union customer is not necessarily likely to know about membership accountability mechanisms much less to spend the time and effort to coordinate a campaign to use them to hold a credit union accountable for small-dollar harms.[680] Further, even if credit union customers do participate in the accountability process, very few are likely to exercise their vote on this basis alone, particularly over small-dollar harms. Indeed, the Bureau has observed violations of the law by credit unions with respect to their members.[681] For similar reasons, the Bureau further believes that the presence of a financial institution in a community, with the interest of developing and retaining customers in that community, also is not a sufficient compliance incentive to replace a right to enforce relevant laws on a class basis.

[679] Robert F. Hoel, "Power and Governance: Who Really Owns Credit Unions," at 25 (Filene Research Institute 2011), *available at* https://filene.org/assets/pdf-reports/244_Hoel_Power_Governance.pdf.
[680] Although Appendix A to the Proposal identified several class action settlements from the Study involving credit unions related to products and services that would be covered by the rule (*i.e.*, excluding EFTA ATM "sticker" litigation), industry commenters did not point to any efforts by customers at these or other credit unions to hold the credit union accountable through membership accountability mechanisms.
[681] *E.g.*, Press Release, Bureau of Consumer Fin. Prot. "CFPB Orders Navy Federal Credit Union to Pay $28.5 Million for Improper Debt Collection Actions," Oct. 11, 2016, *available at* https://www.consumerfinance.gov/about-us/newsroom/cfpb-orders-navy-federal-credit-union-pay-285-million-improper-debt-collection-actions/; Tina Orem, "12 Credit Unions Face Overdraft Suits," Credit Union Times (Jan. 5, 2016), *available at* http://www.cutimes.com/2016/01/05/12-credit-unions-face-overdraft-suits. *See generally* NCUA, "Administrative Orders," *available at* https://www.ncua.gov/regulation-supervision/Pages/rules/administrative-orders.aspx (listing dozens of government enforcement actions against credit unions each year).

Moreover, in the period since the Bureau released the proposal, several more large-scale violations of consumer finance law have become public. In one example discussed above, the Bureau fined a large bank $100 million for widespread illegal practices related to the opening of thousands of unauthorized accounts on behalf of its customers.[682] The Bureau's order in this case addressed unfair and deceptive conduct between 2011 and the date of the order. The existence of the Bureau and the threat of enforcement and supervisory actions evidently did not deter employees of the bank from routinely opening unauthorized accounts on behalf of its customers. Nor did the prospect of individual lawsuits or the threat of losing customers apparently deter the bank's employees from that conduct.

Another example involved a large money transmitter that recently agreed to a $586 million settlement with several public enforcement agencies, including the FTC and the Department of Justice. In that settlement, the money transmitter admitted to criminal and civil violations of the law involving aiding and abetting massive wire fraud by its agents.[683] As the complaint in this case demonstrates, the money transmitter not only failed to meet legal requirements to maintain an effective anti-money laundering program but also appeared to ignore ample evidence gathered through its complaint system (*i.e.*, its mechanism for resolving informal disputes) that indicated the extent of the problem.[684]

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[682] Press Release, Bureau of Consumer Fin. Prot., "Consumer Financial Protection Bureau Fines Wells Fargo $100 Million for Widespread Illegal Practice of Secretly Opening Unauthorized Accounts," (Sept. 8, 2016), *available at* http://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-fines-wells-fargo-100-million-widespread-illegal-practice-secretly-opening-unauthorized-accounts/.

[683] Press Release, Fed. Trade Comm'n, "Western Union Admits Anti-Money Laundering Violations and Settles Consumer Fraud Charges, Forfeits $586 Million in Settlement with FTC and Justice Department," (Jan. 19, 2017), *available at* https://www.ftc.gov/news-events/press-releases/2017/01/western-union-admits-anti-money-laundering-violations-settles.

[684] The complaint in this case detailed how the company had gathered 550,928 complaints of fraudulent money transfers involving $632 million. The complaints allowed the company to identify particular agents that should have made the company aware of the agents who were likely implicated in fraudulent transfers. The company not only ignored these complaints on an individual basis but also did not take steps to eliminate the fraudulent agents from its network. *See* Complaint at ¶¶ 18-19, FTC v. The Western Union Co., No. 17-00110 (M.D. Pa. Jan. 17, 2017), https://www.ftc.gov/system/files/documents/cases/western_union_complaint-jan2017.pdf.

In general, the Bureau disagrees with commenters that stated that the Bureau should have further studied current levels of compliance in the marketplace. The Bureau's supervision function has the purpose of assessing compliance and remedying non-compliance either through supervisory resolutions or through referral of cases for public enforcement actions. The Bureau's enforcement function investigates cases where there is reason to believe violations are occurring and pursues those where the evidence warrants doing so. It would not be practical to somehow study compliance levels independent of the work the Bureau does on an ongoing basis through supervision and enforcement, nor would the Bureau expect companies to be forthcoming with evidence of non-compliance were the Bureau to attempt such a study.

With respect to the Bureau's preliminary finding that precluding providers from using arbitration agreements to block class actions would better enable consumers to enforce their rights and obtain redress, some commenters suggested that the other means do sufficiently remedy all violations of law. Those comments are discussed in above in Part VI.B. Otherwise, no commenters disagreed with the Bureau's findings in this regard and the Bureau adopts these findings with respect to the final class rule.

*Whether the rule will cause providers to remove arbitration agreements.* The Bureau is not persuaded by the industry commenters' claims that, if the Bureau's rule goes into effect, providers inevitably would remove their pre-dispute arbitration agreements because they would be unwilling to subject themselves to the costs of arbitration while simultaneously being exposed to class action defense costs. Once the Bureau's rule goes into effect, class actions will become available to all consumers. Thus, the relevant question is whether, in a world where class actions are available, maintaining arbitration agreements would no longer be in the companies' interest, resulting in the loss of arbitration as a dispute resolution option for those consumers that would

have elected to pursue it. If a company were to decide to remove individual arbitration agreements from their consumer contracts, the Bureau believes that these decisions would not be motivated by the costs associated with individual arbitrations because those costs are minimal. Instead, such a decision would suggest the company only viewed the agreement as useful for blocking class actions and no other significant purpose.

Insofar as the Bureau believes that the cost of individual arbitration is minimally different from litigation, it remains skeptical that this is the reason that will cause companies to remove arbitration agreements from their contracts. Specifically, the Bureau is unpersuaded that providers incur significant net costs in connection with maintaining pre-dispute arbitration agreements today. As the commenters indicated, providers generally pay the bulk of the filing fees, hearing fees, and arbitrator compensation in individual consumer financial arbitrations. In consumer arbitrations conducted by AAA, the provider is responsible for a filing fee of $1,700 to $2,200; a hearing fee of between $0 and $500; and arbitrator compensation of between $750 per case and $1,500 per day, depending on the type of arbitration.[685] However, the Bureau believes that, in many cases, these fees may be offset by savings from streamlined procedures, such as limited discovery in arbitration, fewer in-person hearings, reduced motions practice, and less need to hire local counsel, among others.[686] Indeed, one research center commenter that otherwise strongly opposed the rule stated its belief that arbitration saves money for both consumers and companies. Further, as noted above, while commenters asserted that they expend significant resources to "subsidize" arbitration, no commenter provided a specific accounting or any other concrete evidence to support this assertion.

[685] AAA, "Consumer Arbitration Rules," at 33 (fees effective January 1, 2016).
[686] *See generally* Study, *supra* note 3, section 4 (comparing the procedures available in Federal court with the generally more streamlined procedures in arbitration). *See also AT&T Mobility, LLC* v. *Concepcion*, 563 U.S. 333, 345 (noting that "the informality of arbitral proceedings is itself desirable, reducing the cost and increasing the speed of dispute resolution.").

The commenters' arguments that they incur significant net costs in connection with individual arbitration are further undermined by the fact that most providers face no arbitrations and those that do, face very few. The Study identified about 616 AAA consumer arbitrations per year for six large consumer financial markets, about 411 of which were filed by consumers.[687] Because individual providers face so few arbitrations, even if individual arbitration is marginally more expensive than defending the same claim in court (and the Bureau makes no determination on that issue), providers are unlikely to realize such dramatic cost savings by removing their arbitration agreements that it is inevitable that they will do so for cost savings reasons alone.

The Bureau also remains skeptical that providers would be unwilling to litigate individual disputes in both arbitration and court once the Bureau's rule goes into effect because providers already litigate disputes in both fora today. Providers with arbitration agreements also must litigate in State and Federal court to the extent they are sued by individuals with whom they do not have contractual relationships or to the extent that consumers sue them in Federal or State court and the provider does not move to compel arbitration (which the Study showed occurred in nearly all individual cases filed in Federal court).[688] While commenters cited several reasons why providers currently maintain two tracks of litigation, they did not challenge the Bureau's underlying assertion that providers indeed do so. With respect to the commenter that criticized the Bureau's sample of 140 individual Federal court cases against companies with arbitration agreements as too small to draw the conclusion that providers rarely invoke arbitration in individual cases, the Bureau disagrees because its analysis of individual Federal cases reviewed

[687] Study, *supra* note 3, section 1 at 11.
[688] *Id.* section 6 at 57-60.

1,205 cases and found invocation of arbitration was very rare.[689] More broadly, neither that commenter nor others cited specific evidence suggesting that the Study undercounted instances in which companies invoked arbitration clauses in individual cases.

With respect to some industry commenters' contention that anti-severability provisions in arbitration agreements show that providers would choose to remove arbitration agreements if this rule were finalized, the Bureau understands that providers have adopted anti-severability provisions for the purpose of preventing cases from proceeding as class arbitrations if a court were to find a no-class provision to be unenforceable in a particular case.[690] Because those provisions were created for a different purpose, the Bureau does not construe the clauses to reveal a preference against maintaining individual arbitration once this rule becomes effective.[691]

For the reasons described above, the Bureau does not believe that commenters set forth persuasive reasons for concluding that the costs of individual arbitration would cause them to remove their arbitration agreements once the class rule becomes effective.

*Whether loss of individual arbitration harms consumers.* The Bureau further believes that, even if providers do remove their arbitration agreements, harm to consumers would be negligible because so few consumers pursue arbitration today. The Study showed that very few individual consumers filed claims in arbitration about consumer financial products; as noted, there were just over 600 arbitration filings per year in the six product markets studied and just

[689] *Id.* section 6 at 59. The 140 individual cases cited by the commenter were those against credit card companies where the Bureau could determine that those companies included arbitration agreements in their consumer contracts. *Id.* section 6 at 61. In that set of cases, the rate of invocation was 5 percent. In the larger set of 1,205 Federal individual cases where the Bureau could not determine whether the defendant companies included arbitration agreements in their consumer contracts, the Bureau also found a very low rate of invocation, only 1 percent. *Id.* section 6 at 59.

[690] *See, e.g.*, Alan S. Kaplinsky & Mark J. Levin, "Arbitration Update: Green Tree Financial Corp. v. Bazzle–Dazzle for Green Tree, Fizzle for Practitioners," 59 Bus. L. 1265, at 1272 (2004) (stating that companies should consider adopting anti-severability provisions "in order to protect themselves from class-wide arbitration such as occurred in [*Green Tree Financial Corp.* v. *Bazzle*, 539 U.S. 444 (2003)].").

[691] With respect to the industry commenter's contention that post-dispute arbitration will not fill the void created by the removal of pre-dispute arbitration agreements, the Bureau does not address this comment because the Bureau did not assert in the proposal (and does not assert in the final rule) the argument that this comment is addressing, nor did any other commenter make it.

over 400 of those were filed by consumers. By contrast, more than 60 million consumers per year were eligible for either cash or in-kind relief from class actions in the five-year period covered by the Study. Indeed, more than 34 million of these consumers obtained cash relief over five years studied, or more than six million per year. Thus, the number of consumers who sought relief in arbitration pales in comparison to the number who actually obtained relief through class actions. The number of consumers who sought relief in arbitration also pales in comparison to the benefited to consumers from the deterrent effect of class actions, which is discussed above in this Part VI.C.1.

In any event, even if consumers do not have access to arbitration for individual claims those still can be filed in court, including small claims court. As is discussed above, the Bureau is not making a finding as to whether individual arbitration is superior to individual litigation for consumers; it finds that any such comparison is inconclusive. However, even assuming that arbitration is a better forum for resolution of individual disputes than the courts – and the Bureau does not have any basis to so assume – the few hundred consumers who would be forced to file in court rather than in arbitration if providers stopped using arbitration agreements would be harmed only to the extent that arbitration is worse for them than litigation. These consumers would not be left without a forum to prosecute their individual claims. Given the extremely low number of consumer-filed AAA and JAMS arbitrations, the Bureau believes that the magnitude of consumer benefit, if any, of individual arbitration over individual litigation would need to be implausibly large for the elimination of some, or even all, arbitration agreements to make a noticeable difference to consumers in the aggregate.

Because the Bureau believes that preserving consumers' right to participate in a class action is for the protection of consumers even if providers will no longer include arbitration

agreements in their consumer contracts, it is not necessary to address each individual argument cited by commenters about why arbitration is a superior forum for dispute resolution than litigation. However, the Bureau notes that there is reason to be skeptical of those arguments. For example, while many industry commenters asserted that arbitration is less expensive for consumers to pursue than litigation because filing fees are generally less, the Bureau notes that one-third of the arbitration agreements analyzed in the Study required consumers to reimburse fees and expenses paid by the company if the consumer loses the arbitration.[692] Thus, while arbitrating a successful claim might cost less in fees than an individual litigation, arbitrating an *unsuccessful* claim could be quite expensive for a consumer, especially as compared to litigation where a consumer will not bear additional expenses if he or she loses a claim. Indeed, this risk may even deter consumers who are aware of these cost-shifting provisions from pursuing individual arbitration because a consumer who loses the case could end up worse off than if he or she had never filed a claim in the first place.

Moreover, some of the commenters that addressed the cost of arbitration only compared it to the cost of litigating in Federal court. The Bureau believes that many of the consumers who would otherwise choose arbitration will pursue their claims in small claims courts or courts of general jurisdiction if arbitration is not available going forward. Filing fees in these courts are frequently quite reasonable and almost always far lower than Federal court.[693]

As to the comments that noted that consumers often succeeded in arbitration claims without an attorney and thus did not need attorneys in arbitration, the Bureau notes that

[692] Study, *supra* note 3, section 2 at 65-66 tbl. 13.
[693] *E.g.*, N.Y. Uniform. Just. Ct. Act section 1803(a) (setting filing fees for small claims court at between $10 and $20); Cal. Civ. Proc. sections 116.230(b) – 116.230(d) (same with fees between $30 and $75). *See also* Study, *supra* note 3, section 4 at 10-12 (which stated that the fee for filing a case in Federal court is a $350 plus a $50 administrative fee, while the fee for a small claims filing in Philadelphia Municipal Court ranges from $63 to $112).

consumers likewise do not need attorneys to pursue claims in small claims court, which is the most apt comparison to arbitration because it offers streamlined procedures similar to those available in arbitration.[694] As to the comments that noted that arbitration can be conducted telephonically or online, the Bureau notes that this may save consumers some time compared to individual litigation which may be required to be filed and heard in-person. But this time savings alone does not make arbitration superior, given the other issues described above.

As for the commenters' assertion that most harms that are suffered by consumers are individualized and not classable, the Study showed that there are millions of consumers who suffer group harms, as reflected by the number of consumers who obtained relief in class actions (60 million per year), and the Bureau's experience and expertise in supervision and enforcement is consistent with this conclusion. Most consumer financial products and services involve products offered on the same terms to all customers, so it stands to reason that when these terms violate the law, they harm all consumers bound by them. While there was no dispute that some consumers suffered individualized harms, commenters did not put forth any data that both contradicted the Bureau's Study and supported commenters' assertion that most harms were individualized and not classable.[695]

Some industry commenters have argued that more consumers would use arbitration if only they understood the process more, if arbitration agreements were drafted more clearly, or if consumers were properly educated to the benefits of arbitration (whether by the Bureau or by

[694] *E.g.*, District of Columbia Court, "Small Claims and Conciliation Branch," (noting that "The Small Claims Branch is less formal than other branches of the Court. The procedures are simple and costs kept low so that most people do not need a lawyer to represent them in their small claims case. You must be 18 years old to file a case."). http://www.dccourts.gov/internet/public/aud_civil/smallclaims.jsf (last visited Dec. 20, 2016).

[695] While many commenters highlighted that the amount of relief awarded in arbitration was much higher than what was awarded in individual litigation, they failed to explain the relevance of this distinction. As noted above in Part VI.B.2 class actions are typically brought to remedy small harms suffered by large groups of people that are unlikely to be brought individually. Thus, it is not surprising that those claims that consumers do bring individually involve much larger claim sums.

providers or both), thereby reducing the disparity between the number of consumers who use arbitration and the number who obtain relief in class actions. The Bureau is not persuaded that the presence of education or promotional materials would, for dispute resolution, materially alter the dynamics that result in so few individual arbitrations for all of the reasons discussed above at Part VI.B.2. The alternatives offered by commenters are addressed in detail in the Section 1022(b)(2) Analysis below at Part VIII.G.

*2. By Enhancing Compliance with the Law and Improving Consumer Remuneration and Company Accountability, the Class Rule Is in the Public Interest*

In the proposal, the Bureau also preliminarily found that the class rule would be in the public interest. This preliminary finding was based upon several considerations which individually and collectively supported that finding. First, as discussed extensively above, the Bureau believed that its preliminary finding that the class proposal would protect consumers also contributed to a finding that the class proposal would be in the public interest.

Second, the Bureau preliminarily found that the proposal was in the public interest because of the effect it would have on leveling the playing field in markets for consumer financial products and services. The Bureau preliminarily found 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. Specifically, the Bureau stated in the proposal that it believed that companies that adopt arbitration agreements with class action prohibitions 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 that have class action prohibitions would necessarily shift market share to companies that eschew such arbitration agreements (and instead focus on upfront compliance) because the competitive balance between companies would continue to depend on many additional factors. It thus did not count the effects of this factor as a major element of the Section 1022(b)(2) Analysis. However, the Bureau preliminarily found that eliminating this type of arbitrage as a potential source of competition would be in the public interest.[696]

Third, the Bureau preliminarily found that the class proposal was in the public interest because it would have the effect of achieving greater compliance with the law which creates 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 disserves 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 believed that by creating enhanced incentives and remedial mechanisms to enforce compliance,

[696] 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 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. The Restoring American Financial Stability Act of 2010, S. Rept. 111-176 (2010), at 10 ("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.'').

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 believed 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 stated in the proposal that it believed that promoting the rule of law – in the form of accountability under transparent application of the law by providers of consumer financial products or services – would be in the public interest.

In the proposal, the Bureau also addressed several reasons stakeholders had given during both the SBREFA process and ongoing outreach to support their belief that the class rule was not in the public interest. These stakeholders had expressed concern that the class rule would, among other things, cause providers to remove arbitration agreements from their contracts thereby negatively impacting the means available to consumers to resolve individual disputes formally and informally, impose costs on providers that would be passed through to consumers, and reduce incentives for innovation in markets for consumer financial products and services. In the proposal, the Bureau addressed concerns regarding whether the class rule would cause providers to remove arbitration agreements from their contracts in the context of its public interest finding; however, for this final rule, the Bureau addresses those comments above in Part VI.C.1 in connection with its finding that the class rule is for the protection of consumers. The Bureau does so because many commenters contended that the loss of individual arbitration would harm concerns because arbitration is a superior form of dispute resolution than individual

litigation. The Bureau notes, however, that if providers choose to remove arbitration agreements from their contracts, that the loss of individual arbitration as a form of dispute resolution arguably impacts both providers and the public interest. Accordingly, the Bureau incorporates that discussion with respect to its public interest findings as well.

With respect to pass-through costs, the Bureau preliminarily found that the class rule would still be in the public interest, even if some costs of the rule may be passed through to customers. First, the Bureau stated in the proposal its belief 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. Thus, the Bureau preliminarily found that the specific marginal costs that would be attributable to the class rule are similarly justified, even if some of those costs are passed through to consumers. Second, the Bureau preliminarily found that 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 in the Section 1022(b)(2) Analysis, the Bureau did not believe that the expenses due to the additional class settlements that would result from the class rule would result in a noticeable impact on access to consumer financial products or services. Similarly, the Bureau preliminarily found 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 in the Section 1022(b)(2) Analysis that factors in the likelihood of litigation, recovery rates, and other considerations.

With respect to innovation, the Bureau noted that some stakeholders suggested that the class rule would discourage innovation in that providers would refrain from developing or

offering products and services that benefit consumers and are lawful due to concerns that the products may pose legal risk, for instance because they are novel. The Bureau preliminarily found that some innovation can disserve the public and that deterring such innovation would actually be in the public interest. The Bureau noted examples of such innovation in the mortgage market that were a major cause of the financial crisis and led to the introduction of a set of high-risk products and underwriting practices.[697] Similarly, the Bureau noted that 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 unpredictable for consumers and distorted what was then the second largest consumer credit market.[698]

Conversely, the Bureau preliminarily found 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 overdraft) and 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 believed that to this extent the class proposal would affect positive innovations of this type – it would tend to facilitate them. The Bureau further preliminarily found that even if the class rule deterred some positive innovation on the margins, the benefits of the class proposal justified any such impact on innovation.[699] Thus, the Bureau preliminarily found that the class rule would still

[697] *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).
[698] *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.
[699] In the proposal, the Bureau also discussed two other reasons that stakeholders had given for why the class rule was not in the public interest: that class settlements deliver windfalls to named plaintiffs and class members and that the class rule would negatively affect the means available

be in the public interest, notwithstanding its impact on innovation in the consumer financial marketplace.

*Comments Received*

The Bureau preliminarily found that the class proposal would protect consumers for all of the reasons described above in Part VI.C.1, level the playing field in the market for consumer financial products and services, and that compliance with the law generally benefits the public interest. Commenters that opposed this preliminary finding on the public interest generally did not dispute the affirmative points made by the Bureau in the proposal, but rather cited several reasons that the commenters believed led to the conclusion that the class proposal was not in the public interest (at least some of which the Bureau had preliminarily addressed in the proposal). These arguments are discussed in detail below. Many consumer advocate and individual commenters agreed with the Bureau's preliminary findings that the class proposal is in the public interest because it would level the playing field between providers and produce other benefits through enhanced compliance with the law. For example, a consumer advocate commenter agreed with the Bureau's preliminary finding that pre-dispute arbitration agreements harm competition and put providers that do follow the law at a competitive disadvantage. An individual commenter that was formerly the FINRA Director of Arbitration also agreed that the rule was in the public interest and cited the long-term success of FINRA's similar rule as applied to broker-dealers and their customers.[700]

*Pass-through costs.* Numerous individual commenters expressed a general concern about the possibility of higher prices for their products as a result of the proposal. These comments

for consumers to resolve individual disputes in arbitration because the class rule will cause companies to remove arbitration agreements from their contracts. The first issue is addressed above in Part XX, and the second issue is addressed above in Part XX.

[700] FINRA, "Class Action Claims," at Rule 12204(d).

urged the Bureau not to adopt the proposal but did not elaborate on their pricing concerns.[701] Numerous industry, research center, and State regulator commenters also asserted that the potential for pass through of costs of the rule to consumers and related effects on consumers should invalidate the Bureau's preliminary finding that the class proposal was in the public interest. These commenters contended that an increase in defense costs for companies will force them to raise prices for consumers, decrease their services or slow innovation, none of which are in the public interest. For example, a comment from trade associations representing depository institutions cited law and economics research – some of which relied in part on empirical studies outside of the consumer finance context and one of which made claims about the lack of consumer benefit achieved by statutory claims – as support for its conclusion that the cost of class actions are passed through to consumers and that consumers gain little benefit in return. To support this point, another industry trade association cited to a law review article discussing economic principles. That industry commenter also asserted that the Bureau's preliminary findings largely rejected the notion that businesses pass on the cost savings of arbitration to consumers.

In contrast, some commenters were supportive of the Bureau's preliminary finding acknowledging that some costs of the rule may be passed on to consumers, but concluded that this effect did not negate the impacts of the rule that advanced the public interest. For example, two commenters questioned whether providers would in fact pass through costs to consumers. A public-interest consumer lawyer stated that, in its view, assertions of pass-through costs have not been supported by credible economic data or studies. Similarly, a research center stated that the Bureau's Study supported the conclusion that any cost savings from arbitration agreements are

[701] The Bureau received over 110,000 similar comments, mostly from individuals.

not, in fact, passed on to consumers. A few consumer advocate commenters and a public-interest consumer lawyer commenter stated their belief that there is no evidence that companies pass-through savings from pre-dispute arbitration agreements to customers and thus conversely no evidence that the class rule would increase costs for consumers.

An individual commenter contended that higher prices passed on to consumers may force some consumers out of particular credit markets that the consumers could have afforded if the Bureau's proposal were not finalized. Several automobile dealers commented that the class rule will raise the price of automobile loans significantly, even pricing some credit-challenged customers out of automobiles, although the commenters provided no specific calculations or details. A group of automobile dealers also asserted that the cost of a motor vehicle could increase. Several other automobile dealers further asserted that costs may be passed on by the indirect automobile lenders to the dealers through indemnification obligations. An individual commenter further noted that, although Section 10 of the Study found no statistically significant increase in the total cost of credit (whether for consumers overall or any sub-segment) in analyzing credit card pricing patterns after some issuers temporarily dropped their arbitration agreements, the Study found an increase in Annual Percentage Rate (APR) for consumers with lower credit scores and an increase in annual fees for all customers. In the view of this commenter, this data suggests that the card issuers' goal was not necessarily to pass on new costs to their customers, but instead to adjust certain pricing components that tended to make cards *appear* less attractive for riskier customers. That is, this commenter believed card issuers sought to "screen out" lower-value customers in particular due to the increased probability that amounts

would be refunded in class actions, which rendered such customers particularly less profitable to the card issuer.[702]

An industry association representing small-dollar lenders and a commenter in this industry asserted that because many States limit not only the interest rates but also the fees that small-dollar lenders can charge consumers, those lenders may not be able pass through such costs onto consumers. These commenters contended that the class rule would therefore pose a particular threat to the business model for small-dollar lenders, who are lenders of last resort for consumers. The commenters predicted that the class rule could force consumers to resort to unlawful lenders if the rule forced small-dollar lenders out of business. Similarly, a Tribe that operates a small-dollar lender stated that the class rule would harm the underbanked in particular. Several credit union and credit union trade association commenters noted that credit unions are member-owned and thus the cost on providers to defend additional class actions is passed on to their members directly even in the absence of higher fees. A credit union trade association also cited a survey of its members as indicating that almost half expected to need to raise the cost of credit as a result of the class rule.[703] As discussed above in Part III.D.9, automobile dealer commenters and others also criticized the Bureau's Study of pricing by credit card issuers that had removed arbitration agreements from their consumer contracts as the result of litigation and raised a number of criticisms of the methodology and analysis of that Study. A Congressional commenter stated his view that the class rule would likely cause financial institutions to increase the cash reserves they hold to mitigate litigation risk. The commenter stated that this increase in cash reserves could, in turn, reduce the amount of cash that institutions have available to lend to

[702] Some commenters also characterized the removal of arbitration agreements by companies in response to the class rule as a form of pass-through costs to consumers. The Bureau analyzes the issue of whether providers will remove arbitration agreements separately, above in Part VI.C.1.
[703] The application of the rule to Tribal entities and credit unions is discussed below in the section-by-section analysis of 1040.3 in Part VII.

consumers and small businesses, or to invest in technology upgrades and employee retention. The commenter referred to this effect as creating "dead capital."

*Innovation and availability of products.* Several industry commenters, a research center, and a group of State attorneys general contended that the class rule as proposed is not in the public interest because it would deter innovation. In general, these comments were very high-level and did not offer specific data or examples of how this would happen. A group of State attorneys general, who described the rule as paternalistic, asserted in their comment that the class proposal would limit competition among providers and that competition benefits consumers because it generally produces lower prices and better products. An association of State regulators asserted that the rule will deter innovation, which would harm consumers and the public interest. An industry commenter asserted that the class rule is not in the public interest because it would deter innovation without producing a corresponding benefit to consumers or the public.

Generally, comments about the impacts on innovation did not touch on particular products. The Bureau did receive comments from a credit reporting agency and an industry trade association that raised concerns regarding the impact the class rule could have on their ability to offer credit monitoring and related credit education products they may develop due to potential for new exposure to CROA class actions, as discussed more fully above in Part VI.C.1 above. The Bureau explains below in the section-by-section analysis of § 1040.3(a)(4) in Part VII why it finds an exemption for these products not to be in the public interest. A research center commenter also stated its belief that the rule would have a devastating effect on peer-to-peer lending and financial technology products because individuals lending money through these

platforms may no longer be able to do so if they are subject to class action lawsuits and have to bear that risk.

One industry commenter appeared to agree with the Bureau's preliminary finding that some types of innovation can harm consumers and the public interest while noting that some types of innovation fall in a "gray area" between benefitting and harming the public interest. A consumer advocate commenter agreed with the Bureau's preliminary finding, asserting that valuing unbridled innovation over compliance with the law is inappropriate.

*Payments to plaintiff's attorneys.* Many Congressional, industry and individual commenters and a research center criticized the Bureau's preliminary finding that class actions are in the public interest because they believe the Bureau failed to adequately consider the costs of class actions that settle, both to consumers and to industry. Many industry and individual commenters stated their view that class actions are not in the public interest because a disproportionate share of class action settlement proceeds go to plaintiff's attorneys rather than to consumers. According to many of these commenters, the amounts that plaintiff's attorneys receive from class actions are relevant to determining whether class actions are in the public interest because attorney's fees are often deducted from settlement amounts that would otherwise go to consumers. For example, one industry commenter noted that the Study showed that plaintiff's attorneys received, on average, more than $1 million in fees from each class settlement. As a percentage of the total settlement amount, the commenter further noted that the attorney's fees were 41 percent of each settlement, on average, with a median of 46 percent.[704]

[704] Study, *supra* note 3, section 8 at 34 tbl. 11.

Another commenter cited examples from an external study of class actions in which class members received small payouts while attorneys received large fee awards.[705]

Relatedly, many industry commenters criticized the Study for reporting on the percentage of attorney's fees compared to the total settlement amount available to consumers, rather than compared to the amount actually paid to consumers. These commenters stated that this was misleading because consumers in class settlements often do not file claims in those cases that require it and thus consumers rarely receive the full settlement amount. Accordingly, these commenters believe that the proportion of the settlement payments that are paid to attorneys is significantly higher than reflected in the Study. One research center commenter suggested that the Bureau should have considered whether the total amount of money paid to plaintiff's attorneys from class action settlements analyzed in the Study – $424,495,451 – is an acceptable cost. This commenter also noted that the Study showed that attorney's fees were a significantly higher proportion of smaller class action settlements than of larger settlements. For example, the commenter noted that attorney's fees were 56 percent of the total relief in settlements of less than $100,000.

Some industry commenters questioned the accuracy of the Bureau's Study with respect to the amounts paid to plaintiff's attorneys from class action settlements because those amounts were lower than found in other studies. For example, whereas the Bureau's Study found that the combined plaintiff's attorney fees over all of the 419 class action settlements analyzed were 16 percent of gross relief made available, and 21 percent of the combined payments made to consumers, one research center commenter cited a study of class action settlements in cases filed in one Federal district court concerning both consumer financial and other products under a

[705] Mayer Brown, *supra* note 519.

limited number of Federal statutes that found plaintiff's attorney fees were rarely less than 75 percent of the total amount paid to the class.[706] Similarly, another industry commenter cited a 1999 study of class action settlements that found that in three out of 10 cases studied, involving a range of consumer markets not limited to consumer finance, plaintiff's attorneys received more in fees than consumers received in compensation.[707] Another industry commenter criticized the efficiency and fairness of class action settlements that provide significant plaintiff's attorney fees but provide only *cy pres* relief to consumers.[708]

Several consumer advocate commenters explained that in many cases attorney's fees are awarded after a settlement is reached and that, therefore, they do not impact consumers' recovery; one commenter also provided several examples. A consumer advocate commenter explained that courts typically calculate fees as a reasonable percentage of the value of the settlement and, therefore, attorneys receive fees only when they have created value for class members. This commenter noted that Federal Rule 23(h) empowers judges to determine reasonable compensation for attorneys in class actions. Several commenters noted that various factors, including results achieved, risk, and the age and difficulty of the case may impact a court's fee award. A letter from a coalition of consumer advocates further disputed claims that attorney's fees are excessive in class actions. Several comments cited to the Study and noted that fees were a reasonable 21 percent of cash compensation paid to consumers and only 16 percent of all relief awarded. One of these commenters cited to another study that showed that attorney's fees may be even lower than found in the Study – only 15 percent of awards in an

[706] Note that this figure refers to the amount paid to the class (*e.g.*, after claims have been made), not the amount actually awarded. Johnston, *supra* note 520.
[707] Hensler et al., *supra* note 669, at 5, 14. Notably, this Study pre-dated the passage of CAFA.
[708] In class actions, *cy pres* relief is relief that is distributed to a third party (often a charity) on behalf of consumers, instead of to consumers directly in cases where doing so is difficult or impossible.

analysis of 688 Federal class actions.[709] A public-interest consumer lawyer commenter further disputed the relative impact of attorney's fees by noting its agreement with the Bureau that mechanisms exist to curtail frivolous litigation. A comment from a consumer lawyer explained that attorney's fees provide motivation to private attorneys to act as a market check on bad actors and bad practices. One consumer advocate commenter noted that the cost of class action settlements, including the cost of settlements themselves and defense costs, is likely lower than the cost of litigating each class member's claims in a separate case. Another consumer lawyer acknowledged that some lawsuits are frivolous but stated that the court system does a good job at weeding them out.

Several industry commenters criticized the Bureau's preliminary finding that class actions are in the public interest because they contend that the class action mechanism primarily benefits plaintiff's attorneys who abuse the mechanism for their own financial gain. One such industry commenter contends that attorneys file putative class claims out of self-interest, rather than to benefit consumers. That same industry commenter cited instances from the mid-2000s where courts or prosecutors found plaintiff's attorneys had made improper payments to individuals to recruit potential plaintiffs. The commenter further contended that class action settlements are typically structured to benefit the plaintiff's attorneys rather than the absent plaintiffs because the named plaintiffs have almost no involvement in the case. Indeed, the commenter argued that because plaintiff's attorney fees are based on the total amount of the settlement, attorneys have an incentive to negotiate a high settlement amount, but have no incentive to structure the settlement such that absent class members actually receive that amount.

[709] The commenter cited to Brian T. Fitzpatrick, "An Empirical Study of Class Action Settlements and Their Fee Awards," (Vand. U. Sch. of L. Pub. L. & Legal Theory Working Paper No. 10-10, 2010), *available at* https://ssrn.com/abstract=1442108 (this paper analyzed all Federal class action settlements in all markets, not just consumer finance, in 2006 and 2007).

This commenter further asserted that plaintiff's attorneys often enter into "clear sailing" agreements with defense counsel in class cases, through which defendants agree not to object to awards of attorney's fees below a certain amount. In the commenter's view, these agreements benefit plaintiff's attorneys at the expense of absent class members because the plaintiff's attorneys have no incentive to negotiate for better compensation for class members when they know that they will receive high fees through the settlement. One industry commenter added together the amounts awarded to plaintiff's attorneys in the Study and the Bureau's estimate of costs to defend class actions from the Section 1022(b)(2) Analysis below in Part VIII and contends that the combined totals indicate that attorneys (whether plaintiff's attorneys or defense attorneys) benefit more from the rule than do consumers.[710]

The same industry commenter further contended that courts do not adequately supervise class action settlements to ensure that they are fair to absent class members, notwithstanding the court's obligation to do so under the Federal Rules of Civil Procedure and analogous State rules. The commenter, citing a law review article that refers to the legislative history leading to the adoption of CAFA, asserted its belief that courts face pressure to approve settlements in class action cases to clear their dockets and thus do not adequately supervise settlements.[711] A research center commenter cited a study for the proposition that judges are more likely to approve class settlements in cases where the claims are weak because of the high cost of litigating the case on the merits.[712]

[710] The Bureau notes that the commenter incorrectly totaled the Bureau's estimates of defense costs from the proposal, as noted in the Section 1022(b)(2) Analysis below in Part VIII.
[711] Linda S. Mullenix, "Ending Class Actions as We Know Them: Rethinking the American Class Action," 64 Emory L. J. 399, at 430 (U. Tex. Sch. of L., Pub. L. Res. Paper No. 565, 2014) (citing Edward Purcell, "The Class Action Fairness Act in Perspective: The Old and The New in Federal Jurisdictional Reform," 156 U. Pa. L. Rev. 1823, at 1883 (2008) (citing House Judiciary views in CAFA legislative process).
[712] Johnston, *supra* note 520, at 13.

A consumer advocate commenter disputed the relevance of attorney's fees, noting that they often come from a common fund, meaning that the cost of litigation is paid out of the common fund created by the settlement, and that attorneys only receive fees when they have created value for class members. Other commenters, including consumer advocates, consumer law firms, law academics and others emphasized that attorneys should be compensated for their time. One of these commenters explained that attorneys litigate class actions at considerable risk to themselves. In addition to paying all costs upfront, they do not get paid for their time unless they prevail or settle the case.

*Strain on the court system.* Several industry commenters, a group of State attorneys general, and a group of Congressional commenters contended the class proposal is not in the public interest because it would increase the number of class action lawsuits filed and therefore create a strain on the Federal and State court systems, which the commenters believe are already overburdened. These commenters asserted that an increase in class action lawsuits will cause delays in judicial administration and increased costs to Federal and State courts. One commenter pointed out that even an unmeritorious class action lawsuit creates a burden on the court system because a court must use its resources to determine whether it should be dismissed. Several industry commenters cited reports and statistics for both State and Federal courts supporting this overcrowding and showing that the number of cases filed have increased significantly since 2013.[713] One industry commenter referred to the class proposal as an "unfunded mandate" that the Bureau is imposing on the courts. In contrast, a consumer commenter expressed an opinion

[713] U.S. Courts, "Federal Judicial Caseload Statistics 2016," (June 2016), *available at* http://www.uscourts.gov/statistics-reports/federal-judicial-caseload-statistics-2016; Exec. Comm. of the Bd. of the N.Y. Cty. Lawyers' Ass'n, "Task Force on Judicial Budget Cuts Report," (Jan. 18, 2014), *available at* https://www.nycla.org/siteFiles/Publications/Publications1516_0.pdf.

that strain on the courts should be minimal because parties pay their own court costs (as opposed to taxpayers funding additional public enforcement).

*Harm to relationships between customers and providers.* Another industry commenter criticized the proposal as not in the public interest because the commenter predicted that it would harm the relationships between consumers and their financial institutions. The commenter stated its belief that the availability of class actions discourages consumers and financial institutions from informal resolution of disputes.

*Federalism concerns.* An individual commenter contended that the class rule is not in the public interest because the commenter predicted that it would encourage companies to change their behavior nationwide in response to class actions brought under a single State's consumer protection laws, which could lead to that one State's consumer protection laws trumping Federal laws and other States' laws. This phenomenon was described by the commenter as "inverse federalism," which the commenter viewed as problematic because it contended that certain State legislatures are captured by the plaintiff's bar and thus pass statutes that are not in the public interest. An industry commenter expressed a similar federalism concern. Similarly, an industry commenter contended that *Gutierrez* v. *Wells Fargo*,[714] the overdraft case discussed above in Part VI.B.3 is an example of such inverse federalism in that the case was based on State contract law, rather than Federal law, but nonetheless generated nationwide changes in behavior with regard to bank overdraft practices.

*Impairment of freedom of contract.* A group of State attorneys general commented that the class proposal is not in the public interest because they believed that it would impair the freedom of contract by preventing consumers and financial institutions from agreeing to certain

[714] *Gutierrez* v. *Wells Fargo Bank, N.A.*, 730 F. Supp. 2d 1080, 1082 (N.D. Cal. 2010).

forms of arbitration. In these commenters' view, there is significant benefit to empowering consumers and companies to contract freely in part because doing so creates prosperity and political freedom. Similarly, one industry commenter suggested that the class rule would deprive consumers of the ability to choose a consumer financial product or service with an arbitration agreement that blocks class actions in order that the consumers could avoid being part of a class action or potentially having contact with plaintiff's attorneys. A research center commenter and a comment from several State attorneys general asserted that because arbitration agreements are not universal in consumer finance contracts, they do not pose substantial problems for consumers because consumers can therefore choose products without them.

In contrast to these comments, a consumer advocate commenter stated its belief that arbitration agreements in consumer contracts are contracts of adhesion because consumers lack bargaining power with their providers and do not negotiate the contracts. An individual commenter asserted that this rule does not implicate freedom of contract because consumers are powerless to refuse terms imposed upon them.

*Public policy concerning arbitration and legal uncertainty.* Many industry commenters contended that public policy strongly favors arbitration, as exemplified by the Supreme Court's decision in *AT&T* v. *Concepcion*.[715] In *Concepcion*, the Court held that the FAA preempted a California law that would have prohibited the enforcement of a consumer arbitration clause that disallowed participation in class actions. The commenters noted that, in doing so, the majority opinion had referenced "a liberal Federal policy favoring arbitration."[716] In these commenters' view, the class rule would override both the FAA and the Supreme Court precedent upholding

[715] 563 U.S. 333 (2011).
[716] *Id.* (quoting *Moses H. Cone Memorial Hospital* v. *Mercury Constr. Corp*., 460 U.S. 1, 24 (1983)).

arbitration agreements and is thus against this public policy. These commenters believed that the authority provided to the Bureau under Dodd-Frank section 1028 is insufficient to supplant this longstanding policy in the absence of clear evidence from the Study, which these commenters asserted the Study did not provide.

A group of State regulators contended that the class rule will harm the public interest because they predicted that the rule would create legal uncertainty in various ways, thereby amplifying the risk of litigation exposure for consumer financial service providers. For example, the commenter asserted that it is unclear how a class rule would affect future cases following *Concepcion* and other case law regarding preemption of State law under the Federal Arbitration Act. The commenter asserted that there was uncertainty with respect to whether proposed § 1040.4(a)(2) would apply to class actions under consumer finance laws only or to all State and Federal class actions. The commenter asserted there was also uncertainty concerning whether Congress's delegation of authority to the Bureau under section 1028 was proper.

*Impact on certain State laws.* An industry commenter contended that the proposal was not in the public interest (or for the protection of consumers) because of the effect it may have on certain State laws. The comment specifically referred to a Utah statute which authorizes creditors to include class-action waivers in bold type and all capital letters in consumer contracts for closed end credit.[717] The commenter believed that this law would be preempted by the Bureau's proposal and asserted that such a result would not be in the public interest (or for the protection of consumers) because it would contradict the determination of the Utah legislature.[718]

[717] Utah Code 70C-3-14.

[718] The commenter also stated that the rule would conflict with similar provisions in other State laws. The commenter did not cite to other laws, however, and the Bureau has not identified other laws of this type. Separately, a credit reporting industry commenter stated that expanding the coverage to reach security freeze activity by consumer reporting agencies would be tantamount to a preemption of State laws allowing consumers

*Response to Comments and Findings*

The Bureau has carefully considered the comments received on the proposal and further analyzed the issues raised in light of the Study and the Bureau's experience and expertise. Based on all of these sources, the Bureau reaffirms its preliminary findings that the class rule is in the public interest because it will benefit consumers (for the reasons discussed above at Part VI.C.1), will level the playing field in the market for consumer financial products and services, and will promote the rule of law – in the form of accountability under and transparent application of the law to providers of consumer financial products or services. As noted, no commenters disagreed with the Bureau's findings with respect to leveling the playing field in the market or promoting the rule of the law. The Bureau addresses commenters' other arguments challenging the Bureau's public interest finding below.

*Pass-through costs.* With respect to commenters that asserted that the class rule is not in the public interest because providers will pass through increased costs of compliance activities or litigation to consumers, the Bureau disagrees that the risk of a pass-through impact on consumers negates a finding that the rule is in the public interest. The Bureau acknowledged in the proposal and acknowledges again here that there is a risk that some or potentially even all such costs will be passed through to consumers.[719] Commenters have been unable to identify empirical sources that would permit an estimate of the extent of any pass-through effect in consumer financial

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to place a security freeze on their credit reports, since, in its view, it is the prerogative of the State legislatures to determine whether to permit class actions under these State laws, whose requirements vary.

[719] As summarized above and in Section 10 of the Study, the Bureau performed what it believes is the most rigorous analysis of potential pass-through effects in the use of arbitration agreements in the consumer financial products and services context by analyzing pricing patterns in the credit card market after certain issuers dropped their arbitration agreements as part of a settlement in an antitrust case. The Bureau found no statistically significant evidence of changes in overall pricing among the issuers who dropped their agreements relative to issuers who did not change their approach to arbitration. However, the Bureau acknowledged in the Study and in the proposal that the results do not allow for conclusive determinations with respect to the likelihood of pass-through costs given that the settlement only required issuers to drop their arbitration agreements for a limited time period. The Bureau's proposal did not make a preliminary finding that the Study indicated that pass-through effects would not occur if the proposal were adopted. In addition, the Bureau disagrees with commenters that assumed that, if the Bureau did not generate an estimate of a particular type of cost, this meant that the Bureau assumed or found that such a cost would not be passed through in the first instance. For example, the Bureau acknowledges that State class action costs and costs of individual settlements may be as likely to be passed through to consumers as other costs that the Bureau was able to generate numerical estimates for.

products and services as a whole or for specific markets.[720] However, despite the lack of conclusive quantifiable data on this issue, the Bureau has carefully analyzed it at each stage of the rulemaking process as detailed in the Study, the proposal, this public interest finding, and the Section 1022(b)(2) Analysis below in Part VIII. The Bureau finds that the risk of pass-through impacts is real, but believes that even if all costs of the rule are passed through to consumers that the overall impact would be relatively modest on any per-consumer basis. Indeed, the Section 1022(b)(2) Analysis finds that the pass-through costs would be, on average, less than one dollar per account per year. The Bureau further finds that these impacts do not negate the conclusion that the class rule is in the public interest.

Furthermore, the Bureau disagrees that the general risk of pass-through costs necessitates a conclusion that the class rule is not in the public interest. Rather, the Bureau believes, as it stated in the proposal, that complying with laws has costs, because exposure to class litigation deters non-compliance (or incentivizes compliance), these additional costs are justified. To incentivize such compliance there must be meaningful consequences for non-compliance. Given the Bureau's findings, as discussed above, that few consumers will invoke individual remedies (either through litigation or arbitration) and that public enforcement is not sufficient to enforce the relevant laws in light of the size of these markets and the limitations on public resources, exposure to class action litigation will serve as an effective compliance incentive. Accordingly, litigation and remediation costs generally are a necessary component of the success of the broader private enforcement scheme.

[720] As noted above, commenters cited some limited empirical evidence from markets for other types of products and services but largely relied on more general economic principles and reasoning.

Thus, in the Bureau's view, the specific marginal costs that are attributable to the class rule are justified and in the public interest because of the resulting benefits in the form of protection of consumers (chiefly deterrence, and where non-compliance has not been deterred, remediation of consumer harm along with a more level playing field). The Bureau finds that the class rule would bring about better compliance and make more remedies for non-compliance available to consumers. Both of these may result in increased costs, but the Bureau finds that the costs are necessary to make covered products generally safer and fairer for consumers. [721]

It is possible that, in certain markets, a particular provider may increase its pricing so as to make its products unaffordable for persons of more limited means, or otherwise change its pricing structure to attract fewer of these customers. Commenters raised concerns along these lines related to certain credit and deposit products, for example. However, the Bureau does not believe that overall pricing across providers in these markets would be so affected as to limit access to products or services. In several of the markets covered by the Bureau's Study, the Bureau found that many providers do not use arbitration agreements today. As demonstrated by the information gathered to estimate prevalence in those markets for the Bureau's impacts analysis in Part VIII below, the Bureau believes the same is likely to be true of many other markets covered by the rule but outside the scope of the Study. In all of these markets, the pricing of providers who do not use arbitration agreements would be unaffected by the rule.

[721] 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 costs in the compliance function 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. Compliance investments are generally risk-based, and if those activities identify areas where there are consistently no errors detected, then firms may shift their efforts to other areas of higher risk. 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.

Moreover, even in markets where arbitration agreements are ubiquitous, the Bureau does not believe that to the extent providers pass through costs, they will do so in a way that materially shrinks their customer base. For example, in the automobile market, the Section 1022(b)(2) Analysis below in Part VIII estimates that the overall annual increase in costs to the average firm is $17,049, and the Bureau does not expect any resulting price increase for automobile loans to be significant enough to price a substantial number of consumers out of that market. As for the commenter that suggested that the pass-through costs from the class rule will cause providers to stop offering products to lower-value customers, the Bureau does not believe that the costs as estimated in the Section 1022(b)(2) Analysis are large enough to cause this to occur at an industry-wide level (though it could, however, occur for certain individual providers).

To the extent that commenters such as small-dollar lenders asserted that their industry's profit margins are so thin that their products cannot be offered in a legally compliant manner (including by complying with State usury and other pricing limitations), the Bureau believes that such arguments essentially assert that those products do not currently comply with the law and thus the providers would likely be sued in class actions if their arbitration agreements did not block class actions. To the extent that is the case, the Bureau believes that protecting consumers against products and services that do not comply with the law both benefits consumers for the reasons explained above in Part VI.C.1 and advances the public interest.

To the extent that commenters asserted that the possibility of a differential impact on other particular types of providers or their customers negates a finding that the class rule is in the public interest, the Bureau disagrees.[722] With regard to the particular economic structure of

[722] To the extent that commenters argued instead that the rule should exempt particular types of providers, those arguments are discussed in greater detail below in the Section 1022(b)(2) Analysis.

credit unions, as further discussed in the section-by-section analysis of § 1040.3 in Part VII and in the Section 1022(b)(2) Analysis below in Part VIII, the Bureau recognizes that to the extent credit unions absorb increased costs as a result of the class rule, at least some of those costs may be passed on to credit union members in the form of lower dividends. It is also true, of course, that the credit union members will benefit from those costs to the extent they reflect increased levels of compliance or redress for wrongful or legally risky conduct. In any event, the Study indicated, and credit union industry commenters acknowledged, that credit unions do not rely heavily on arbitration agreements. Furthermore, even for the small percentage of credit unions that do employ arbitration agreements, the fact that credit unions are member-owned – and the fact that most credit unions are small institutions – suggests that credit unions are unlikely to face a significant increase in the frequency of class actions and thus unlikely to incur a significant cost increase.[723]. Similarly, to the extent that creditors hold extra cash reserves or are unable to pass through costs and therefore reduce lending, the Bureau believes that this effect would be relatively modest and does not alter the conclusion that the class rule is in the public interest.

The Bureau also has considered the comments that expressed concern that rather than raising prices, companies could instead be forced out of business as a result of the class proposal. To the extent these commenters were concerned that a class action settlement could put a provider out of business, the Bureau believes that risk is low.[724] If paying full relief to consumers in a class settlement would threaten a provider's financial condition, that institution

[723] The particular impact of the class rule on small entities is addressed in the Final Regulatory Flexibility Act Analysis below at Part IX. As discussed in detail there, an exemption to the class rule for small entities would not reduce burden by any significant degree for most of the over 50,000 small entities covered by the rule, while at the same time would potentially create significant unintended market distortions. Further, the Bureau notes that insurance may be another way for small businesses to manage concerns about the unpredictability of litigation costs. Insurance is itself a cost, but it reduces exposure to a larger cost that is incurred episodically by some insureds by spreading those costs across a large base of insureds. Some small businesses that participated in the SBREFA process indicated that they maintained potentially useful coverage, although they indicated some uncertainty due to such factors as ambiguous language in insurance contracts and caps on coverage against certain types of claims. SBREFA Report, *supra* note 419, at 23-24.

[724] To the extent these commenters were concerned that compliance with the law would put providers out of business, as discussed below, the rule would still be in the public interest even if certain providers could not offer their products if they had to comply with the law.

may have leverage to negotiate a settlement that provides less than full relief. In particular, Federal courts have broad discretion to consider the financial condition of the defendant as a factor when determining whether a proposed class action settlement is fair, reasonable, and adequate, as is required by Rule 23 of the Federal Rules of Civil Procedure.[725] Courts have exercised that discretion to approve class settlements that provide considerably less relief to consumers than may have been available if the case proceeded to trial and consumers prevailed.[726] And on the rare occasion that a class action does proceed to trial, the trial court must take into account due process considerations when determining or reviewing damage awards, which naturally leads to a review of the defendant's financial condition.[727]

*Innovation and availability of products.* In response to commenters that contended that the class rule would deter innovation, the Bureau notes that the implicit premise of this argument is that innovators will be prepared to engage in more legally risky behavior in a regime in which they are exposed only to the risk of individual arbitration or litigation than in a regime in which they face potential class action exposure. That is at the heart of why the Bureau believes that, on

[725] *See, e.g.*, *County of Suffolk* v. *Long Island Lighting Co.*, 907 F.2d 1295, 1323-24 (2d Cir. 1990) (affirming that "ability of the defendants to withstand a greater judgment," announced in *City of Detroit* v. *Grinnell Corp.*, 495 F.2d 448, 463 (2d Cir. 1974), remains a factor to be considered by the court when determining whether a class settlement is fair, reasonable, and adequate); *New England Carpenters Health Ben. Fund* v. *First DataBank, Inc.*, 602 F.Supp.2d 277, 280 (D.Mass. 2009) (noting that many courts in the 1st Federal appellate circuit have relied upon the test announced in *Grinnell*); *Girsh* v. *Jepson*, 521 F.2d 153, 157 (3d Cir. 1975) (adopting "ability of defendants to withstand a greater judgment" as a factor to be considered), *cited in Osher* v. *SCA Realty I, Inc.*, 945 F.Supp. 298, 304 (D.D.C. 1996) (trial court in D.C. Federal circuit considering ability to withstand greater judgment as a factor); *In re: Jiffy Lube Securities Litigation*, 927 F.2d 155, 159 (affirming trial court approval of settlement taking into account the solvency of the defendants); *Swift* v. *Direct Buy, Inc.*, 2013 WL 5770633 at *7 (N.D. In. 2013) (trial court in 7th Federal appellate circuit considering financial condition of defendant as a factor, based on *Grinnell*); *In re: Wireless Telephone Federal Cost Recovery Fees Litig.*, 396 F.3d 922, 932 (8th Cir. 2005) ("defendant's financial condition" is a factor that a court must consider); *Torrisi* v. *Tucson Elec. Power Co.*, 8 F.3d 1370, 1376 (9th Cir. 1993) (affirming consideration of defendant's financial condition as a predominant factor).

[726] *See, e.g.*, *In re: Capital One TCPA Litig.*, 80 F.Supp.3d 781, 790 (N.D. Ill. 2015) (court approving proposed $75.5 million settlement, despite estimating that class recovery in a successful litigation would range between $950 billion and $2.85 trillion, because courts "need not—and indeed should not" reject a settlement solely because it does not provide full relief, "especially…when complete victory would most surely bankrupt the prospective judgment debtor").

[727] Courts must take into account the reasonableness of the damages awarded at trial including whether they are so severe and oppressive as to be wholly disproportionate and offending due process under the U.S. Constitution. These considerations naturally lead to analysis of a defendant's financial condition as well. *See, e.g.*, *United States, et al* v. *Dish Network LLC*, Case No. 09cv3073 (C.D.Ill.) (Slip Op. of June 5,2017 at 373-75, 427-28) (citing due process standards announced in *St. Louis I.M. & S. Ry. Co.* v. *Williams*, 251 U.S. 63, 66-67 (1919), as a significant factor in support of court's decision to award penalties and statutory damages totaling $280 million for violations of telemarketing laws including the TCPA, based on detailed consideration of defendant's financial condition, where plaintiffs had requested $2.1 billion and defendants faced maximum exposure of over $727 billion).

balance, the rule is in the public interest. As the Bureau noted in its proposal, not all forms of innovation necessarily benefit consumers. No commenters disagreed with the Bureau's preliminary findings noting that there are some types of innovation that disserve consumers and the public and the Bureau reaffirms its preliminary findings in this regard. To the extent innovations of these types would be discouraged, the Bureau believes such a result would be in the public interest.[728]

Conversely, the Bureau notes, as it stated in the proposal, that some innovation is designed to mitigate risk and that to the extent that the class rule would affect positive innovations of this type, it would tend to facilitate them. No commenters disagreed with the Bureau's preliminary findings in this regard and the Bureau reaffirms them here.

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, carries legal risk. The Bureau believes that these innovators who create such products, in general, consider a variety of concerns when bringing their ideas to market and doubts that the innovators would be deterred from launching a new product they would otherwise choose to launch because of the risk of class action exposure. But, even if at the margins, the effect of the class rule would be to deter certain innovations from occurring or to reduce the availability of certain products, the Bureau believes that, on balance, that would be a reasonable cost to achieve the benefits of the rule for the public and consumers. The Bureau believes that, in general, in a well-functioning regulatory regime, entities must balance their desire to profit, such as through innovation, with the need to comply with laws

[728] To the extent that the rule encourages compliance with relevant laws by deterring innovation that involves legally-risky behavior, the Bureau nevertheless believes that the rule would be for the protection of consumers as well as discussed above in Part VI.C.1.

designed to protect consumers.[729] With respect to the commenter that particularly focused on the effect of the rule on peer-to-peer lending, without taking a position on the liability of such peer lenders, the Bureau notes that the pre-dispute arbitration agreements of online lending platforms, generally reference and protect only the platform, not the individual lenders.

In response to commenters that asserted that the proposal would chill innovation without providing any corresponding benefit, the Bureau finds that the class rule would produce significant benefits, as noted throughout the Section 1022(b)(2) Analysis, such as relief provided to consumers through class action settlements and deterring companies from future violations of the law. The Bureau thus finds that the impact of the class proposal on innovation and the availability of products 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 as well as to encourage innovation leading to more efficient compliance. For all of these reasons, the Bureau reaffirms its preliminary findings, as elaborated here, that the class rule is in the public interest both because of and notwithstanding its impact on innovation or the availability of products in the marketplace for consumer financial products and services.

*Payments to plaintiff's attorneys*. Many commenters, including those from Congress, industry nonprofits, and individuals also criticized the class rule as not being in the public interest because a substantial portion of class action settlement funds goes to plaintiff's attorneys instead of to consumers. As commenters noted and the Study reflected, the amounts paid to plaintiff's attorneys from class action settlements are substantial – a total of $424,495,451 – for

[729] *See* Dan Quan, "Project Catalyst: We're open to innovative approaches to benefit consumers," Bureau of Consumer Fin. Prot. Blog (Oct. 10, 2014), https://www.consumerfinance.gov/about-us/blog/were-open-to-innovative-approaches-to-benefit-consumers/ ("Consumer-friendly innovation can drive down 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.").

the 419 class settlements analyzed in a five-year period, for an average of more than $1 million per settlement.[730] This amounts to 16 percent of gross relief awarded to consumers, and 21 percent of the amounts actually paid to consumers, and are the averages more likely applicable to consumers. And while one commenter emphasized per-settlement attorney's fees percentages from the Study – with a mean of 41 percent and median of 46 percent – such data is less relevant to the average consumer. This per-settlement data reflects the high number of settlements involving claims under statutes that cap the amount of recovery in a class action (such as those involving debt collection under the FDCPA), which necessarily result in lower gross relief to the class and proportionally higher attorney's fee awards, as discussed in detail below in this Part VI.C.2. Indeed, the Study broke out the attorney's fee percentages by class size, which showed that as the size of the class settlement decreases, the proportion of the attorney's fees relative to the total relief awarded consumers increases.[731]

The Bureau does not believe that these data suggest that plaintiff's attorneys are being unjustly enriched, let alone call into question the overall efficacy or value of class actions to the public interest. Commenters did not dispute that it is time-intensive and expensive to litigate large-scale consumer class actions and that most plaintiff's attorneys would not take on such cases if they did not expect to be paid for successful cases. In the typical individual case, an attorney will request a 33 percent or higher contingency from any funds that their client might receive.[732] Indeed, and as is discussed above, the class action procedure was designed to make it economical to pursue small claims *en masse*. Further, no commenters suggested that class

[730] Study, *supra* note 3, section 8 at 33 tbl. 10.
[731] Study, *supra* note 3, section 8 at 34 tbl. 11. Indeed, the Study showed that in many of the smaller cases, attorney's fee awards were often higher than the amounts awarded to consumers
[732] *E.g.*, Nora Freeman Engstrom, "Attorney Advertising and the Contingency Fee Cost Paradox," 65 Stan. L. Rev. 633, at 692 (2013) ("For years, commentators have observed that contingency fees are remarkably sticky, hovering around 33 percent.").

actions could be prosecuted on a pro se basis especially given Federal Rule 23's requirement that representation be adequate in order for a class to be certified, and the Bureau found no support for this notion in the Study either. Thus, for class actions to make it economical to pursue small claims *en masse*, they would need to provide fee awards to attorneys, in part, to incentivize attorneys to invest time and resources to litigate class actions on behalf of individual consumers who rationally do not litigate small claims.[733] Under this system, there is no guarantee that plaintiff's attorneys who invest their time and money in such cases will receive any fee at all. In addition, as described in the summary of the comments above, many plaintiff's attorneys commented in support of the class rule and explained the role that fee awards play in allowing them to pursue class action relief on behalf of consumers that they would not rationally pursue (and thus typically do not pursue) on an individual basis.

With respect to commenters that criticized the fact that plaintiff's attorney fees are deducted from the settlement amounts intended for consumers, the Bureau notes that legal representation has a cost and this cost must be paid so that consumers can achieve class relief. To the extent the fees of plaintiff's attorneys are paid by the beneficiaries of their services (and diminish the beneficiaries' net recovery) that is not, in the Bureau's view, an inappropriate allocation of costs. Indeed, legal representation, like any other service, has a cost and is how most plaintiff's attorneys – class or otherwise – are compensated. The Bureau also notes that deduction of plaintiff's attorney fees from consumer recoveries does not occur in all class actions. Plaintiff's attorney fees in class action settlements can be based on recovery from the

[733] *See* Theodore Eisenberg, et al., "Attorneys' Fees in Class Actions: 2009-2013," (N.Y.U. Sch. of L. Law & Economics Res. Paper Series Working Paper No. 17-02, 2016) *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2904194 ("If fees are set too low, counsel will not receive fair compensation for their services to the class. Worse yet, if fees are too low, then qualified counsel will not bring these cases in the first place. Injured parties will receive no redress and potential wrongdoers will no longer be deterred out of fear of potential class action liability.").

"common fund" (in which case the fees are subtracted from the amount agreed to be paid to consumers) or they can be awarded separate from the fund in cases where the underlying statute under which claims were asserted provides for attorney's fees.[734] Some commenters suggested that even when attorney's fees are awarded separate from the fund, the company still has an incentive to reduce the amount of the fund in order to make room for the attorney's fees. Assuming this is true, as noted above, this is the cost of litigating class actions and it is reasonable for that cost to be paid (even by consumers) when benefits are achieved in a class settlement.

Similarly, some commenters criticized plaintiff's attorney fee awards because they are based on the amount available to be paid to the class, rather than the amounts that end up being paid out after consumers make claims. As discussed above in Part VI.B.3, however, a significant number of consumer finance class actions settlements provide for automatic payments. With respect to all class settlements, including claims-made settlements, courts oversee the fairness and adequacy of fee awards in accordance with case law. Pursuant to these precedents, courts are required to find that fee awards in settled class action cases are fair.[735] As part of that review, the courts also examine consumer notice procedures and can consider potential claims rates. Further, in cases in which attorney's fee awards are statutory, courts typically award the fees based on a reasonable number of hours expended working on the case, multiplied by a reasonable rate and by a factor to compensate the plaintiff's attorneys for the risk they took (the

[734] *See, e.g.*, Federal Judicial Center, "Manual for Complex Litigation," at § 21.7 (4th ed. Thomson West 2016).

[735] *E.g.*, Newberg et al., *supra* note 65, at § 15. *See also,* Order & Final Judgment at 1, Trombley v. National City Bank, No.10-00232, (D.D.C. Dec. 1, 2011), ECF No. 56 ("Upon careful consideration of the Revised Settlement Agreement, its subsequent modifications, plaintiffs' motion for final approval of the class action settlement, *plaintiffs' motion for an award of attorneys' fees, reimbursement of expenses, and incentive awards to the representative plaintiffs* . . . and the entire record herein, . . . the Court grants final approval of the settlement as set forth in the parties' Revised Settlement Agreement . . . .") (cited at 81 FR 32830, 32932 (May 24, 2016)); Memorandum Order & Opinion at 2, In Re: Trans Union Corp. Privacy Litig., No. 1350, (N.D. Ill. Apr. 6, 2009) ECF No. 591-2 (reducing requested attorney's fees to 10 percent of recovery where "[m]ovants . . . submitted extensive, yet flawed, documentation and declarations to support their requests for these fees") (cited at 81 FR 32830, 32849 (May 24, 2016)).

"lodestar" method).[736] Even in common fund cases, courts typically require plaintiff's attorneys to justify their request for fees by submitting records of the number of hours that they worked on the case, so that the court can ensure that the fee award is reasonable.[737] Thus, it is not surprising that the Study found that the overall attorney's fee percentages did not increase significantly when calculated as a percentage of amounts actually paid (21 percent) as compared to when calculated as a percentage of the gross relief awarded to consumers (16 percent).

As to the commenters that noted that plaintiff's attorney fees are proportionately higher in smaller settlements than in larger settlements, the Bureau believes that this likely reflects that there are certain minimum "fixed costs" to litigating a class action, which courts recognize as reasonable to recover, and also that a number of Federal consumer laws cap the amount available for recovery in a class action. When these costs occur in a case that ultimately provides smaller amounts of relief to consumers, the percentage of attorney's fees will necessarily be higher.[738] In terms of hours, as noted above, courts often take into account the number of hours an attorney worked on a class action case in awarding attorney's fees. The Bureau does not agree that the potential for consumer finance cases in which plaintiff's attorney fees are high relative to the

[736] Newberg et al., *supra* note 65, at § 15:38. *See e.g.*, Order Granting Plaintiff's Motion for Final Settlement Approval & Granting Plaintiff's Application for Attorney's Fees, Expenses, & Incentive Awards, Villaflor v. Equifax Info. Svcs., L.L.C., No. 09-00329 (N.D. Cal. May 3, 2011), ECF No. 177 (approving attorney's fee application based on hours worked in case based on FCRA claim and request for statutory attorneys fees) (cited at 81 FR 32830, 32932 (May 24, 2016)); Order Granting: (1) Final Approval to Class Action Settlement; (2) Award of Attorney's Fees; and (3) Judgment of Dismissal at 7, Lemieux v. Global Credit & Collection Corp., No. 08-01012, (S.D. Cal. Sept. 20, 2011), ECF No. 46 (analyzing attorney's fee request in a settlement involving TCPA claims and a request for statutory attorney's fees, under the lodestar method and determining "[u]nder the facts presented in this case, the Court finds the amount of hours expended, Counsel's billing rates, and the positive multiplier of 1.46 to be reasonable," justifying payment of requested fees) (cited at 81 FR 32830, 32931(May 24, 2016)).

[737] Federal Judicial Center, "Manual for Complex Litigation," at § 21.724 (4th ed. Thomson West 2016). *See, e.g.*, Order Awarding Attorneys' Fees And Reimbursement of Expenses at 3-4, Faloney v. Wachovia Bank, N.A., No. 07-01455 (E.D. Pa. Jan. 22, 2009), ECF No. 118 (granting an attorney's fees request in common fund case, noting that 6,372 attorney hours had been billed, and that the fee requested was based on a reasonable multiple of the resulting loadstar of $2,266,691) (cited at 81 FR 32830, 32931 (May 24, 2016)); Final Approval Order & Judgment at 3-4, In re: Chase Bank USA, N.A. ''Check Loan'' Contract Litig., No. 09-02032, (N.D. Cal. Nov. 19, 2012), ECF No. 386 ("The Court further finds the requested service awards are fair and reasonable, given the time and effort expended by the recipients on behalf of the Class. Accordingly, Class Counsel is hereby awarded attorneys' fees . . . to be paid from the common Settlement Fund . . . .") (cited at 81 FR 32830, 32931(May 24, 2016)).

[738] *See, e.g.*, Theodore Eisenberg & Geoffrey P. Miller, "Attorney Fees and Expenses in Class Action Settlements: 1993-2008," 7 J. Empirical Legal Stud. 248, at 279 (2010) (noting that class action awards exhibit a strong "scale effect" in that attorneys receive a smaller proportion of the recovery as the size of the recovery increases, and stating that this effect occurs because increased aggregation of claims leads to greater efficiency).

settlement amount or even more than the settlement amount compels a finding that those class actions do not protect consumers or are not in the public interest. The Bureau finds that such an outcome is uncommon, and notes that courts scrutinize these settlements like any other, rejecting them when they are not fair and reasonable or approving them when they are.[739] These cases still provide benefits to consumers, whether in the form of injunctive relief or more limited compensation, and deter companies from violating the law, as discussed above in Part VI.C.1. Indeed, the prospect that a company might be forced to pay attorney's fees in a class action settlement deters violations of the law just as much as the prospect that a company might be forced to provide relief to consumers. Given the limited resources of public enforcers, it is less likely that public enforcement would devote resources to cases involving harms totaling relatively small amounts; thereby making private enforcement more important for such cases.

Further, certain statutes cap the total amount of relief that can be awarded in a class action under that statute. For consumer finance laws, these include the Expedited Funds Availability Act (EFAA), EFTA, 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.[740] Given the fixed costs of litigating, it is therefore more likely that cases

[739] *E.g.*, *Allen* v. *Bedolla*, 787 F.3d 1218, 1224, 24; 165 Lab. Cas. P 36348, 91 Fed. R. Serv. 3d 1108, 24 Wage & Hour Cas. 2d (BNA) 1437 (9th Cir. 2015) (emphasizing that warning signs such as the fact that the amount of attorney's fee was three times higher than the amount paid to the class "does not mean the settlement cannot still be fair, reasonable, or adequate"); *Harris* v. *Vector Marketing Corp.*, 2011 WL 4831157, *4 (N.D. Cal. 2011) ("This is not to suggest that fees which exceed actual class recovery are necessarily disproportionate or reflect a conflict of interest."); *Koby* v. *ARS*, 846 F.3d 1071 (9th Cir. 2017) (rejecting class settlement approved by magistrate judge because there was no evidence that class members received any benefit from the settlement and class members relinquished their rights to seek damages on the same issue in any other class action).

[740] These caps can be summarized as follows:

EFAA: capped amount of lesser of $500,000 or 1 percent of net worth of creditor; capped amount is in addition to any actual damages; punitive damages are not expressly authorized. 12 U.S.C. 4010(a)(2)(B)(ii);

EFTA: capped amount of lesser of $500,000 or 1 percent of net worth of the defendant; capped amount applies to statutory damages for "the same failure to comply"; punitive damages are not expressly authorized. 15 U.S.C. 1693m(a)(2)(B). As discussed in Appendix L of the Study, we did not cover cases related solely to violation of EFTA ATM disclosure requirements. EFTA also authorizes trebling of actual damages for certain claims under 15 U.S.C. 1693f(e);

asserting claims under such capped statutes would result in attorney's fee awards that are higher in relation to the amount of monetary relief awarded to the class than awards in cases asserting claims under uncapped statutes or under common law theories. The Bureau does not believe that the existence of these damages caps or the resulting relationship between attorney's fees and consumer relief suggests that class actions for violations of these statutes are not in the public interest. The Bureau finds no evidence to suggest that class actions with lower recovery amounts (and potentially relatively higher attorney's fees) do not benefit consumers in part because, as discussed above in Part VI.C.1, the Bureau believes such class actions, like all class actions, have a deterrent effect.[741]

With respect to commenters that questioned the accuracy of the Study's data as it pertained to attorney's fees in class action settlements, the Bureau points out that the two competing studies cited by commenters covered many cases that would not be covered by this rule and were not covered in the Study. For example, the RAND study cited by one commenter was a 1999 case study of 10 cases that pre-dated CAFA, and only four of the cases studied were consumer finance cases.[742] For comparison, the Bureau's Study analyzed 419 class action settlements, all of them concerning consumer financial products or services.[743] Moreover, while one commenter cited the RAND study for the proposition that attorney's fees were higher than

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FDCPA: capped amount of lesser of $500,000 or 1 percent of net worth of defendant; capped amount is in addition to any actual damages; punitive damages are not expressly authorized. 15 U.S.C. 1692k(a)(2)(B);

TILA including CLA, FCBA: capped amount of lesser of $1 million or 1 percent net worth of creditor; capped amount is in addition to any actual damages; punitive damages are not expressly authorized; prior to Dodd-Frank July 2010 DFA 1416(a)(2), was $500,000. 15 U.S.C. 1640(a)(2)(B); and

ECOA: does not authorize statutory damages, but rather actual damages, as well as punitive damages up to $10,000, with combined amounts in a class case subject to limit of lesser of $500,000 or 1 percent of net worth of creditor. 15 U.S.C. 1691e(b).

[741] Indeed, some of the law firm alerts cited by the Bureau as examples of the deterrent effect of class action settlements involve class actions asserting claims under capped statutes.
[742] Hensler, et al., *supra* note 669, at 5, 14.
[743] Study, *supra* note 3, section 8 at 3.

relief provided to consumers in three out of 10 cases, two of those cases were small settlements (each just under $300,000), which as discussed above are more likely to lead to situations in which attorney's fees are higher than consumer payout. Further, that study's authors ultimately did not agree with the conclusion that class actions produce large payouts for the attorneys at the expense of plaintiffs and consumers. Instead, the authors opined that "[t]he wide range of outcomes that we found in the lawsuits contradicts the view that damage class actions invariably produce little for class members, and that class action attorneys routinely garner the lion's share of settlements."[744]

With respect to a paper cited by several commenters as supporting the conclusion that attorney's fees are higher than shown by the Bureau's Study and "rarely less than 75 percent of the amount actually paid to consumers," the paper does not appear to have reported the overall mean for attorney's fees of all the cases analyzed as a percentage of payments.[745] Instead, the attorney's fee data in that paper was reported for "claim types" that were subsets of claims under particular statutes.[746] The data was not reported for cases under each statute as a whole. Thus, the 75 percent figure appears to be an estimate of the various percentages data that were reported for each claim type within the various statutes.[747] The paper analyzed a set of class actions from a single Federal district court concerning claims under the FDCPA, TCPA, FCRA, and EFTA. As noted above in Part VI.B.3 in a discussion of a separate study cited by commenters,[748] many of those statutes cover activity that extends beyond consumer financial services, to include nonfinancial goods or services that were neither included in the Study nor are

[744] Hensler et al., *supra* note 669, at 18.
[745] See the Section 1022(b)(2) Analysis below in Part VIII for a related discussion of attorney's fees.
[746] For example, cases asserting claims under the FDCPA were divided into four claim-types: bad affidavit; bad debt; formality; and litigation threat. Johnston, *supra* note 520, at 31.
[747] Johnston, *supra* note 520, at 41.
[748] Shepherd, *supra* note 515, at 2, 13.

subject to the final rule.[749] Indeed, of those cases analyzed in the paper, only the FDCPA cases and a few of the TCPA debt call cases would likely involve consumer financial products and services covered by this rule. For those cases, the relative proportion of attorney's fees to consumer payout does not appear inconsistent with what was found in the Study for cases with smaller class settlements.

Specifically, the paper analyzed 26 FDCPA class action settlements and found the proportion of attorney's fees to cash relief to be between 62 percent and 84 percent and the proportion of attorney's fees to cash payments to be 64 percent to 100 percent.[750] Accordingly, the ratio of attorney's fees to nominal relief is consistent with that reported in the Study for settlements of $100,000 or less which showed that the proportion of attorney's fees to gross relief for such cases averaged 55.9 percent.[751] The Study did not disaggregate the data with respect to fee awards in relation to cash payout by size of settlement or type of claim, but the ratios likely would have been similar to what the paper found for settlements of that size given the data reported in the Study on the attorney's fees by size of settlement.[752] As for comments that criticized high attorney's fees in settlements that provided for *cy pres* relief, the Study's analysis of cash payments to consumers did not include any additional value of *cy pres* relief. Indeed, the Study found relatively few consumer finance settlements providing for *cy pres* relief without also providing relief directly to consumers – 28 out of 419 analyzed. Had the Bureau

[749] For example, as discussed more fully above regarding "no-injury statutes" in "Monetary Relief Provided," FCRA class actions can involve merchants and employers. EFTA class actions in this period were often ATM "sticker" claims that no longer violate EFTA. As the proposal noted, the rule would have no impact on such cases because they are either brought against merchants, or by non-customers who do not have contractual relationships with a provider. FDCPA class actions cover the collection of all types of debt, including debt that does not arise from a consumer financial product or service (such as taxes, penalties and fines), whereas the Study and the rule only covered collection of debt to the extent it was a collection on a consumer financial product or service. Finally, TCPA class actions often involve marketing communications unrelated to consumer finance. Such claims are often brought against a merchant or a company with whom the consumer otherwise has no relationship (contractual or otherwise).
[750] Johnston, *supra* note 520, at 31. That paper also found the average nominal settlement in those cases to be relatively low: $58,724.
[751] Study, *supra* note 3, section 8 at 34 tbl. 11.
[752] *Id.*

included *cy pres* in its analyses, the attorney's fees ratios would have been even lower. For these reasons, the Bureau finds that the attorney's fees awarded in *cy pres* cases, when they occur, do not undermine the findings that class actions are in the public interest insofar as *cy pres* payouts are above and beyond the amounts reported by the Study.[753]

Many of the commenters criticized the role of plaintiff's attorneys in class action settlements, asserting that they often have improper conflicts of interest with absent class members. However, judicial review of class action settlements, including the portion of any settlement allocated to the attorneys, is required in part because of the potential for such conflicts. Indeed, the Federal Judicial Center Manual notes, with respect to class action settlements, that "the parties or the attorneys often have conflicts of interest…" and instructs courts on how to manage those conflicts.[754] In other words, while the commenters are correct that class actions can pose potential conflicts of interest between plaintiff's attorneys and absent class members, courts are explicitly aware of these conflicts and, for those reasons among others, have procedures in place to review class action settlements. While many commenters expressed their belief that courts do not adequately review class action settlements for fairness or reasonableness, there are numerous examples of courts that, in exercising their power to review class action settlements, found certain aspects of settlements to be unfair or unreasonable.[755]

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[753] *Id.* section 8 at 4 n.5 and n.9.

[754] Federal Judicial Center, "Manual for Complex Litigation," at § 13.14 (4th ed. Thomson West 2016). A separate section of that manual notes "[i]n common-fund litigation, class counsel may be competing with class members for a share of the fund, thus placing a special fiduciary obligation on the judge because class members are unrepresented as to this issue." *Id.* § 14.231.

[755] *See generally* Newberg et al., *supra* note 65, at § 13:61, citing many cases. *See also In re Bluetooth Headset Products Liability Litigation*, 654 F.3d 935, 947 (9th Cir. 2011) (describing possible signs of collusion, such as "when counsel receive a disproportionate distribution of the settlement, or when the class receives no monetary distribution but class counsel are amply rewarded" (quoting *Hanlon* v. *Chrysler Corp*., 150 F.3d 1011, 1021 (9th Cir. 1998)); *Crawford* v. *Equifax Payment Services, Inc*., 201 F.3d 877, 882, 45 Fed. R. Serv. 3d 811 (7th Cir. 2000) (reversing settlement approval where it appeared plaintiffs' counsel was "paid handsomely to go away" and "the other class members received nothing … and lost the right to pursue class relief."). *Vought* v. *Bank of America, N.A.*, 901 F. Supp. 2d 1071, 1100–01 (C.D. Ill. 2012) (stating that "[t]he terms of the settlement, despite the superficially generous $500,000 cap, ended up being a zero-sum framework where the putative attorneys' fees award cannibalized the funds that would otherwise have gone to the class" and denying approval). Sobel v. Hertz Corp., 2011 WL 2559565, *13 (D. Nev. 2011) (denying approval in part because "the only components with any determinate—or on this record, determinable—value are the attorneys' fees, incentive payments, and to some extent the costs of notice and administration"). *True* v. *American Honda Motor Co*.,

Commenters and commentators may debate whether an attorney's fee award in a particular case is appropriate, but commenters have not put forth evidence to suggest that courts cannot and do not effectively supervise class action settlements or attorney's fee awards or that they fail to do so in such a way that the entire class action process is rendered faulty.[756]

Similarly, some industry commenters put forward examples, prior to the period analyzed in the Study, of plaintiff's attorneys who engaged in unlawful practices such as paying individuals to serve as lead plaintiffs or recruiting professional plaintiffs to serve as lead plaintiffs in multiple cases. However, no commenters submitted evidence to support that such abuses are widespread, nor is the Bureau aware of support for that view. Further, the nature of the examples submitted indicates that prosecutors and the courts have uncovered and remedied such abuses when they occurred. Indeed, in the example cited by one commenter that involved plaintiff's attorneys who paid people to be lead plaintiffs, those attorneys were criminally charged with racketeering, mail fraud, and bribery and pleaded guilty to numerous charges.[757]

As to commenters that criticized plaintiff's attorneys as "self-interested" in choosing to bring class action cases that might benefit them personally through generation of large fee awards, the Bureau recognizes that plaintiff's attorneys are unlikely to be motivated purely by altruism and may, indeed, factor the potential to earn a fee into their decisions about whether to pursue a case. The Bureau does not agree that the pecuniary motives of the plaintiff's attorney in

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749 F. Supp. 2d 1052, 1078 (C.D. Cal. 2010) (noting that "there is no certainty that class members will receive any cash payments or rebates at all," then concluding "to award three million dollars to class counsel who may have achieved no financial recovery for the class would be unconscionable"). *In re TJX Companies Retail Sec. Breach Litigation*, 584 F. Supp. 2d 395, 406 (D. Mass. 2008) ("Similarly, unscrupulous class counsel may agree to conditions on a settlement—such as a short timeframe in which to make claims or a burdensome claims procedure—in order to obtain additional concessions from the defendant that purportedly increase the value created by the litigation and that support an enhanced fee award.").

[756] One commenter cited a study that the commenter claimed supports the proposition that judges are more likely to approve class settlements in cases where the claims are weak. Johnston, *supra* note 520, at 13. The Bureau has reviewed that Study and disagrees that it supports such a proposition.

[757] Martha Graybow, "US Shareholder Lawyer Melvyn Weiss to Plead Guilty," Reuters (Mar. 21, 2008), *available at* http://www.reuters.com/article/sppage014-n20401632-oistl-idUSN2040163220080321; Business Day, "Lawyer Pleads Guilty in Securities Case," N.Y. Times (July 10, 2007), *available at* http://www.nytimes.com/2007/07/10/business/09cnd-bershad.html?hp.

pursuing a class action on behalf of absent class members determine whether a case ultimately provides relief to consumers or is in the public interest, much like the Bureau would not consider a provider's profit motive as evidence of whether the provider's product or service complies with the law.

In any event, plaintiff's attorneys are incentivized by the prospect of fee awards to pursue relief on behalf of consumers in cases where individual recoveries would be small and thus both individual consumers and individual attorneys would not have a financial motivation to proceed. By design, the class vehicle groups individual claims and thereby provides the plaintiff's attorney with the incentive to bring them.[758] The fact that a plaintiff's attorney was motivated to bring a class action case by the potential to earn a profit does not undermine the validity of the case. Indeed, individual consumers are not generally qualified to represent themselves in filing a class action, so someone else must bring it for them. As long as courts continue to review settlements and attorney's fee awards for reasonableness and fairness, there is a check on the self-interest of plaintiff's attorneys to ensure that it does not prevent consumers from benefitting from the class action procedure.

*Strain on the courts.* A few commenters stated that the rule would encourage class action litigation and therefore strain the resources of the court system. As noted above in Part VI.A, for the public interest standard, the Bureau considers benefits and costs to consumers and firms, including more direct consumer protection factors, and general or systemic concerns with respect to the functioning of markets for consumer financial products or services, the broader economy,

[758] *See, e.g.*, John C. Coffee, Jr., "Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions," 86 Colum. L. Rev. 669, at 677-679 (1986) (stating that, in the context of class and derivative actions, "our legal system has long accepted, if somewhat uneasily, the concept of the plaintiff's attorney as an entrepreneur who performs the socially useful function of deterring undesirable conduct").

and the promotion of the rule of law and accountability.[759] The Bureau does not believe that the impact of the rule on the resources of the court system per se or to the extent it impacts non-consumer product and service-related litigation is appropriately considered under this standard; this impact does not fall under the Bureau's purposes and objectives.[760] To the extent any strain on the court system could impact consumers bringing claims related to consumer financial products and services by, for example, increasing court costs as well as the waiting time for court dates or decisions, the Bureau has considered this impact in its public interest analysis. The Bureau has also considered impacts on providers in their claims related to consumer financial products or services. In any event, the Bureau does not believe that strain on the court system to be a likely or significant outcome of its rule.

The Bureau does estimate that there will be some increased class action litigation as a result of the class rule. Indeed, the Section 1022(b)(2) Analysis below in Part VIII estimates that there will be 3,021 additional Federal court class actions over a five-year period, or 604 Federal cases per year. The Bureau does not agree, however, that this increase in class action cases will overburden the Federal court system. In the most recent year for which data is available, there were 673 authorized district court judgeships.[761] Accordingly, the class rule would likely increase the case load of each Federal district judge by slightly less than one case per year, which the Bureau believes would be a minimal impact. Similarly, there are approximately 11,800 State court judges of general jurisdiction.[762] Assuming the same number of additional class actions are

[759] The Bureau uses its expertise to balance competing interests, including how much weight to assign each policy factor or outcome.
[760] *See, e.g.*, *Nat'l Ass'n for Advancement of Colored People* v. *FPC*, 425 U.S. 662, 667-68 (1976).
United States Courts, *Authorized Judgeships*,
http://www.fjc.gov/history/home.nsf/page/research_categories.htmlhttp://www.uscourts.gov/sites/default/files/allauth.pdf (last visited Jun. 23, 2017).
[762] Nat'l Ctr. for State Courts, "Number of Authorized Justices/Judges in State Courts, 2010," (Court Statistics Project 2012), *available at* http://www.courtstatistics.org/~/media/Microsites/Files/CSP/SCCS/2010/Number_of_Authorized_Justices_and_Judges_in_State_Courts.ashx.

filed in State courts as in Federal courts as a result of the class rule[763] and that class actions can be heard by these judges, each State court judge would face an additional 0.05 cases per year, or one case per judge over the course of 20 years. The Bureau finds that these increases per judge are so small that the increase in the number of class cases caused by the class rule would not significantly impact the costs or efficiency of administration of the Federal and State court system. However, even if the entirety of the strain on the court system fell upon consumers and providers, as explained below, the Bureau finds that the relatively small impact in the form of additional class action cases is preferable to class action cases that could have provided relief to consumers from violations of the law being blocked by arbitration agreements or never filed at all.

To the extent that this small impact on the court system occurs, the Bureau finds that resolution of the additional class cases will provide relief for consumers and the threat of liability in those cases will deter providers from violating the law and therefore that the impact on the court system is justified. In other words, the Bureau finds that a relatively small impact on the court system in the form of additional class action cases is preferable to class action cases that could have provided relief to consumers from violations of the law being blocked by arbitration agreements or never filed at all. Accordingly, the impact on the court system from the class rule does not detract the Bureau's finding that the class rule is in the public interest.

*Harm to relationships between customers and providers.* As to commenters that contended that the class rule is not in the public interest because it would harm relationships between consumers and their financial institutions because the availability of class actions discourages informal resolution of disputes, the Bureau does not agree. The Bureau does not

[763] For the basis for this assumption, see the detailed discussion in the Section 1022(b)(2) Analysis below in Part VIII.

believe that the mere possibility of obtaining relief through a class action, or the pendency of a putative class action, will materially affect the number of consumers who seek to resolve complaints informally. Nor does the Bureau believe that class action exposure or the pendency of a class action will reduce the frequency with which providers will agree to informal resolution. If anything, the Bureau believes the reverse to be true as companies may be more likely to resolve complaints informally to reduce the risk that a consumer initiates a class action and, if a putative class action is pending, to reduce the likely class recovery as the class action settlement may deduct the amount of the company's informal relief provided to customers when calculating damages.[764]

*Federalism concerns.* In response to the research center commenter that contended that the class rule will encourage "inverse federalism," the Bureau notes that this argument rests on the premise that providers that face only exposure to individual arbitrations or litigation will not deem it necessary to conform to the most protective State laws, whereas the availability of class relief will result in compliance with such laws and have spillover effects on other States. Thus, like the objection based on the impact of the rule on innovation, this comment conceded the key predicates on which the class rule rests – that class actions deter violations of the law.

The Bureau does not agree that to the extent the class rule increases compliance with the most protective State laws and has spillover effects in other States such a result would represent federalism in reverse. Companies that operate in multiple States have a choice of either acting differently in different States depending upon the permissiveness of State law or acting uniformly in a manner consistent with the most consumer-protective State law. The Federal

[764] For example, in 17 of the 18 Overdraft MDL settlements analyzed in the Study, the settlement amounts and class members were 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. Study, *supra* note 3, section 8 at 46 n.63.

system does not presuppose that a company may choose to so cabin its exposure in certain States (*e.g.*, by entering into arbitration agreements) so as to enable it to ignore the laws of more protective States. Thus, if the result of the class rule is to cause companies to comply with protective State laws – and if, as a result, those companies choose to adopt the same practices in States with fewer restrictions – such an outcome would be entirely consistent with the Federal system.

*Impairment of freedom of contract.* In response to a group of State attorneys general that contended that the class rule harms the public interest because it reduces parties' freedom of contract, the Bureau notes that consumer finance contracts are not negotiated; they are almost always standard-form contracts that consumers may either choose to sign in order to obtain the product or not. Further, the Study's consumer survey of credit card customers found that consumers did not mention dispute resolution features as relevant to them when shopping for credit cards and chose dispute resolution last on a list of nine features that influenced their decision of whether to choose a particular credit card.[765] These findings suggest that consumers do not consider dispute resolution when obtaining consumer financial products.[766] The survey further found that consumers generally do not understand the consequences of entering into a contract that includes an arbitration agreement.[767] Thus, while it is true that in certain covered markets the rule will eliminate the option for consumers to choose a contract on the basis of its dispute resolution procedures, the Bureau does not view that as negatively impacting consumers' freedom of contract, in practice. Furthermore, to the extent that the class rule affects the

[765] *Id.* section 3 at 11-15.
[766] This also addresses the comment that consumers do have a choice regarding whether to enter into contracts with arbitration agreements. The survey demonstrated that dispute resolution was not something most consumers considered at the time they acquired a product. In any event, the Study showed that for some products, there was almost no option for a consumer who did not want an arbitration agreement. *Id.* section 2 at 6-26.
[767] *Id.* section 3 at 18.

providers' freedom of contract, the Bureau notes that there are any number of laws and regulations that take precedence over the unfettered freedom of contract in consumer finance. For example, State usury laws limit the interest than can be charged to consumers who borrow money,[768] State and Federal consumer protection laws establish certain minimum standards which cannot be varied by contract, and State common law typically does not permit enforcement of contractual terms that are unconscionable.[769] The Bureau therefore finds that, to the extent the class rule has any impact on the freedom of contract, that limited impact to consumers and providers' freedom of contract is justified by the consumer protection and other public interest benefits of the class rule, discussed herein. Put another way, the commenters did not explain why consumers' freedom to contract (for products with form contracts) should take precedence over their liberty to engage with providers more likely to comply with consumer protection laws. Similarly, the Bureau believes that any limited impact the class rule may have on consumers' freedom of contract and, in turn, consumers ability to avoid contact with plaintiff's attorneys, is justified for all the reasons discussed herein.

*Public policy concerning arbitration and legal uncertainty.* Lastly, with respect to commenters' assertion that the class rule contravenes public policy and Supreme Court precedent culminating in *AT&T* v. *Concepcion*, the Bureau notes that this assertion stems from the general

[768] *E.g.*, Tex. Fin. Code Ann. § 302.001 ("The maximum rate or amount of interest is 10 percent a year except as otherwise provided by law."); N.Y. Banking Law § 14-a ("The maximum rate of interest…shall be sixteen per centum per annum."); Ohio Rev. Code Ann. § 1343.01 ("The parties to a bond, bill, promissory note, or other instrument of writing for the forbearance or payment of money at any future time, may stipulate therein for the payment of interest upon the amount thereof at any rate not exceeding eight per cent per annum payable annually, except as authorized in division (B) of this section.").

[769] *E.g.*, Richard A. Lord, "Williston on Contracts" at § 18.1 (Thomson Reuters, 4th ed. 2010) ("[W]hile freedom of contract has been regarded as part of the common-law heritage . . . courts of equity have often refused to enforce some agreements when, in their sound discretion, the agreements have been deemed unconscionable."). *See also Gandee* v. *LDL Freedom Enters., Inc.*, 293 P.3d. 1197, 1199-1202 (Wash. 2013) (finding arbitration agreement unconscionable where agreement required arbitration to take place in Orange County, California; contained provision shifting all costs to losing party; and shortened statute of limitations from four years to 30 days); *Newton* v. *Am. Debt Services, Inc.*, 854 F. Supp. 2d 712, 722-27 (N.D. Cal. 2012) (same, where agreement was part of an adhesion contract; was inconspicuously located within the contract; deprived plaintiff of statutory rights; required plaintiff to arbitrate in Tulsa, Oklahoma; and gave defendant unilateral right to choose arbitrator, among other things); *Bragg* v. *Linden Research, Inc.*, 487 F. Supp. 2d 593, 605-11 (E.D. Pa. 2007) (same, where agreement was included in a lengthy paragraph under the benign heading "General Provisions;" consumer was required to advance a significant share of the fees; and venue was limited to San Francisco, among other things).

public policy established by Congress in passing the Federal Arbitration Act. But the Supreme Court has also acknowledged that this general "'liberal federal policy favoring arbitration agreements'" may be overridden in specific instances where "Congress itself has evinced an intention to preclude a waiver of judicial remedies for the statutory rights at issue."[770] The Bureau further notes that section 1028 of the Dodd-Frank Act provides the Bureau with authority to regulate arbitration agreements.[771] To do so, the Bureau must find, consistent with the Study, that doing so is in the public interest and for the protection of consumers. For all of the reasons discussed herein, the Bureau finds that class rule meets the standard for the Bureau to exercise its section 1028 authority.

In response to commenters' concerns regarding the legal uncertainty that may follow from the class rule that may create potential liability for covered providers, the Bureau does not believe that the rule creates any uncertainty as to the type of actions to which it would apply. Rather, the Bureau believes that the regulation text is clear that the final class rule applies to all State and Federal class actions, as discussed more fully in the section-by-section analysis to § 1040.4(a)(2) below in Part VII. To address any potential confusion, the Bureau intends to develop a suite of compliance materials for new part 1040, just as it has done with the other regulations it has issued. Nor does the Bureau believe that the rule creates any uncertainty as to the scope of preemption under the Federal Arbitration Act, since the Supreme Court has been quite clear that Congress can authorize exceptions to the FAA by statute as Congress did in section 1028.

[770] *Gilmer* v. *Interstate/Johnson Lane Corp*., 500 U.S. 20, 26 (1991) (citing *Moses H. Cone Memorial Hospital v. Mercury Construction Corp*., 460 U.S. 1, 24 (1983)).
[771] *Compucredit Corp.* v. *Greenwood*, 132 S. Ct. 665 (2012).

Moreover, to the extent that covered entities have the ability to challenge legislation or rulemaking through the litigation process or otherwise, there is always some degree of uncertainty with respect to any statute or rulemaking. If the potential for that type of legal uncertainty discouraged the adoption of new legislation or regulations, new legislation or regulations would rarely occur. For this reason, the Bureau finds that the potential for legal uncertainty, if any, does not undermine a finding that the class rule is in the public interest.

*Impact on certain State laws.* The Bureau disagrees with industry commenter that asserted that the proposal was not in the public interest because of its potential effect on Utah's law authorizing class-action waivers in closed-end consumer credit contracts.[772] As relevant here, the Bureau has found that certain limitations on the use of pre-dispute arbitration agreements related to class waivers are in the public interest and for the protection of consumers. As noted above, the Bureau has determined that eliminating class actions reduces and weakens consumer protections because the remaining forms of dispute resolution are insufficient. In addition, as discussed in the Section 1022(b)(2) Analysis, the Bureau does not believe that a disclosure-focused regulation would address the market failure the Bureau has identified in this rule.[773] Accordingly, these findings are equally applicable where a State law authorizes the use of class waivers in arbitration agreements that apply to consumer financial products and services covered by this final rule, such as the Utah law does with respect to consumer credit contracts.[774] Based on the Bureau's findings, even if such a law would conflict with the class rule to the extent it allows providers to rely on class waivers in arbitration clauses in the absence of the

[772] Utah Code 70C-3-14.
[773] Moreover, the Bureau has emphasized the importance of the coverage of extensions of consumer credit in the rule, as it did in the Study, based on date gathered since the adoption of the Utah law in 2006 by searching cases in Federal courts including any cases in Utah Federal court or in other courts based on choice of Utah law.
[774] The commenter suggested other States have similar laws but provided no citations to those laws nor is the Bureau aware of any.

class rule, the class rule is in the public interest and for the protection of consumers and affords consumers greater protections than such a State law. The Bureau also believes that a uniform approach to the conduct covered by this rule across the States is consistent with the goal of promoting consistency in compliance and a level playing field across the providers covered by the rule.[775]

It also bears noting that, as described in Part VI.A above, a group of State-legislator commenters argued that the proposed class rule was in the public interest precisely because Federal law currently undermines States' ability to pass laws that will be privately enforced, measure the efficacy of those laws, or observe their development.

*D. The Bureau Finds That the Monitoring Rule Is in the Public Interest and for the Protection of Consumers*

As described above, in the proposal, the Bureau preliminarily found – in light of the Study, the Bureau's experience and expertise, and the Bureau's analysis – that a comparison of the relative fairness and efficiency of individual arbitration and individual litigation was inconclusive and thus that a complete prohibition on the use of pre-dispute arbitration agreements in consumer finance contracts was not warranted. Accordingly, the class proposal would not have prohibited covered entities from continuing to include arbitration agreements in consumer financial contracts generally; providers would still have been able to include them in consumer contracts and invoke them to compel arbitration in court cases that were not filed as class actions. In addition, the class proposal would not have foreclosed class arbitration; it

[775] As to the commenter concerned about potential preemption of States' laws regarding security freezes, when a State law provides a private right of action and does not explicitly prohibit class claims, then claims under that law generally may be classable under Federal Rule 23 or an analogous State law. In such a situation, the class rule provides that arbitration agreements cannot be used to block class actions. However, when a State law precludes class actions for violations of that State law, the class rule will not alter that legislative decision.

would be available when the consumer chooses arbitration as the forum in which he or she pursues the class claims and the applicable arbitration agreement permits class arbitration.

However, in light of historical evidence that there have been serious concerns about the fairness of thousands of past arbitration proceedings, and that the Study identified some fairness concerns about certain current arbitration agreement provisions and practices, the Bureau believed that it was appropriate to propose a system to facilitate monitoring and public transparency regarding the conduct of arbitrations concerning covered consumer financial products and services going forward. Specifically, the Bureau proposed § 1040.4(b), which would have required providers to submit certain arbitral records to the Bureau that the Bureau would then further redact, if necessary, and publish. The Bureau preliminarily found this part of the proposal to be consistent with the Bureau's authority under section 1028(b) including finding that this part was in the public interest and for the protection of consumers. The Bureau made this preliminary finding after considering such countervailing considerations as the costs and burdens to providers.

This section discusses the bases for the preliminary findings, comments received, and the Bureau's further analyses and final findings pertaining to the monitoring rule. Similar to the Bureau's analysis of the statutory elements pertaining to the class rule, this discussion first addresses whether the monitoring rule is for the protection of consumers, and then addresses whether the rule is in the public interest. As discussed briefly in the findings and in the section-by-section analysis of § 1040.4(b) below, the Bureau is expanding the list of records that must be reported to the Bureau as urged by some commenters in order to better promote both statutory objectives. The Bureau is also finalizing its proposal to publish the reported records, with appropriate redactions, on the Bureau's website.

*1. The Monitoring Rule Is for the Protection of Consumers*

In the proposal, the evidence before the Bureau, including the Study, was inconclusive as to the relative fairness and efficacy of individual arbitration compared to individual litigation. The Bureau remained concerned, however, that the historical record demonstrated the potential for consumer harm in the use of arbitration agreements in the resolution of individual disputes. 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 Bureau preliminarily found, consistent with the Study, that the monitoring proposal would have positive outcomes that would be for the protection of consumers. Specifically, the Bureau preliminarily found that the collection of arbitration documents would help the Bureau monitor how arbitration proceedings and agreements evolve and to see if they evolve in ways that harm consumers.[776] The collection of arbitration claims would provide transparency regarding the types of claims consumers and providers are bringing to arbitration and would allow the Bureau to monitor the raw number of arbitrations.

While the Study data identified only hundreds of arbitrations per year filed with the AAA in selected markets, in the period before the Study, there were tens of thousands of arbitrations per year, largely filed by providers. For instance, a large increase in the volume of provider-filed claims identified by the Bureau under the monitoring rule could suggest a need to monitor for potential fairness issues associated with large-scale debt collection arbitrations, such as those historically filed by providers before NAF and the AAA. The collection of awards would

[776] As explained in Part VI.A the transparent application of laws has general benefits to society and is therefore a factor that the Bureau considers as a part of the public interest analysis. In this section, however, "transparency" is used in a different sense to refer to access for both the Bureau and the public to information related to arbitrations that serves to directly facilitate deterrence and redress.

provide insights into the types of claims that reach the point of adjudication and the way in which arbitrators resolve these claims. The collection of correspondence on nonpayment 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 or otherwise act in ways that prevent consumers from accessing dispute resolution.

The Bureau also stated in the proposal that, more generally, the collection of these documents would help the Bureau monitor consumer finance markets for risks to consumers, potentially providing the Bureau and the public with additional information about the types of potential violations of consumer finance or other laws alleged in arbitration, and whether any particular providers are facing repeat claims or have engaged in potentially illegal practices, and the extent to which providers may have adopted one-sided agreements in an attempt to avoid liability altogether by discouraging consumers from seeking resolution of claims in arbitration. Finally, monitoring would allow the Bureau to take action against providers that harm consumers.[777]

*Comments Received*

Some commenters opposed the monitoring proposal, though they were split on whether it was inadequate to protect consumers in light of concerns about the fairness of arbitration or whether action by the Bureau was not warranted at all.

[777] In the proposal, the Bureau treated the question of whether the use of individual arbitration in consumer finance cases is in the public interest and for the protection of consumers as discrete from the question of whether some covered persons are engaged in unfair, deceptive, or abusive acts or practices in connection with their use of individual arbitration agreements. The Bureau emphasized in the proposal that it intended to continue 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.

On one side, a consumer advocate commenter suggested that the Bureau adopt what it deemed a stronger alternative to the monitoring proposal[778] in which it would identify and ban a number of specific practices in arbitration agreements and proceedings, such as fee-shifting provisions requiring the losing party in the arbitration to pay the fees of the winning party. The same commenter expressed the concern that fee-shifting could harm consumers because the major arbitration administrators currently do not have any *in forma pauperis* provisions (which allow impoverished consumers to file arbitrations without paying filing fees). Another consumer advocate commenter contended that the proposal did not go far enough, asserting that law-breaking companies are unlikely to provide documents to the Bureau pursuant to the proposed monitoring rule, and thus the rule might not accomplish the Bureau's goals.

On the other side, some industry commenters wrote in general opposition to the Bureau's monitoring proposal, asserting that the record before the Bureau did not warrant taking action with regard to the fairness of arbitration proceedings. One industry commenter made several arguments in opposition to the monitoring proposal generally. First, the commenter asserted that the Study found no evidence of harm in arbitrations that warranted the Bureau's intervention. Next, the commenter asserted that the Bureau did not meet its burden to show that monitoring and publication were in the public interest and for the protection of consumers because the Study's assessment of AAA arbitrations did not show that arbitration was unfair to consumers. Finally, the commenter asserted that this must be so because the Bureau did not propose to also regulate post-dispute arbitration agreements. Another industry commenter asserted that, based upon its review of the Bureau's consumer complaints database, consumers are not experiencing

[778] Many of the comments on this issue urged the Bureau to adopt a total ban on arbitration agreements in contracts for consumer financial products and services. Those comments are addressed above in Section VI.B. This section addresses only those comments that urge the Bureau to take action regarding arbitration other than a total ban and issues related to the class rule.

unfairness in arbitration that warranted the proposed monitoring rule. An industry trade association commenter criticized the Bureau's citation of NAF as an example of the risks posed by individual arbitration to consumers as a red herring on the grounds that NAF is no longer an active risk to consumers as very few agreements currently specify NAF as an administrator, and that consumers are free to seek a different administrator even if NAF is specified in the agreement.

By contrast, many commenters supported the Bureau's preliminary finding that monitoring would have positive outcomes for consumers and for the public. A group of State attorneys general, nonprofit, individual, Congressional, consumer advocate, academic, industry, consumer law firm, and individual commenters wrote in general support of the Bureau's monitoring proposal. More specifically, the group of State attorneys general and nonprofit commenters supported the Bureau's preliminary finding that the collection and publication of documents would be valuable because it would help the Bureau and the public better understand arbitration generally. The academic commenters observed that the past existence of NAF provided a case study on the need for the transparency that the Bureau's monitoring proposal would provide. The academic commenters also suggested that NAF may have stopped certain practices sooner had more information about the outcomes of its arbitration proceedings been publicly available earlier.

*Responses to Comments and Final Findings*

The Bureau has carefully considered the comments received on the monitoring proposal and further analyzed the issues raised in light of the Study and the Bureau's experience and expertise. Based on all of these sources and for the reasons discussed above, in the proposal, and further below, the Bureau finds that requiring providers to submit specified, redacted arbitral

records and then publishing redacted versions of these records will be for the protection of consumers by helping the Bureau and the public monitor for the risks to consumers in the underlying consumer finance markets.

The Bureau believes that such monitoring is important to this ongoing risk assessment because the kinds of fairness concerns that have been raised about some arbitration proceedings historically could prevent consumers from obtaining redress for legal violations and expose them to harmful practices in arbitrations filed against them. While the Bureau expects that the number of consumer-filed individual arbitrations will remain low for the reasons discussed above, to the extent that arbitrations occur (and consumers are precluded from proceeding in court), it is in their interest that the proceeding be fair. The Bureau believes that the monitoring rule is for the protection of consumers because the awareness that certain basic information about disputes filed in arbitration will be available to the public will tend to discourage unfair and unlawful conduct by provides of both consumer financial products and services and arbitral services. In the event that transparency alone is not sufficient, the monitoring rule will also facilitate appropriate follow-up actions by the Bureau and others to protect consumers.

Specifically, the Bureau finds that the monitoring rule is for the protection of consumers for several reasons. It would deter potential wrongdoers who would know that their practices, with respect to both their use of arbitration proceedings and to their provision of consumer financial products and services, will be made public and would facilitate redress for related harms to consumers. Additionally, the Bureau finds that the rule will allow the Bureau and the public to better understand arbitrations that occur under arbitration agreements entered into after the compliance date and to determine whether further action is needed to ensure that consumers are being protected. The materials the Bureau is requiring providers to submit in redacted form –

similar to the AAA materials the Bureau reviewed in the Study – will allow the Bureau to more broadly monitor how arbitration proceedings are conducted, what provisions are contained in the underlying arbitration agreements, and whether providers are taking steps to prevent consumers from being able to seek relief in arbitration.

In particular, the Bureau finds, consistent with the Study, that the documents the Bureau collects will provide the Bureau with different and useful insights relevant to the above-mentioned assessment of risks to the consumers. The collection of arbitration claims will provide transparency regarding the types of claims consumers and providers are bringing to arbitration and the number of arbitrations filed,[779] and the collection of awards will provide insights into the types of claims that reach the point of adjudication and the way in which arbitrators resolve these claims. The collection of arbitration agreements, when considered with other arbitral documents, will 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, as noted before, the collection of correspondence regarding nonpayment of fees and non-compliance with due process principles will allow the Bureau to understand the extent to which providers do not meet the arbitral administrators' fairness standards and to identify when consumers are harmed by providers' nonpayment of fees.

The Bureau notes that the two categories of documents it is adding to what it had proposed will protect consumers by providing the Bureau and the public further insights into the risks that the use of arbitration agreements may pose for consumers in the covered consumer finance markets. The collection of answers to arbitral claims, required by new

[779] *See, e.g.*, Preliminary Results, *supra* note 150 at 61; Study, *supra* note 3, section 5 at 9. 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).

§ 1040.4(b)(1)(i)(B), will supplement the Bureau's collection of claims and awards and will provide additional insights by providing a more balanced understanding of the facts (or disputes regarding the facts) in an arbitration proceeding, especially in cases where no award is issued. The collection of provider-filed motions in litigation in which they rely on arbitration agreements (and the collection of the underlying arbitration agreements that are invoked in such proceedings), as required by new § 1040.4(b)(1)(iii), will aid the Bureau in determining the frequency with which providers compel arbitration in response to individual litigation claims as well as to monitor the content of arbitration agreements for reasons similar to those described above. The Bureau also finds that this collection, in conjunction with the other arbitral records it will receive, will over time help track whether such claims are ultimately heard in arbitration rather than being dropped entirely, which could in turn shed more light on the extent to which consumers are deterred from pursuing individual claims more generally because of arbitration agreements.[780]

The Bureau further finds that the collection of these documents will enhance the Bureau's ability to protect consumers by monitoring consumer finance markets for risks to consumers. The collection of these documents will provide another source of information to help the Bureau and others understand the markets in which claims are brought more broadly and how consumers and providers interact. For example, the collection of claims and awards will provide additional information about the types of issues that consumers and providers face that are not or cannot be resolved informally, including those issues that appear to give rise to repeat claims. This

[780] The Bureau has no practical way to determine when a consumer was inclined to file some sort of individual claim, in litigation or arbitration, but was deterred by the prospect of an arbitration agreement. With the new requirement the Bureau will be able to measure directly the extent to which individual litigation filings are dismissed by a provider-filed motion to compel arbitration, and the extent to which those consumers try to press their claims in an individual arbitration proceeding. If few consumer-filed individual arbitrations are filed after the dismissal of individual litigation cases dismissed pursuant to provider motions, an inference may be made that the net effect of arbitration agreements is to discourage individual claims.

monitoring may facilitate the ability of the Bureau and other actors to address emerging market concerns for the protection of consumers.

As described above in Part VI.B.2, the Bureau believes that the number of consumer-filed individual arbitrations is likely always to be too low to provide optimal levels of deterrence and redress for legal violations affecting groups of consumers, and thus that greater advancements to the protection of consumers and public interest derive from the class rule. Nevertheless, the Bureau notes, as described further below, that some commenters expressed concern that the records from individual arbitrations would trigger increased scrutiny by regulators and increased litigation risk with regard to the disputed conduct by the affected financial services providers. The Bureau agrees with these commenters' underlying assumption that the monitoring rule would tend to increase deterrence and redress for legal violations but sees this as a positive impact. This is, in fact, one of the purposes of the rule.

In addition, if sunlight is not a sufficient disinfectant to discourage unfair practices in connection with arbitration proceedings,[781] the monitoring rule will better position the Bureau to address conduct or practices that impede consumers' ability to bring claims against their providers, for instance, if a particular company was routinely not paying arbitration fees and thus preventing arbitrations against it from proceeding.[782]

As noted in the proposal and above, the Bureau intends to draw upon all of its statutorily authorized tools to address conduct that harms consumers that may occur in connection with providers' use of arbitration agreements. For example, the Bureau intends to continue to use its supervisory and enforcement authority, as appropriate, to evaluate whether specific practices in

[781] *See* Louis. D. Brandeis, "Other People's Money – and How the Bankers Use It" at 62 (Washington, National Home Library Foundation ed., 1933) ("Publicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants; electric light the most efficient policeman.").
[782] Study, *supra* note 3, section 5 at 66 n.110 (identifying over 50 instances of nonpayment of fees by companies in cases filed by consumers).

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 expects to pay particular attention to any provisions in arbitration agreements that might function in such a way as to deprive consumers of their ability to meaningfully pursue their claims.

With regard to commenters that generally opposed the monitoring proposal, the Bureau disagrees with comments suggesting that the Study provided no basis for the monitoring proposal or that no consumer harm has been shown. As noted above in Parts II and III, the Study identified evidence of multiple historical problems with the conduct of arbitration, including potential conflicts of interest involving a major arbitration administrator, general fairness concerns about the filing of thousands of debt-collection arbitrations across multiple administrators, failure to pay fees by some individual financial services providers, and at least sporadic use of particular clauses in arbitration agreements that raise fairness concerns.[783] Additionally, the Study's analysis of pre-dispute arbitration agreements identified the prevalence of some provisions that may make arbitration proceedings more difficult for consumers.[784] Further, the Study showed that, in the markets covered by the Study, an overwhelming majority of arbitration agreements specified 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.[785] While the Bureau believes that these safeguards currently apply to the vast majority of consumer finance arbitrations being conducted, this could change over time. Administrators, including potentially new ones, may decline to

[783] *See* Study, *supra* note 3, section 4 at 2 n.3 and section 5 at 16-17 and n.29.
[784] *See generally id.* section 2 at 40-44 (identifying incidence in pre-dispute arbitration clauses of, *inter alia*, confidentiality and non-disclosure provisions, limits on substantive relief, and cost and fee-shifting).
[785] *Id.* section 2 at 34-40; *see generally id.* section 4.

adopt or change the safeguards in ways that could harm 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 agreements may evolve in other ways that the Bureau cannot foresee, particularly as the markets reacts to the adoption of the class rule. Finally, in response to the commenter that asserted that the Bureau's citation of NAF was a red herring, the Bureau's citation of NAF was illustrative of what could occur and not intended to suggest that NAF was still a problem. The commenter did not dispute the Bureau's finding that NAF's past practices were problematic, that other administrators such as AAA may have identified problematic practices such that they also altered their policies in response to NAF's settlement with the Minnesota Attorney General, and that a new administrator may replace NAF in the future or current administrators may change their standards.

In addition, as noted by other commenters, State monitoring and publication laws have helped identify and stop potentially problematic practices. As set out in Part II.C, the California law requiring the reporting of arbitration statistics led to the investigations of arbitral administrators by city and State regulators,[786] caused NAF to stop administering consumer arbitrations, and may have led to additional changes, such as the AAA's voluntary moratorium on debt collection arbitrations and JAMS's adoption of fairness standards.[787] The Bureau believes that the facts set out above point to the importance of collecting arbitration records and publishing them. Based on the above, the Bureau finds, as it set out in the proposal, that it is in

[786] Sam Zuckerman, "S.F. Sues Credit Card Service, Alleging Bias: S.F. City Attorney Alleges Bias for Debt Collectors in Arbitration," sfgate.com (Apr. 8, 2008) ("The complaint cites forum statistics showing that of 18,075 cases brought before one of its arbitrators from January 2003 to March 2007, a total of 30 resulted in victories for consumers.").
[787] *See* AAA Press Release, *supra* note 102; JAMS Policy on Consumer Arbitrations, *supra* note 140.

the public interest and for the protection of consumers for the Bureau to monitor providers' use of arbitration agreements and arbitration proceedings to determine if there are any changes in the overall volume in arbitrations, in the types of arbitrations filed, in the outcome of arbitrations, or in the prevalence of certain harmful clauses in arbitration agreements.

In response to a commenter's assertion that the Study's analysis of AAA arbitrations did not demonstrate that arbitration was unfair to consumers, the Bureau disagrees that the monitoring rule must only be based upon demonstrated unfairness in the status quo. As set out in Part VI.B, the Bureau notes that the AAA data merely showed that (1) there were very few arbitrations, and (2) the data were *inconclusive* as to whether individual arbitration proceedings lead to better outcomes than individual litigation. This data alone does not support a finding that individual arbitration is fair, *ipso facto*. Indeed, as discussed above, other AAA data and Study analyses as well as broader historical information suggested that continued monitoring is warranted because consumer finance arbitration is dynamic and continues to pose a potential ongoing risk to consumers.[788]

With regard to the commenter that suggested that, because the Bureau's proposal did not address post-dispute arbitration, the Bureau must have regarded arbitration as fair overall, the Bureau observes that section 1028 only authorizes the Bureau to study and regulate the use of pre-dispute arbitration agreements.[789] The Bureau therefore did not analyze the use of post-dispute agreements and takes no position on their fairness but notes that proceedings pursuant to

[788] Some commenters seemed to suggest that under section 1028(b) a Bureau rulemaking imposing limitations or conditions on arbitration must be based only on data found in the Study. The Bureau interprets section 1028(b), in accord with the plain text of the statute, to say that any findings supporting the rulemaking must be "consistent with" the Study. Dodd-Frank Act, section 1028(b) ("The findings in such rule shall be consistent with the study conducted under subsection (a)."). Moreover, the Bureau notes that the Bureau's analysis of the AAA data did flag certain problematic practices by providers in arbitration proceedings, such as the nonpayment of fees to delay consumer-filed proceedings. Study, *supra* note 3, section 5 at 34 n.69. (The Bureau has similarly received consumer complaints involving entities' alleged failure to pay arbitral fees.) The Study's analysis of arbitration agreements also catalogued problematic clauses as discussed above, and the Study recounted several fairness concerns raised in the years preceding the study (enforcement actions against NAF, administrators adopting due process protocols, and fairness concerns regarding debt-collection arbitrations raised across multiple administrators as discussed in Part III above).

[789] *See* Dodd-Frank, section 1028(c).

an agreement between parties who are aware of a specific present conflict and jointly agree to resolve it through arbitration rather than litigation may be different in nature than proceedings subject to pre-dispute arbitration agreements, which are typically entered into by parties not necessarily anticipating future conflict and, in the context of consumer finance, are often included in a larger form contract rather than being the subject of negotiations between the parties. As such, the fact that the Study and proposal did not mention post-dispute arbitration does not alter the Bureau's overall findings on the fairness of pre-dispute arbitration.

With regard to the comment that the data in the Bureau's consumer complaint database proves that arbitration is not unfair, the Bureau notes that its complaints function takes in informal complaints before the start of formal dispute resolution such as arbitration. The Bureau believes that a low volume of complaints about arbitration in the consumer complaint database is not dispositive of the fairness of arbitration. Moreover, the monitoring rule does not rest on a finding that arbitration as it is occurring today is unfair but rather that there is a significant risk that arbitration could operate in the future in ways that are injurious to consumers and that monitoring will enable the Bureau to mitigate that risk and to address it should it occur.

With regard to the comment that law-breaking providers might not submit documents to the Bureau pursuant to the proposed monitoring rule, the Bureau agrees that there is some risk of non-compliance, but notes that this is true of any regulation that the Bureau implements. The Bureau has no reason to believe that any substantial number of providers will not comply, such that the Bureau should not implement the monitoring rule. Further, the Bureau does not at this time believe that the risk of underreporting by providers is likely to be severe enough that a different type of intervention is warranted, such as a total ban on the use of pre-dispute arbitration agreements or standards for arbitration proceedings. As set out in Part VI.B, the

Bureau is not adopting either intervention instead of monitoring. Nevertheless, the Bureau will monitor efforts to comply with the reporting requirements of providers over which it has enforcement or supervisory authority.

*2. The Monitoring Rule Is in the Public Interest*

In the proposal, the Bureau also preliminarily found that the monitoring proposal would be in the public interest. This preliminary finding was based upon several considerations, including the considerations pertaining to the protection of consumers set out above. The Bureau also considered potential benefits stemming from the other public interest factors.

Consistent with the legal standard outlined above, in making its preliminary findings, the Bureau also analyzed potential tradeoffs under the public interest factors such as the monitoring proposal's potential compliance burden on providers, the potential confidentiality concerns of providers, and the potential privacy considerations affecting consumers and providers.

The Bureau summarizes comments on these preliminary findings and sets out final findings in response to these comments below.

*Comments Received*

The Bureau received three general categories of comments in response to the public interest factors addressing (1) consistent enforcement of consumer laws; (2) issues relating to whether the publication component of the monitoring rule in particular was in the public interest; and (3) privacy, redaction, and related issues associated with the proposal.

*Consistent enforcement of consumer laws*. One consumer advocate commenter agreed generally that the monitoring proposal was likely to provide policymakers, including the Bureau, with additional information that would enable it to develop better substantive policies for the

consumer finance markets. No commenter opposed to the intervention commented on this aspect of the Bureau's preliminary public interest findings.

*Publication.* Several comments addressed whether publication in particular was in the public interest. One set of academic commenters, State attorneys general, and nonprofit commenters wrote in support of the monitoring proposal on the grounds that it would improve transparency in consumer finance markets. In addition, a group of State attorneys general noted in their comment that publication of arbitral records would assist the Bureau and other regulators with analyzing arbitration outcomes and would help regulators determine if additional regulation of arbitration was necessary. Academic commenters noted that, with the exception of California's arbitration disclosure law, researchers only have access to those case-level data and documents on arbitration proceedings that arbitral administrators permit non-parties to see. These commenters noted that access to more comprehensive arbitration data would aid their work.

Another set of commenters asserted that making arbitral decision-making more transparent to the general public would have such negative impacts as to negate a finding that publication is in the public interest. One industry commenter argued that the Bureau should not publish awards because transparency in the decision-making of arbitrators would be detrimental to arbitrators and providers. That is, according to the commenter, arbitrators would face disincentives to make explicit findings, publication would put the onus on arbitrators to keep arbitration fair, and providers would be subject to further Bureau scrutiny. By contrast, other commenters argued that such transparency was beneficial, for many of these same reasons. For instance, academic commenters identified NAF as a case study on the importance of making arbitration records transparent, noting that NAF kept its arbitration files private until the

Minnesota Attorney General's office obtained documents, and speculated that NAF may have been less likely to enter questionable agreements with certain debt collectors had it known its files would be made publicly available. A trade association of lawyers representing investors asserted that the public has an interest in accessing arbitral records and data. A nonprofit commenter suggested that there was a public interest in analyzing potential issues with individual arbitration, citing as examples secrecy, limited discovery, and arbitrator bias.

Another set of comments offered differing views on the attention that publication would draw to the underlying substantive claims, and the providers associated with them, set out in arbitration records. Some commenters believed this added attention – to business practices and particular providers – was unwarranted. Several industry commenters asserted that publication, and the accompanying publicity as to business practices identified in arbitration records would lead plaintiff's attorneys to bring more frivolous litigation generally, including additional class action lawsuits and follow-on individual arbitrations. One industry commenter expressed concern that the publication of records would subject providers to class actions concerning non-compliance with the monitoring rule if providers made errors in redacting arbitration documents or if pre-dispute arbitration agreements did not comply with the requirements of proposed § 1040.4(a)(2)(i). Other industry commenters suggested that providers would remove pre-dispute arbitration agreements from contracts with consumers to avoid the increased exposure to litigation risk associated with publication. A commenter that is an association of State regulators suggested that the publication would lead to more class action litigation, which it contended would exacerbate the difficulties State bank examiners face in assessing the risks associated with such class actions in their examinations. An industry commenter argued that the Bureau should not publish arbitration records because the Bureau's consumer complaint database already exists

and serves the same function in alerting the public to potentially objectionable business practices. Another industry commenter suggested that important or relevant information in arbitration records should be pursued by the Bureau itself, not published for others to see and exploit.

Another group of commenters focused on other negative impacts on financial services providers besides increased litigation risk, emphasizing that they viewed arbitral confidentiality as one of the main benefits of the process that would be harmed by the proposal. Some commenters were concerned that, without confidentiality, providers would be subject to reputational risks if arbitrations filed against them were public. Some credit union and trade association commenters opposed the publication proposal on the grounds that it would expose credit unions and their members to reputational risk, especially because allegations made in arbitral filings could be taken as fact. Other industry commenters further complained that consumer data was to be redacted but not information on providers and their employees, potentially compromising the privacy of the provider's employees. Other industry commenters opposed the Bureau's monitoring proposal on the grounds that confidentiality was standard or customary in arbitration, and that the Bureau's publication proposal would undermine that. A commenter that is an association of State regulators also opposed the publication rule on the grounds that it may conflict with State laws on the confidentiality of arbitral records.

Other commenters contended that providers should not be able to maintain secrecy about their disputes with customers. A trade association of lawyers representing investors contended that the public has an interest in accessing arbitral records and data. Some academic and nonprofit commenters referenced other types of arbitrations where they asserted that results are published with no ill effects (*e.g.*, FINRA, labor arbitration, and internet domain name disputes before the Internet Corporation for Assigned Names and Numbers, known as ICANN). These

commenters stated that publication would not deter or impede the use of arbitration as a dispute settlement mechanism; instead, they asserted that the willingness of these administrators to publish arbitration records shows the value of transparency in arbitration proceedings.

Several commenters also argued that the publication of claims and awards could help to facilitate the development of consumer protection law. A consumer advocate commenter argued that the publication of arbitration records is likely to help industry understand what actions might violate the law. Several consumer advocate commenters argued that the publication of arbitration records is likely to help consumer advocates and others advising consumers directly know what issues to pursue, in particular when they advocate on behalf of or advise low-income consumers. A consumer advocate commenter also argued that the publication of arbitration records collected from providers would permit consumers themselves to avoid harm by becoming aware of certain business practices.

*Privacy, redaction, and related issues*. Several commenters focused on the proposal's provisions concerning redaction of certain consumer information prior to submission of arbitral records. For example, some asserted that the proposal's redaction provisions would be more burdensome to providers than the Bureau estimated. An industry commenter asserted that the redaction of arbitration documents, as required by proposed § 1040.4(b)(3), would be costly for credit unions, taking time and money that they could otherwise use to serve their members. Relatedly, a credit union industry commenter requested an exemption for credit unions from this requirement because of the burdens the monitoring proposal would impose on them. The commenter stated that the estimate of $400 per institution to redact documents in the proposal's Section 1022(b)(2) Analysis underestimated the cost of a program to redact and submit documents to the Bureau.

In contrast, other commenters agreed with the Bureau's assessment of the burden of complying with the proposal as being relatively low, but for different reasons. A consumer advocate commenter observed that the burden under the monitoring proposal would be minimal. An industry commenter argued that the burden would be low because it predicted that providers would drop their arbitration agreements in response to the risk of increased litigation exposure arising from publication and thus few would have to comply with the substantive requirements of this rule.

Second, several industry commenters asserted that the collection of both public and non-public information by financial regulators poses a threat to consumer privacy. One of these industry commenters asserted that the collection of even redacted information could be combined with public information to re-identify consumers. Other industry commenters expressed concerns that monitoring and publication would expose consumers to a risk of privacy and data security violations. Another industry commenter suggested that the proposal would force consumers to expose their private data without consent. One trade association commenter asserted that consumers in debt collection cases may not wish to have their personal finances publicly disclosed. (The trade association made this comment in the context of opposing the class rule, but the Bureau construes this as a comment on privacy concerns pertaining to publication). Finally, another industry commenter expressed skepticism about permitting government regulators to collect data because of a lack of security at regulators, citing examples such as a recent Office of the Inspector General report on the security of the Bureau's consumer complaint database and issues affecting other Federal regulators.[790]

[790] *See* Office of the Inspector General, "Security Control Review of the CFPB's Data Team Complaint Database" (2015), *available at* https://oig.federalreserve.gov/reports/cfpb-dt-complaint-database-summary-jul2015.htm.

Finally, several comments focused on the impact that the publication proposal would have on arbitral confidentiality. Some commenters were concerned that, without confidentiality, providers would be subject to reputational risks if arbitrations filed against them were public. Some credit union and trade association commenters opposed the publication proposal on the grounds that it would expose credit unions and their members to reputational risk, especially because allegations made in arbitral filings could be taken as fact. Other industry commenters raised a further concern that consumer data was to be redacted but not information on providers and their employees, potentially compromising the privacy of the provider's employees. Other industry commenters opposed publication on the grounds that confidentiality was standard or customary in arbitration, and that the Bureau's publication proposal would undermine that. A commenter that is an association of State regulators opposed the publication rule on the grounds that it may conflict with State laws on the confidentiality of arbitral records.

Other commenters agreed with the Bureau that providers should not be able to maintain secrecy about their disputes with customers in arbitration. A trade association of lawyers representing investors contended that the public has an interest in accessing arbitral records and data. Some academic and nonprofit commenters referenced other types of arbitrations where results are published with no ill effects (*e.g.*, FINRA, labor arbitration, and internet domain name disputes before the Internet Corporation for Assigned Names and Numbers, known as ICANN). Thus, these commenters stated that publication would not deter or impede the use of arbitration as a dispute settlement mechanism; instead, the willingness of these administrators to publish arbitration records shows the value of transparency in arbitration proceedings.

*Responses to Comments and Final Findings*

The Bureau has carefully considered the comments received on the monitoring proposal and further analyzed the issues raised in light of the Study and the Bureau's experience and expertise. Based on all of these sources, the Bureau finds that requiring providers to submit redacted arbitral records and publishing them in redacted form is in the public interest. The Bureau finds that the monitoring rule is in the public interest because, along with creating deterrence and facilitating redress, as described above, it will allow the Bureau to better evaluate whether the Federal consumer finance laws are being enforced consistently; promote confidence in a fair and efficient arbitration system; and facilitate transparency and accountability in the broader markets for consumer financial products and services. The Bureau also finds that the potential costs and burdens of the monitoring rule identified by commenters – including the cost of compliance and potential privacy and confidentiality issues – are modest and do not overshadow the rule's benefits to the public interest.

*Consistent enforcement of consumer laws*. The Bureau finds that the monitoring rule is in the public interest because it will 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."[791] As a consumer advocate commenter pointed out, with the insight garnered from a fuller collection of arbitral records, the Bureau will be 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 may warrant further action by the Bureau. The Bureau's experience with the Study showed how the analysis of arbitral records is likely to

[791] *See generally* Dodd-Frank section 1021(b) (setting forth the Bureau's purposes).

provide useful information to policymakers and insights into particular consumer financial products and services.

*Publication.* The Bureau finds that the publication rule will tend to promote confidence in the fairness of the arbitration system for covered markets and in the functioning of the markets themselves by promoting transparency and accountability generally, beyond the specific benefits discussed above for any individual consumers who are victims of legal violations or unfair proceedings. While the impact will not be as substantial as the class rule given the relatively small number of individual arbitrations currently, the logic is related in that the Bureau believes that the availability of fair remedial mechanisms to enforce compliance with the law will tend to create a more predictable, efficient, and robust regulatory regime for all participants. Thus, the Bureau believes that the way that publication promotes the rule of law – in the form of accountability through transparent application of the law to providers of consumer financial products or services – contributes to the conclusion that the rule is in the public interest.

The Bureau finds that the publication requirement is in the public interest because, as commenters observed, it will promote transparency and insight into the conduct of arbitration proceedings. The Bureau believes that creating a transparent system of accountability is an important part of any dispute resolution system for formally adjudicating legal claims. By allowing the public access to redacted documents about the conduct of arbitrations, the public will be able to learn of and assess consumer allegations that providers have violated the law and, more generally, assess the degree to which arbitrations may proceed in a fair and efficient manner. By publishing the materials, the rule will also promote greater transparency among consumers and other members of the public. The Bureau also believes that providers may find

the increased transparency arising from the Bureau's publication of records helpful to monitor best practices and avoid potentially unfair conduct or arbitration administrators.

The Bureau agrees with commenters that noted that publication would assist the members of the public and other regulators with analyzing arbitration outcomes and would help regulators determine if additional regulation of arbitration is warranted. Just as Dodd-Frank section 1028 called upon the Bureau to publish a report on arbitration to Congress, the Bureau finds it is in the public interest to permit anyone to review records of arbitration proceedings to better understand the workings of arbitration and its impact on consumers. The Bureau believes that the publication of claims will lead to transparency by revealing to the public the types of claims filed in arbitration and whether consumers or providers are filing them. The publication of answers will shed some light on the potential merits of these claims. The publication of awards will lead to increased transparency by revealing how different arbitrators decide cases. The Bureau believes that publishing redacted awards may 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. Publication of all of these arbitral records collectively could help educate the public and demonstrate the extent to which arbitration results in fair processes and outcomes for consumers. In particular, the Bureau agrees with the commenter that suggested that there is a public interest in analyzing potential issues with individual arbitration, such as limited discovery and arbitrator bias.

The publication of redacted awards will also signal 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 informally.[792] Publication may also help develop a more general understanding among consumers of the facts and law at issue in consumer financial arbitrations.

The Bureau believes that publication will assist academic researchers with analyzing consumer arbitration. To date, academic studies of arbitration[793] and the Study were made possible only by the voluntary participation of the AAA. Such analyses will likely be made easier, and more widespread, if more data were available on a regular basis, in a standard form, and regardless of the arbitral forum.

The Bureau also finds that the publication of records would lead to greater transparency of the operation of the markets for consumer financial products and services. As noted by commenters, the publication of records under the monitoring rule will permit consumers, regulators, consumer attorneys, and providers to identify trends that warrant further action. 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 Consumer Sentinel database[794]) today in conducting their work.

The Bureau agrees with commenters that asserted that the publication requirement would help consumer advocates identify issues to pursue in assisting consumers, and may help

[792] The Bureau already publishes certain narratives and outcomes data concerning consumer complaints submitted to 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 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).

[793] *See* Drahozal & Zyontz, Empirical Study, *supra* note 233, at 845 (reviewing 301 AAA consumer disputes); Drahozal & Zyontz, Creditor Claims, *supra* note 233 (follow-on study analyzing collection claims by companies in AAA consumer arbitrations).

[794] Fed. Trade Comm'n, "Consumer Sentinel Network," https://www.ftc.gov/enforcement/consumer-sentinel-network (last visited Mar. 13, 2017) ("Consumer Sentinel is the unique investigative cyber tool that provides members of the Consumer Sentinel Network with access to millions of consumer complaints. Consumer Sentinel includes complaints about: Identity Theft, Do-Not-Call Registry violations,…Advance-fee Loans and Credit Scams, …[and] Debt Collection, Credit Reports, and Financial Matters").

consumers themselves to avoid harm by becoming aware of certain business practices. In these ways, the Bureau believes that the monitoring rule will 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 further finds that the publication of arbitral records will help draw attention to certain business practices by providers. This is beneficial because it will help not just consumers but also providers understand what actions might violate the law. While not binding precedent, arbitral awards in consumer finance cases (not currently available to non-parties in most cases) may provide an analysis of relevant law and facts that can assist others. Making awards available may help consumers identify potentially harmful practices by providers and may create incentives for providers to identify potentially safer practices. The Bureau agrees with commenters that this will assist the development of persuasive reasoning, including arbitration and litigation disputes, on issues of consumer financial protection.

While one commenter suggested the publication of awards would act as a disincentive for arbitrators to make explicit findings, no evidence was presented of this phenomenon. If this were true, it would generally only be known as a result of analyzing awards that have actually been published. Yet the Bureau is not aware of evidence of such a disincentive reflected in arbitration awards made public by FINRA and the AAA. The Bureau does agree with the commenter that publication will further incentivize arbitrators to keep arbitration fair. Arbitrators may feel more pressure knowing that their decisions are more likely to be scrutinized, and the Bureau believes that this awareness will have a salutary effect on arbitrator decisions, making them more likely to be fair.

With regard to the commenters concerned that providers would be subject to reputational risks unless arbitrations were kept confidential, the Bureau acknowledges the concern that publication may expose providers to reputational risk to the extent that mere allegations made in arbitral statements of claim would be taken as fact. In response, the Bureau has drafted, as set out below in the section-by-section analysis of § 1040.4(b)(1)(i)(B), a provision requiring providers to submit answers as well as arbitral counterclaims to balance out one-sided accounts and mitigate any perceived reputational risk. In any case, as is noted above, relatively few providers may be subject to any form of reputational risk according to the Bureau's estimate of the number of providers likely to submit records to the Bureau. In addition, in the Bureau's experience with publishing consumer complaints, reputational risk is not necessarily significant when there are low numbers of complaints; and the Bureau does not estimate that any one provider is likely to have a significant number of arbitrations with public records. The reputational risk associated with arbitration is not unique – providers are already exposed to reputational risk when complaints are filed in litigation, given that such records are public by default. Further, the Bureau believes that the potential benefits of transparency to consumers and the public at large outweigh any potential reputational risk to providers. The Bureau further agrees with commenters, as is noted above, that NAF is a key case study demonstrating the importance of transparency and how arbitral records can produce private and public responses to potentially problematic practices, and notes that the default for individual litigation is that records, absent compelling reasons, are available to the public.[795] This is also the case with the

[795] *See, e.g.*, *Nixon* v. *Warner Communications, Inc*., 435 U.S. 589, 597 and n.7 (1978) (noting that historically courts have recognized a "general right to inspect and copy public records and documents, including judicial records and documents").

practice of many arbitral administrators, including FINRA and the AAA (for certain types of cases).

While one commenter expressed the concern that providers that lose in arbitration proceedings in which they are accused of violations of consumer protection law may face more scrutiny from the Bureau than others, the Bureau finds that the loss of a single dispute with one consumer does not necessarily trigger such scrutiny, but to the extent this occurs it will benefit the public interest. The Bureau believes that any risk of added scrutiny could result in more relief for consumers and better business practices by providers deterred by the prospect of additional public enforcement or litigation in response to arbitral awards identifying certain illegal business practices.

The Bureau also believes that the publication portion of the rule is in the public interest because it will increase transparency and accountability with regard to conduct in the underlying consumer financial services markets. In contrast to commenters that viewed the possibility of increased scrutiny by regulators or plaintiff's attorneys as a negative outcome from the monitoring rule, the Bureau believes that the increased transparency will tend to increase consumers' ability to seek redress for legal violations, providers' incentives for compliance, and general public confidence in the orderly operation of the markets. While these impacts are likely to be modest compared to the class rule given that the number of consumer-filed individual arbitrations is so low, the Bureau still views them as supporting the adoption of the publication portion of the rule.

While some commenters were concerned that the publication of arbitral records may permit plaintiff's attorneys to identify potentially classable claims or claims that could be brought in individual arbitrations or litigations, the Bureau does not find this is necessarily a

frequent result of publication. As discussed in Part VI.B.3 above, class actions are more likely to serve as a vehicle for adjudicating small-dollar claims affecting large groups of consumers than are individual arbitrations. The Bureau also notes, as discussed above in Parts III and VI.B.3, that there are many differences between the few claims consumers bring in arbitration and those brought in class actions. To the extent that individual arbitrations do lead to class claims, however, the Bureau finds no evidence that such suits would necessarily be frivolous or meritless insofar as attorneys are prohibited by ethics and court rules from bringing such cases. For example, the Study identified several arbitrations in which consumers were awarded relief by the arbitrators and many more that may have settled on terms favorable to the consumers.[796] Nor is there evidence that any significant number of arbitrations involve consumers succeeding on claims that are frivolous or meritless.

With regard to the industry commenter's concern that the publication requirement would subject providers to class actions concerning provider compliance with the monitoring rule itself, the Bureau will review records received from providers to ensure compliance with § 1040.4(b)(3) before publishing them, and pursuant to new § 1040.4(b)(5) the Bureau will further redact the records to reduce re-identification risk. The Bureau notes that, in any case, this rule does not permit private claims for non-compliance with § 1040.4(b)(3). The Bureau also believes that, given the low number of arbitrations identified by the Bureau in the Study, it is unlikely that any given provider would make enough redactions (let alone redaction mistakes) to face class liability. As to the concern that noncompliance of pre-dispute arbitration agreements

[796] *See* Study, *supra* note 3, section 5 at 32 (likely settlements); *see also id.* section 5 at 13 (arbitrators provided some kind of relief in favor of consumers' affirmative claims in 32 disputes).

with § 1040.4(a)(2)(i) may result in class action liability, the Bureau notes that there is no private right of action for non-compliance with this rule does not give rise to a private right of action.

With regard to the comment that providers would remove pre-dispute arbitration agreements from contracts with consumers because the publication of awards favoring consumers would increase provider exposure to litigation risk, the Bureau believes it unlikely that the publication requirement will cause providers to remove pre-dispute arbitration agreements above and beyond those that would do so because of the class rule. As explained further in the Section 1022(b)(2) Analysis, the odds that any one provider will be required to comply with the reporting and redaction requirements in a given year are quite low; out of the approximately 50,000 providers covered by the rule, the Bureau expects that each year less than 1,000 or so providers will be involved in arbitration proceedings or litigation motions relying on pre-dispute arbitration agreements such that they would be required to submit records to the Bureau. Moreover, the Study indicated that awards favoring consumers in individual arbitration are uncommon.[797] Given these small odds and the modest burdens involved, the Bureau is skeptical that the monitoring rule would be the decisive factor in a provider's dropping of arbitration agreements. In any case, to the extent that any providers would drop their pre-dispute arbitration agreements due to the publication requirement, the Bureau concludes that the publication requirement is still in the public interest. In particular, the Bureau believes that transparency from the publication regime for those arbitrations subject to it will provide benefits described above that will more than offset the possible loss of access to arbitration under pre-dispute arbitration agreements that some consumers may experience if any providers chose to

[797] Study *supra* note 3, section 5 at 13 (arbitrators reached decisions in less than one third of cases with affirmative consumer claims and awarded consumers relief in only about one- fifth of those).

remove their arbitration agreements. In other words, the Bureau believes that the public interest favors a more transparent system, even at the potential cost of forgoing some non-transparent arbitration. Indeed, to the extent that consumers who would have brought claims in individual arbitrations must bring them in court instead, where litigation documents are made public by default, transparency would be advanced.

With regard to the commenter concerned that publication would make the work of State bank examiners more complicated, the Bureau disagrees that this is a reason not to publish arbitral records, as discussed above. In any event, for the reasons discussed above in connection with the class rule, the Bureau believes that investment in compliance activities is the best way to reduce class action risk; State bank examiners are well positioned to evaluate such compliance activities and encourage providers to take additional mitigation actions where warranted. The Bureau also believes that ease of forecasting class action risk does not outweigh the benefits to consumers and the public described above in connection with the monitoring rule, including the expressed interests of other State government commenters in using published arbitration data to protect consumers. As noted above, if there is additional class action litigation resulting from the publication of arbitral awards, the Bureau believes that such activity may benefit consumers and the public interest.

With regard to the comment that suggested that the existence of the Bureau's consumer complaint database obviated the need for the publication of arbitral records, the Bureau disagrees that the complaint database serves the same function. As discussed above, the consumer complaints database lists complaints that typically occur prior to a consumer's engagement with a formal dispute mechanism such as arbitration. The Bureau's consumer complaint function exists to ensure that "consumers can be heard by financial companies, get help with their own

issues, and help others avoid similar ones."[798] Any resolution of complaints through the service is informal and does not serve as precedent for future disputes or as guidance for like situations. By contrast, Bureau-published arbitration records may contain awards that could serve as useful guidance. And, as set out below in the Bureau's Section 1022(b)(2) Analysis, unlike the complaint database, the publication of arbitration records will make public binding decisions on the merits of a case by a third party that can serve as a means by which the public can better understand potential areas of non-compliance.

With regard to the comment that important information derived from arbitration records should be pursued by the Bureau itself, not published for others to see and exploit, the Bureau disagrees because it has, as is set out in Part VI.B, limited enforcement and supervisory resources and does not have the ability or authority to pursue every potential violation of law. Other State and Federal regulators, or private attorneys, may be able to further investigate and pursue trends that they discover in the arbitration records on the Bureau's website.[799]

*Privacy, redaction, and related issues*. The Bureau finds that the potential costs and burdens on providers of the monitoring rule will be sufficiently low such that they are not a significant factor weighing against the rule being in the public interest. 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. As noted above, most providers will have no obligations under the

[798] Bureau of Consumer Fin. Prot., "Consumer Complaint Database," http://www.consumerfinance.gov/data-research/consumer-complaints/ (last visited June 22, 2017) ("By submitting a complaint, consumers can be heard by financial companies, get help with their own issues, and help others avoid similar ones. Every complaint provides insight into problems that people are experiencing, helping us identify inappropriate practices and allowing us to stop them before they become major issues. The result: better outcomes for consumers, and a better financial marketplace for everyone.").

[799] Transparency into arbitral claims and awards may aid other regulators and private attorneys identify consumer harms. Otherwise, consumer harms may be hidden from the public. For instance, as noted above, providers have filed motions to compel arbitration even in individual litigation in court. See *Douglas* v. *Wells Fargo*, BC521016 (Ca. Super. Ct. 2013); *Mokhtari* v. *Wells Fargo*, BC530202, (CA. Super Ct. 2013).

monitoring proposal in any given year because most providers do not face even one consumer arbitration in a year and motions to compel arbitration in individual litigation are rare as the Study indicated.[800] In any event, the burden of redacting and submitting materials for any given provider will be relatively low when they did have an arbitration. While a few commenters suggested the Bureau's estimates were too low, they neither offered alternative estimates nor identified items left out of the Bureau's estimates.

With regard to the comment that the cost of complying with the rule would be low because providers would drop their arbitration agreements in response to the publication requirement, the Bureau disagrees that this is because the publication requirement will induce providers to drop their arbitration clauses. As set out above, the cost to providers is likely to be low because relatively few will face individual arbitrations and be required to submit documents to the Bureau. The Bureau believes that the publication requirement is unlikely to be a decisive factor in convincing providers to drop their clauses.

The Bureau finds that the monitoring rule will minimize any adverse impact to consumer privacy. The key potential concern identified by commenters is that consumers may fear that, by engaging in arbitration, the Bureau's requirements may cause information about them to be divulged. The Bureau does not believe that these concerns will materialize because the final rules set out below require providers to redact information that identifies consumers, and also requires the Bureau to redact additional information (as well as any private information the providers may have inadvertently left unredacted) before publishing any records to further reduce the risk that consumers are identified.

[800] Study *supra* note 3, section 6 at 54-61.

The Bureau acknowledges the concern expressed by commenters that even redacted information could be combined with publicly available information to re-identify specific consumers, but the Bureau believes that the redactions required of providers under § 1040.4(b)(3) will substantially reduce the availability of personal and financial information. Further, to address these concerns, the Bureau is adopting § 1040.4(b)(5), which was not in the proposal and which requires the Bureau to further redact other information to reduce even further any risk of re-identification before it publishes the materials.

With regard to the comment that the publication proposal will result in the exposure of private consumer data without consumer consent, § 1040.4(b)(3) requires the redaction of information identifying individual consumers, and new § 1040.4(b)(5) requires the redaction of additional data that could be used to re-identify individuals. The Bureau also notes that no consumer or consumer advocates submitted comments that suggested that the monitoring proposal created a concern with the disclosure of private consumer data. As to the comment that consumers in debt collection cases may not wish to have their personal finances publicly disclosed, the Bureau reiterates its belief that the redactions it requires of providers, along with the additional redactions to be made by the Bureau, will sufficiently reduce re-identification risk.

With regard to the comment that expressed skepticism about allowing government regulators to collect private data, the Bureau notes that the information it will receive from providers will generally be devoid of personal information to begin with, and the information the Bureau publishes will be redacted even further. While data breaches are a general concern for any public institution, the data that the Bureau will keep and publish will be redacted to reduce re-identification risk. The Bureau will also employ the same data security measures that it employs for other sensitive data that it currently maintains.

With regard to the comments that suggested that the Bureau exclude credit unions from the Bureau's monitoring requirement because of the burdens it would impose on credit unions, the Bureau declines to do so for several reasons. Most importantly, the commenter did not point to any unique burden that a credit union would face in complying with the monitoring rule that would warrant an exemption for credit unions. In fact, as the Study showed,[801] pre-dispute arbitration agreements are not common in credit union products. Further, the Bureau determined, as set forth below, to not adopt a blanket exemption from the rule for credit unions. Finally, while credit unions may be nonprofit, member-owned entities that may have fewer incentives to engage in problematic practices with their members, it is not true that credit unions have never violated the law and have never faced cases in response to their past violations of the law.[802] To the extent that credit unions enter pre-dispute arbitration agreements and engage in business practices that result in arbitration awards favoring consumers, the Bureau concludes that they should be subject to the monitoring and publication requirements.

With regard to the concern that the loss of arbitral confidentiality would compromise the privacy of providers and their employees, the Bureau notes that § 1040.4(b)(3) requires the redaction of personal information of all individuals, not just consumers. This would include providers' employees unless the provider is an individual. In addition, the Bureau will redact other information to comply with applicable privacy laws, if necessary.

Confidentiality is not, as some commenters suggested, standard or custom in all arbitrations. As noted in the Study and by some commenters above, other arbitral administrators publish records by default, as set out above in the context of FINRA and AAA consumer

[801] Study, *supra* note 3, section 2 at 14 (noting that of the sample of 49 credit unions surveyed, just four credit unions, representing 8.7 percent of insured deposits in that sample, used arbitration agreements in consumer contracts).
[802] *See*, *e.g*., Tina Orem, "12 Credit Unions Face Overdraft Suits," Credit Union Times (Jan. 5, 2016), *available at* http://www.cutimes.com/2016/01/05/12-credit-unions-face-overdraft-suits.

arbitrations.[803] The AAA, the largest administrator of consumer arbitrations, makes some consumer arbitrations available to the public,[804] and maintains consumer rules that permit it to publish consumer awards, thus putting providers on notice that their arbitration proceedings may become public.[805] FINRA, the arbitration administrator and self-regulatory organization for the securities industry, has long published all arbitration-related documents without redactions. The Bureau finds that the trend among administrators is to expand public access to arbitration documents. The Bureau agrees with the commenters that argued that the public has an interest in accessing arbitral records and data, and the comments citing the experience of other arbitration administrators and State governments that publication does not deter or impede the use of arbitration as a dispute settlement mechanism.

In any case, any expectation of confidentiality is lost to the extent parties to an arbitration file arbitration awards and other documents containing parties' names and other information with a court, such as in an effort to enforce an award. Finally, the Bureau finds the publication of arbitration records will likely not result in conflict with State laws on the confidentiality of arbitral records, given the experience of other nationwide administrators, such as FINRA, that publish arbitration records by default. To the extent that there is a conflict with State laws, the Bureau finds that publication would still be in the public interest.

[803] *See* Study, *supra* note 3, section 2 at 51-52 ("Arbitration rules typically do not impose express confidentiality or nondisclosure obligations on parties to the dispute, although arbitrator ethics rules do impose confidentiality obligations on the arbitrator. Most arbitration clauses in the sample were silent on confidentiality and did not impose any nondisclosure obligation on the parties.").
[804] *See* AAA, "Consumer Arbitration Statistics," https://adr.org/ConsumerArbitrationStatistics (last visited Jan. 27, 2017).
[805] AAA, Consumer Arbitration Rules," *supra* note 137, at 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, "Case Docket," *supra* note 141.

## VII. Section-by-Section Analysis

*Section 1040.1 Authority and Purpose*

The Bureau proposed § 1040.1 to set forth the authority for issuing the regulation and the regulation's purpose.

*1(a) Authority*

Proposed § 1040.1(a) provided that the rule is being issued pursuant to the authority granted to the Bureau by sections 1022(b)(1), 1022(c), and 1028(b) of the Dodd-Frank Act. As the proposal noted, 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 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. 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 of pre-dispute arbitration agreements conducted under section 1028(a).

For the reasons described in Part VI and below, the Bureau issues this final rule pursuant to its authority as described in § 1040.1(a), with findings that are consistent with the Study conducted under section 1028(a). The Bureau did not receive any comments on proposed § 1040.1(a) and is finalizing this provision as proposed.

*1(b) Purpose*

Proposed § 1040.1(b) stated that the purpose of part 1040 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. This statement of purpose is consistent with Dodd-Frank section 1028(b), which authorizes the Bureau to 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. 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 that the final rule is in the public interest and for the protection of consumers, and that its findings are consistent with the Study. The Bureau did not receive any comments on proposed § 1040.1(b) and is finalizing this provision as proposed with one addition. Final § 1040.1(b) incorporates the Bureau's exercise of its authority in Dodd-Frank section 1022(c), the purpose of which is monitoring for risks to consumers in the offering or provision of consumer financial products or services, including developments in markets for such products or services.

*Section 1040.2 Definitions*

Proposed § 1040.2 set forth definitions for certain terms relevant to the proposal. The Bureau received a number of comments on those proposed terms and their definitions, as well as suggestions to define additional concepts. The Bureau is finalizing § 1040.2 with certain revisions from the proposal as discussed below.

*2(a) Class Action*

The Bureau proposed to define the term class action because the substantive provisions of § 1040.4(a)(1) concern class actions. Proposed § 1040.2(a) would have defined the term class action as 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.

Some consumer advocates and public-interest consumer lawyer commenters requested that the Bureau expand the definition of class action to include other types of mass actions that the commenters believed would have been excluded from the proposed definition. While the commenters suggested different approaches, they generally recommended that the definition be extended to cover two types of actions: (1) actions in which one or more parties seek relief on a representative basis; and (2) actions in which there is more than one plaintiff but the plaintiffs do not seek relief on a representative basis (for example, mass joinder cases). One of the commenters, a public-interest consumer lawyer, suggested that the Bureau address this concern not by revising the definition of class action, but by adding a provision to proposed § 1040.4 that would prohibit providers from moving to compel arbitration in a multiple-plaintiff action brought by a group of plaintiffs after they have been denied class certification. The commenters stated that some pre-dispute arbitration agreements expressly prohibit these types of mass actions separate from the prohibition on class actions. The commenters also noted that these types of mass actions resemble class actions in that they enable multiple consumers to obtain relief through a single lawsuit.

After considering the comments, the Bureau is finalizing § 1040.2(a) as proposed, with a technical edit to clarify that the definition of the term class action still applies even after class action status is obtained. When a court certifies a class action, class action status is no longer

sought but instead, has been obtained. The Bureau declines to extend the definition of class action to cover additional types of mass actions. Although there may be similarities between class actions and the mass actions referenced in these comments, the Study did not analyze these types of actions, and the commenters did not provide any data or other evidence regarding the extent to which these types of actions enable consumers to enforce their rights under Federal and State consumer financial law. The Bureau also notes that it intends the phrase "State process analogous to Rule 23" to refer to any State process substantially similar to the various iterations of Federal Rule 23 since its adoption; the State process in question need not precisely match Federal Rule 23. The Bureau further notes that the term class action refers to cases in which one or more parties seek class treatment regardless of when they seek class treatment; it is not intended to be limited to cases filed initially as class actions.

*2(b) Consumer*

Section 1028(b) of the Dodd-Frank Act authorizes 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 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 have incorporated the Act's definition of consumer by stating that a consumer is an individual or an agent, trustee, or representative acting on behalf of an individual.

An industry commenter stated the proposed definition of consumer is sufficiently clear, and a consumer advocate commenter requested that the Bureau finalize the definition of consumer as proposed. The consumer advocate commenter stated that the proposed definition was clear and easy to apply and that including agents, trustees, and representatives acting on behalf of individuals would ensure that the rule protects important groups of consumers.

Another consumer advocate commenter expressed concern that companies contracting with one another could agree to relinquish a consumer's right to participate in a class action in a manner that binds the consumer even though the consumer was not a party to the contract. The commenter stated that the proposal acknowledged this issue by defining consumer to include an agent, trustee, or representative acting on behalf of an individual, and requested that the definition be amended by adding "or otherwise purporting to obligate, or limit the rights of, an individual."

The Bureau is finalizing § 1040.2(b) as proposed. Regarding the consumer advocate's concern that companies could contract with one another to relinquish a consumer's right to participate in a class action in a manner that binds the consumer, the Bureau believes that a company would only have the legal authority to relinquish the consumer's rights if it were an "agent, trustee, or representative acting on behalf of" the consumer, and thus the company would be covered by the definition as proposed. The commenter did not explain how such a relinquishment could happen otherwise. Accordingly, the Bureau declines to revise the definition of consumer in response to this concern. The Bureau believes that, to the extent that a consumer is party to an arbitration agreement and a provider seeks to assert that agreement in a class action involving a covered product, this rule would apply.

*2(c) Pre-dispute Arbitration Agreement*

Proposed § 1040.2(d) would have defined the term pre-dispute arbitration agreement as an agreement between a provider and a consumer (as separately defined in proposed § 1040.2(b) and § 1040.2(c)) providing for arbitration of any future dispute between the parties.[806] The

[806] As noted below, for ease of reference, the Bureau has re-numbered the definition of pre-dispute arbitration agreement in the final rule as § 1040.2(c). The definition of provider, which was § 1040.2(c) in the proposal, is § 1040.2(d) in the final rule.

Bureau derived its proposed definition from Dodd-Frank section 1028(b), which, under certain conditions, authorizes the Bureau to regulate the use of agreements for consumer financial products or services that provide for arbitration of future disputes between covered persons and consumers. Proposed comment 2(d)-1 would have stated that the term 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, and provided illustrative examples of contract types.

Both a consumer advocate and a public-interest consumer lawyer commenter expressed concern about the phrase "between a provider and a consumer" in the proposal's definition of pre-dispute arbitration agreement. The commenters asserted that the phrase is confusing and could potentially limit the rule's application in ways the Bureau did not appear to intend, given that the Bureau stated elsewhere in the proposal that the provisions of proposed § 1040.4 were intended to apply to pre-dispute arbitration agreements that were originally between consumers and entities other than providers. These commenters also stated that the phrase is redundant, because the substantive provisions in proposed § 1040.4 would have applied only to providers; thus, in the commenters' view, it is unnecessary also to limit the scope of the term pre-dispute arbitration agreement to an agreement between a provider and a consumer. The consumer advocate commenter suggested that the Bureau remove the phrase "between a provider and a consumer," while the public-interest consumer lawyer commenter requested that the Bureau replace the word "provider" with the phrase "person" as defined in Dodd-Frank section 1002(19).[807]

[807] Dodd-Frank section 1002(19) defines "person" as "an individual, partnership, company, corporation, association (incorporated or unincorporated), trust, estate, cooperative organization, or other entity."

Additionally, the public-interest consumer lawyer commenter suggested that the Bureau amend proposed comment 2(d)-1 or add a new comment, to clarify that the presence or absence of opt-out provisions does not affect whether an agreement is a pre-dispute arbitration agreement under the rule. According to this commenter, providers sometimes argue that opt-out provisions make arbitration agreements fairer and that a consumer's failure to opt out indicates the consumer's assent to the arbitration agreement's terms. The commenter did not say, however, why it was necessary to clarify the definition of pre-dispute arbitration agreement on this point.

Additionally, several commenters expressed concern that providers would seek to evade the rule if it was finalized as proposed by adopting a practice of amending their consumer agreements after a class action has been filed but before certification to state that any claims related to the dispute that is the subject of the class action must be resolved individually. These commenters were concerned that the definition of pre-dispute arbitration agreement in proposed § 1040.2(d) was limited to agreements providing for arbitration of any *future dispute* between the parties because they were concerned that a dispute related to a pending class action could be construed as a "current dispute" between the consumer (who is presumably an absent class member) and the provider. One of the commenters, a public-interest consumer lawyer, predicted that providers might stop using pre-dispute arbitration agreements and instead adopt ad hoc agreements requiring arbitration of particular disputes that have given rise to class actions.[808] Additionally, a consumer advocate commenter requested that the Bureau clarify that the definition of pre-dispute arbitration agreement includes delegation provisions, which are

[808] This commenter also recommended that the Bureau revise § 1040.4 (a)(1) and (a)(2) to address this concern. However, for the reasons described below in its response to this comment, the Bureau does not believe that the revisions to either are necessary.

agreements to delegate to arbitration decisions regarding threshold issues concerning an arbitration agreement (such as enforceability).[809]

After consideration of the comments, the Bureau is finalizing the definition of pre-dispute arbitration agreement with modifications as described below.[810] Final § 1040.2(c) defines pre-dispute arbitration agreement as an agreement between a covered person as defined by 12 U.S.C. 5481(6) and a consumer providing for arbitration of any future dispute concerning a consumer financial product or service covered by § 1040.3(a). The final rule's definition of pre-dispute arbitration agreement mirrors Dodd-Frank section 1028(b), which authorizes the Bureau, if certain conditions are met, to regulate "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."

Final § 1040.2(c) reflects two modifications from the proposal. First, the final rule's definition contains a new limitation: pre-dispute arbitration agreements must be agreements providing for arbitration of any future dispute "concerning a consumer financial product or service covered by § 1040.3(a)." This limitation is already built into the operation of the rule because § 1040.4 only applies to pre-dispute arbitration agreements concerning consumer financial products or services. Nonetheless, for clarity, the Bureau has added this limitation into the definition of pre-dispute arbitration agreement itself to reflect section 1028(b), which authorizes the Bureau to regulate agreements "for a consumer financial product or service" providing for arbitration of any future dispute between the parties.

[809] The commenter also recommended that the Bureau revise § 1040.4 to prohibit providers from relying on delegation provisions.
[810] For ease of reference, the Bureau has re-numbered this definition in the final rule as § 1040.2(c); the definition of provider, which was proposed § 1040.2(c), is § 1040.2(d) in this final rule.

Second, the Bureau has replaced the phrase "between a provider and a consumer" with the phrase "between a covered person as defined by 12 U.S.C. 5481(6) and a consumer." The Bureau is persuaded that defining pre-dispute arbitration agreement as an agreement "between a provider and a consumer," as in the proposal, is unnecessary and potentially confusing as to the intended scope of the rule. Specifically, as stated in the proposal, the Bureau had intended that the substantive provisions in proposed § 1040.4 apply to providers as defined in proposed § 1040.2(c) when they are relying on arbitration agreements in contracts for consumer financial products and services that were originally between consumers and persons who were excluded from the definition of provider in accordance with proposed § 1040.3(b). The Bureau believes the phrase "between a consumer and a covered person as defined by 12 U.S.C. 5481(6)" addresses this concern and more closely reflects the Bureau's intention. The Bureau also notes that, while the term "covered person" is broader than the term "provider," the final rule's use of the term "covered person" does not expand the universe of persons subject to the rule's requirements. That is because the rule's substantive requirements – the requirements imposed by § 1040.4(a)(1), (a)(2), and (b), discussed below – apply only to "providers."

New comment 2(c)-1 further clarifies this concept. Comment 2(c)-1.i explains that, while § 1040.2(c) defines "pre-dispute arbitration agreement" as an agreement between a covered person and a consumer, the rule's substantive requirements, which are contained in § 1040.4, apply only to "providers." Comment 2(c)-1.i notes further that, while "covered persons," as that term is defined in Dodd-Frank section 1002(6), includes persons excluded from the Bureau's rulemaking authority under Dodd-Frank sections 1027 and 1029, the requirements contained in § 1040.4 would not apply to any such persons entering into a pre-dispute arbitration agreement because they are not "providers," by virtue of § 1040.2(d) (stating that persons

excluded under § 1040.3(b) are not providers) and § 1040.3(b)(6) (excluding any person to the extent not subject to the Bureau's rulemaking authority including under sections 1027 or 1029). The comment further clarifies that the requirements in § 1040.4 would apply, however, to the use of any such pre-dispute arbitration agreement by a different person that meets the definition of provider, when the pre-dispute arbitration agreement was entered into after the compliance date.

New comment 2(c)-1.ii illustrates this concept with an example. Comment 2(c)-1.ii states that an automobile dealer that provides consumer credit is a covered person under Dodd-Frank section 1002(6) – and such a person's contracts may contain pre-dispute arbitration agreements as that term is defined in § 1040.2(c). Yet an automobile dealer that is excluded from the Bureau's rulemaking authority in circumstances described by Dodd-Frank section 1029 would not be required to comply with the requirements in § 1040.4, because those requirements apply only to providers, and such automobile dealers, while they are covered persons, are excluded by § 1040.3(b)(6) and therefore are not providers under § 1040.2(d). The requirements in § 1040.4 would apply, however, to the use of the automobile dealer's pre-dispute arbitration agreement by a different person that meets the definition of provider, such as a servicer, or purchaser or acquirer of the automobile loan, where the agreement was entered into after the compliance date.

To clarify the relationship between the definition of pre-dispute arbitration agreement and delegation provisions, the Bureau is adding comment 2(c)-2 to the final rule.[811] Comment 2(c)-2 clarifies that the term pre-dispute arbitration agreement as defined in § 1040.2(c) includes delegation provisions, which the comment identifies as agreements to arbitrate threshold issues

[811] As noted above, the commenter also recommended that the Bureau revise proposed § 1040.4 to prohibit providers from relying on delegation provisions. New comment 2(c)-3 addresses how delegation provisions relate to the Bureau's rule.

concerning the arbitration agreement, which may sometimes appear elsewhere in a contract containing or relating to the arbitration agreement.[812] The Bureau believes that the definition of pre-dispute arbitration agreement in § 1040.2(c) includes delegation provisions because such provisions are agreements between covered persons and consumers providing for arbitration of any future dispute concerning a consumer financial product or service – namely, disputes over threshold issues concerning the arbitration agreement for such a consumer financial product or service. Accordingly, § 1040.4(a)(1) prohibits a provider from relying on a delegation provision entered into after the compliance date with respect to any aspect of a class action that concerns a covered consumer financial product or service until such time as the case is determined not to be a class action. This interpretation is consistent with jurisprudence recognizing delegation provisions as arbitration agreements for purposes of the FAA.[813]

The Bureau intends this interpretation to apply even if the delegation provision is contained in a separate provision of the contract. In accordance with the Supreme Court's decision in *Jackson*, delegation provisions are themselves arbitration agreements that the Bureau has the authority to regulate under section 1028(b). That section 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." A delegation provision in a consumer contract for a consumer financial product or service is an "agreement between a covered person and a consumer for a consumer financial product or service providing for arbitration of any future dispute" pertaining to threshold issues concerning the arbitration agreement; thus, section

[812] This comment is consistent with *Rent-A-Center West, Inc.* v. *Jackson*, 561 U.S. 63, 68 (2010) (stating that "[t]he delegation provision is an agreement to arbitrate threshold issues concerning the arbitration agreement.").
[813] *See Jackson*, 561 U.S. at 70 ("An agreement to arbitrate a gateway issue is simply an additional, antecedent agreement the party seeking arbitration asks the federal court to enforce, and the FAA operates on this additional arbitration agreement just as it does on any other.").

1028(b) authorizes the Bureau to prohibit or impose conditions or limitations on the use of such provisions.

The Bureau believes it is not necessary to revise the definition of pre-dispute arbitration agreement to address the commenters' concern that providers will seek to evade the rule by amending consumer agreements after a class action has been filed (but before certification) to state that any claims related to the dispute that is the subject of the class action must be resolved individually. The Bureau believes that, under existing precedents, courts would not enforce such agreements. Courts have routinely held arbitration agreements adopted after a class action has been filed, but before certification, unenforceable as unconscionable or as improper communications with the class.[814] Regarding the public-interest consumer lawyer's concern that providers would respond to the rule by abandoning pre-dispute arbitration agreements and adopting ad hoc agreements requiring arbitration of particular disputes that have given rise to class actions, the Bureau believes that, to the extent that providers adopt such agreements to bind putative class members, the precedents described above would apply. And to the extent that providers adopt such agreements to bind their consumers before a class action is filed against that provider, the Bureau believes that those types of agreements are plainly pre-dispute arbitration agreements under § 1040.2(d), because they concern a future dispute.

[814] *See, e.g.*, *O'Connor* v. *Uber Techs., Inc.*, No. 13-3826, 2013 WL 6407583, at *7 (N.D. Cal. Dec. 6, 2013) (defendant communicated improperly with class where it sought approval of arbitration agreement after class action was filed); *Balasanyan* v. *Nordstrom, Inc.*, Nos. 11-2609, 10-2671, 2012 WL 760566, at *4 (S.D. Cal. Mar. 8, 2012) (denying employer's motion to compel arbitration based on arbitration agreement adopted by defendant after class action was filed on the ground that agreement was an improper communication with class); *In re Currency Conversion Fee Antitrust Litig.*, 361 F. Supp. 2d 237, 250-254 (S.D.N.Y. 2005) (denying defendants' motion to stay litigation pending arbitration based on arbitration agreements adopted through change-in-terms notices that did not inform class members of lawsuit, on the ground that the agreements were improper communications with class); *Carnegie* v. *H&R Block, Inc.*, 687 N.Y.S.2d 528, 533 (N.Y. Sup. Ct. 1999) (ordering that arbitration agreements in loan contracts entered into with consumers after filing of class action could not be enforced, on the basis that agreements were improper communications with putative class members); *Powertel* v. *Bexley*, 743 So. 2d 570, 577 (Fla. Dist. Ct. App. 1999) (affirming trial court's denial of motion to compel arbitration and ruling that arbitration agreements adopted through change-in-terms notice after filing of class action were unconscionable). *Cf. Balasanyan* v. *Nordstrom, Inc.*, 294 F.R.D. 550, 574 (S.D. Cal. 2013) (holding that where, after class action was filed, employer began requiring new employees to sign an arbitration agreement, new employees who signed that agreement may be excluded from class, because company was not communicating improperly with class members but "engaging in standard practice that many companies engage in when hiring new employees").

Regarding the public-interest consumer lawyer commenter's concern about opt-out provisions, the Bureau does not believe that it is necessary to clarify that the presence or absence of an opt-out provision does not affect whether an agreement is a pre-dispute arbitration agreement within the meaning of § 1040.2(c). The Bureau believes that it is clear that, where a pre-dispute arbitration agreement includes an opt-out provision, and the consumer has not opted out, there remains a governing pre-dispute arbitration agreement to which the Bureau's rule would apply.

The Bureau did not receive comment on proposed comment 2(d)-1 and is finalizing the proposed comment, renumbered as comment 2(c)-3, as proposed.

*2(d) Provider*

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 a "covered person" and a consumer. 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 proposal, the Bureau used the term provider to refer to the entity to which the requirements in the proposal would have applied.[815] Proposed § 1040.2(c) would have defined the term provider as a subset of the term covered person. Specifically, proposed § 1040.2(c) would have defined the term provider to mean (1) a person as defined by Dodd-

[815] For example, proposed § 1040.4(a)(1) would have prohibited a provider from seeking to rely in any way on a pre-dispute arbitration agreement entered into after the compliance date in a class action related to a covered consumer financial product or service.

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).

Proposed comment 2(c)-1 would have clarified 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 must comply with this part only for the products or services that it offers or provides that would be covered by proposed § 1040.3. The proposed comment would have illustrated this concept by noting that a merchant that transmits funds for its customers would be covered pursuant to proposed § 1040.3(a)(7) with respect to the transmittal of funds, but the same merchant generally would not be covered with respect to its sale of durable goods to consumers, except as provided in 12 U.S.C. 5517(a)(2)(B)(ii) or (iii).[816]

Other than a comment from an industry commenter, which stated that the proposed definition of provider was sufficiently clear, the Bureau received no comments on this proposed provision.[817] The Bureau is finalizing the definition of provider largely as proposed, except for minor technical revisions.[818] For ease of reference and as noted previously, the Bureau has also

[816] As stated in the proposal, 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 proposal 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).

[817] A consumer advocate commenter also commented on this proposed definition. However, these comments related more directly to the rule's coverage mechanism. For this reason, the Bureau summarizes and responds to these comments in the section-by-section analysis for § 1040.3, below.

[818] In the commentary to the definition of provider, the Bureau has corrected the cross-reference to transmitting funds coverage, which is in § 1040.3(a)(7), and has clarified when that coverage would apply. The Bureau also has shortened the definition in § 1040.2(d)(1) to refer to an

re-numbered this definition in the final rule as § 1040.2(d); the definition of pre-dispute arbitration agreement, which was § 1040.2(d) in the proposal, is § 1040.2(c) in the final rule. Having not received any comment, the Bureau is also finalizing proposed comment 2(c)-1, renumbered as comment 2(d)-1, as proposed, with minor updates to align the comment with changes to § 1040.3(a)(7) to which the comment refers and to clarify that the references to Dodd-Frank section 1027 refer to the activity of extending consumer credit. The Bureau is also adding comment 2(d)-2 to clarify that a person is a provider if it meets either prong of the definition of provider in § 1040.2(d)(1) and (2). In particular, even if an affiliated service provider does not meet the definition of provider in § 1040.2(d)(2), because it provides services to a person who is excluded from the rule under § 1040.3(b) and who thus is not a provider, the affiliated service provider still could be a provider as defined in § 1040.2(d)(1). For example, if an affiliate of a merchant excluded by § 1040.3(b)(6) services consumer credit extended by the merchant, the affiliate servicer may meet the definition of provider in § 1040.2(d)(1) even though the merchant is not a provider. The comment also emphasizes that the rule applies to affiliated service providers in certain circumstances even when they are not themselves offering or providing a consumer financial product or service.

As stated in the proposal, the definition of the term "person" under section 1002(19) of the Dodd-Frank Act includes an individual, partnership, company, corporation, association (incorporated or unincorporated), trust, estate, cooperative organization, or other entity, and the term "entity" readily encompasses governments and government entities. Even if the term were ambiguous, the Bureau, based on its expertise and experience with respect to consumer financial

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"activity" covered by § 1040.3(a), so that the terms governing which activities are covered appear in § 1040.3(a). Finally, the Bureau has deleted the second usage of the phrase "as defined in paragraph (c)(1)" from the proposed definition, as only one usage of that phrase is needed.

markets, believes that interpreting the term to encompass governments and government entities would promote consumer protection, fair competition, and other objectives of the Dodd-Frank Act. Further, as stated in the proposal, the Bureau 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. In addition, 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. Accordingly, while the Bureau has chosen to exempt certain government entities under § 1040.3(b)(2), the term provider is broad enough to encompass such entities to the extent that they are not otherwise excluded from the rule.[819]

*Comments on Possible Additional Definitions*

Several commenters requested that the Bureau define additional terms relevant to this rulemaking that the Bureau did not propose to define.

A public-interest consumer lawyer commenter and an industry commenter requested that the Bureau define the term "arbitration." The public-interest consumer lawyer commenter suggested that the Bureau define "arbitration" as "any binding alternative dispute resolution process" and stated that this definition would provide clarity and limit evasion. The industry commenter did not recommend a specific definition of "arbitration" but stated that a definition would ensure compliance with the regulation.

The Bureau declines to add a definition of "arbitration" to § 1040.2. While neither commenter stated why they believed a definition of arbitration would either prevent evasion or

[819] *See supra* section-by-section analysis of § 1040.3(b)(2).

improve compliance, the Bureau believes that the relevant evasion concern would be that providers would create a binding alternative dispute resolution (ADR) process that is similar to arbitration but that uses a different name, and that such an arrangement could harm consumers were a court to conclude that it would not be covered by this rule. The Bureau believes that any such evasion attempts would fail. The Bureau is aware that there has been extensive litigation on the question of whether a particular ADR process is arbitration, in part because the FAA does not define the term. Most circuits apply a "Federal common law" standard that looks to whether disputants empowered a third party to render a final and binding decision settling their dispute.[820] Two circuit courts apply the relevant State law, as long as that law does not frustrate the purposes of the FAA.[821] The Bureau believes these precedents are broad enough to capture any ADR process that entities could implement in an effort to evade the rule, but the Bureau will nonetheless monitor the market for any attempts by providers to evade application of this rule in this manner.

A consumer lawyer commenter requested that the Bureau add to § 1040.2 a definition of "business of insurance" that would cross-reference the definition of "business of insurance" in Dodd-Frank section 1002(3).[822] The commenter also requested that the Bureau adopt commentary stating that certain contractual arrangements similar to guaranteed asset protection (GAP) waiver arrangements are not the "business of insurance."[823] The commenter stated that

[820] *See, e.g.*, *Bakoss* v. *Certain Underwriters at Lloyds of London Issuing Certificate No. 0510135*, 707 F.3d 140 (2d Cir. 2013) (affirming district court's application of Federal common law standard that "if the parties have agreed to submit a dispute for a decision by a third party, they have agreed to arbitration").

[821] *See Portland General Electric Co.* v. *U.S. Bank Trust Nat'l Ass'n*, 218 F.3d 1085 (9th Cir. 2000) (applying Oregon law); *Hartford Lloyd's Insurance Co.* v. *Teachworth*, 898 F.2d 1058 (5th Cir. 1990) (applying Texas law).

[822] Dodd-Frank section 1002(3) states that the term business of insurance means the writing of insurance or the reinsuring of risks by an insurer, including all acts necessary to such writing or reinsuring and the activities relating to the writing of insurance or the reinsuring of risks conducted by persons who act as, or are, officers, directors, agents, or employees of insurers or who are other persons authorized to act on behalf of such persons.

[823] In a typical GAP waiver arrangement, a lender agrees, for an additional charge, to forgive some or all of any remaining debt following a covered loss. For example, where a waiver covers automobile theft, the lender would forgive the amount of any difference between the

these revisions are needed because judges and litigants often deem such arrangements to be the business of insurance, when, in the commenter's view, they are not. If considered the business of insurance, such arrangements would be exempt from the rule under Dodd-Frank section 1027(m).[824] If not, part 1040 could apply to pre-dispute arbitration agreements in contracts for such arrangements where charges incurred by consumers pursuant to such arrangements are included in the cost of credit.[825]

The Bureau declines to add to § 1040.2 a definition of "business of insurance" that cross-references the Dodd-Frank Act's definition of that term. The Bureau also declines to add commentary stating that contractual arrangements similar to GAP waiver agreements are not the business of insurance. The Bureau understands that a number of State courts and State banking regulators have determined that debt cancellation or suspension products such as those described by the commenter are not insurance.[826] However, whether a particular debt cancellation arrangement involves the business of insurance may vary based on the particular facts and circumstances. The Bureau believes that whether a product involves the business of insurance is best ascertained by the provider's obtaining legal advice based on the facts in a particular case.[827]

An industry commenter requested that the Bureau define "account" and "pre-dispute." The commenter did not recommend specific definitions for these terms but stated that they would help ensure compliance with the regulation. The Bureau believes it is unnecessary to define

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remaining balance on the consumer's automobile loan and the payout by the consumer's automobile insurance company following the theft of the consumer's automobile.

[824] Section 1027(m) explains that the Bureau may not define as a financial product or service, by regulation or otherwise, engaging in the business of insurance.

[825] *See* § 1040.3(a).

[826] *See, e.g.*, *First Nat'l Bank of E. Arkansas* v. *Eubanks*, 740 F. Supp. 1427 (E.D. Ark. 1989) (holding that bank did not engage in the business of insurance when it entered into debt cancellation agreements); *Automotive Funding Group, Inc.* v. *Garamendi*, 7 Cal. Rptr. 3d 912 (Cal. Ct. App. 2003) (holding that an automobile lender's debt cancellation program was not insurance); 7 Tex. Admin. Code 12.33(b)(3) (Texas rule adopted in 2003 providing that State banks' debt cancellation and suspension agreements are governed by the Texas Administrative Code and applicable provisions in the Finance Code and not State insurance laws).

[827] *See also* the section-by-section analysis for § 1040.3(a)(1), below, which discusses additional comments the Bureau received concerning life insurance policy loans.

either of these terms. In the final rule, two provisions – § 1040.3(a)(5) and (a)(6) – use the term account. However, these provisions cross-reference TISA and EFTA respectively and their implementing regulations, both of which define the term.[828] Thus, the Bureau believes it unnecessary to define those terms here. While § 1040.4(b)(3)(vi) uses the term "account number," the Bureau does not believe that the commenter was indicating confusion over this term or that there is confusion about this concept. The Bureau believes it is unnecessary to define the term pre-dispute because the term is only relevant in the context of the term pre-dispute arbitration agreement, which § 1040.2(c) already defines.

*Section 1040.3 Coverage and Exclusions from 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, the Bureau proposed § 1040.3 to set forth the products and services to which proposed part 1040 would apply. Proposed § 1040.3(a) generally would have provided a list of products and services that would be covered by the proposal, while proposed § 1040.3(b) would have provided limited exclusions.

The Bureau proposed to cover a variety of consumer financial products and services that the Bureau believed 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. Lending money includes, for example: most types of consumer lending (such as making secured loans or unsecured loans or issuing credit cards), activities related to that consumer

[828] *See* 12 CFR 1030.2(a) (defining "account" for purposes of Regulation DD); 12 CFR 707.2(a) (defining "account" for purposes of National Credit Union Administration's rule implementing TISA); 12 CFR 1005.2(b)(1) (defining "account" for purposes of Regulation E).

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 leases that are consumer financial products or services because they are similar to automobile loans. Storing money includes storing funds or other monetary value for consumers (such as providing deposit accounts). Moving money includes 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) described the products and services in these core consumer financial markets that the Bureau proposed to cover in part 1040. Each component is discussed separately below in the discussion of each subsection of § 1040.3(a), along with a summary of comments received on each component, the Bureau's response to these comments, and any changes the Bureau is making to the subsection in the final rule.[829] The Bureau notes that both banks and nonbanks may provide the products and services described in § 1040.3(a). As discussed in the section-by-section analysis of "provider" (see § 1040.2(d) above), below in this section, and in the Bureau's Section 1022(b)(2) Analysis, 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 is subject to the proposal, except to the extent an exclusion in proposed § 1040.3(b) applies to that person. Proposed § 1040.3(b) thus described exceptions to proposed § 1040.3(a). Each proposed exception is discussed separately below, along with a summary of comments received related to each proposed exception, the Bureau's response to these comments, and any changes the Bureau is making to the subsection in the final rule.

[829] 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 § 1040.3(b).

*3(a) Covered Products and Services*

*The Bureau's Proposal*

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[830] 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.[831]

In exercising its authority under Dodd-Frank section 1028, the Bureau proposed to cover consumer financial products and services in what it described as the core markets of lending money, storing money, and moving or exchanging money. Accordingly, the Bureau did not propose 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. As the proposal explained, Bureau intends to continue to monitor other markets for consumer financial products and services in order to determine over time whether to revisit the scope of this rule.

In addition, the Bureau structured the proposed scope provisions to use a number of terms derived from existing, enumerated consumer financial protection statutes implemented by the Bureau in order to facilitate compliance. In so doing, the Bureau expected that the coverage of proposed part 1040 would have incorporated relevant future changes, if any, to the enumerated

[830] 12 U.S.C. 5517 and 5519.

[831] However, as also discussed in greater detail in the section-by-section analysis of proposed § 1040.3(b)(5) and clarified in comments 2(c)-1 and 2(c)-1.i to the final rule, 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 consumer financial product or service offered or provided by the entity excluded from the Bureau's rulemaking authority (such as the automobile loan referenced above).

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, the proposal noted that changes that the Bureau had proposed regarding the definition of an account with regard to prepaid products under Regulation E would have, if adopted, affected the scope of proposed § 1040.3(a)(6).[832]

To effectuate this approach, the Bureau specifically proposed in § 1040.3(a) that proposed part 1040 generally would have applied 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 have explained, that statutory 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.

*Comments Received*

A number of consumer advocates, nonprofits, consumer law firms, and industry commenters identified specific products or services that, in their view, should or should not be covered; these comments are addressed in relevant subsections of the section-by-section analysis

[832] The Bureau did adopt changes to that regulation in a final rule issued in October 2016 that, when it takes effect, will expand the types of products that are considered accounts and that would be subject to proposed § 1040.3(a)(6), as is discussed below. *See* Prepaid Accounts Under the Electronic Fund Transfer Act (Regulation E) and the Truth in Lending Act (Regulation Z), 81 FR 83934 (Nov. 22, 2016); 82 FR 18975 (Apr. 25, 2017) (setting effective date of April 1, 2018 for most provisions). *See also* Prepaid Accounts Under the Electronic Fund Transfer Act (Regulation E) and the Truth in Lending Act (Regulation Z), 82 FR 29630 (June 29, 2017) (proposal seeking comment on whether the effective date should be further delayed).

below.[833] Some industry commenters challenged areas of proposed coverage, on the basis that their industry was either not analyzed, or not sufficiently analyzed, in part or all of the Study. Those comments are discussed in the analysis of comments on the Study above in Part III.

In addition, the Bureau received several comments more generally addressing its overall proposed approach to scope of coverage that focused on three core markets and its frequent reliance on already-enumerated terms in Federal consumer financial laws. One consumer advocate agreed with the Bureau's proposed approach to delineating the scope of coverage, which, in its view, would reduce uncertainty and assist the Bureau and courts in administration of the rule. Three public-interest consumer lawyer commenters believed the proposed coverage was extensive. Nonetheless, a trade association of consumer lawyers, a consumer advocate, and an individual commenter stated in their comments that the scope of coverage should be broadened to reach all consumer financial products and services that may be regulated by the Bureau in the Dodd-Frank Act.[834] These commenters generally believed that consumers of financial products and services do not knowingly and voluntarily enter into arbitration agreements, which often cover a broad range of claims, and as a result, arbitration agreements should be regulated wherever they occur in Bureau-regulated markets without limitation.

A public-interest consumer lawyer commenter supported the proposal's references to other laws and regulations to define scope, as this would ensure that the scope of coverage in the proposal would evolve as those laws and regulations are updated to address developments in the relevant markets. The commenter stated that this feature of the proposal would be particularly

[833] In addition, a consumer advocate also urged the Bureau to cover real estate brokerage and title insurance because arbitration agreements in those markets are, in their view, common and have the effect of suppressing claims. Having not sought notice and comment, the Bureau declines to add these markets to the rule.

[834] This other consumer advocate also noted, however, that the rule should cover at least those products and services in the proposal because, in their view, consumers have been subjected to arbitration agreements in most, if not all, of those markets. Other consumer advocate comments similarly indicated that arbitration agreements were common in consumer finance markets.

important for African American communities the commenter represents, which, in its view, are often a target for novel, and sometimes exploitative, consumer financial products and services. This commenter also suggested that for clarity the Bureau noted this feature in the official interpretations to part 1040. A consumer advocate commenter also supported the Bureau's proposed incorporation of definitions found in other regulations that may later be amended, noting the availability of notice-and-comment rulemaking for such amendments would allow commenters on those potential changes to address the relevance and application of part 1040.[835]

In addition, a consumer advocate and a public-interest consumer lawyer also expressed concern in their comments that persons who provide services to providers covered by the proposal (but who are not themselves providers) could escape the reach of the proposal. In particular, these commenters asserted that if a covered provider failed to comply with the proposal's requirement to insert a contract provision preventing reliance on the arbitration agreement in a class action (proposed § 1040.4(a)(2)), then the service provider might attempt to rely on the arbitration agreement of the provider in a class action against the service provider because another provision of the rule, prohibiting invocation of an arbitration agreement in a class action (proposed § 1040.4(a)(1)) would not apply.

*The Final Rule*

The Bureau is finalizing the rule consistent with the overall approach it had set forth in the proposal to defining a broad but specific scope of coverage within the core markets of storing, lending, and moving money. The Bureau continues to believe that this approach will facilitate compliance with the rule and its administration. The Bureau recognizes, however, that

[835] This commenter also stated in its comment that the rule should cover all types of mortgage settlement services, and not just mortgage brokering or mortgage lending. Having not sought notice and comment, the Bureau declines to add these markets to the rule.

the use of arbitration agreements for other consumer financial products or services not covered by the final rule nonetheless has a potential to cause harm to consumers. As stated in the proposal, the Bureau therefore plans to monitor the impact of arbitration agreements in these other markets. Based upon this monitoring, the Bureau may consider adjusting the scope of coverage of the rule in the future, whether by adjusting an existing category of coverage or by adding a new category of coverage, consistent with its rulemaking obligations and authority including Dodd-Frank section 1028.

In addition, the Bureau believes that the references in the scope of coverage § 1040.3 to existing laws and regulations is sufficient to signal that the coverage is determined based upon the content of those laws, as they exist now and as they may evolve in the future through amendments or new interpretations. Because this is how any regulation defining scope would function when it incorporates citations to existing laws, the Bureau does not believe it is necessary to adopt a specific comment to this effect, as one commenter suggested.

With regard to the commenter that sought broader coverage of service providers, the Bureau does not believe a change is necessary to address this commenter's concern. To the extent a service provider is providing or offering a covered consumer financial product or service, then the class rule (§ 1040.4(a)(1)) prohibits that service provider from relying upon any arbitration agreement entered into after the compliance date, regardless of whether the service provider itself had entered into the agreement (see comment 4-2). For example, a debt collector collecting consumer credit on behalf of the creditor may be a service provider, but also would be covered directly (see § 1040.3(a)(10)(iii)). To the extent this commenter was, in effect, seeking an expansion in the proposed scope of coverage to reach persons who are not offering or providing a covered consumer financial product or service and are not an affiliated service

provider to persons offering or providing a covered consumer financial product or service, the Bureau does not believe such an expansion in scope of coverage is warranted. Nevertheless, the Bureau shares the commenter's concern regarding a situation in which a person provides services to a provider that had failed to comply with this rule, and relies on the provider's non-compliant arbitration agreement. The Bureau believes that this problem can be addressed through means other than adding unaffiliated service providers to the coverage of this rule. For example, consumers may assert that the arbitration agreement in this example was invalid or unenforceable for its failure to comply with the Bureau's rule.[836]

The Bureau is also making minor technical revisions to the introductory paragraph of § 1040.3(a). First, because the definition of pre-dispute arbitration agreement in § 1040.2(c) already refers to agreements concerning the consumer financial products and services listed in § 1040.3(a), it is not necessary to repeat the term "pre-dispute arbitration agreement" when describing the provisions relating to coverage and exclusions from coverage in § 1040.3(a). Second, the Bureau also is replacing the term "generally applies" from the proposal with the phrase "except for persons when excluded from coverage pursuant to § 1040.3(b)." The Bureau is adopting this change to indicate that although a product or service may be listed in § 1040.3(a), a person described in § 1040.3(b) nonetheless will not be subject to the rule.[837] Finally, the Bureau has added language to clarify that the rule applies to both the offering and provision of any product or service described in § 1040.3(a) when such offering or provision is a

[836] *See, e.g.*, Cal. Civ. Code § 1608 (providing that a contract is void if any component of consideration is unlawful), 1667(1) (defining unlawful to include a contract that is "contrary to an express provision of law").
[837] *But see* comment 2(c)-1 (clarifying that the rule applies to providers even when they are relying on pre-dispute arbitration agreements entered into by another person that is not subject to the rule).

consumer financial product or service in the Dodd-Frank Act.[838] Section 1040.3(a) describes some of the covered products and services using the term "providing." For example, § 1040.3(a)(1)(i) covers an extension of consumer credit under Regulation B. Accordingly, the Bureau believes it is important to clarify that offering such a product also is covered by the rule.

The Bureau is adopting comment 3(a)-1 to § 1040.3(a) as proposed to explain the two general categories of consumer financial products or services defined in the Dodd-Frank Act. In addition, in response to comments described below in the section-by-section analysis of § 1040.3(a)(3), the Bureau also is adopting comment 3(a)-2 concerning the rule's coverage of mobile phone applications and online access tools for covered products.

*3(a)(1)*

The Bureau believed that the proposal should apply to consumer credit and related activities including collecting on consumer credit. Specifically, proposed § 1040.3(a)(1) would have included in the coverage of proposed part 1040 consumer lending under the ECOA, as implemented by Regulation B, 12 CFR part 1002, and various supplemental activities related to that lending, while the related activity of debt collection would have been covered by proposed § 1040.3(a)(10).

In particular, proposed § 1040.3(a)(1) would have covered 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) would have broken these covered consumer financial products or services into the following five types: (i) providing an "extension of credit" that is "consumer credit" as defined

[838] *See* 12 U.S.C. 5481(5) (defining the term consumer financial product or service to include a financial product or service that is "offered or provided" in specified circumstances).

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 § 1040.3(a)(1)(i); or (v) servicing an extension of consumer credit covered by proposed § 1040.3(a)(1)(i). The Bureau describes and responds to the comments in categories (i) and (ii), (iii), and (iv) and (v), respectively, below.

*3(a)(1)(i) and (ii)*

*The Bureau's Proposal*

Proposed § 1040.3(a)(1)(i) would have covered providing any "extension of credit" that is "consumer credit" as defined by Regulation B, 12 CFR 1002.2.[839] In addition, proposed § 1040.3(a)(1)(ii) would have covered 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). This coverage proposed in § 1040.3(a)(1) would have reached creditors whether they approve consumer credit transactions and extend credit, or 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

[839] As is explained 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. 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). In addition, by proposing to cover only credit that is "consumer credit" under Regulation B, the Bureau was making clear that the proposal would not have applied to business loans.

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."[840] 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 expected that participants in the consumer credit market would have a significant body of experience and law to draw upon to understand how the proposal would have applied to them, which would have facilitated compliance with proposed part 1040.

As indicated in the proposal, the Bureau had considered covering consumer credit under two statutory schemes: TILA and ECOA, as well as their implementing regulations. The Bureau believed, however, that using a single definition would have been simpler and thus it proposed to use the Regulation B definitions under ECOA because they are more inclusive. For example, unlike the TILA and its implementing regulation (Regulation Z, 12 CFR 1026.2(17)(i)), ECOA and Regulation B do not include an 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 noted in the proposal that in many circumstances, merchants, retailers, and other sellers of nonfinancial goods or services (hereinafter, merchants) may act as creditors under ECOA in extending credit to consumers. While such extensions of consumer

[840] 12 CFR 1002.2(j). *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").

credit would have been covered by proposed § 1040.3(a)(1), exemptions proposed in § 1040.3(b) would have excluded certain merchants from coverage.[841] 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, as indicated in the proposal, proposed part 1040 generally would have applied to the merchant with respect to such transactions. For example, the Bureau believed merchant creditors significantly engaged in extending consumer credit with a finance charge often would have been ineligible for these exemptions.[842]

*Comments Received*

The Bureau received a number of comments on in its proposed approach to covering extensions of consumer credit in proposed § 1040.3(a)(1). For the most part, these comments focused on coverage (or exclusion) of specific types of consumer credit and related activities.

Two public-interest consumer lawyer commenters and a consumer advocate expressed support for the proposal's defining covered consumer credit based upon the coverage in Regulation B implementing ECOA, rather than what they viewed as a narrower universe of consumer credit transactions covered by Regulation Z implementing TILA. One of the public-interest consumer lawyers noted the ECOA-based coverage would be broader than TILA-based coverage, and importantly, in its view, reach persons with roles in the decision to approve or deny credit beyond only the person extending the credit. This commenter also stated that ECOA coverage would reach certain activities in relation to credit extended to consumers by merchants that are not subject to TILA. In the view of the consumer advocate, ECOA-based coverage is

[841] *See* 81 FR 32830, 32879-84 (May 24, 2016), and the discussion of § 1040.3(b) below.
[842] As indicated in the proposal, certain automobile dealers would have been 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 would have been exempt under proposed § 1040.3(b)(5) in other circumstances, such as those specified in Dodd-Frank section 1027(a)(2)(D). A merchant that is a government or government affiliate also would have been exempt in circumstances described in proposed § 1040.3(b)(2). *Id.* at 32873 n.449.

important because the alternative – TILA-based coverage – could incentivize companies to try to avoid coverage by reducing the number of installments or embedding a finance charge into the purchase price in order to render the credit not subject to TILA. A consumer lawyer also stated that, based on his experience counseling members of the armed forces, the proposal is important because it would extend its protections to products and services, such as loans secured by automobiles and other personal property, that are not reached by regulations implementing the MLA's restrictions on arbitration agreements. Finally, another public-interest consumer lawyer stated that the proposed broad coverage of consumer credit, including short-term loans, is particularly important, as these products are used at higher rates by African Americans.

*Comments concerning mobile wireless third-party billing.* A few comments focused specifically on a passage in the proposal's section-by-section analysis in which the Bureau had noted that mobile wireless third-party billing could be subject to proposed § 1040.3(a)(1)(i) to the extent that providers pass on charges to consumers for goods or services provided by third parties. Some comments specifically supported treatment of mobile wireless third-party billing as credit. For example, a consumer advocate commenter stated that the use of these platforms to impose charges for goods or services that consumers did not authorize (which often is called cramming) is a serious consumer protection problem and that arbitration agreements impede consumers harmed by these practices from seeking relief. However, an industry trade association commenter asserted that mobile wireless providers when they provide such billing platforms do not extend consumer credit within the meaning of proposed § 1040.3(a)(1)(i).[843] The commenter noted that extending credit entails the granting of a right to defer payment of a

[843] See also the section-by-section analysis of § 1040.3(a)(7) and (a)(8) below (discussing other issues raised by the industry trade association commenter, concerning uncertainty about the application of the rule to mobile wireless third-party billing and advocating for an exemption to ensure these products or services are not discontinued to the detriment of consumers§ 1).

debt, and asserted that mobile wireless providers do not grant the consumer the right to defer payment for the nonfinancial goods or services of the third party in such situations. In this commenter's view, the right to defer payment for those goods or services is granted, if at all, only by the provider of those goods or services (*i.e.*, the third party). As a result, in this commenter's view, the mobile wireless third-party billing product or service is merely a billing platform, and not itself a credit granting process that would cause it to be covered under this proposed subsection. This commenter urged the Bureau to reconsider its position that the proposed categories of coverage would reach mobile wireless third-party billing platforms.

*Comments concerning life insurance policy loans.* An association of State insurance regulators, two insurance industry trade associations, a financial services industry trade association, and a consumer advocate specialized in insurance matters in their comments all took issue with the observation in the proposal's Section 1022(b)(2) Analysis that an impact on life insurance policy loans[844] was unlikely but not entirely certain because whether life insurance policy loans would be covered by the proposal would depend on the facts and circumstances determination of whether they are the "business of insurance" under Dodd-Frank section 1002(15)(C)(i) and 1002(3).[845]

The consumer advocate stated its support for coverage of any life insurance policy loans that are not the business of insurance. The industry trade association commenters asserted,

[844] The Bureau understands that a life insurance policy loan is generally a transaction in which the insurer of a life insurance policy that has an accumulated cash value provides money to the insured, and this amount is paid to the insurance company with interest either through payments made by the insured or as a deduction by the insurer from the cash value or payable benefits under the policy. *See* Nat'l Ass'n Ins. Comm'rs, "Life Insurance Buyer's Guide," at 4 (2007) (describing loan features on insurance with a cash value), *available at* http://www.naic.org/documents/prod_serv_consumer_lig_lp.pdf.

[845] Comments on insurance matters focused almost exclusively on the potential coverage of life insurance policy loans. One industry trade association asked whether the proposal would cover insurance. Products that are the business of insurance are excluded from the Bureau's title X authority, and § 1040.3(b)(6) incorporates that exclusion by reference. In addition, one consumer law firm stated in its comment that the proposed business of insurance exclusion should not apply to contractual commitments of automobile lenders to waive any loan amount in excess of the collateral value in the event of destruction or damage to the automobile. This comment cited an opinion from a State insurance regulator declining to regulate these debt cancellation or suspension products. The Bureau notes that the consumer law firm commenter did not identify in its comment any reasons why contractual commitments of automobile lenders might be the business of insurance, or why there was uncertainty over that question.

however, that the Bureau unnecessarily created uncertainty for the insurance market by insinuating that there are loans administered by insurers that are not in business of insurance. These commenters requested that the Bureau confirm life insurance policy loans are categorically excluded from the rule because they are always the business of insurance, so that there is no uncertainty regarding the potential impact of the rule on them. In support of their arguments, they pointed to a number of ways in which, in their view, State law and State regulators treat policy loans as the business of insurance. These commenters emphasized that many States have adopted a model policy loan interest rate bill issued by the National Association of Insurance Commissioners (NAIC),[846] and a number of States also specifically require that policy loan features be included in insurance contracts. They also noted that State insurance regulators typically review policy loan features of insurance contracts and that the NAIC has adopted accounting principles governing these transactions that are applied by insurance regulators.[847] One commenter further urged that Regulation B should be construed as excluding policy loans just as they had been excluded from Regulation Z when there was no independent obligation to repay.[848] This commenter cited to a prior statement of the Federal Reserve Board indicating that policy loans were not credit transactions because they were "in effect, using the consumer's own money," *i.e.*, the accrued cash value.[849] Finally, one commenter asserted that State regulation of policy loans is sufficiently comprehensive that a

[846] Nat'l Ass'n Ins. Comm'rs, "Model Policy Loan Interest Rate Bill, An Act to Regulate Interest Rates on Life Insurance Policies," Model Regulation Service (Apr. 2000), *available at* http://www.naic.org/store/free/MDL-590.pdf.
[847] Nat'l Ass'n Ins. Comm'rs, "Statement of Statutory Accounting Principles," No. 49.
[848] This commenter cited to the exclusion of such a product from the definition of credit in Regulation Z. *See* 12 CFR 1026.2 comment 2(a)(14)-1(v) (explaining that "[b]orrowing against the accrued cash value of an insurance policy or a pension account, if there is no independent obligation to repay" is excluded from Regulation Z's definition of credit). This commenter believed this exclusion also should apply to the definition of consumer credit under Regulation B, and thus that such loans would therefore not be covered by proposed § 1040.3(a)(1).
[849] 46 FR 20848, 20851 (Apr. 7, 1981).

Bureau assertion of authority over the product would violate the McCarran-Ferguson Act,[850] a Federal law specifically directed at the regulation of insurance, which, in its view, prohibits Federal regulation of State-regulated insurance products absent a specific authorization from Congress.[851]

*The Final Rule*

The Bureau is adopting § 1040.3(a)(1)(i) and (a)(1)(ii) as proposed, with minor edits to more clearly signify how the coverage of these provisions is tied to established terms in Regulation B. For example, subparagraph (i) is revised to emphasize that it only applies to persons who are "creditors" under Regulation B. By proposing to cover extension of "consumer credit," the proposal had already implicitly incorporated the term "creditor," which is part of the definition of "credit" in Regulation B.[852] Nonetheless, the Bureau believes the scope of subparagraph (i) is clearer if the regulation text explicitly states that it only applies to creditors as defined in Regulation B. The Bureau also notes that Regulation B defines the term "creditor" as covering persons regularly engaging in the activities described 12 CFR 1002.2(l) in the ordinary course of business. Because the term "regularly" is included in the definition of "creditor" in Regulation B, that term will have the meaning given by Regulation B, and persons not regularly engaged in those activities in the ordinary course of business will not be covered by § 1040.3(a)(1)(i)-(ii). In addition, in subparagraphs (i) and (ii), the Bureau is placing terms that are derived directly from Regulation B in quotes to improve clarity. The Bureau believes these revisions will provide greater certainty as to the scope of these subparagraphs.

[850] 15 U.S.C. 1012(b).
[851] This commenter also noted that Dodd-Frank section 1027(m) prohibits the Bureau from "defin[ing] as a financial product or service, by regulation or otherwise, engaging in the business of insurance."
[852] 12 CFR 1002.2(j) (defining "credit" as certain rights granted by a "creditor"). *See also* 12 CFR 1002.2(h) (defining "consumer credit" by incorporating the defined term "credit").

As to the comments addressing whether mobile wireless third-party billing providers extend consumer credit, as noted above, because this rule borrows defined terms from an existing regulation, providers can look to interpretations of ECOA and Regulation B for the particular circumstances as they may arise. It is beyond the scope of this rulemaking to specify or describe the details of the circumstances that are covered by ECOA and Regulation B. Moreover, regardless of whether mobile wireless third-party billing providers are granting the consumer a right to defer payment, there are other potential bases for coverage, such as transmitting or exchanging funds under § 1040.3(a)(7) or payment processing under § 1040.3(a)(8). In addition, if the third party is the one granting the consumer a right to defer payment in circumstances described in § 1040.3(a)(1)(i), and the mobile wireless provider is billing for and collecting those payments, these billing activities of the mobile wireless provider may involve the servicing of consumer credit covered by § 1040.3(a)(1)(v).

The Bureau also acknowledges the comments from the association of State insurance regulators and the industry trade associations that expressed concern over a statement in the Bureau's Section 1022(b)(2) Analysis in the proposal that did not rule out the possibility that the proposal could cover some life insurance policy loans. As the Bureau noted in its Section 1022(b)(2) Analysis in the proposal, however, the Bureau did not believe such coverage was likely.[853] As the commenters recognized, and as stated in § 1040.3(a) of the final rule, the final rule only covers products that are defined as consumer financial products and services under the Dodd-Frank Act, which, in its section 1002(15)(C)(i), excludes the "business of insurance." The Bureau is not interpreting the term business of insurance in this final rule, and

[853] 81 FR 32830, 32917 (May 24, 2016) (indicating that life insurance policy loans were unlikely to be affected by the proposal). *See also id.* at 32933 appendix B (indicating that three cases against life insurance companies were excluded from the impacts analysis).

observations in the Bureau's impacts analysis regarding a low likelihood of impact on life insurance policy loans should not be construed as a determination of coverage of any particular product or service. The Bureau recognizes that commenters have provided relevant information on how State insurance laws and State insurance regulators regulate or supervise aspects of this product. The Bureau therefore believes that the comments, taken as a whole, supported the estimate the Bureau had made in the Section 1022(b)(2) Analysis in the proposal, that any impact on this product is unlikely, whether because these loans would be determined to be the business of insurance, or for other reasons, such as laws precluding the use of arbitration agreements.[854] The Bureau's Section 1022(b)(2) Analysis in this final rule therefore confirms this estimate. Contrary to the request of industry commenters, the Bureau does not believe it would be appropriate to delete that observation in the impacts analysis, as the observation does not reflect a determination of coverage. In any event, the Bureau confirms that when these products constitute the business of insurance, they are not subject to this rule, and thus the rule does not violate the McCarran-Ferguson Act.

*3(a)(1)(iii)*

*The Bureau's Proposal*

Proposed § 1040.3(a)(1)(iii) would have covered persons who, as their primary business activity, act as "creditors" as defined by Regulation B, 12 CFR 1002.2(l), by referring consumers to other ECOA creditors and/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

[854] With regard to the comment that the Bureau should in this rule construe the definition of credit in Regulation B similarly to Regulation Z, the Bureau was not proposing to interpret Regulation B in this rule and does not do so in the final rule.

persons engaged in such activities.[855] 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 have applied to persons who are regularly engaging in these activities.[856]

Because the Bureau did not generally propose to cover activities of merchants to facilitate payment for the merchants' own nonfinancial goods or services,[857] proposed § 1040.3(a)(1)(iii) would only have applied to persons providing these types of referral or selection services as their primary business.[858] Thus, as proposed comment 3(a)(1)(iii)-1 would have clarified, a merchant whose primary business activity consists of the sale of nonfinancial goods or services generally would not have fallen into this category. Proposed § 1040.3(a)(1)(iii) would not have applied, 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.[859]

*Comments Received*

With regard to proposed § 1040.3(a)(1)(iii)'s treatment of persons providing creditor referral or selection services as their primary business, several commenters, including consumer advocates, consumer law firms, public-interest consumer lawyers, and a nonprofit, stated that lead generators for consumer credit products should be explicitly covered because these persons can steer consumers to harmful consumer credit products. A consumer advocate added in its comment that it assumed that these lead generators would have been covered by the proposal

[855] 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."
[856] The Bureau also had 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, 81 FR 32830, 32882-83 (May 24, 2016), and the discussion below on § 1040.3(b)(3) in the final rule.
[857] As noted above, however, the proposal would have applied to merchant creditors engaged significantly in extending consumer credit with a finance charge.
[858] Transmitting or payment processing in similar circumstances also generally would not have been covered by paragraphs (7) and (8) of proposed § 1040.3(a), as discussed in the section-by-section analysis of those provisions in the proposal. 81 FR 32830, 32876-77 (May 24, 2016). *See also* below.
[859] As the proposal noted, however, if the merchant regularly participates in a consumer credit decision as a creditor under Regulation B, the merchant would have been subject to the proposal under proposed § 1040.3(a)(1)(ii) unless the merchant was subject to one of the exemptions in proposed § 1040.4(b). 81 FR 32830, 32874 n.454 (May 24, 2016).

based on the coverage in this provision of persons regularly engaged in consumer credit referrals or creditor selection as their primary business. This commenter stated that the final rule should include a clarification making this assumption explicit, otherwise, the commenter was concerned that lead generators that sell a list of leads to creditors may claim that the mere act of selling leads does not constitute "referring" or "selecting" a creditor to make an offer within the meaning of Regulation B.

A consumer lawyer also stated that, based on his experience counseling members of the armed forces, the proposed coverage concerning consumer credit referrals is important because these activities are not reached by regulations implementing the MLA's restrictions on arbitration agreements.

Two consumer advocates and a public-interest consumer lawyer also urged the Bureau to remove the "primary business" limitation in proposed § 1040.3(a)(1)(iii). One of the consumer advocate commenters asserted that this limitation was a loophole that would allow companies engaged in credit referrals or creditor selection to restructure their business to avoid coverage of the rule. The other consumer advocate commenter asserted that a company can have more than one primary business and thus the proposed exclusion was confusing. Finally, the public-interest consumer lawyer commenter stated that the rule should cover merchants providing credit referrals (including automobile dealers, medical providers and others) even when their primary business activity is the sale of nonfinancial goods or services to consumers.

*The Final Rule*

The Bureau is finalizing proposed § 1040.3(a)(1)(iii) and its associated commentary with certain technical edits[860] and a change to the scope of this provision. In particular, final § 1040.3(a)(1)(iii)(C) excludes from the coverage of § 1040.3(a)(1)(iii) creditor referral or selection activity by a creditor that is incidental to a business activity that is not covered by § 1040.3(a).

As explained in the proposal, the Bureau's goal in proposing a primary business limitation on § 1040.3(a)(1)(iii) was to exclude from coverage merchants that are facilitating payment for their own nonfinancial goods or services in transactions with consumers through, for example, creditor referrals or selection activities.[861] The Bureau specifically requested comment on its proposed approach to this issue. In light of the comments asserting that the term primary business may have an uncertain meaning in this context, the Bureau believes that using the term incidental would more clearly accomplish the goal stated in the proposal. In particular, the Bureau believes that the term incidental more clearly denotes the relationship between the creditor referral or selection activity and the underlying business activity that the Bureau is not seeking to cover in this rule.[862]

The Bureau also is making conforming changes to comment 3(a)(1)(iii)-1 and providing an example of incidental merchant referral or selection activity that would be excluded, even if

[860] For clarity, the Bureau is adding the term "consumer credit" to clarify that is the type of credit referral and selection activity that triggers coverage, is moving the term "creditor" to later in the provision and making associated edits, is placing defined terms in Regulation B in quotes for clarity, and is dividing the components of § 1040.3(a)(1)(iii) into subparagraphs (A), (B) and (C).
[861] 81 FR 32830, 32874 (May 24, 2016). The public-interest consumer lawyer commenter stated that the rule should cover merchant credit referrals such as those made by automobile dealers to a third-party financing company. The Bureau declines to cover such referrals and instead is maintaining the general goal of excluding merchant referrals.
[862] The Bureau also believes that covered persons may be more familiar with the term "incidental," which is used in a separate but related context in Regulation B. *See* 12 CFR 1002.3(c)(1) (defining the term "incidental credit").

performed regularly by a merchant who therefore may meet the definition of the term creditor in Regulation B.

With regard to the commenters seeking coverage of consumer credit lead generators under proposed § 1040.3(a)(1)(iii), the Bureau is not including an express reference to lead generation in the final rule. As noted above, the Bureau believes that basing consumer credit coverage on a longstanding regulation implementing an enumerated consumer protection law (*i.e.*, Regulation B), including its provisions covering referral or creditor selection activity, facilitates compliance with this rule and reduces uncertainty over the scope of this rule. As a result, any person engaged in lead generation would be covered by the rule whenever their activities fall into one or more of the coverage categories in § 1040.3(a), including § 1040.3(a)(1)(iii), which is linked to existing coverage in Regulation B. Whether a person is engaged in creditor referral or selection services within the meaning of Regulation B is a matter of application of that regulation based on the relevant facts and circumstances.[863] The Bureau believes that extending the final rule beyond Regulation B to separately cover "lead generation," a term that has no definition in existing law, could introduce the very uncertainty that the Bureau seeks to prevent by relying on Regulation B to define the scope of coverage. Having not sought notice and comment, the Bureau is not defining "lead generation" in this rulemaking.

*3(a)(1)(iv) and (v)*

Proposed § 1040.3(a)(1)(iv) and (v) would have covered 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 have

[863] For example, some lead generators may take credit applications from consumers. *See* Fed. Trade Comm'n, "Follow the Lead" Workshop, Staff Perspective," at 4 (Sept. 2016), *available at* https://www.ftc.gov/system/files/documents/reports/staff-perspective-follow-lead/staff_perspective_follow_the_lead_workshop.pdf. *See also* section-by-section analysis of § 1040.3(a)(3) below (discussing comments on lead generators more broadly).

covered acquiring, purchasing, or selling an extension of consumer credit that would have been covered by proposed § 1040.3(a)(1)(i). In addition, proposed § 1040.3(a)(1)(v) would have covered servicing of an extension of consumer credit that would have been covered by proposed § 1040.3(a)(1)(i). With regard to servicing, the Bureau did not propose a specific definition but noted in proposed comment 3(a)(1)(v)-1 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).

The Bureau received one comment on its proposal to cover acquiring, purchasing, or selling an extension of consumer credit in proposed § 1040.3(a)(1)(v). A consumer advocate expressed support for covering those who acquire credit extended by others. The commenter cited the example of indirect automobile finance companies that acquire loans from automobile dealers in circumstances where the Dodd-Frank Act excludes the dealer from the Bureau's rulemaking authority. The commenter stated that, in its view, acquirers and purchasers of consumer debts risk harming consumers if they fail to pass along information about the debt to debt collectors or subsequent purchasers.

The Bureau received some comments concerning its proposal to cover the servicing of consumer credit in proposed § 1040.3(a)(1)(v). A consumer advocate and a public-interest consumer lawyer expressed support for how this proposed coverage would reach third-party servicers of consumer credit extended by medical providers. In addition, many commenters addressed the Bureau's request for comment on whether the Bureau should add language explicitly covering furnishing information to consumer reporting agencies. These commenters, including consumer advocates, nonprofits, public-interest consumer lawyers, consumer law firms, and a research center urged the Bureau to add language explicitly covering furnishing

information to consumer reporting agencies.[864] Some of these commenters urged that furnishing should be covered in particular when carried out in connection with the servicing of an extension of consumer credit. A consumer advocate urged the Bureau to cover certain types of electronic funds transfer activity, including those involving payments on loans.[865] In contrast, an industry trade association commenter argued that furnishing is not part of servicing because servicing can occur without furnishing. This commenter asserted that if the Bureau were to cover furnishing by servicers, the burdens of the rule would create a disincentive to engage in furnishing, and the corresponding reduction in furnishing would be detrimental to the overall credit reporting system insofar as fewer instances of credit activity would be reported.

Another industry trade association stated in its comment that entities affiliated with merchants often engage in servicing of consumer credit extended by such merchants. In the view of this commenter, the rule's exclusions for merchants engaging in certain types of credit transactions (*see* proposed § 1040.3(b)(4)-(5)) should also apply to affiliates of these merchants as well. This commenter explained its understanding that the decision to use an affiliate for servicing, rather than the merchant itself, is typically made for reasons, such as tax, cash flow, and other considerations, that have nothing to do with consumer access to remedies and do not affect consumers.

The Bureau is adopting § 1040.3(a)(1)(iv) and (v) as proposed. With regard to comments that requested that the Bureau separately cover furnishing of information on covered consumer credit accounts to a consumer reporting agency, the Bureau reiterates that it did not propose to identify furnishing separately as a covered product or service because it believes these activities

[864] These comments are discussed in more detail in the section-by-section analysis of § 1040.3(a)(4) below.
[865] This comment is discussed in more detail in the section-by-section analysis of § 1040.3(a)(7) below.

are commonly carried out by servicers.[866] With regard to comments that requested that the Bureau cover processing of funds transfers to make payments on consumer credit accounts, the Bureau similarly believes these activities also are commonly carried out by servicers. The Bureau therefore believes that when these activities are carried out by servicers in connection with servicing activity, they would be part of the servicing activity covered by § 1040.3(a)(1)(v). The Bureau disagrees with the industry commenter's view that only activities that always occur in the course of servicing can be treated as part of servicing in this rule. This rule covers servicing regardless of whether a servicer engages in furnishing. When a servicer does furnish on a consumer credit account it services, that furnishing is part of the servicing.[867] In any event, to the extent a servicer is furnishing, its furnishing activities must comply with FCRA, and the Bureau believes this coverage will promote increased compliance by better ensuring a remedy for any FCRA non-compliance. The Bureau also disagrees that considering furnishing to be a part of servicing for purposes of this rule would create a disincentive for servicers to engage in furnishing. The Bureau is not aware, for example, of any difference in the level of furnishing between servicers on accounts with arbitration agreements and servicers on accounts without arbitration agreements, nor did commenters provide any data suggesting such a difference.

With regard to the industry trade association that requested an exemption for merchant affiliates, the Bureau does not believe an exemption is warranted. Regardless of a firm's motivation for utilizing an affiliate for servicing of an extension of consumer credit (as opposed to having the originating creditor handle servicing in-house), that affiliate must comply with applicable laws in its servicing activities, and the Bureau believes that consumers should have an

[866] 81 FR 32830, 32874 (May 24, 2016).
[867] *See, e.g.*, Defining Larger Participants of the Student Loan Servicing Market, 78 FR 73383, 73400 (Dec. 3, 2013) (noting that supervision of student loan servicing would examine servicing-related activities, such as furnishing).

effective remedy for any violation of those laws. Any asymmetry in coverage between servicing by merchants and merchant affiliates is a function of the statutory exclusion for merchants pursuant to Dodd-Frank section 1027(a)(2), and not a policy determination by the Bureau that the rule should never apply to consumer financial product or service activity related to merchants. The Bureau believes that merchant affiliates engaged in servicing should be covered for the same reasons that it believes servicing by unaffiliated servicers and servicing of any type of consumer credit should be covered.

*3(a)(2)*

Proposed § 1040.3(a)(2) would have extended coverage to brokering or extending consumer automobile leases as defined in 12 CFR 1090.108, which applies to leases of automobiles with an initial term of at least 90 days and either of the following two characteristics: (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 automobile finance market.[868] The Bureau believed that the proposal should reach 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. The proposal noted that the Bureau had explained in that prior rulemaking that, from the perspective of the consumer, many automobile leases function similarly to financing for automobile purchase transactions (which generally would have been

[868] 12 CFR 1001.2(a). As the proposal noted, in 2015 the Bureau finalized its larger participant rule for automobile financing. 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 explains 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 . . . ." 81 FR 32830, 32874 n.457 (May 24, 2016).

covered by proposed § 1040.3(a)(1)) and have a similar impact on the consumer and his or her well-being.[869]

With regard to the proposed coverage of automobile financing, an industry trade association whose members participate in vehicle financing asked whether the rule would cover automobile club memberships.

The Bureau also received a few comments from consumer advocates on proposed § 1040.3(a)(2). One consumer advocate supported coverage of automobile financing including leasing contracts. The commenter cited several risks of harm that consumers face in this market and several examples that the commenter asserted illustrate the importance of class actions in this market.[870] Two other consumer advocates urged the Bureau to expand this proposed coverage beyond leases of automobiles to include leases for other types of property. They contended that insofar as the proposal would cover consumer credit financing a purchase of goods but not consumer leases of those same types of goods, the proposal could incentivize some creditors to restructure these transactions as leases, and thereby avoid coverage of the rule. One of these commenters asserted that there are many leases of personal property that are the functional equivalent of purchase finance arrangements within the reach of the Bureau's authority under Dodd-Frank section 1002(15)(A)(ii) and they should be covered by this rule. The commenter referred to "rent-to-own" leases of real estate (which it stated are often long-term

[869] As noted in the proposal, an automobile as defined in 12 CFR 1090.108(a), 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. 81 FR 32830, 32874 n.456 (May 24, 2016).

[870] This commenter also suggested that automobile industry opposition to regulation of consumer arbitration agreements has not always existed. The commenter cited what it described as a statement from 2000 by a national automobile industry trade association (which did not file comments on this proposal). According to this commenter, the letter stated that the trade association "does not support or encourage the use of mandatory binding arbitration in any contract of adhesion, whether a motor vehicle franchise contract between a manufacturer and dealer or a consumer contract."

contracts), recreational vehicles, furniture, electronics, alarm systems, and solar panels, and stated a belief that these transactions can create risk of harm to consumers.

The Bureau is adopting § 1040.3(a)(2) as proposed. As discussed in the proposal, the Bureau has identified the market for automobile leases as a significant one to millions of consumers and concluded that it is part of the core consumer finance market for lending money that the Bureau proposed to cover in this rule. The Bureau did not propose to cover forms of consumer leasing other than automobile leasing. The Bureau notes that it is unclear from the comments urging expansion to other forms of leasing, which industry comments did not address, what the impact of expanding coverage to reach all forms of personal property leasing under Dodd-Frank section 1002(15)(A)(ii) would be. The Bureau also notes, with regard to concerns that lack of coverage under the rule would incentivize providers to restructure credit transactions as leases, that the rule's coverage of merchants extending credit is limited anyway[871] and that a variety of other tax, accounting, insurance, and legal title or ownership considerations may affect structuring decisions. In any event, the Bureau can monitor developments in the provision of any consumer leases under Dodd-Frank section 1002(15)(A)(ii), and consider whether to amend this rule to reach those transactions at a future time.

With regard to the question from an industry trade association concerning coverage of automobile club memberships, such memberships are not per se covered by the rule, as the Bureau believes that they would generally be nonfinancial goods or services. This does not necessarily mean, however, that the rule would never apply to claims concerning such products or services. For example, claims concerning the marketing of "add-on" products or services by

[871] As the impacts analysis in the proposal noted, the Bureau believes that merchants rarely offer the type of credit financing that would subject them to the rule in the first place. 81 FR 32830, 32917 (May 24, 2016).

lenders in connection with extending consumer credit could "concern" the loan, within the meaning of § 1040.4(a) or (b), depending on the facts and circumstances of the claim.

*3(a)(3)*

*The Bureau's Proposal*

As stated in the proposal, the Bureau believed that the proposal should cover debt relief services, such as services that offer to renegotiate, settle, or modify the terms of a consumer's debt.[872] Proposed § 1040.3(a)(3) would have included 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)(1)(i), or avoiding foreclosure. With the exception of the reference to an extension of consumer credit covered by proposed § 1040.3(a)(1)(i), these terms would have derived directly from the definition of this consumer financial product or service in Dodd-Frank section 1002(15)(A)(viii)(II).[873] The Bureau noted that some consumer debts are not consumer credit, which the Bureau proposed to cover in proposed § 1040.3(a)(1)(i). As a result, as explained in proposed comment 3(a)(3)-1, proposed § 1040.3(a)(3)(i) would have reached 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.

*Comments Received*

Two public-interest consumer lawyer commenters expressed support for the proposal's coverage of debt relief services. These commenters pointed to consumer harms they believe

[872] 81 FR 32830, 32874-75 (May 24, 2016).

[873] 12 U.S.C. 5481(15)(A)(viii)(II). For examples of the types of services that would have fallen within this proposed coverage, the proposal (at 32875 n.458) identified the following Bureau enforcement actions: Complaint at ¶ 4, Consumer Fin. Prot. Bureau v. Meracord, LLC, No. 13-05871 (W.D. Wash. Oct. 3, 2013); Complaint at ¶ 4, Consumer Fin. Prot. Bureau v. Global Client Solutions, No. 14-06643 (C.D. Cal. Aug. 25, 2014); Complaint at ¶¶ 8-14, Consumer Fin. Prot. Bureau v. Orion Processing, LLC, No. 15-23070 (S.D. Cal. Aug. 17, 2015).

these products have caused, and supported the proposal to cover debt relief not only for unsecured credit, but also for secured credit (including mortgage relief services) and non-credit debts. One commenter said this breadth of coverage would help to prevent circumvention but did not explain how.

One public-interest consumer lawyer commenter urged the Bureau to cover general credit counseling in the rule. The commenter asserted that credit counselors can play an important role in consumers' decisions regarding consumer credit and are therefore a part of this core market. Another public-interest consumer lawyer commenter asserted that these credit counseling services often target low-income individuals. Neither commenter offered a suggestion for how the Bureau can define this market.

Many commenters, including consumer advocates, nonprofits, public-interest consumer lawyers, consumer law firms, and a research center advocated to expand the scope of coverage to reach a particular kind of credit counseling – credit repair services. These commenters asserted that many scams are perpetrated on consumers in the guise of credit repair services. Some of these commenters noted that some credit repair services include neither debt relief nor the provision of consumer reports to consumers and thus would not be covered by the proposal. In addition, an industry commenter described ongoing problems that third-party credit repair companies were creating for consumer reporting agencies.

Some commenters, including consumer advocates, nonprofits, consumer law firms, and others, also urged that the scope of coverage of the rule be expanded to include certain other services that the Bureau can regulate as financial advisory services pursuant to 12 U.S.C. 5481(15)(A)(viii). These commenters referred to a wide range of services, including "lead generation" by providing information to facilitate the marketing of a variety of types of

consumer financial products or services beyond consumer credit; and technological applications that collect personal financial information of consumers to facilitate delivery of advice on matters of consumer finance, whether budgeting, managing credit, or otherwise. Some of these commenters noted that lead generators can steer consumers to harmful products or services, and that all of these products and services can expose consumers to data breaches. A consumer law firm commenter asserted that unless the Bureau's proposal specifically covered lead generators, they could enter into their own arbitration agreements with consumers and shield themselves from class actions, even when they were generating leads for a covered product or service.[874]

*The Final Rule*

The final rule adopts proposed § 1040.3(a)(3) as proposed, with an addition to cover providing products or services "represented to remove derogatory information from, or improve, a person's credit history, credit record, or credit rating." The Bureau requested comment on the possibility of separately covering credit repair services and is making this change because it shares commenters' concerns over the potential for consumer harm in the credit repair market.[875] In its experience and expertise, the Bureau believes credit repair services can have an important influence on consumers' participation in the core consumer credit market, and can create significant risks of harm to consumers when not provided in a legally compliant manner. Therefore, the Bureau believes that credit repair services are an appropriate form of credit counseling services to include in the scope of coverage in the final rule.

[874] This commenter noted an example of a lead generator that had done so, and sought to rely on its arbitration agreement in a class action filed against it for alleged harms arising from the product or service that was the subject of the leads generated. *See Rodriguez* v. *Experian Services Corp.* (9th Cir. 15-56660) (in which the commenter is co-counsel).

[875] *See, e.g.*, Bureau of Consumer Fin. Prot., "Consumer Advisory, "How can I avoid a credit repair scam?," *available at* http://www.consumerfinance.gov/askcfpb/1343/how-can-i-recognize-credit-repair-scam.html (last visited Jun. 1, 2017); Complaint, Consumer Fin. Prot. Bureau v. Prime Marketing Holdings, No. 16-7111 (C.D. Cal. Sept. 22, 2016 ) (enforcement action under the Telemarketing Sales Rule). *See also* section-by-section analysis of § 1040.3(a)(4) (reciting numerous enforcement activities against credit repair organizations).

The final rule's description of credit repair services is based on the description of credit repair services in the Telemarketing Sales Rule (TSR), which the Bureau, together with the FTC, enforces.[876] Unlike the TSR, however, this coverage would not be limited to credit repair services offered only through telemarketing. The Bureau believes that credit repair providers often offer these services via online, radio, billboard, or television advertising platforms, which do not necessarily involve inbound or outbound telemarketing, and thus does not believe it necessary or appropriate to limit the coverage to telemarketing. Accordingly, for the sake of clarity, the Bureau is adding comment 3(a)(3)(ii)-1 to confirm that § 1040.3(a)(3)(ii) includes in the coverage of this rule credit repair products or services not covered by the TSR solely because they were not the subject of telemarketing as defined in 16 CFR 310.2(gg). With regard to the commenters that urged an expansion of coverage to include lead generators, including for credit repair services, the Bureau notes that the case cited by a consumer advocate commenter actually alleged that the defendant company was itself providing credit repair services.[877] The coverage in § 1040.3(a)(4) would reach credit repair services. To the extent a person is not offering or providing a product or services described in § 1040.3(a), however, the Bureau declines to cover them separately as a lead generator for the reasons discussed above in connection with § 1040.3(a)(1)(iii).

With regard to coverage of other types of services that commenters characterized as financial advisory services, the Bureau did not propose in this rulemaking to cover financial advisory services generally. At this time, the Bureau is not expanding the coverage of this rule to include these products or services. The Bureau will continue to monitor the use and impact of

[876] 16 CFR 310.4(a)(2); *see, e.g.*, Complaint at ¶¶ 60-80, Consumer Fin. Prot. Bureau v. Prime Marketing Holdings, No. 16-7111 (C.D. Cal. Sept. 22, 2016).
[877] Complaint at Count III, Rodriguez v. Experian Cred. Svcs. Corp., No. 15-3553 (C.D. Cal. May 12, 2015).

arbitration agreements in the provision of financial advisory services as part of its overall role in monitoring consumer finance markets. The Bureau also may determine at a future time that coverage of other forms of credit counseling would be warranted.

The Bureau also recognizes that any number of consumer financial products or services it is not covering in this rule may involve the collection of the personal financial data of consumers, giving rise to a risk of a data breach and potentially identity theft. However, the Bureau in this rule is not seeking to cover providers merely based on their collection of consumer financial data. At the same time, the Bureau recognizes that the collection of such data in connection with a service or product covered by the rule is important to include within the scope of this rule. Accordingly, the Bureau is adopting comment 3(a)-2 to clarify that when a person is a provider, the technological tools they provide in connection with the covered product, such as internet or mobile phone apps, also are covered. This comment applies to all of the covered products and services in § 1040.3(a).

For the reasons described in the proposal and reiterated above, the final rule adopts § 1040.3(a)(3) and comment 3(a)-1 as proposed, renumbers them as § 1040.3(a)(3)(i) and comment 3(a)(3)(i)-1, adds § 1040.3(a)(3)(ii) and comment 3(a)(3)(ii)-1 to cover credit repair services, and adds comment 3(a)-2 as described above.

*3(a)(4)*

*The Bureau's Proposal*

As explained in the proposal, the Bureau believed that the proposal 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.[878] Specifically, proposed § 1040.3(a)(4) would have included 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 (10) of proposed § 1040.3(a).[879]

As the proposal noted, the FCRA, enacted in 1970, defines which types of businesses are consumer reporting agencies.[880] Consumer reporting agencies are the original sources of consumer reports as defined by the FCRA.[881] 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 derived from the reports to consumers.[882] The consumer reporting agencies also provide consumer reports directly to consumers. The proposal stated that the Bureau believed 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, and thus facilitate compliance with part 1040 as proposed.[883]

[878] 81 FR 32830, 32875-76 (May 24, 2016).
[879] As stated in the proposal, the Bureau believed 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. 81 FR 32830, 32875 n.462 (May 24, 2016).
[880] 15 U.S.C. 1681a(f).
[881] 15 U.S.C. 1681a(d).
[882] 15 U.S.C. 1681m.
[883] As the proposal noted, 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

Proposed § 1040.3(a)(4) therefore would have applied 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 have covered not only credit monitoring services that monitor entries on a consumer's 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.[884] 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 credit application[885]; in connection with a risk-based pricing notice generally required under Regulation V, 12 CFR 1022.72; when a consumer receives materially less favorable 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.[886]

Proposed § 1040.3(a)(4) would not have covered 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

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implementing regulation would be used, in conjunction with the statute, to define this component of coverage of this proposal. 81 FR 32830, 32875 n.465 (May 24, 2016).

[884] *See also* Press Release, Bureau of Consumer Fin. Prot., "CFPB Orders TransUnion and Equifax to Pay for Deceiving Consumers in Marketing Credit Scores and Credit Products" ( Jan. 3, 2017), *available at* https://www.consumerfinance.gov/about-us/newsroom/cfpb-orders-transunion-and-equifax-pay-deceiving-consumers-marketing-credit-scores-and-credit-products/; Press Release, Bureau of Consumer Fin. Prot., "CFPB Fines Experian $3 Million for Deceiving Consumers in Marketing Credit Scores" (Mar. 23, 2017), *available at* https://www.consumerfinance.gov/about-us/newsroom/cfpb-fines-experian-3-million-deceiving-consumers-marketing-credit-scores/ (enforcement actions alleging deceptive practices in connection with, among other activities, providing credit scores to consumers).

[885] *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).

[886] *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).

credit report solely in connection with an adverse action taken on an application for employment would not have been covered by proposed § 1040.3(a)(4).

*Comments Received*

One consumer advocate urged the Bureau to revise the proposed language to refer to the term "consumer file disclosure" from FCRA, and to cover products or services provided by affiliates of consumer reporting agencies to account for recent case law that might otherwise cause confusion or be construed to narrow the scope of coverage from what the proposal intended.

A credit reporting industry commenter and a credit reporting industry trade association, with support from several Members of Congress and another industry trade association, urged the Bureau to structure the rule to avoid creating class action exposure under the CROA for credit monitoring or credit education products and services. CROA was enacted in 1996 for the purpose of ensuring that prospective buyers of services from credit repair organizations can make informed decisions and are protected from unfair or deceptive practices.[887] CROA requires, for example, that credit repair organizations' products and services use certain disclosures; that any written contracts including a performance guarantee, an estimate of service completion or length, a cancellation right, and a three-day waiting period before these products and services can be provided; and that consumers only be charged after any service has been fully performed.[888] In light of the potential for application of CROA, including its provision for disgorgement of all revenues as statutory damages,[889] to credit monitoring and credit education products and services, these commenters urged that credit monitoring and credit education

[887] *See* 15 U.S.C. 1679(b).
[888] 15 U.S.C. 1679 *et seq.*
[889] 15 U.S.C. 1697g(a)(1) (providing for damages in the event of a CROA violation in an amount that is the greater of actual damages or any amount paid to the credit repair organization).

products and services be exempt entirely from the rule or at least from CROA claims. The credit reporting industry commenters asserted that if necessary, an exemption could be limited to consumer reporting agencies (CRAs) providing these products or services so as to distinguish them from the credit repair activities offered by businesses which are not affiliated with CRAs, which are the businesses these commenters believed Congress intended CROA to cover.[890] The commenters challenged the Bureau's view in the proposal that the fact that the FTC administers CROA would be a basis for not excluding CROA claims involving credit monitoring from the rule. In their view, the fact that the Bureau does not administer CROA suggests that the Bureau should be reluctant to apply its rule to it.

In particular, two industry commenters asserted that the Bureau either failed to make findings that applying the rule to credit monitoring would be for the protection of consumers and in the public interest or improperly shifted the burden to industry to establish that applying the rule to credit monitoring does not meet those legal standards in Dodd-Frank section 1028. A nonprofit commenter also objected more broadly to the Bureau's preliminary view in the proposal that it would be more appropriate for issues such as these, which concern particular statutes with high statutory damages, to be dealt with by the Congress and the courts. The nonprofit stated that because the Bureau was exercising discretion to fashion the rule and determine how it should apply, that the Bureau would be the appropriate body to determine how to develop exemptions.

[890] These commenters also requested that an exemption also exclude identity theft products. As discussed below, however, the Bureau declines to cover those products per se, whether they are offered on their own or bundled with credit monitoring or credit repair products or services.

These industry commenters asserted that CROA, which regulates contracts, disclosures, and other practices of credit repair organizations,[891] does not apply to credit monitoring and credit education services offered by CRAs because these services do not meet the definition of such services set forth in CROA.[892] However, the commenters pointed to two Federal appellate court decisions that have held that CROA may apply to credit monitoring and credit education services respectively depending on the facts of the particular product and how it is marketed.[893] They also emphasized that the FTC, which is the only agency charged with enforcing CROA, has never taken an action under CROA against credit monitoring services and has in the past indicated in communications to Congress that it would not be good consumer policy to apply CROA to these products or services.[894] The commenters also explained that, given the industry's disagreement with the Federal appellate court decisions noted above, credit monitoring providers do not treat these products and services as subject to CROA, and instead arbitration agreements insulate them from exposure to class action suits. The commenters indicated that there has been no litigation since 2014 involving the application of CROA to credit monitoring products.

These commenters further asserted that exposure to class action liability for CROA violations could prompt providers to stop offering credit monitoring services. This, the industry commenters believe, would deprive consumers of a product that is valuable and serves an important function of helping consumers prevent or mitigate the impact of identity theft, and could drive consumers to riskier products. They asserted that it would be infeasible for credit

[891] In particular, CROA proscribes certain practices and requires certain contractual provisions and disclosures for the purpose of ensuring that prospective buyers of services from credit repair organizations can make informed decisions and are protected from unfair or deceptive practices. *See* 15 U.S.C. 1679(b).
[892] To support their position, they cited to *Hillis* v. *Equifax Consumer Servs. Inc.*, 237 F.R.D. 491 (N.D. Ga. 2006).
[893] *See, e.g.*, *Stout* v. *Freescore, LLC*, 743 F.3d 680, 687 (9th Cir. 2014), citing *Helms* v. *ConsumerInfo.com, Inc.*, 436 F.Supp.2d 1220, 1224-26 (N.D.Ala. 2005); *Zimmerman* v. *Puccio*, 613 F.3d 60, 72 (1st Cir. 2011) ("[C]redit counseling aimed at improving future creditworthy behavior is the quintessential credit repair service."). Industry comments also described the *Stout* case as an example of a class action that drove a defendant out of business.
[894] Letter from Donald S. Clark, Sec'y, Fed. Trade Comm'n, to Hon. Hon. Edward R. Royce (July 1, 2005), attached to industry comment letter (same).

monitoring services to comply with several CROA provisions, the application of which they asserted also would be confusing or inconvenient for consumers. For example, the commenters asserted that mandatory disclosure language might be confusing to consumers because it refers to the credit repair organization dealing with consumer reporting agencies, and yet some credit monitoring providers are themselves consumer reporting agencies.[895] The commenters also asserted that consumers would be inconvenienced by certain requirements regarding providing guarantees and obtaining consumer signatures,[896] a prohibition on the provision of services before consumers pay or are charged,[897] and a provision that the FTC and at least one court has interpreted as requiring a three-business-day waiting period before services are provided.[898] These commenters also stated the threat of CROA exposure under the rule would inhibit innovation in credit education products, citing market research that, in their view, supports the contention that consumers are much less willing to subscribe to a product or service when faced with the CROA disclosures and waiting periods.

The consumer reporting industry trade association also asserted that proposed § 1040.3(a)(4) would create an un-level playing field in the market of identity theft prevention products and services. The commenter stated this would occur because some products or services monitor information from a consumer report as defined in FCRA, while others do not use such reports. In the view of this commenter, by basing coverage on whether the consumer report as defined in FCRA is a source of information, the proposal would disadvantage those

[895] 15 U.S.C. 1679c. In the commenter's view, the disclosure indicates that the credit repair organization is separate from the consumer reporting agency. Yet when consumer reporting agency affiliates are providing credit monitoring, they are not separate.
[896] 15 U.S.C. 1679d.
[897] 15 U.S.C. 1679b(b).
[898] *United States* v. *Cornerstone Wealth Corp., Inc.*, 2006 WL 522124 (N.D. Tex. 2006) (unpublished Federal district court opinion affirming FTC position that 15 U.S.C. 1679d requires both a three-day waiting period and specified contract language). The consumer reporting agency commenter also stated that State laws concerning credit repair products may require longer waiter periods, such as five business days that are required under California and Florida laws. A consumer reporting trade association commenter noted that the California law includes disgorgement-based damages provisions (as do other credit services organization statutes in Texas and New York), but that the Florida law excludes consumer reporting agencies.

identity monitoring products that rely upon that source of information. This commenter cited a particular concern with how identity monitoring products that do not rely on FCRA-defined information would be able to use arbitration agreements to prevent exposure to CROA liability.[899]

Other commenters sought an expansion of this category of coverage. Specifically, several commenters, including consumer advocates and advocacy groups, a research center, two trade associations of consumer lawyers, and a small business advocacy group urged the Bureau to expand the coverage in proposed § 1040.3(a)(4) to include identity monitoring services that monitor and provide consumers with information from sources other than consumer reporting agencies. One of these consumer advocates noted that identity monitoring services may monitor the internet for references to consumers' personal financial information, citing a service provided by a consumer reporting agency as an example. This commenter asserted that these services are related to the protection of the financial assets and financial reputation of the consumer, and may monitor financial or banking data of the consumer, bringing them within the authority of the Bureau to regulate.

In response to the request for comment in the proposal on whether the scope of coverage should be expanded to include other activities of consumer reporting agencies, many commenters, including consumer advocates, nonprofits, a consumer law firm, and others, indicated that the Bureau should do so. Several of these comments expressed the view that consumer complaints concerning information in consumer credit files are very common, and collective remedies under FCRA are important to addressing inaccurate consumer credit

[899] The commenter did not explain how identity monitoring products that do not rely on FCRA-defined information could be subject to CROA, which applies to products with the purpose of "improving any consumer's credit record, credit history, or credit rating." 15 U.S.C. 1679a(3)(A)(i).

reporting practices. An industry trade association stated in its comment, however, that arbitration agreements are not and could not be used in the context of consumer reporting agencies carrying out their statutory duties. Therefore, the commenter asserted that there is no support in the Study for this expansion of coverage and the Bureau lacks any rationale for considering it.

A number of consumer advocates, nonprofits, and others also stated in their comments that the final rule should cover furnishing of information to consumer reporting agencies. These comments indicated that the coverage of furnishing should be broader than the proposal and not be limited to furnishing in connection with a consumer credit transaction. One consumer advocate seeking this expansion noted that check collection, automobile leasing, and deposit accounts can lead to furnishing.

*The Final Rule*

After consideration of the comments, the Bureau is adopting revisions to proposed § 1040.3(a)(4) with minor wording modifications to clarify the intended scope of coverage by referring not only to the provision to consumers of "consumer reports" and "credit scores" as defined in FCRA,[900] but also to other information derived from a "consumer file," as defined in FCRA. The Bureau also is making a minor modification to the exception for certain adverse action notices.[901]

As discussed above, in proposed § 1040.3(a)(4) the Bureau sought to cover credit monitoring as well as services providing consumers with their credit reports or a credit score.

[900] The Bureau is clarifying in the final rule that the term credit scores in § 1030.3(a)(4) means credit scores as defined in FCRA. 15 U.S.C. 1681g(f)(2)(A).

[901] The proposed exception would only have applied to certain adverse action notices provided by a user covered by FCRA. 15 U.S.C. 1681m. The term "user" is not defined in FCRA, however, and the Bureau did not intend for the exemption to turn on the identity of the person directly providing the notice to the consumer. By deleting the reference to this term, the exception applies regardless whether the notice is provided directly to the consumer by a user covered by 15 U.S.C. 1681m or a third party contracted by such a person. The Bureau also is shortening the description of the exception.

These types of products and services all provide consumers with information that ultimately originates from a consumer reporting agency as defined in FCRA. In response to the comments suggesting that providing information to a consumer from a "consumer file" as defined in FCRA should be separately covered, in an abundance of caution, the Bureau is revising the terminology in the final rule to clarify this activity is covered by § 1040.3(a)(4). The Bureau is clarifying that § 1030.3(a)(4) covers providing information derived from a consumer's "file," which FCRA, 15 U.S.C. 1681a(g), defines as "all of the information on [the] consumer recorded and retained by a consumer reporting agency …"

However, the Bureau is not adopting the consumer advocate commenter's suggestion of referring to a "consumer file disclosure," as that is not a defined term in FCRA and relying on that term could raise doubt over the coverage of products or services whose information comes from a consumer's "file" but not as a result of the consumer file disclosure. Instead, the Bureau's revision to § 1030.3(a)(4) reaches more broadly, to information "derived from the consumer's file."[902] For example, this would cover a person that obtains information from a third-party who obtained or derived the information from the consumer's file.[903]

The Bureau has carefully considered the comments relating to potential class liability for credit monitoring services under CROA, but does not agree that an exemption is warranted. In enacting CROA, Congress included a definition of the term credit repair organization in the statute.[904] The Bureau is not taking a position on whether or when credit monitoring products or

[902] The phrase "derived from" is consistent with existing regulations implementing certain FCRA provisions. *See* 16 CFR 682.1(b) (defining coverage of FTC rule on disposal of consumer report information and records by reference to information "derived from" such materials).
[903] The scope of this provision remains limited, however, by the focus on the source of the information being the consumer's file as defined in FCRA. A person that provides a consumer with information that also is kept in a consumer file would not be covered, unless the information provided actually came, directly or indirectly, from the consumer's file.
[904] *See* 15 U.S.C. 1679a(3) (notwithstanding exclusions not relevant here, defining a "credit repair organization" as "any person who uses any instrumentality of interstate commerce or the mails to sell, provide, or perform (or represent that such person can or will sell, provide, or perform)

services provided by consumer reporting agencies are subject to CROA.[905] However, based on its experience and expertise with respect to the credit repair market generally, the Bureau believes that if providers of credit monitoring products or services are subject to CROA because they are credit repair organizations, it is appropriate for this rule to apply to those products without an exemption.

At the outset, the Bureau notes that it disfavors exemptions to the class rule for claims under a particular statute. For the Bureau to decide a Congressionally-created private right of action does not protect consumers would amount to reconsideration by the Bureau of legislative policy choices. Further, the Bureau is concerned about taking actions that would be construed as allowing companies to avoid complying with applicable law. Indeed, such a result would be contrary to the goals of this rulemaking including deterring violations of the law and promoting the rule of law. And for the reasons discussed below, the Bureau does not believe commenters have presented persuasive evidence that compliance with or the remedial scheme established by the statute creating that private right of action is against the public good.[906]

With regard to CROA specifically, as the proposal indicated, the Bureau's Study covered class actions involving CROA and the Bureau has conducted pre-proposal outreach and research concerning CROA. The Bureau subsequently received a number of industry comments, which

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any service … for the express or implied purpose of—(i) improving any consumer's credit record, credit history, or credit rating; or (ii) providing advice or assistance to any consumer with regard to any activity or service described in clause (i)").

[905] If they are not, then the exemption the commenters have requested would be unnecessary.

[906] The Bureau disagrees with the industry commenters that the proposal shifted a burden to them or that the Bureau has otherwise neglected to make required findings in the rule in support of the coverage of credit monitoring products and services, including CROA claims to which they may be subject. As is discussed above in Part VI, the Bureau has made findings regarding the application of laws with private remedies to covered products and services and has found such application to be in the public interest and for the protection of consumers. These findings apply to CROA, which is one such law. The Bureau solicited comment on its preliminary findings in the proposal. The Bureau has carefully considered those comments, including comments raising concerns with the application of particular statutes in class actions. And for the reasons discussed herein, the Bureau disagrees that these findings are undermined with respect to providers of credit monitoring by the potential application of CROA to them. Comments regarding other particular statutes are discussed in Part VI. In addition, in the Bureau's Section 1022(b)(2) Analysis, the Bureau discusses the potential alternative raised by industry trade associations of excluding a broad set of statutes – those that provide for statutory damages or recovery of attorney's fees.

are discussed above. These inputs did not provide evidence that CROA, on the whole, fails to promote the public good and protection of consumers.

In adopting CROA, Congress sought to protect consumers in the credit repair market as a whole, which it covered comprehensively, with limited exceptions.[907] In the Bureau's experience and expertise, this market has been fraught with products that pose significant risks to consumers.[908] In the more than two decades since the enactment of CROA, the agencies charged with enforcing the statute, the FTC and State law enforcement officials, have brought numerous CROA enforcement actions.[909] The Bureau's Study also identified six Federal class action settlements based on CROA claims finalized between 2008 and 2012.[910] Indeed, as discussed above, the Bureau believes it is important that the final rule cover credit repair services, and it has added credit repair services based on coverage in the TSR to the coverage in § 1040.3(a)(3)(ii).

Moreover, the Bureau notes that concerns about whether and when the statute applies to credit monitoring and (if so) whether the statute should be scaled back raise difficult policy and legal issues. Specifically, the Bureau notes that since 2005, there have been a number of efforts

[907] Congress excluded the following three entities from the definition of credit repair organization in CROA: nonprofit organizations, creditors assisting with debts owed to them, and depository institutions and credit unions. 15 U.S.C. 1679a(3)(B). For the purposes of CROA, see Public Law 104-208, § 2451 (1996) (adopting CROA, and making findings in the statute that the statute seeks to protect consumers from certain credit repair business practices that have "worked a financial hardship upon consumers, particularly those of limited economic means and who are inexperienced in credit matters.").

[908] Some of the most recent actions are described in the section-by-section analysis of the coverage of credit repair firms under § 1040.3(a)(3)(ii) above.

[909] *See, e.g.*, Press Release, Fed. Trade Comm'n, "At FTC's Request, Court Shuts Down Credit Repair Scam that Impersonates FTC," (Mar. 27, 2015) (announcing CROA enforcement action), *available at* https://www.ftc.gov/news-events/press-releases/2015/03/ftcs-request-court-shuts-down-credit-repair-scam-impersonates-ftc; Press Release, Fed. Trade Comm'n, "FTC Asks Court to Shut Down Phony Debt Relief and Credit Repair Scheme," (Aug. 22, 2014), *available at* https://www.ftc.gov/news-events/press-releases/2014/08/ftc-asks-court-shut-down-phony-debt-relief-credit-repair-scheme; Press Release, Fed. Trade Comm'n, "FTC Charges Credit Repair Operators with Misleading Credit Bureaus and Charging Consumers Illegal Up-Front Fees," (Oct. 13, 2011) (same), *available at* https://www.ftc.gov/news-events/press-releases/2011/10/ftc-charges-credit-repair-operators-misleading-credit-bureaus; Press Release, Fed. Trade Comm'n, "'Operation Clean Sweep': FTC and State Agencies Target 36 'Credit Repair' Operations," (Oct. 23, 2008) (announcement of Federal and State actions against 33 credit repair operations), *available at* https://www.ftc.gov/news-events/press-releases/2008/10/operation-clean-sweep-ftc-and-state-agencies-target-36-credit; Press Release, Fed. Trade Comm'n, "Project Credit Despair Snares 20 Credit Repair Scammers," (Feb. 2, 2006) (announcement of Federal and State actions against 20 credit repair operations), *available at* https://www.ftc.gov/news-events/press-releases/2006/02/project-credit-despair-snares-20-credit-repair-scammers; Press Release, Fed. Trade Comm'n, "List of Law Enforcement Actions: Operation New ID – Bad Idea," (Feb. 2, 1999) (announcement of more than 30 actions), *available at* https://www.ftc.gov/news-events/press-releases/1999/02/list-law-enforcement-actions.

[910] Study, *supra* note 3, section 8 at 13 fig. 1.

in Congress to determine whether CROA could be improved by clarifying the CROA credit monitoring coverage issue that commenters raised here.[911] No consensus has been reached to date. In connection with these efforts, the FTC has twice expressed concern about the difficulty in structuring a revision to CROA that would distinguish between products that may pose significant risks to consumers and those that may not.[912] This history suggests that the author of CROA (Congress) and its enforcer (the FTC) are not certain CROA should be revised, or how. Particularly given that an exception to the class rule would need to grapple with these same questions about distinguishing between different types of products, the Bureau is hesitant to decide them ahead of these primary actors.

With regard to the industry commenters' claims that compliance with CROA is infeasible or would result in substantial price increases, the Bureau is not persuaded of these claims based on the record before it.[913] Even if CROA's disclosure requirements apply, the Bureau believes that they could be bundled with a contract and/or provided electronically.[914] And if CROA bars

[911] *See* H. Rept. 114-903 (2017) (describing hearing held Sept. 27, 2016, as part of legislative history of including H.R. 347, Facilitating Access to Credit Act (Bill to exclude consumer reporting agencies from CROA and commission FTC study on whether other entities should be excluded, introduced Jan. 14, 2015)); Facilitating Access to Credit Act, H.R. 5446, 113th Cong. (2014) (Bill to exclude consumer reporting agencies from CROA and commission FTC study on whether other entities should be excluded, introduced Sept. 10, 2014); "An Overview of the Credit Reporting System," Hearing on the Fair Credit Reporting Act before the Subcomm. on Fin. Insts., and Consumer Credit, H. Comm. on Fin. Servs., 113th Cong, (2014) (industry representative urging amendments to CROA concerning credit monitoring); "Examining the Need for H.R. 2885, The Credit Monitoring Clarification Act," Hearing on H.R. 2885 before the H. Comm. on Fin. Servs., 110th Cong. (2008) (examining bill to amend CROA to provide a disclosure requirement and right to cancel for credit monitoring); Credit Monitoring Clarification Act, H.R. 6129, 109th Cong. (2006) (Bill to amend CROA to provide a disclosure requirement and right to cancel for credit monitoring, introduced Sept. 20, 2006); Credit Monitoring Enhancement Act, S. 3662, 109th Cong. (2006) (Bill to amend CROA to provide a disclosure requirement and right to cancel for credit monitoring, introduced July 14, 2006); Credit Repair Organizations Act Technical Corrections Act, H.R. 5445, 109th Cong. (2006) (Bill to amend CROA to provide a disclosure requirement and right to cancel for credit monitoring, introduced May 22, 2006); H.R. 4127, Financial Data Protection Act (Bill to amend CROA to provide a disclosure requirement and right to cancel for credit monitoring, introduced Oct. 25, 2005, and reported out by three House committees); Data Accountability and Trust Act, H.R. 3997, 109th Cong. (2005) (Bill to amend CROA to provide a disclosure requirement and right to cancel for credit monitoring, introduced Oct. 6, 2005, reported by three House committees as described in H. Rept. 109-454).

[912] *See* "Oversight of Telemarketing Practices and the Credit Repair Organizations Act," Hearing before the S. Comm. on Commerce, Sci., and Transp., 110th Cong. (2007) (testimony by FTC Bureau of Consumer Protection Director citing prior proposals to amend CROA and concern that fraudulent credit repair firms could use exemptions to evade CROA, and urging further Congressional review); Letter from Donald S. Clark, Sec'y, Fed. Trade Comm'n, to Hon. Edward R. Royce (July 1, 2005), attached to industry comment letter (same).

[913] With respect to the industry commenter's assertion that the *Stout* decision shows that CROA would drive credit monitoring providers out of business, the Bureau disagrees with this claim. To the extent credit monitoring is subject to CROA, credit monitoring firms could prevent substantial CROA class exposure by complying with CROA. The *Stout* decision does not reflect efforts by the defendant to comply with CROA.

[914] *See* 15 U.S.C. 1679c(a) (requiring only that written disclosure be provided "before" execution of the contract); Electronic Signatures in Global and National Commerce (ESIGN) Act, 15 U.S.C. 7001(c) (proscribing standards permitting electronic delivery of disclosures that are required to be provided in writing). This sort of disclosure is among the least costly types of mandated disclosures. *See generally* Bureau of Consumer Fin.

collecting payment until the end of a service period, such as a monthly subscription period, it is unclear why providers could not make such a price structure work. Indeed, the Bureau notes that all three major consumer reporting agencies already forgo some or all revenues during an introductory period by offering credit monitoring at a discounted or even free price during that time.[915] The commenters also did not demonstrate the infeasibility of complying with other CROA requirements.[916] Thus, the Bureau does not find that the record supports a conclusion that these products or services cannot comply with CROA (if they are, in fact, subject to CROA). As to potential price increases, the Bureau believes that competition in this product market, including from depository institutions, which are exempt from CROA under 15 U.S.C. 1679a(3)(B)(iii), might be a limiting factor.[917]

Commenters also contended that application of CROA to credit monitoring products could potentially inconvenience consumers and confuse them. The Bureau has not seen support for commenters' concern about the potential for consumer confusion, which is based on disclosures referring to the credit monitoring provider and consumer reporting agency as separate persons. These disclosures would appear to remain accurate in the credit monitoring context, since the Bureau understands that credit monitoring providers are not the same entities as

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Prot., "Understanding the Effects of Certain Deposit Regulations on Financial Institutions' Operations," at 98 (2013), *available at* http://files.consumerfinance.gov/f/201311_cfpb_report_findings-relative-costs.pdf.

[915] *See, e.g.*, Equifax, "Get your Equifax 3-Bureau Credit Scores with your Free 7-day Trial," http://www.equifax.com/freetrial/ (last visited May 23, 2017) (offering free 7-day trial then $19.95 per month); Experian, "Credit Monitoring, Try Experian CreditWorks for $4.99/first month," *available at* http://www.experian.com/consumer-products/credit-monitoring.html (last visited May 23, 2017) (offering $4.99 price for the first month and $24.99 for each month thereafter); TransUnion, "Get all 3 bureau scores for FREE, Begin monitoring your credit reports when you start a 30 day trial for $4.95," https://www.transunion.com/ppc-credit-report-495 (last visited May 23, 2017) (offering 30-day trial for $4.95). *See also, e.g.*, *Ducharme* v. *Heath*, 2010 WL 5211502 at *6 (N.D. Cal.) (Slip Op. of Dec. 16, 2010) (holding that CROA does not prohibit billing on a monthly basis for a service performed during the prior month).

[916] Specifically, in particular, the commenters also have not demonstrated that it would be infeasible to provide a guarantee of performance (based on whatever service is being offered), to provide an estimate of the period necessary for performing services (such as a subscription period), or to obtain a signature of a consumer (which may be obtained electronically).

[917] The Bureau also understands that the credit monitoring market includes dozens of competitors and that competition may reduce the degree to which CROA compliance costs would be passed through to consumers. WalletHub, "2017's Best Credit Monitoring Service," https://wallethub.com/best-credit-monitoring-service/ (last visited May 23, 2017) (An industry website that lists nearly 30 providers.). *See also* Gov't Accountability Office, "Identity Theft Services: Services Offer Some Benefits but are Limited in Preventing Fraud," at 5 (Mar. 2017) (Report to Congressional Requesters), *available at* http://www.gao.gov/assets/690/683842.pdf (finding about 50 to 60 companies providing identity theft services in 2015 and 2016).

consumer reporting agencies. In addition, to the extent CROA might alter how credit monitoring is offered and that this may inconvenience consumers, the Bureau notes that consumers have other options in lieu of or in addition to credit monitoring products if such inconvenience would in fact be significant. With respect to credit monitoring itself, a brief cancellation period of a few days before commencing the product or service under CROA would not necessarily lead to many cancellations. The commenters did not contend that consumers were likely to cancel the product or service in this time period, and to the extent any consumers voluntarily choose not to use a product or service, this does not mean that the product or service is not accessible to them. Consumers also have a number of potential alternatives to credit monitoring. For example, consumers may place a freeze on the release of information from their consumer files in the first place[918] or place a fraud alert on their consumer report in order to obtain alerts from potential creditors of potential new accounts before they are actually opened,[919] and they may obtain free copies of their consumer report each year and in a number of other circumstances described in FCRA.[920] In addition, depository institutions issuing credit cards have become a common provider of free credit scores to consumers.[921] Additionally, the Bureau notes, as confirmed by the industry commenters, that a variety of identity theft prevention and remediation products or services may be bundled with credit monitoring, such as identity monitoring from non-FCRA sources, identity restoration services, and identity theft insurance. These products and services would not be covered by § 1040.3(a)(4) if they do not involve providing information from the

[918] *See* Bureau of Consumer Fin. Prot., "What Does it Mean to Place a Security Freeze on My Credit Report?," (reporting that 47 States have laws governing these freezes and the major consumer reporting agencies also provide credit freezes to consumers in the other States), https://www.consumerfinance.gov/askcfpb/1341/what-security-freeze-my-credit-report.html (Updated June 1, 2017).
[919] 15 U.S.C. 1681c-1(a)-(b).
[920] 15 U.S.C. 612(a)-(d)
[921] 15 U.S.C. 1679a(3)(B)(iii). Those depository institutions issuing credit cards have become a common provider of free credit scores to consumers. *See* Bureau of Consumer Fin. Prot., Notice of Public List of Companies Offering Existing Customers Free Access to a Credit Score, 81 FR 69046 (Oct. 5, 2016); Maria Jaramillo, "Check Our New List to See if Your Credit Card Offers Free Access to One of Your Credit Scores," CFPB Blog Post (Mar. 2, 2017) (providing list of credit card issuers offering free credit scores), https://www.consumerfinance.gov/about-us/blog/check-our-new-list-see-if-your-credit-card-offers-you-free-access-one-your-credit-scores/.

consumer's report,[922] and, in the case of identity theft insurance, it may be excluded pursuant to § 1040.3(b)(6) as the business of insurance.[923]

Relatedly, with respect to credit education services, the Bureau notes that the commenters' principal concern seems to be that consumers may not elect to use a CROA-compliant service. Although the commenters speculated that a brief waiting period before commencement of the service was a reason for this, the record did not establish that. In any event, as noted above, to the extent consumers voluntarily choose not to use a product or service, this does not mean that the product or service is not accessible to them.

Insofar as compliance is not infeasible and cost increases are unlikely, commenters' primary concern appears to be that the disgorgement remedy available under CROA makes it difficult – if not impossible – for providers to irreversibly pass any increased costs on to consumers. This is because no matter how high a provider raises its prices, it may not be able to retain that increase to cover CROA liability in the event that all revenue must be returned to injured consumers. The Bureau is not persuaded for several reasons. First, the Bureau recognizes, as confirmed by the industry commenters, that a variety of identity theft prevention and remediation products or services may be bundled with credit monitoring, such as identity monitoring from non-FCRA sources, identity restoration services, and identity theft insurance. As noted above, these products and services would not be covered by § 1040.3(a)(4) if they do not involve providing information derived from the consumer's file maintained by the consumer reporting agency, and in the case of identity theft insurance may be excluded pursuant to

[922] The Bureau similarly notes that credit education services (whether existing now or in the future) would not be covered by § 1040.3(a)(4) if they do not involve providing information from the consumer's report.

[923] For example, identity theft insurance may be regulated under applicable State insurance laws. *See, e.g.*, N.Y. Consol. State. § 28-1113 (authorizing burglary and theft insurance to include identity theft insurance) & § 28-3451 (regulating identity theft group insurance policies); Ariz. Rev. Stat. § 20-1694 (regulating identity theft group insurance policies); Code of Maine Rules part 02-31 Ch. 375 § 3.4 (authorizing writing of group identity theft insurance).

§ 1040.3(b)(6) as the business of insurance. Thus the impact of disgorgement would not necessarily fall on the entire bundled suite of services, but generally only on the credit monitoring component of those services (to the extent CROA applies and a violation occurs). The commenters did not assert that the CROA exposure that the provider of a bundled suite of services may face would be based on the fees consumers paid for the bundled suite of services. Accordingly, the Bureau believes this exposure, to the extent it exists, may be more limited for bundled services. Second, the Bureau further understands that, under CROA,[924] the disgorgement remedy only applies to the amount paid by the person against whom a violation was committed. Thus, when a consumer receives credit monitoring for free from a firm in the event of a data breach, there are no consumer payments to be disgorged in a CROA class action.[925] The Bureau notes that, increasingly, tens of millions of consumers receive free credit monitoring as the result of such breaches.

For all of the reasons discussed above, the Bureau does not believe that it would be appropriate, in this rule, for the Bureau to substitute its judgment for that of Congress, which has so far not acted to restructure the scope of CROA in this area.

With regard to other concerns raised by some commenters that the scope of proposed § 1040.3(a)(4) was too narrow, the Bureau disagrees that the scope should be expanded. For example, the Bureau is not expanding the scope of proposed § 1040.3(a)(4) to reach forms of identity monitoring services that do not involve providing consumers with consumer reports, credit scores, or information derived from consumer files at this time. Given the limited nature of the comments received, the Bureau has insufficient information in this rulemaking to develop

[924] 15 U.S.C. 1679g(a)(1),
[925] *Cf. FTC* v. *Gill*, 71 F.Supp.2d 1030, 1048 (C.D. Cal. 1999) (observing that the plain language of the damages provision of CROA does not allow the FTC to recover damages incurred by consumers). One of the industry commenters discussed above stated that over 130 million consumers received some form of identity theft protection, which can include credit monitoring, in the previous year.

a legal definition of this type of product or service. At the same time, however, the Bureau disagrees with the industry association commenter that by focusing its coverage in § 1040.3(a)(4) on information derived from CRA records, the Bureau is creating an un-level playing field by generating CROA class liability exposure for those market participants but not identity monitoring firms that rely on information from sources other than FCRA-regulated consumer reporting agencies. This commenter noted, for example, that its product also scans the internet in addition to consumer reports; providing information derived from a general search of the Internet would not be subject to the rule, whether it is done by a person whose other products or services are covered, or by a person who is not covered by the rule at all. Where a product or service bundles together activities that are covered with activities that are not, the rule (§ 1040.4(a)(1), (a)(2), and (b)) still only applies to activities that are covered. Thus, participants in the market are being treated equally in that the rule equally excludes products or services outside its scope, regardless of who provides them. In any event, to the extent different types of identity monitoring products or services face different risks of being covered by CROA, that is a function of the scope of CROA.

The Bureau also is not expanding the scope of proposed § 1040.3(a)(4) to include consumer reporting agency activities beyond those that involve providing consumer reports, credit scores, or information derived from a consumer file under FCRA. The Bureau is not persuaded that arbitration agreements affect these activities, and agrees with the industry association comment that it is unclear how a consumer reporting agency would be able to enter into an arbitration agreement with a consumer in this context. The Bureau may inquire into this question in its supervision and monitoring of the consumer reporting market. If arbitration

agreements did appear to be limiting the ability of consumers to obtain relief from a consumer reporting agency in a FCRA class action, the Bureau could address that issue at a future time.

With regard to the comments seeking an expansion of scope to cover furnishing, independent of other proposed coverage, the Bureau is not persuaded that it should do so at this time. The examples these commenters described pertained to furnishing by persons as part of a product or service that is already covered by the rule, such as debt collection (§ 1040.3(a)(10)) and servicing consumer credit (§ 1040.3(a)(1)(v)). As stated in the section-by-section analyses of those provisions, furnishing in connection with these products or services already would be covered as part of the coverage of those products or services. For debt collection, this would be true whether the collection is on an extension of consumer credit, an automobile lease, a check, or a deposit account. Thus, the Bureau does not believe separately covering furnishing is necessary at this time.

*3(a)(5)*

As explained in the proposal, the Bureau believed the proposal should apply to deposit and share accounts.[926] Proposed § 1040.3(a)(5) would have included 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.[927] TISA has existed since 1991 and the Bureau believes that banks and credit unions are familiar with TISA's application to accounts that they may offer. Accordingly, as explained in the proposal,

[926] 81 FR 32830, 32876 (May 24, 2016).
[927] 12 U.S.C. 4301(b).

the Bureau believed that defining the accounts the Bureau proposes to 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 did not receive comments on proposed §1040.3(a)(5).[928] The final rule adopts this provision as proposed.

*3(a)(6)*

As explained in the proposal, 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 believed the proposal should cover other accounts as well as remittance transfers subject to the EFTA.[929] EFTA applies generally to "consumer asset accounts," including those provided by nonbank companies as well as to most if not nearly all of the deposit and share accounts provided by depository institutions. Thus, proposed § 1040.3(a)(6) would have included in the coverage for proposed part 1040 both 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.[930] As explained in the proposal, the Bureau believed that defining this coverage by reference to accounts and remittance transfers subject to EFTA as implemented by Regulation E would facilitate compliance with proposed part 1040.

[928] Some comments from providers of products and services covered by this proposed provision, such as credit union and community bank industry comments, sought an exemption from the rule. Because this request was not specific to these types of products, those comments are discussed separately, in the section-by-section analysis of §1040.4(b) below.
[929] 81 FR 32830, 32876 (May 24, 2016).
[930] *See* 15 U.S.C. 1693(b); 12 CFR 1005.2(b) (defining "account") and 12 CFR 1005.30(e) (defining "remittance transfer").

The Bureau noted in the proposal that it had separately proposed a rule to extend the Regulation E definition of "account" to include "prepaid accounts."[931] As the Bureau further noted, where the proposal on arbitration agreements 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 have applied to the use of that term in proposed § 1040.3. Here, for example, any new definition of account that would include prepaid products would have been incorporated into proposed § 1040.3(a)(6).

In the proposal, the Bureau noted that EFTA also regulates preauthorized electronic fund transfers (PEFTs) and store gifts cards and gift certificates. The Bureau had not proposed to include those activities as covered products or services under proposed § 1040.3(a)(6). The Bureau noted that certain gift cards and gift certificates redeemable only at a single store or affiliated group of merchants, while subject to Regulation E,[932] are payment devices that merchants use to help consumers pay for their own goods or services, which as noted above and discussed in more detail below, the Bureau was not proposing to cover except in limited circumstances. In addition, PEFTs, while not described as a separate category of coverage, generally would have been covered when offered as part of a covered product or service. For example, the Bureau understands that PEFTs are often offered by creditors and servicers of consumer credit under proposed § 1040.3(a)(1), providers of TISA or EFTA accounts or remittance transfers under proposed § 1040.3(a)(5) or (6), funds transmitting services under

[931] Prepaid Accounts Under the Electronic Fund Transfer Act (Regulation E) and the Truth in Lending Act (Regulation Z), 79 FR 77101 (Dec. 23, 2014) (proposing to define a new term, "prepaid accounts," to include certain categories of accounts that were already subject to Regulation E as well as to certain categories that had historically been treated as excluded from the regulation). In the proposal for this rule concerning arbitration agreements, the Bureau sought 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). 81 FR 32830, 32876 n.470 (May 24, 2016).
[932] *See* 12 CFR 1005.20(a).

proposed § 1040.3(a)(7), payment processing under proposed § 1040.3(a)(8), or debt collection under proposed § 1040.3(a)(10).

The Bureau received several comments related to proposed § 1040.3(a)(6). Some consumer advocates and nonprofits urged the Bureau to apply the rule to stored value products, regardless of whether they are accounts under Regulation E. One commenter noted that the enumerated laws do not evolve as quickly as the markets, leaving gaps in coverage. Two commenters raised specific concerns with prison release cards. One commenter stated that, regardless of whether they are covered as accounts under Regulation E, the rule should cover general use gift cards, non-merchant rewards cards, Supplemental Nutrition Assistance Program (SNAP) cards, and cards linked to health savings accounts, noting that some of these are network branded just like other types of cards that are covered under Regulation E.

An industry trade association commenter in the consumer payments sector also stated that clarifications in the final rule should address the coverage of prepaid and stored value cards. The commenter did not say, however, whether the rule should include or exclude these products.

The Bureau adopts § 1040.3(a)(6) as proposed. Since the close of the comment period, the Bureau has adopted changes to the definition of "account" in Regulation E in its final prepaid accounts rule that it issued in October 2016. That rule, the relevant provisions of which are scheduled to take effect on April 1, 2018, expands the definition of account under Regulation E to include certain types of prepaid products not previously covered.[933] Those types of prepaid accounts would therefore be included within the scope of coverage of accounts under Regulation E, upon the latter of the compliance date of this rule or the prepaid accounts rule. When prison

[933] *See* 81 FR 83934 (Nov. 22, 2016); 82 FR 18975 (Apr. 25, 2017) (setting effective date of April 1, 2018). *See also* Prepaid Accounts Under the Electronic Fund Transfer Act (Regulation E) and the Truth in Lending Act (Regulation Z), 82 FR 29630 (June 29, 2017) (proposal seeking comment on whether the effective date should be further delayed).

release cards and general-use gift cards meet the definition of prepaid account in that rule,[934] they would be covered by this rule. With respect to rewards programs, food stamp programs, and health savings accounts, these are generally not covered as accounts under Regulation E as revised by the prepaid accounts rule. The Bureau does not believe it would be necessary or appropriate to use this final rule as a vehicle for defining coverage of these types of products or services under the Dodd-Frank Act. The Bureau will continue to monitor the markets for stored value products and services not covered by this rule and may, at a future time, determine to adjust the scope of coverage of these markets in this rule.

*3(a)(7)*

*The Bureau's Proposal*

As explained in the proposal, the Bureau believed that the proposal should apply to transmitting or exchanging funds.[935] Proposed § 1040.3(a)(7) would have included 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 have been covered by proposed § 1040.3(a)(7). As noted above, however, proposed § 1040.3(a)(7) would not have applied to transmitting or exchanging funds where that activity is

[934] *Id.* at 83968 (discussing coverage of prison release cards as prepaid accounts) and 83977 (discussing coverage of gift cards as prepaid accounts depending on several factors, including the nature of their marketing and labelling).
[935] 81 FR 32830, 32876-77 (May 24, 2016).

integral to a non-covered product or service. Thus, proposed § 1040.3(a)(7) generally would not have applied, 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 have been covered by proposed § 1040.3(a)(7). In addition, the Bureau believed that mobile wireless third-party billing services that engage in transmitting funds would have been covered by proposed § 1040.3(a)(7), as the Bureau understood that such services would not typically be integral to the provision of wireless telecommunications services.

*Comments Received*

A consumer advocate commenter generally expressed support for the coverage in proposed § 1040.3(a)(7). This commenter stated support for the view that this provision may apply to mobile wireless third-party billing, asserting that cramming is a serious consumer protection problem and that arbitration agreements impede relief. This commenter urged the Bureau to narrow the proposed exclusion for transfers that are integral to a product or service not covered by the rule, to prevent evasion. The commenter stated that only transfers that are necessary and essential for a non-covered service should be excluded.

An industry trade association commented, however, that, in their view, mobile wireless third-party billing is not a consumer financial product or service and therefore should not be cited as an example that would be covered by the rule.[936] The commenter stated that any transmission of funds by a wireless telecommunications service provider is done for the third-party recipient of the funds and not for consumer, household, or family purposes within the

[936] *See also* discussion of § 1040.3(a)(1) above and § 1040.3(a)(8) below.

meaning of the Dodd-Frank Act. The commenter also stated that the rule should exclude mobile wireless third-party billing on policy grounds, in addition to legal authority concerns. Otherwise, the commenter asserted, providers would be required to engage in a nuanced and ongoing evaluation of each of their third-party relationships to determine whether those relationships give rise to coverage under the rule. In the commenter's view, because third-party billing services provide a relatively small revenue stream for mobile wireless companies and are merely incidental to its members' core wireless business, providers may choose to discontinue offering third-party billing services, which, in the commenter's view, are desirable to consumers. The commenter explained that the covered product or service may be abandoned because, in its view, it would be infeasible for its member companies to create a compliance system and endure class action exposure just for this activity given that is so incidental and minor to the overall suite of products and services the companies provide to their customers. In addition, the commenter stated that if mobile wireless third-party billing were not excluded from the rule, then the Bureau should articulate the particular features of third-party billing that make it a product or service a covered by the rule.

*The Final Rule*

The Bureau is finalizing § 1040.3(a)(7) as proposed, but changing the exclusion in two ways to prevent evasion and uncertainty. First, the Bureau sought comment on whether the Bureau should define the limitation on coverage in a different way, including whether the Bureau should adopt "necessary or essential to a non-covered product or service" as the limitation. Consistent with the consumer advocate's comment described above, as revised in the final rule, the limitation would apply only for transmitting or exchanging funds when necessary to a product or service that is not covered by the rule (which could include, for example, another

consumer financial product or service that is not listed in § 1040.3(a) or a nonfinancial good or service). The Bureau also is replacing the term "integral," with the term "necessary," which the Bureau believes is a narrower term.[937] Second, the Bureau is clarifying that this limitation only applies when the non-covered products and services and the transmitting or exchanging funds are done by the same person. The Bureau is making this clarification to prevent confusion over whether arranging payments for goods or services sold by a third party is "necessary" to that sale. As clarified, § 1040.3(a)(7) will cover transmitting or exchanging funds by one person to pay for a non-covered product or service provided by a third party, without regard to whether the funds transmitting or exchanging activity is "necessary" to the non-covered product or service.[938]

With regard to the industry trade association comment that stated that mobile wireless third-party billing is not a service undertaken for consumer, household, or family purposes within the meaning of the Dodd-Frank Act, the Bureau notes that the where the provider is acting as a bill payment service provider like other financial services providers,[939] the Bureau believes this typically would be a service provided for consumer purposes. On the other hand, where the provider is simply acting as a merchant collecting funds for its own nonfinancial goods or services, that conduct generally would not be covered by § 1040.3(a)(7). Thus, the coverage of § 1040.3(a)(7) will depend on the nature of a person's funds transmitting and exchange activities.

The Bureau recognizes that, to comply with the final rule, mobile wireless providers engaged in providing third-party billing services would need to analyze the extent to which their products or services include transmitting or exchanging funds for consumer purposes. The

[937] *See* "Merriam-Webster Online Dictionary" ("necessary" generally defined as "absolutely needed," while "integral" may describe one thing that is "formed as a unit with another part"), *available at* https://www.merriam-webster.com/dictionary (last visited May 30, 2017).
[938] For example, proposed § 1040.3(a)(8) included a limitation for processing payments for a product or service that the provider itself sold or marketed. This clarification to limitations in this rule on the coverage of transmitting and exchanging funds in § 1040.3(a)(7) therefore is consistent with the approach to the limitations in this rule on the coverage of payment processing in proposed § 1040.3(a)(8).
[939] *See* 12 U.S.C. 5481(29) (defining "transmitting or exchanging funds" to include such activities carried out "through bill payment services").

Bureau further recognizes that the scope of transmitting and exchanging funds under the Dodd-Frank Act has not been interpreted by regulation. Nonetheless, the Bureau is not persuaded by the suggestion in the comment that for providers to determine whether they are covered would be particularly burdensome. As noted in the proposal, the phrase transmitting and exchanging funds is defined in the Dodd-Frank Act.[940] The elements of this financial product or service are therefore laid out there, including the reference to bill payment services, which the Bureau believes provides useful guidance.

In addition, to the extent the application of the rule creates an incentive for the provider to develop a compliance system and creates class action exposure for providers who fail to meet their legal obligations in delivering consumer financial services, these are the chief goals of this rulemaking. The findings in Part VI and the Bureau's Section 1022(b)(2) Analysis account for the fact that, on the margins, providers may forgo offering a product because they do not want to invest in compliance and make private aggregate relief available to consumers for that product. In addition, applying the rule to an incidental product or service would not create coverage for the provider's core product. If the provider included an arbitration agreement for the products and services that are not covered by the rule, the rule would not prohibit the provider from relying on that arbitration agreement for those products and services in a class action. Relatedly, as noted below, the provider would have the option, under the final rule, of including contract language that clarifies that some products or services provided are not covered by the rule, which would limit the impact of the § 1040.4(a)(2) of the rule. Thus, the impact of the rule on the provider would presumably be in proportion to the importance that the covered product or service has to the provider.

[940] *Id.*

*3(a)(8)*

*The Bureau's Proposal*

As explained in the proposal, the Bureau believed that the proposal should cover certain types of payment and financial data processing.[941] Proposed § 1040.3(a)(8) therefore would have included 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 by 15 U.S.C. 5481(18)[942] 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 nonfinancial good or service for which the payment, credit card, or charge card transaction is being made. Proposed comment 3(a)(8)-1 would have clarified 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 have included 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 have been 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 have been 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

[941] 81 FR 32830, 32877 (May 24, 2016).
[942] As noted in the proposal, 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)." *Id.* at n.472.

consumers to initiate payments to third parties through its billing platform would have been covered by proposed § 1040.3(a)(8).

The Bureau notes that the breadth of proposed § 1040.3(a)(8) would have been limited in several ways. First, the coverage of proposed § 1040.3(a)(8) would not have included merchants, retailers, or sellers of nonfinancial goods or services when they are providing payment processing services directly and exclusively for the purpose of initiating payment 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 have stated 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 have applied 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 have reached, 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 have been covered by other provisions of proposed § 1040.3(a). This may include, 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).

*Comments Received*

A public-interest consumer lawyer commenter stated that the exclusion in proposed § 1040.3(a)(8) should not exclude sellers of automobiles, in particular when the payment being processed is for a loan to finance the purchase of the dealer's automobiles.

A consumer advocate commenter recommended that the Bureau expand the scope of payment and financial data processing coverage in three ways. First, this commenter stated that the rule should explicitly cover electronic funds transfers (EFTs) and preauthorized electronic funds transfers (PEFTs) as those terms are defined in Regulation E. Second, this commenter stated that transfers of funds between accounts at the same financial institution, which are not EFTs under Regulation E, should be covered. Third, this commenter stated that the Bureau should remove the word "directly" from proposed § 1040.3(a)(8), so that the rule would reach persons who work behind the scenes to arrange debiting funds from consumer accounts as part of work-at-home schemes, fake dating apps, or other schemes perpetrated by third parties who are not offering consumer financial products or services.

This consumer advocate commenter also expressed support for coverage that would regulate mobile wireless third-party billing, asserting that cramming is a serious consumer protection problem and that arbitration agreements impede relief to consumers harmed by cramming practices. As noted above, an industry trade association, however, disagreed with the Bureau's observation that proposed § 1040.3(a)(8) could apply to mobile wireless third-party

billing.[943] This commenter stated that, in its view, mobile wireless third-party billing would not be covered by proposed § 1040.3(a)(8) because the nonfinancial goods or services of the third party are virtually always marketed by the mobile wireless provider whether because of the scope of the provider's activities, or simply due to the nature of payment processing itself. For example, mobile wireless providers engage in promotional activities or distribute the nonfinancial good or service for which payment is made. The commenter also asserted that simply by making their payment channel available to pay for a given nonfinancial good or service, mobile wireless providers are marketing the nonfinancial goods or service because doing so promotes that good or service.

*The Final Rule*

For the reasons described in the proposal, and explained below, the final rule adopts § 1040.3(a)(8) and comment 3(a)(8)-1 as proposed with minor edits for clarity. The proposal described the payment processing activity excluded from § 1040.3(a)(8) based on whether it was to process a payment or card transaction for a nonfinancial good or service sold or marketed by the processor. Rather than using the term nonfinancial good or service, which is not defined, the Bureau believes it would be clearer to refer to goods and services that are not covered by § 1040.3(a).[944]

With regard to the public-interest consumer lawyer comment that stated that automobile dealers should not be excluded when processing payments on their loans, the Bureau does not believe an adjustment to § 1040.3(a)(8) is necessary. As discussed in the proposal and further below with regard to § 1040.3(b)(6), the Bureau's jurisdiction over certain automobile dealers

[943] *See also* section-by-section analysis of § 1040.3(a)(1) and (a)(7) above.
[944] This revision is consistent with the wording of other limitations in § 1040.3(a), including its paragraphs (1)(iii), (4), and (7).

and other merchants is constrained by the Dodd-Frank Act.[945] The Bureau has conformed the scope of the rule to these limitations. Except when persons are excluded under § 1040.3(b), however, the final rule treats providers that process payments on their own extension of consumer credit with a finance charge as engaged in servicing,[946] debt collection, or both.

The Bureau disagrees with the consumer advocate commenter that any of the changes it seeks are necessary. The Bureau notes that EFTs and PEFTs will typically be covered pursuant to § 1040.3(a)(5) or (a)(6) because they are made to or from an account as defined under EFTA or TISA and/or pursuant to § 1040.3(a)(8) because they also are processed by persons who accept data directly from the consumer to initiate payments for services these persons neither sold nor marketed. Similarly, a transfer of funds between accounts need not be defined as covered payment processing, since the underlying accounts are already themselves covered, for example, by § 1040.3(a)(5) and (a)(6).

With regard to the commenter's suggestion to remove "directly" from proposed § 1040.3(a)(8), the Bureau believes that limiting the scope of § 1040.3(a)(8) to situations involving the acceptance "directly" from the consumer is important because it helps to distinguish consumer-focused products and services from third-party, back-office operations.[947] This term therefore increases clarity of coverage under this provision, facilitating implementation of the rule.

[945] *See* Dodd-Frank sections 1027 and 1029.
[946] *See, e.g.*, Complaint at ¶ 97, Consumer Fin. Prot. Bureau v. Navient Corp., No. 17-00101 (M.D. Pa. Jan. 18, 2017) (alleging student loan servicer engaged in payment processing as part of its servicing activity).
[947] The Bureau acknowledges section 1002(15)(A)(vii) does not include that term in defining data processing services that can be a type of consumer financial product or service, and that the Bureau's authority under the statute reaches more broadly than does § 1040.3(a)(8). However, in this rule, the Bureau does not believe it is necessary to incorporate the entire scope of Dodd-Frank section 1002(15)(A)(vii). To the extent a back-office processor is an affiliated service provider to a provider of a product or service covered by § 1040.3(a), that back-office processor may still be covered by the rule as a provider pursuant to § 1040.2(d)(2).

The Bureau agrees with the industry trade association comment that, when a mobile wireless provider markets its own nonfinancial goods or services, then any payment processing the mobile wireless provider provides to the consumer in the course of purchasing the nonfinancial good or service it has marketed to the consumer would not be covered by § 1040.3(a)(8) because this provision specifically excludes such situations. However, the Bureau disagrees with the commenter's view that merely providing payment processing services constitutes marketing of the goods or services for which the payments are being processed so as to warrant categorically excluding third-party billing from the scope of the rule. In the Bureau's experience, this view is overbroad and could render the coverage in § 1040.3(a)(8) meaningless because an exception for simply facilitating payment of goods or services would swallow the rule. While it is true that making a payment method available can facilitate sales of a product, the Bureau does not believe that act by itself would constitute marketing as the Bureau interprets that term in the context of this regulation. To be eligible for the marketing exclusion, a payment processor would need to be engaged in marketing activity for the nonfinancial good or service independent of the payment processing activity itself.[948]

*3(a)(9)*

As stated in the proposal, the Bureau believed that the proposal 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 have included in the coverage of proposed part 1040 check cashing, check collection, or check guaranty services, which are types of consumer financial products or services identified in Dodd-Frank section 1002(15)(A)(vi).

[948] More broadly, for the reasons already discussed in the response to this comment in the section-by-section analysis of § 1040.3(a)(7) above, the Bureau does not agree that a blanket exemption for mobile wireless third-party billing is warranted. For the reasons the industry trade association commenter noted, to the extent mobile wireless third-party billing providers are processing payments for nonfinancial goods or services they market, § 1040.3(a)(8) would not apply to them.

The Bureau did not receive comments on its proposal to cover cashing checks for consumers and associated check collection and check guaranty services. The final rule adopts proposed § 1040.3(a)(9) as proposed. The Bureau also notes that, as discussed below in the section-by-section analysis of § 1040.3(a)(10), furnishing in connection with debt collection would be covered as a collection activity. This also would be true for furnishing in connection with covered check collection or check guaranty activity.

*3(a)(10)*

*The Bureau's Proposal*

As explained in the proposal, the Bureau believed that the proposal should apply to debt collection activities arising from consumer financial products and services covered by paragraphs (1) through (9) of proposed § 1040.3(a).[949] 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 proposal, the Bureau was 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 that would have been covered by proposed § 1040.3(a) may lead to collections; the Bureau was concerned that if any of these collection activities were not separately covered, collectors in these cases could seek to invoke arbitration agreements.

As the proposal explained, the Bureau believed that collections coverage was particularly important because the Study showed that class actions alleging violations of the FDCPA were the most common type of class actions filed across the six significant markets that the Bureau

[949] 81 FR 32830, 32878-79 (May 24, 2016).

studied. Debt collection class settlements were also by far the most common type of class action settlement in all of consumer finance,[950] which in turn suggested 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. The proposal added that, particularly in light of the fact that collectors often bring suit against consumers and the history discussed in Part II of the proposal concerning serious fairness concerns raised in connection with the filing of numerous debt collection claims with a particular arbitration administrator, the Bureau believed that application of the proposal to collection activities may be one of the most important components of the rule.

Specifically, proposed § 1040.3(a)(10) would have applied 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 have identified 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 proposed coverage of each of these types of entities engaged in debt collection is described separately below.

Proposed § 1040.3(a)(10)(i) would have applied to collection by a person offering or providing the covered product or service giving rise to the debt being collected, an affiliate of

[950] *See* Study, *supra* note 3, section 6 at 19 and section 8 at 12.

such person,[951] or a person acting on behalf of such person or affiliate. This coverage would have included, for example, collection by a creditor extending consumer credit. The Bureau noted in the proposal, however, that as with proposed § 1040.3(a)(1) discussed above, proposed § 1040.3(a)(10)(i) would not have extended 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 have been exempt in the circumstances described in proposed § 1040.3(b).

In addition, proposed § 1040.3(a)(10)(ii) would have covered 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 have reached such persons even when proposed § 1040.3(b) would have excluded the original creditor from coverage. For example, such collection activities by acquirers or purchasers would have been covered even when the original creditor, such as a government or merchant, would have been 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 have been covered by proposed § 1040.3(a)(10)(ii), even in circumstances where proposed § 1040.3(b)(5) would have excluded the medical creditor from coverage.[952] In other words, although hospitals, doctors, and other service providers extending incidental ECOA consumer credit would not have been subject

[951] As proposed comment 3(a)(10)-2 would have clarified, 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."

[952] As noted in the proposal, 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."). 81 FR 32830, 32878 n.475 (May 24, 2016).

to the requirements of § 1040.4 to the extent proposed § 1040.3(b)(5) would have excluded them from coverage because the Bureau lacks rulemaking authority over them under Dodd-Frank section 1027 or they would have been excluded under another provision of proposed § 1040.3(b), an acquirer or purchaser of such consumer credit generally would have been subject to proposed § 1040.4.[953]

The proposal explained that the Bureau believed that many activities involved in the collection of debts arising from extensions of consumer credit would also constitute servicing under proposed § 1040.3(a)(1)(v). However, the Bureau was proposing the coverage of collection activities by any other person acting on behalf of the provider or affiliate in proposed § 1040.3(a)(10)(i) and (ii) to confirm that collection activity by such other persons would have been 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) described below) because they are not collecting on an account obtained in default.[954] By proposing coverage of debt collection by such other persons, the Bureau also sought 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, the proposal explained that 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

[953] As the proposal further noted, 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). In this connection, the proposal also noted, that other regulatory guidance in the past has indicated that a "health care provider" is a creditor under ECOA if it "regularly bill[s] 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 healthcare providers need to know," Modern Medicine Network (Jan. 11, 2010), *available at* http://www.modernmedicine.com/modern-medicine/news/modernmedicine/modern-medicine-feature-articles/red-flags-rule-what-healthcare-. The Bureau stated in the proposal that it was not interpreting ECOA or Regulation B. 81 FR 32830, 32878 n.476 (May 24, 2016).

[954] *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").

to post-default activities.[955] Both types of collection activity would have been covered under the proposal.

As discussed in the proposal as described 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 and subjects them to its various statutory requirements and prohibitions against abusive collection 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 have included in the coverage of proposed part 1040 collecting debt by a debt collector as defined by the FDCPA, 15 U.S.C. 1692a(6),[956] when the debt arises from any consumer financial products and services described in proposed § 1040.3(a)(1) through (9).

As discussed in the proposal as described above, the Bureau believed 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, 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 have extended 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

[955] *See* Fed. Trade Comm'n, "The Structure and Practices of the Debt Buying Industry," at 13 n.57 (Jan. 2013), *available at* https://www.ftc.gov/sites/default/files/documents/reports/structure-and-practices-debt-buying-industry/debtbuyingreport.pdf ("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.").

[956] As the proposal explained, 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 proposal. 81 FR 32830, 32879 n.479 (May 24, 2016).

proposed § 1040.3(a)(1)(iv). The Bureau believed that proposed § 1040.3(a)(10)'s references to these existing regulatory regimes would facilitate compliance, since the Bureau expected that industry has substantial experience with existing contours of coverage under the FDCPA and ECOA. As discussed above, proposed § 1040.3(a)(10)(ii) would have applied proposed part 1040 to purchasers of consumer credit extended by persons over whom the Bureau lacks rulemaking 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 have applied 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 rulemaking authority under Dodd-Frank section 1027 or 1029 or who otherwise would have been exempt under proposed § 1040.3(b).

The Bureau recognized 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. As the proposal explained, however, there are a number of ways in which the proposal would have regulated or otherwise affected the conduct of debt collectors. First, under proposed § 1040.4(a)(1), described below, the debt collector would have been prohibited from invoking a pre-dispute arbitration agreement in a class action dispute concerning such collection activities. Second, 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 would have been covered by the proposal, then the debt collector may 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 have required the collector to include the prescribed language in that pre-dispute arbitration agreement.[957]

Proposed comment 3(a)(10)-1 would have further clarified that collecting debt by persons listed in § 1040.3(a)(1) would have been 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.

*Comments Received*

A debt collection industry trade association challenged the Bureau's findings generally, mostly echoing other industry comments criticizing the proposal and the class rule in particular, as discussed above in Part VI. In addition, this commenter asserted that individual arbitration was superior to class litigation in consumer disputes. Some of the reasons it offered in support of this claim were specific to debt collection. For example, the commenter stated that in debt collection disputes, consumers place a particularly high value on confidentiality, which it believed arbitration better preserves. It also stated that debt collection claims are simpler to adjudicate, and thus suited to a simpler dispute process, which it believed arbitration offers. The commenter also noted that debt collectors, and small entities in particular, can use creditors' arbitration agreements to avoid the burdens of challenging flawed class litigation.

Three public-interest consumer lawyer commenters and a consumer advocate commenter supported the proposed coverage of debt collection, which in their view was one of the most important components of the proposed coverage. One of the public-interest consumer lawyers stated that a significant portion of the complaints these commenters have seen pertain to unfair

[957] *See* proposed comment 4-1.

debt collection practices. The consumer advocate commenter also noted the prevalence of class actions addressing debt collection problems as providing support for coverage of debt collection in the proposal. A public-interest consumer lawyer commenter also expressed support in particular for the coverage in proposed § 1040.3(a)(10)(i) and (ii), noting its understanding that these provisions would apply even when the covered person is not a debt collector as defined in the FDCPA, and also when the debt being collected arises from other covered activities beyond extending consumer credit. Another public-interest consumer lawyer commenter asserted that recourse to class actions for violation of debt collection laws is critically important for the protection of consumers. This commenter also stated that coverage of collection by third parties on consumer credit extended by exempt persons, such as medical providers, was particularly important. It stated that it has seen a number of instances of improper medical billing or collection practices, indicating that coverage in this rule is important.

The consumer advocate commenter also urged the Bureau to clarify that, with regard to proposed § 1040.3(a)(10)(iii), the FDCPA applies to debt buyers. For example, collectors may collect on debts they have purchased arising from deposit accounts, automobile leases, or check collection activities.[958] In addition, this commenter urged the Bureau to confirm that furnishing is among the debt collection activities included within the scope of proposed § 1040.3(a)(10). This commenter similarly urged that the rule explicitly cover consumer financial products that are ancillary to a covered product, such as payment processing that is ancillary to debt collection.

Finally, the consumer advocate commenter urged the Bureau to clarify that proposed § 1040.3(a)(10)(i) covers third parties acting on behalf of an exempt creditor or its affiliate when

[958] One public-interest consumer lawyer commenter also stated that the rule should apply to this type of collection activity.

collecting on a debt arising from a covered consumer financial product or service. As an example, this commenter referred to a third-party collector of a medical credit account.

*The Final Rule*

The Bureau adopts § 1040.3(a)(10) and its commentary in comments 3(a)(10)-1 and 3(a)(10)-2 as proposed.

The industry trade association commenter's criticisms of the class rule were principally directed at the findings in support of rule as a whole, and are therefore addressed in Part VI above and, to the extent they relate to small entities, in the discussion of the potential alternative of a small entity exemption in Part IX below. With regard to the commenter's assertion that individual arbitration is superior to class litigation of debt collection disputes, the Bureau emphasizes that, as discussed in Part VI, creditors may continue to make individual arbitration available, which may also make it available for disputes with debt collectors. In addition, with regard to its claim that arbitration better protects consumer confidentiality, the Bureau notes that arbitration also depends on courts for enforcing awards, which may expose consumers to the same confidentiality concerns as individual litigation (indeed, the Bureau understands that many of the debt collection arbitrations in NAF discussed in Part II led to court actions to enforce arbitral awards in debt collection) and further that, according to the Study, the majority of arbitration agreements did not have confidentiality provisions.[959] In any event, 87 percent of the individual lawsuits in Federal court analyzed in the Study asserted FDCPA claims,[960] indicating that individual litigation is most often used in consumer finance markets for debt collection

[959] Study, *supra* note 3, section 2 at 52 tbl. 10.
[960] *Id.* section 2 at 27 fig. 6.

claims. This data suggests that for those consumers intent on bringing suit, litigation is a viable alternative.

The Bureau agrees with the consumer advocate comment that, as proposed, § 1040.3(a)(10) would apply to a third party collecting on consumer credit originated by an exempt person, such as a medical provider exempt in circumstances described in proposed § 1040.3(b)(6).[961] The rule confirms this in comment 2(c)-1.i, discussed above.

With regard to the consumer advocate commenter's request that this rule clarify the coverage of debt buyers under the FDCPA, the Bureau is not, in this rulemaking, interpreting the scope of the FDCPA. The scope of that statute as it stands now therefore determines the scope of § 1040.3(a)(10)(iii). The Bureau also notes, however, that the Supreme Court recently issued a decision holding that a debt buyer collecting on its own behalf debts that it purchased was not collecting or attempting to collect, directly or indirectly, debts owed or due or asserted to be owed or due to another within the meaning of the FDCPA.[962] In any event, any future interpretation of the FDCPA will be automatically incorporated by reference into the scope of this rule, as described above. Moreover, a debt buyer engaged in collection on a consumer credit account they purchase generally would be covered by § 1040.3(a)(10)(ii), which covers collecting debt by a purchaser of consumer credit, even when the purchaser is not a debt collector under the FDCPA.[963] Therefore, the Bureau declines to address, at this time, the commenter's request concerning the FDCPA's coverage of debt buyers.

[961] *See, e.g.*, Syndicated Office Systems, LLC, 2015-CFPB-0012, Consent Order (June 18, 2015), *available at* http://files.consumerfinance.gov/f/201506_cfpb_order-syndicated.pdf (Bureau finding that affiliate of hospital chain engaged in collection on debts originated by the hospital and other non-affiliated medical providers was a "covered person" subject to the Bureau's enforcement jurisdiction).
[962] *Henson, et al.* v. *Santander Consumer USA, Inc.*, No. 16-349 (Slip Op. June 12, 2017).
[963] As discussed in the proposal, servicing and collection activity may overlap. As a result, the debt buyer also may be covered under § 1040.3(a)(1)(iv)-(v) which generally cover purchasing and servicing consumer credit accounts.

With regard to the consumer advocate commenter's request to confirm that furnishing is a debt collection activity, when a person is collecting debt within the meaning of § 1040.3(a)(10), the Bureau agrees that if that person furnishes information on that debt in the course of that debt collection, then furnishing falls within the scope of the rule. The relevant factor is therefore whether the furnishing is done in the course of the debt collection, and not whether the debt collector is required to engage in the furnishing. However, the only commenter to address this question was this consumer advocate; the Bureau did not receive any other comments indicating uncertainty over the coverage of furnishing by debt collectors as a debt collection activity. Therefore, the Bureau believes this clarification is sufficient.

With regard to the consumer advocate comment concerning coverage of payment processing that may be ancillary to debt collection activities, the Bureau agrees that this would be covered by § 1040.3(a)(10) regardless of whether it is also covered by any other provision in § 1040.3(a). The Bureau interprets the term debt collection to include processing payments made by consumers as part of debt collection activity (*i.e.*, processing payments consumers make to satisfy a debt). However, the only commenter to address this question was this consumer advocate; the Bureau did not receive any other comments indicating uncertainty over the coverage of payment processing that may be ancillary to debt collection activities. The Bureau does not believe this example supports the commenter's broader claim that the rule should cover any consumer financial product or service that is ancillary to another covered product. The Bureau is concerned that that type of coverage definition could lead to uncertainty and would not facilitate compliance and administration of the rule.

*3(b) Exclusions from coverage*

Proposed § 1040.3(b) would have identified the set of conditions under which certain persons would have been excluded from the coverage of proposed part 1040 when providing a certain products or services that were otherwise covered by proposed § 1040.3(a).[964] As discussed above, if an exclusion in proposed § 1040.3(b) did not apply to a person that offers or provides a product or service described in proposed § 1040.3(a), that person would have met the definition of a provider in proposed § 1040.2(c) and would have been subject to the proposal. The exclusion was structured to be specific to the provision of particular products and services listed in 1040.3(a). In other words, even if an exclusion in proposed § 1040.3(b) would have applied to a person offering or providing one particular product or service, that person still would have been 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) would not have applied to that second product or service.

For illustrative purposes, the Bureau noted in the proposal that persons offering or providing consumer financial products or services covered by proposed § 1040.3(a) described above would have included, without limitation, banks, credit unions, credit card issuers, certain automobile lenders, automobile 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

[964] As the proposal noted, certain additional limitations would have been inherent in proposed § 1040.3(a). 81 FR 32830, 32879-80 (May 24, 2016). 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) referenced 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. *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 . . . ."). These limitations would have been incorporated into the coverage of proposed part 1040, regardless of whether they were explicitly mentioned in the text of the regulation or the commentary of the proposal.

organizations, providers of consumer credit 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.[965]

Some commenters sought exclusions for certain persons, rather than certain products or services. Comments concerning a possible small entity exemption are discussed in Part IX below. In addition, a number of credit union and community bank industry commenters sought an exemption from the rule, for a variety of reasons. For example, credit union commenters cited their member-owned, not-for-profit cooperative structure[966] as providing adequate accountability incentives to comply with the law, such that class actions are not necessary. A community bank commenter similarly stated that community banks are relationship-oriented, and the need to develop customer relationships and retain customers provided an adequate incentive to comply with the law. Credit union commenters also generally asserted that their customers are more likely to experience higher costs from the proposal because their customers are owners who would experience reduced dividends as a result of increased costs from the rule.[967]

[965] 81 FR 32830, 32880 (May 24, 2016). The Bureau discussed the examples as well as other types of entities that would have been covered in certain circumstances in the section-by-section analysis to proposed § 1040.3 described above. In addition, the Bureau noted in the proposal that, 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. *Id.* at n.482.

[966] *See generally* Nat'l Credit Union Admin. "Is a Credit Union Right For Me," https://www.mycreditunion.gov/about-credit-unions/Pages/Is-a-Credit-Union-Right-for-Me.aspx (last visited June 22, 2017) ("Credit unions are democratically run financial institutions providing each credit union member one vote. Members vote on those from the membership who are running for the credit union's board of directors, as well as any other credit union official positions open for election at the annual membership meeting.").

[967] Two credit union industry trade associations also noted that there may be impacts on credit unions engaged in the indirect automobile lending market where automobile dealers originating the loans use arbitration agreements. Those comments are discussed in the Bureau's Section 1022(b)(2) Analysis. In addition, another credit union industry commenter stated that credit unions not currently using arbitration agreements still needed an option of using arbitration agreements in the future to block TCPA class actions in light of concerns over uncertainties or ambiguities in the TCPA. As explained in Part VI, the Bureau finds that the class rule is in the public interest and for the protection of consumers notwithstanding that there may be questions regarding legal interpretations of laws that can be enforced through class actions.

Other comments on the proposed exemptions and the Bureau's analysis of those comments are discussed in the section-by-section analysis of each proposed exclusion below.[968]

The Bureau is adopting the text in the introductory paragraphs of § 1040.3(b) as proposed, with a minor clarification to account for the fact that some exclusions apply more broadly to particular parties, rather than simply with regard to specific consumer financial products or services.[969]

With regard to the exemptions requested by credit union and community bank commenters, the Bureau is not adopting such exemptions in the rule as discussed further in Part VI above and the Section 1022(b)(2) Analysis below. As discussed in the section-by-section analysis of § 1040.3(b)(2) below, the Bureau has determined in the final rule that democratic accountability structures are an insufficient basis for excluding governments from the rule. With regard to an exemption for credit unions, the Bureau similarly believes that shareholder ownership, while providing a form of democratic shareholder accountability over the credit union, is not a sufficient compliance incentive to replace a right to enforce the laws on a class basis. The Bureau further believes that the presence of a financial institution in a community, such as a credit union or community bank, with the interest of developing and retaining customers in that community, also is not a sufficient compliance incentive to replace a right to enforce those laws on a class basis.[970] With regard to the potential for pass through of costs of the rule to consumers who also have ownership interests in credit unions, as discussed in the

[968] As discussed further below, the Bureau also received some comments that requested exemptions from the rule on bases other than the identity of the provider. The Bureau does not consider these requests to be requests for exemptions from the scope of coverage per se, but instead as requests for the Bureau to consider certain alternatives to or limitations on the substantive regulation itself. For example, a request to exclude certain causes of action providing for statutory damages or recovery of attorney's fees from the class proposal is discussed in Part VIII. In addition, the Bureau's consideration of other potential alternatives raised by commenters, such as not applying the class proposal to matters that providers self-report to regulators, is discussed in the analysis of impacts of the rule in Part VIII.

[969] Rather than referring to the exclusions as for persons to the extent they are providing consumer financial products or services specified in § 1040.3(b), the introductory paragraph in the final rule states that the exclusions apply in the circumstances described in § 1040.3(b). This is more accurate because some of the exclusions do not refer to particular consumer financial products or services.

[970] The Bureau's response to these comments is further detailed in Part VI.C.1 above.

Bureau's Section 1022(b)(2) Analysis below, the member-ownership structure for credit unions may make it slightly more likely that consumers would face reduced earnings as owners, if costs are not passed through to them as customers. Nonetheless, the Bureau has already considered the potential for pass through of costs of the rule to customers in its Section 1022(b)(2) analysis. The fact that credit unions may pass through costs to consumers as owners, even when costs are not passed through by way of product pricing, does not change the nature of its findings in Part VI above.

*3(b)(1)*

*The Bureau's Proposal*

Proposed § 1040.3(b)(1) would have excluded from the coverage of proposed part 1040 broker-dealers to the extent they are providing any products or 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-dealers" generally refers to persons engaged in the business of effecting securities transactions for the account of others or buying and selling securities for their own account.[971] Broker-dealers may provide products that were 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 proposed to exclude such persons from coverage to the extent they were 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.

[971] *See* 15 U.S.C. 78c(4)-(5) (defining the terms broker and dealer under the Securities Exchange Act).

As discussed above and in the proposal,[972] 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 agreements to class actions filed in court.[973] The SEC, which must authorize FINRA rules, authorized the original version of this rule in 1992.[974] The Bureau also noted that claims in FINRA arbitration between customers and broker-dealers are filed with FINRA,[975] which is overseen by the SEC, and all awards between customers and broker-dealers under FINRA rules must be made public.[976] Proposed comment 3(b)(1)-1 would have clarified 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 that products and services covered by those FINRA rules would have been excluded from the coverage of proposed part 1040.

The proposal also identified a CFTC regulation requiring that pre-dispute arbitration agreements in customer agreements for certain products and services regulated by the CFTC be voluntary, such that the 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.[977] That regulation, however, does not ensure consumers have access to private remedies in class actions and does

[972] 81 FR 32830, 32880-81 (May 24, 2016).
[973] FINRA, "Requirements When Using Predispute Arbitration Agreements for Customer Accounts," at 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, "Class Action Claims," at Rule 12204(d).
[974] Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Approving Proposed Rule Change Relating to the Exclusion of Class Actions from Arbitration Proceedings, Exchange Act Release No. 31371, 1992 WL 324491, (Oct. 28, 1992).
[975] FINRA, "Filing an Initial Statement of Claim; Filing Claim with the Director," at Rule 12302(a) (providing that claimant must file an initial claim with the Director of the FINRA Office of Dispute Resolution).
[976] FINRA, "Awards," at Rule 12904(h) ("All awards shall be made publicly available.").
[977] 17 CFR 166.5.

not provide for transparency of arbitral awards. The Bureau therefore stated in the proposal its belief that the proposal could have provided important consumer protections for providers that might also be subject to the CFTC's regulation. The Bureau also believed 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 did not propose an exemption for those persons, and instead sought further comment on the approach to CFTC-regulated persons.

Thus, under the proposal, any product or service that would be subject to both the Bureau's proposal and the CFTC rule[978] therefore would have needed to meet the requirements of both rules. For example, any pre-dispute arbitration agreement subject to both rules would have needed to satisfy the CFTC requirements to ensure the contract is voluntary and contain the provision mandated by proposed § 1040.4(a)(2).[979]

*Comments Received*

The Bureau consulted with the SEC and CFTC prior to issuing the proposal and after the close of the comment period and received a formal comment letter from the staff of the CFTC. In addition, the Bureau received comments from an industry trade association whose members include both broker-dealers and investment advisers regulated by the SEC, an investment adviser industry trade association, and an industry trade association representing futures commission merchants regulated by the CFTC. These comments generally expressed an opinion that the Bureau lacks any authority under the Dodd-Frank Act to promulgate rules governing the conduct

[978] The Bureau noted in the proposal its understanding that foreign currency spot transactions are not covered by the CFTC rule. 81 FR 32830, 32881 n.492 (May 24, 2016). *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") and 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.").

[979] If a provider offers products or services that would have been covered by the proposal, such as consumer credit, and others that would not have been covered, the provider would have been permitted to use contract language that is tailored to such a circumstance. *See* proposed § 1040.4(a)(2)(ii).

of SEC- or CFTC-regulated persons when acting in a regulated capacity. The commenters referenced provisions in Dodd-Frank section 1027 and in the Act's legislative history that, in their view, support that position.

With respect to broker-dealers and investment advisers, the broker-dealer and investment adviser trade association commenters also stated that their position was further supported by language in Dodd-Frank section 1002(15)(A)(vii), which excludes "services related to securities" from the general definition of financial advisory products or services that are subject to the Bureau's Dodd-Frank Act jurisdiction.[980] With respect to futures commission merchants, the CFTC and futures industry trade association stated that the CEA confers exclusive jurisdiction on the CFTC over CFTC-regulated products or services.[981] As a result, these commenters asserted that the final rule need not exempt these persons because the Bureau cannot regulate them in this rulemaking. Instead, commenters requested that the Bureau, in the final rule, state that it has no regulatory authority over these persons under Dodd-Frank section 1028 and title X of the statute more broadly.[982]

The industry trade associations also observed that the Bureau's Study did not analyze the use of arbitration agreements by their members. The commenters also did not identify any consumer financial products or services provided by their investment adviser or futures commission merchant members that could be subject to this rule. With respect to broker-dealers, a securities industry trade association, whose members include broker-dealers who are also

[980] Section 1002(15)(A)(vii) covers "providing financial advisory services" as defined in that provision, which specifically excludes "services related to securities provided by a person regulated by the [Securities and Exchange] Commission or a person regulated by a State securities Commission, but only to the extent that such person acts in a regulated capacity) …"
[981] 7 U.S.C. 1 *et seq.*
[982] One of these trade associations also stated that, if the Bureau pursued the contrary view and sought to cover any of these persons, there also may be confusion over which types of claims relate to the covered products or services, and which ones relate to other products or services they provide. To address this, they requested that the final rule clarify when a claim is "related" to a covered product or service. That comment is discussed in the section-by-section analysis of § 1040.4(a) below.

registered investment advisers, stated that broker-dealers provide margin loans to purchase securities, and may also provide payment processing or remittances in certain circumstances. In the view of this industry trade association, however, these products or services were related to securities within the meaning of Dodd-Frank section 1002(15)(A)(vii), and, as a result of this relationship, excluded from the rulemaking authority of the Bureau. The commenter asserted that this would be the case regardless of whether the services relating to securities were financial advisory in nature, but further asserted that the products or services do relate to financial advisory services that broker-dealers provide. The industry trade association asked the Bureau to identify what covered products and services that, in the Bureau's view, broker-dealers provide. This commenter also stated that neither it nor its members were aware of any covered products or services that investment advisers provide, and asked the Bureau to specifically identify any such covered products or services of which it was aware.

A trade association of consumer lawyers stated in its comment letter that the Bureau should not exempt any products or services covered by the proposal that are subject to the CFTC's jurisdiction because CFTC arbitration rules are limited and ineffective, do not guarantee the option for participation in class actions, and do not provide for the transparency of arbitral awards. This commenter did not identify, however, any consumer financial products or services provided by CFTC-regulated entities.

An association of lawyers who represent investors also urged the Bureau to not exempt investment advisers providing a covered product or service because there is currently no regulation of the use of arbitration agreements related to these products or services by investment advisers, and the SEC, in its view, has no current plan to exercise its authority to regulate investment adviser arbitration agreements under Dodd-Frank section 921. This commenter did

not identify, however, any consumer financial products or services provided by investment advisers.

*The Final Rule*

The Bureau adopts § 1040.3(b)(1)(i), an exemption for persons regulated by the SEC as defined in Dodd-Frank section 1002(21), which includes broker-dealers and investment advisers, as well as their employees, agents, and contractors, to the extent regulated by the SEC. This exemption also applies to persons acting in other SEC-regulated capacities as defined in Dodd-Frank section 1002(21), such as stock exchanges, self-regulatory organizations, and others. Under Dodd-Frank section 1002(21), persons regulated by the SEC can only meet this definition "to the extent" that they are acting in an SEC-regulated capacity.[983] Thus, it is not placing a condition on the exemption, such as the condition it had in the proposal for the broker-dealer exemption. The Bureau finalizes the exemption as described given that the SEC has authorities to regulate the use of arbitration agreements by SEC-regulated persons, including Dodd-Frank Act section 921 in which Congress delegated authority to the SEC to engage in its own rulemaking concerning the use of arbitration agreements by broker-dealers and investment advisers.[984] In light of the fact that the Bureau has not received comments indicating that any other SEC-regulated persons provide consumer financial products or services that would otherwise be covered by proposed § 1040.3(a), the Bureau has concluded, based on further consideration, that incidental provision of a consumer financial product or service performed by a person when acting in an SEC-regulated capacity should not be covered, just as the Bureau does not seek generally to regulate merchants or employers in this rule, as discussed in the

[983] 12 U.S.C. 5481(21) (clarifying that definition applies "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.").
[984] For example, the Bureau recognizes that the FINRA rules described above already apply to broker-dealers and that the SEC could issue further regulations on this subject under the Dodd-Frank Act.

section-by-section analysis for § 1040.3(a)(1)(iii) above and § 1040.3(b)(5) below, respectively. Moreover, an exclusion for SEC-regulated persons is consistent with the rule's exclusion of CFTC-regulated persons, as described below. For clarity, in light of the above factors, the Bureau believes that when a person is acting in an SEC-regulated capacity as described in Dodd-Frank section 1002(21), the final rule does not need to apply to them.

In addition, the exemption in § 1040.3(b)(1)(ii) applies to any person to the extent regulated by a State securities commission as a broker-dealer or investment adviser. For example, some smaller investment advisers have assets under management that fall below registration thresholds for SEC oversight but that are required to register in the States in which they operate. Similarly, some broker-dealers operating exclusively within a State or only with respect to excluded and exempted securities may not be required to register with the SEC but may be regulated by a State securities commission. The Bureau has decided not to apply the rule only to smaller investment advisers or broker-dealers not registered with the SEC, as it sees no reason to target only this one segment of the market for coverage in this rule and doing so may create confusion in the marketplace. The exclusion in § 1040.3(b)(1)(ii) does not reach more broadly than broker-dealers and investment advisers, however. The Bureau does not confer a blanket exemption on persons regulated by State securities commissions because unlike the term person-regulated by the SEC, there is no definition of this term in the Dodd-Frank Act. In some States, an agency that is a State securities commission regulates securities firms as well as banks and other providers that regularly provide consumer financial products or services.[985] A blanket exclusion could therefore inadvertently exclude State-regulated banks.

[985] For example, in the District of Columbia, one agency – the Department of Insurance, Securities and Banking – regulates both banks and securities.

Thus, as revised, this exclusion applies to a broker-dealer or investment adviser who falls into either or both of the following categories: (1) is a person regulated by the SEC as defined in Dodd-Frank section 1002(21); or (2) to the extent the person is regulated by a State securities commission as described in Dodd-Frank section 1027(h). It also applies to any other person regulated by the SEC as defined in Dodd-Frank section 1002(21).

With respect to persons regulated by the CFTC, the Bureau is similarly adding an exemption in the final rule to exclude persons regulated by the CFTC as defined in 12 U.S.C. 5481(20) or a person with respect to any account, contract, agreement, or transaction to the extent subject to the jurisdiction of the Commodity Futures Trading Commission under the CEA, 7 U.S.C. 1 *et seq*. The Bureau recognizes that the CFTC has authority to issue arbitration rules for persons regulated by the CFTC, as demonstrated by the CFTC arbitration rules discussed above, which have been in place for over four decades.[986] In addition to excluding a person regulated by the CFTC as that term is defined in Dodd-Frank section 1002(20), the exemption separately applies to accounts, contracts, agreements, and transactions subject to CFTC jurisdiction under the CEA. The Bureau understands such activities generally would be carried out by persons registered or required to register with the CFTC, who therefore already would meet the definition of a person regulated by the CFTC in 12 U.S.C. 5481(20). Nonetheless, for the sake of clarity, the Bureau is separately referring to those activities as being excluded. Finally, both the definition of a person regulated by the CFTC in the Dodd-Frank Act

[986] 17 CFR 166.5, originally adopted by 41 FR 42942 (Sept. 29, 1976).

and the additional reference to the exclusion CFTC-regulated accounts, contracts, agreements, and transactions only apply to the extent an activity is regulated by the CFTC under the CEA.[987]

*3(b)(2)*

*The Bureau's Proposal*

Proposed § 1040.3(b)(2) would have excluded from the coverage of proposed part 1040 governments and their affiliates, as defined by 12 U.S.C. 5481(1), to the extent such entities provide products and services directly to consumers within their jurisdiction as specified in proposed § 1040.3(b)(2)(i) or (ii). This proposed exclusion would not have applied 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.[988]

As stated in the proposal, the Bureau believed that private enforcement of consumer protection laws, when provided for by statute, is an important companion to regulation, supervision of, and enforcement against private providers by governments at the local, State, and Federal levels. The Bureau believed, however, that financial products and services provided by governments and 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 that they and their affiliates provide directly to their own constituents.

Specifically, proposed § 1040.3(b)(2)(i) would have excluded 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 have

[987] *See* 15 U.S.C. 5481(20) (defining the term "person regulated by the [CFTC]" as referring to a person registered or required to register with the CFTC "but only to the extent that the activities of such person are subject to the jurisdiction of the [CFTC] under the [CEA].").
[988] 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).

applied, the Bureau posited that the Federal government and its affiliates may be uniquely accountable through the democratic process to consumers to whom the Federal government and its affiliates directly provide products and services. The Bureau additionally posited 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 proposed 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 have exempted nongovernmental entities that provide covered products or services on behalf of the Federal government or its affiliates, such as student loan servicers. Proposed comment 3(b)(2)-1 would have reiterated this point with respect to the exclusions in proposed § 1040.3(b)(2), and also would have noted that the definition of affiliate in Dodd-Frank section 1002(1) would have applied to the use of the term in proposed § 1040.3(b)(2).

Proposed § 1040.3(b)(2)(ii) would have excluded 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 believed 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 have applied, the Bureau posited that governments and their affiliates may be 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 posited 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 proposed 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.

As with the proposed exclusion for the Federal government and its affiliates, proposed § 1040.3(b)(2)(ii) would not have excluded 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 have extended to State, local, or Tribal governments or their affiliates providing products or services to consumers who reside outside the territorial jurisdiction of the particular government. The Bureau believed 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.

Proposed comment 1040.3(b)(2)-2 would have provided 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, as well as products and services that would have fallen outside the scope of the proposed exclusion. The use of the term "affiliated" in these examples also would have indicated that this exemption would not have applied to services provided by persons who are not affiliates of governments. For example, so-called "public utilities" would not have been exempt unless they control, are controlled by, or are under common control with a government or its affiliates. The Bureau requested comment on these proposed examples, and on whether other examples should be included.

The Bureau further noted that the proposal would not have covered 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 have been 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) generally would have applied.

*Comments Received*

A consumer advocate and two public-interest consumer lawyer commenters urged the Bureau not to adopt the proposed exclusions, asserting that democratic processes are insufficient to protect consumers. In particular, they noted that consumers are not necessarily aware of legal harms (as the Bureau had itself noted in the proposal), and thus may be unable to use the democratic process to hold government providers to account. Moreover, even when consumers are aware, the commenters asserted that very few are likely to exercise their vote on this basis

alone, particularly over small-dollar harms. The commenters also cited examples of the use of class actions to protect the rights of minorities, who, in their view, have historically faced particular difficulties holding governments accountable.[989]

These commenters separately urged the Bureau not to use the term "affiliate" as defined in Dodd-Frank Act section 1002(1) because that definition was developed for the private marketplace and would be ambiguous in this context. One of these commenters also stated that affiliates of governments often have weaker accountability than governments themselves. Instead, the commenters advocated using a more developed test applied by the Internal Revenue Service to determine when entities are governmental in nature such that they are not required to file a Federal tax return.[990] The consumer advocate commenter also stated that the Bureau should not use the term "arm of the State" to define which entities are exempt because the application of that term from constitutional immunity law is uncertain, and could lead to the exemption of entities who have only a small amount of capital contribution from governments. Similarly, a public-interest consumer lawyer commenter also stated that the term affiliate in the Dodd-Frank Act should not be used because it was ambiguous, and could reach providers acting as a special counsel to prosecutors in connection with check collection.

As is discussed above in Part IV, the Bureau held a consultation with representatives of Tribal governments in Phoenix, Arizona, on August 22, 2016. Many Tribal government representatives attending the consultation and other Tribal commenters (for convenience, both are referred to here as Tribal commenters, as many of those providing oral input at the

[989] These commenters also referred to particular products or services that may be provided by governments. One commenter identified an arbitration agreement in a particular home-improvement financing contract used in a PACE (Property Assessed Clean Energy) home improvement financing program, as part of a program that, in the view of the commenter, has led to problems for many consumers. (The Bureau understands that PACE financing is typically supported by local governments and structured to be paid off through the local government tax assessment process.) In addition, another public-interest consumer lawyer commenter expressed concern over the government exemption to the extent it would exclude debt collection by State schools, which, in its view, might add arbitration agreements in the future.
[990] *See* I.R.S. Rev. Proc. 1995-48.

consultation also provided written comments) emphasized that, in their view, the proposal would interfere with the sovereign immunity of Tribal governments.[991] Many Tribal commenters also expressed their opinion that the Bureau had no legal authority to regulate Tribal governments for several reasons, including that the reference to regulation of "persons" in the statute, 12 U.S.C. 1002(19), did not specifically list Tribal governments. In addition, many of these commenters criticized the Bureau because it did not propose to exempt Tribal governments entirely or otherwise state that the proposal would not apply to them.

In particular, Tribal commenters criticized proposed § 1040.3(b)(2). With regard to the Bureau's focus on democratic accountability, a number of Tribal commenters stated that their governments are sufficiently accountable, whether to residents or non-residents, and that they should be completely exempted from the rule. One Tribal commenter stated that the lack of a similar exemption in the Bureau's proposed rulemaking for small-dollar loans raised questions about the Bureau's rationale for proposing one here.[992] Several Tribal commenters also suggested in their comments that other mechanisms, such as intergovernmental relations with consumer protection regulators (including the Bureau), were a much stronger guarantor of accountability for consumer protection matters, whereas, in their view, the Bureau has not established that democratic accountability is an adequate form of accountability for consumer protection purposes. A Tribal industry trade association stated that the exclusion should be broadened to apply to all Tribal governments, including arms of Tribal governments, that are subject to Tribal regulatory oversight and dispute resolution mechanisms codified in Tribal law. In the view of this commenter, the Bureau did not find that class actions were in the public

[991] These commenters' disagreement with the class proposal are addressed in Part VI above.
[992] *See generally* Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 FR 47864 (July 22, 2016).

interest and for the protection of consumers in these contexts. In addition, several Tribal commenters noted that the proposal's concept of residency could be difficult to apply to all Tribes. Commenters explained that many Tribes may have members that do not reside on Tribal lands, whether because the Tribe has little or no land or because the Tribal members reside elsewhere (and thus these Tribes would not be able to qualify for the exception even when dealing with their own members), while others may have complicated interpretations of what land is considered their territory (and thus who are their residents).

Several Tribal commenters also stated that the proposal would interfere with Supreme Court and other appellate precedent recognizing that consumers who are not members of a Tribe and not resident in Tribal territory nonetheless can consent to Tribal jurisdiction.[993]

Several Tribal commenters further asserted that there was no basis for applying the proposal to Tribal governments, since they have sovereign immunity from private lawsuits including class actions.[994] One Tribal commenter also stated that Tribal governments may need to spend significant funds, and that based on its experience litigating immunity issues in a recent class action, those could be in excess of $100,000 per case. This commenter suggested that arbitration agreements may reduce this cost, though this commenter also stated that its Tribal lending operation did not use arbitration agreements.

Finally, two Tribal commenters urged the Bureau to expand its proposed exemption to include a service provider that acts on behalf of a government, asserting that these service providers enjoy the same legal status as the government itself. In support of their position, these commenters asserted that contractors may manage Tribal casinos without violating Federal

[993] *See, e.g.*, *Montana* v. *United States*, 450 U.S. 544, 565 (1981) (holding that a Tribe may regulate dealings with nonmembers based on consent); *Dollar Gen. Corp.* v. *Mississippi Band of Choctaw Indians*, 746 F.3d 167, 177 (5th Cir. 2014) (applying *Montana* consent-based test), *aff'd per curiam*, 579 U.S. ___, 136 S.Ct. 2159 (2016).
[994] Some of the comments cited authority, including *C&L Enterprises, Inc.* v. *Citizen Bandpotawatomi Tribe of Okla.*, 532 U.S. 411 (2001).

gambling law, and contractors that run lotteries on behalf of State governments enjoy the same immunities that are conferred on the State government itself.[995]

*The Final Rule*

After consideration of the comments and the Bureau's further analyses, the Bureau has decided to shift away from an exemption for governments based on where their consumers reside, as the Bureau had proposed. The Bureau also understands the concerns raised by commenters about democratic accountability being potentially insufficient to protect consumers in some situations. At the same time, the Bureau also does not see a need, in general, for the rule to apply to persons who cannot be sued in class actions in any event because they are immune from suit. The Bureau is therefore adopting a status-based exemption in § 1040.3(b)(2) for (i) Federal government agencies as defined in the Federal Tort Claims Act, 28 U.S.C. 2671, and (ii) any State, Tribe, or other person to the extent the person qualifies as an arm of the State or Tribe within the meaning of Federal law concerning sovereign immunity and the person's immunities have not been abrogated by the U.S. Congress. The Bureau is adding comment 3(b)(2)(ii)-1 to clarify that, when the rule uses the term State, this includes any State, territory, or possession of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, Guam, American Samoa, and the United States Virgin Islands.[996] The Bureau also is adding comment 1040.3(b)(2)(ii)-2 to clarify that the term "Tribe" in this exemption is a reference to any federally recognized Indian Tribe, as defined by

[995] Many Tribal commenters also objected to the language in Bureau's proposed mandatory provision for arbitration agreements. Those comments are discussed in the section-by-section analysis of § 1040.4(a)(2) below.

[996] This definition mirrors the definition of State in Dodd-Frank section 1002(27), except, however, for purposes of this rule the Bureau is separately using the term "Tribe" for clarity, given that the rule also separately refers to the arm of the State and arm of the Tribe immunity law standards.

the Secretary of the Interior under section 104(a) of the Federally Recognized Indian Tribe List Act of 1994, 25 U.S.C. 479a-1(a).[997]

The Bureau recognizes that certain government actors generally enjoy blanket immunities from private suit except when the immunity is lawfully abrogated by an act of Congress. These actors include not only States and Tribes, but also entities that are determined to be an "arm of a State," and similarly, an arm of a Tribe.[998] The Federal government, including its agencies, also generally enjoys immunity from private suit, again unless waived by Congress for particular Federal law claims.[999] The Bureau does not believe it is necessary for the rule to apply to persons who cannot be sued on any claims in a private lawsuit because they enjoy sovereign immunity and that immunity has not been abrogated. The Bureau believes that, in part because of their general immunities, such entities do not tend to use arbitration agreements in the first instance.[1000] Accordingly, the Bureau is adopting in § 1040.3(b)(2) exemptions for these persons. With respect to the consumer advocate commenter that stated that an exemption based on an arm of a State or an arm of a Tribe could lead to the exclusion of entities that have only a small amount of capital contribution from governments, the Bureau does not believe that would be a reason to subject such persons to the rule when they would be immune from private suit anyway. To the extent the reduced capital contribution raises a genuine belief about whether the

[997] This definition repeats the definition used in Dodd-Frank section 1002(27). These are the Tribal entities recognized and eligible for funding and services from the Bureau of Indian Affairs (BIA) of the U.S. Department of Interior by virtue of their status as Indian Tribes. *See, e.g.*, Indian Entities Recognized and Eligible to Receive Services from the United States Bureau of Indian Affairs, 81 FR 5019 (Jan. 29, 2016).
[998] *Alden* v. *Maine*, 527 U.S. 706, 713 (1999) (State sovereign immunity); *People ex. rel. Owen* v. *Miami Nation Enterprises*, 2016 WL 7407327 (Cal. 2016) (summarizing national jurisprudence on the "arm of the Tribe" doctrine).
[999] *Glidden Co.* v. *Zdanok*, 370 U.S. 530 (1962) (holding that Article III courts exercise jurisdiction over claims against the United States under jurisdiction conferred by Congress).
[1000] One Tribal entity commenter stated that the rule would have a number of effects on Tribal economic development including job growth. This commenter clarified, however, that it does not use arbitration agreements. As a result, it was unclear why the commenter foresaw this result. In any event, the exemption in § 1040.3(b)(2) should prevent any unintended consequences from the rule on Tribal governmental bodies that are immune from private suit as arms of a Tribe.

person truly is an arm of the State or an arm of a Tribe, the person may insert the optional language in § 1040.4(a)(2)(vi).

Insofar as U.S. sovereign immunity law allows for the immunities of a State or Tribe (and by extension, their arms) to be, in some circumstances, abrogated by Congress, the Bureau does not intend for its rule to permit arbitration agreements to block class actions in these instances.[1001] In those circumstances, an entity that may be a State, Tribe, or an arm of a State or Tribe, may be subject to private suit, including a class action. Therefore, the exemption adopted in § 1040.3(b)(2) is not available to an entity to the extent its immunity has been abrogated by Congress.[1002]

The Bureau also recognizes that the existence and nature of sovereign immunity from suit is not always fully certain. If a question or uncertainty were to arise, the final rule provides tailored language for entities to include in their contracts to preserve any immunity claims. Specifically, as discussed in the section-by-section analysis for § 1040.4(a)(2)(vi) below, if a person has a genuine belief that sovereign immunity from private suit under applicable law may apply to a person that may seek to assert the pre-dispute arbitration agreement, the person may voluntarily include a specified provision in its arbitration agreement that is designed to preserve any claim to that immunity that the person may have. This option allows providers covered by the rule to deal with any uncertainty they may perceive concerning the status of their immunities, without taking the risk that a court ultimately would disagree with their reliance on the

[1001] *C&L Enterprises*, 532 U.S. 411, 418 (2001) (affirming that abrogation of Tribal immunities under U.S. law is a matter for Congress alone); *Florida Prepaid Postsecondary Educ. Board* v. *College Svgs. Bank*, 527 U.S. 627, 634 (1999) (limiting, but not abandoning, abrogation powers of Congress with respect to States).

[1002] With regard to the Tribal industry association commenter's request for an exemption for Tribal governments and arms of Tribal governments when subject to Tribal regulatory oversight and Tribal dispute resolution processes, the exemption the Bureau is adopting in § 1040.3(b)(2) would apply to these persons when they are immune from private suit under Federal sovereign immunity law. To the extent these persons' immunity from private suit in non-tribal courts is abrogated by Congress, the Bureau believes this rule should not restrict consumers' access to non-tribal courts in disputes with these persons.

exemption in § 1040.3(b)(2), and potentially subjecting them to a risk of penalties for violation of this rule.

The Bureau also recognizes that some governmental entities may not be eligible for the exemption in § 1040.3(b)(2)(ii). For example, some local governments may not be an arm of the State in which they are located. These governments would be subject to the rule to the extent they use arbitration agreements in connection with offering or providing a covered product or service to consumers and no other exemption applies. The rulemaking record does not establish that such situations are common.[1003] Alternatively, some entities may not be an arm of the State and may be subject to Federal law claims, but may be afforded a governmental status and associated immunities under State law. While those persons would not be eligible for the exemption in § 1040.3(b)(2)(ii), they may still use immunity preserving language permitted by § 1040.4(a)(2)(vi). Finally, the Bureau recognizes that some entities may be affiliated loosely with a State or Tribal government, but in a manner insufficient to create immunity from private suit. The Bureau does not believe that an exemption for these entities would be warranted. The Bureau thinks the case for an exemption is weakest under the logic of either the proposal or the final rule with regard to entities with such loose governmental relationships, and has concluded on balance that it would be beneficial to subject them to the final rule.

The Bureau further notes that the exemption in § 1040.3(b)(2)(ii) applies to an entity that qualifies as an arm of the State or arm of the Tribe under U.S. law, regardless of whether it has waived its immunity. Under sovereign immunity law, States, Tribes, or arms of a State or Tribe

[1003] A consumer advocate identified an arbitration clause in one consumer agreement for a home improvement program funded through tax assessments. The commenter did not establish whether the agreement entails an extension of consumer credit under Regulation B, or whether the provider of the financing is an arm of the State, however. Whether such a program is covered will depend on the facts and circumstances, and the application of these legal standards.

may become amenable to private suit by voluntarily consenting to private suit.[1004] After substantial consideration, however, the Bureau believes that there would be undue complications with basing eligibility for the exemption in § 1040.3(b)(2)(ii) of this rule on whether an entity has voluntarily waived its immunities. First, if a State, Tribe, or other person that is an arm of the State or Tribe uses an arbitration agreement, this may establish a formal dispute mechanism where one did not otherwise exist – unlike for other providers, which are generally amenable to a suit in court absent an arbitration agreement. As a result, the Bureau is concerned that eliminating the exemption in the case of a waiver, such as may occur by use of an arbitration agreement, could discourage all forms of dispute resolution. Second, issues of waiver – including the extent of any waiver – are often fact-dependent, and in some cases may only be resolved through litigation. For example, a State legislature may waive immunities of an arm of the State for certain State law purposes, but leave unresolved whether immunity from Federal law claims has been waived. Thus, conditioning the exemption on the absence of a voluntary waiver may create undue uncertainty. Accordingly, the Bureau is not conditioning the exemption on the absence of a voluntary waiver. An entity that is an arm of the State or Tribe whose attendant immunity from suit has not been abrogated by Congress is eligible for the exemption in § 1040.3(b)(2)(ii), even if the entity is found to have voluntarily waived the immunities that flow from its status as an arm of the State or Tribe. Similarly, even if Tribal law allowed certain claims against an entity that was an arm of the Tribe under Federal law, if that entity's sovereign immunity from private suit under Federal law was not abrogated by Congress, then it would be eligible for the exemption as well. Through monitoring the provision of

[1004] *See, e.g.*, *College Svgs. Bank* v. *Florida Prepaid Postsecondary Educ. Board*, 527 U.S. 666, 673 (1999) (describing voluntary waiver doctrine).

consumer financial products or services provided by governments, however, the Bureau could at a future point condition the exemption on the absence of a waiver of immunities.[1005]

*3(b)(3)*

The Bureau proposed 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 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.[1006] 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 have been eligible for this proposed exemption and generally would have been required to comply with all applicable provisions of the proposal.

As stated in the proposal, the Bureau believed that a threshold of the type described above (based upon provision of a product or service to only 25 or fewer persons annually) may have been appropriate to exclude covered products and services from coverage when they are not offered or provided on a regular basis for several reasons.[1007] First, the Bureau believed that services and products 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

[1005] Although no commenters raised this concern, the Bureau also notes that it is in theory possible that a State law does not afford immunities to an entity that nonetheless has arm of the State status under Federal law and is immune from Federal law claims. This could occur, for example, because the entity is not treated as part of the State government for purposes of the State immunity law, or the immunity such an entity may typically enjoy under State law has been abrogated. The Bureau believes, however, that it would be rare for State law to allow for claims against a body so closely connected with the State that Federal law deems it is an arm of the State. The Bureau also believes it would be impractical to condition the exemption on an entity having immune status under both Federal and State law. This could often implicate complex questions under laws of multiple States and Federal law merely to determine eligibility for the exemption. Accordingly, the Bureau is adopting a simpler approach. If such an entity were an arm of the State under Federal law, then it would be eligible for the exemption in § 1040.3(b)(ii). The Bureau notes that if a similar scenario occurred in which a Tribal law does not afford immunities to a Tribal entity that nonetheless qualifies as an arm of the Tribe under U.S. Federal sovereign immunity law, the entity would, likewise, still be eligible for the exemption.
[1006] As proposed comment 3(b)(3)-1 would have clarified, 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).
[1007] 81 FR 32830, 32882 (May 24, 2016).

covered products or services are provided so infrequently, the likelihood of an individual claim in arbitration also is especially low. Therefore, the Bureau believed that applying the proposal 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 believed that excluding covered products and services that entities provide so infrequently would relieve these entities of the burden of complying with the proposal for those products and services.

As also explained in the proposal, the Bureau was 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),[1008] the underlying statutes and regulations incorporated by reference do not specify particular numeric thresholds.[1009]

For purposes of the proposal, the Bureau believed that a single uniform numerical threshold may facilitate compliance and reduce complexity, particularly given that application of the proposal 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 have been 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

[1008] 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 proposal 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.

[1009] 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.

year. The Bureau emphasized that it was proposing this uniform standard in the unique context of this proposal, and that it expected 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 noted that basing an exemption on the level of activity in the current and preceding calendar year would have been consistent with the threshold under 12 CFR 1026.2(a)(17)(v).

The Bureau received one comment on this proposed exemption from a consumer advocate that supported the proposed exemption as appropriate. In this commenter's opinion, the exemption would have minimal impact on consumers in light of the numerosity requirement for class actions. The commenter noted that the similar exemption in Regulation Z has been well understood and implemented.

The final rule adopts § 1040.3(b)(3) and comment 3(b)(3)-1 as proposed, with two minor clarifications. First, rather than framing the exemption as applying "when" the person provides products or services below the specified threshold frequency, the final rule states that the exemption applies "with respect to" the products or services provided below that frequency. This revision seeks to emphasize more clearly that, if a person provides two products or services covered by § 1040.3(a), one with a frequency that is below the threshold and the other with a frequency that exceeds the threshold, then the exemption only applies to the first product or service and not the second. Second, comment 3(b)(3)-1 is revised to clarify that although the number of times a product is offered is not relevant for purposes of determining eligibility for this exemption, participating in a credit decision with regard to consumer credit in circumstances described in § 1040.3(a)(ii) would count. In particular, this activity constitutes providing a product or service covered by § 1040.3(a), even if an application for consumer credit is denied.

The clarification in comment 3(b)(3)-1 is important to prevent confusion over what constitutes providing a covered product or service in the context of consumer credit, because the number of times a person and its affiliates offer a product or service is not relevant to eligibility for the exemption.[1010]

The Bureau also adopts new comment 3(b)(3)-2 to clarify the obligations of a person providing a covered product or service upon becoming ineligible for the exemption. The Bureau notes that the exclusion in § 1040.3(b)(3) is based on the frequency with which a person and its affiliates collectively "provide" a product or service. That standard is in the present tense so the exemption is available so long as the criteria in the exemption are met. Accordingly, comment 3(b)(3)-2 clarifies that, if, during a calendar year, a person to that point excluded by § 1040.3(b)(3) for a given product or service described in § 1040.3(a) provides that product or service to a 26th consumer, then that person ceases to be eligible for this exclusion at that point in time with respect to that product or service. The provider must begin complying with this part with respect to the covered product or service provided to that 26th consumer. In addition, the provider will not be eligible for the exclusion in § 1040.3(b)(3) whenever it offers or provides that product or service for the remainder of that calendar year and the following calendar year.

*3(b)(4)*

*The Bureau's Proposal*

As stated in the proposal, merchants, retailers, and other sellers of nonfinancial goods and services extending consumer credit are excluded from the Bureau's rulemaking authority except in certain limited circumstances under Dodd-Frank section 1027(a)(2)(B). Thus, while they are

[1010] For example, a person and its affiliates collectively may offer a product or service to more than 25 consumers in a given calendar year, but only provide the product or service to 25 or fewer consumers in that calendar year and 25 or fewer consumes in the prior calendar year. In that example, the person would still be excluded by § 1040.3(b)(3).

covered persons under the Dodd-Frank section 1002(6), the proposal would have applied to them generally only when they act as creditors as defined by Regulation B by extending consumer credit or participating in consumer credit decisions, or when they engage in collection on or sale of these consumer credit accounts beyond the scope of the exclusion in Dodd-Frank section 1027(a)(2). In particular, because section 1027(a)(2)(A) generally excludes activities by a merchant, retailer, or other seller of nonfinancial goods or services to the extent such person extends credit directly to a consumer exclusively for the purchase of a nonfinancial good or service directly from that person, the Bureau proposed to reflect that general restriction through language excluding merchants in § 1040.3(b)(5) as discussed further below.

The Bureau also proposed in § 1040.3(b)(4) to exclude merchants from the scope of the rule for an additional type of activity that is generally not excluded from Bureau jurisdiction under section 1027(a)(2). Specifically, proposed § 1040.3(b)(4) would have excluded merchants to the extent they are engaged in certain "factoring" transactions and other types of commercial credit in which the merchant collateralizes its interest in its own consumer credit receivables on which no finance charge is imposed. *See* Dodd-Frank section 1027(a)(2)(B)(i). As explained in further detail in the proposal, the Bureau would have limited the exemption in § 1040.3(b)(4) to circumstances where the Bureau would not have other bases for jurisdiction, such as under other parts of Dodd-Frank section 1027(a)(2) that subject certain types of credit transactions by merchants to the rulemaking authority of the Bureau.[1011]

Proposed § 1040.3(b)(4)(i) thus would have excluded from the coverage of 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-

[1011] 81 FR 32830, 32883-84 (May 24, 2016).

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 have been eligible for this exemption with respect to such consumer credit transactions when they are sold, assigned, or otherwise conveyed to a third party, so long as the consumer credit was not extended in an amount that significantly exceeded the value of the good or service (which creates a basis for rulemaking authority under section 1027(a)(2)(B)(ii)) and did not have a finance charge (which creates a basis for rulemaking authority under section 1027(a)(2)(B)(iii) except where the creditor is not engaged significantly in that type of lending under section 1027(a)(2)(C)(i)).

In addition, the exclusion in proposed § 1040.3(b)(4)(ii) would have applied 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 proposal would not have applied, 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)).

Further, the Bureau noted that proposed § 1040.3(b)(4) would only have exempted a merchant, retailer, or seller of the nonfinancial good or service, but would not have affected 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 same

extension of consumer credit. As discussed below in the section-by-section analysis to comments 4-1 and 4-2, those providers would have been subject to the proposal.

*Comments Received*

A public-interest consumer lawyer commenter opposed the proposed exemption in § 1040.3(b)(4) but did not elaborate on the basis for its opposition. A consumer advocate commenter was not opposed to the exemption in proposed § 1040.3(b)(4), stating that some merchant financing arrangements may expose the merchant to risks, but that these risks generally should not filter down to consumers. This commenter also supported the view that the Bureau expressed in the proposal that only the merchant itself would be eligible for the exemption, and not third parties such as payment processors, servicers, or debt collectors. This commenter urged the Bureau to memorialize this point in the commentary to the final rule.

An industry trade association expressed concern that the scope of the exemption in proposed § 1040.3(b)(4)(i) would be confusing and difficult to analyze for merchants extending consumer credit with no finance charge. This commenter stated that the Bureau should clarify that any merchant extending consumer credit would be exempt from the rule except where extending consumer credit with a finance charge or in an amount that significantly exceeded the value of the nonfinancial good or service being financed. The commenter also stated that the merchant should be excluded, unless the basis for covering the merchant was established by "clear and convincing evidence." Finally, the commenter stated that the exemption in proposed § 1040.3(b)(4)(ii) should not be limited to the act of acquiring or purchasing the extension of consumer credit, but should also include the activities carried out with respect to that account that would have been exempt had they been performed by the selling merchant, such as servicing. Otherwise, in its view, the purchasing or acquiring merchant would be more limited in

what it could do without triggering the rule than the original merchant would be – without any basis for that differential treatment.

*The Final Rule*

The final rule adopts § 1040.3(b)(4) as proposed, with technical changes to refer to the excluded person in the singular instead of plural and to refer to the activity of offering as excluded,[1012] as well as an additional clarification. In particular, in addition to excluding merchants under the circumstances addressed in proposed § 1040.3(b)(4), the Bureau has added a new subparagraph (A) to extend the exclusion also to apply to circumstances in which the merchant is not subject to Bureau rulemaking authority under any component of Dodd-Frank section 1027(a)(2). While both proposed and final § 1040.3(b)(5) (renumbered as § 1040.3(b)(6)) achieve this same effect because they general exclude parties who are not subject to the Bureau's rulemaking authority, the Bureau believes that including this second element in § 1040.3(b)(4) will help to reduce confusion about whether merchants extending consumer credit with no finance charge would be subject to the rule. Given that proposed § 1040.3(b)(4) already incorporated certain elements of section 1027(a)(2) of the statute, the Bureau believes that, based on the industry trade association comment described above, it would be clearer if this provision also refers to the circumstances where a statutory exclusion in section 1027(a)(2) would apply to the merchant.

Therefore, in light of the addition of subparagraph (A) to § 1040.3(b)(4)(i) to refer to circumstances – *i.e.*, circumstances in which the Bureau does not have rulemaking authority under Dodd-Frank section 1027(a)(2)(B), the Bureau has moved the other references to

[1012] The header of Dodd-Frank section 1027(a)(2) indicates that statutory provision relates to "offering or provision" of certain consumer financial products. For clarity, the Bureau is similarly revising the scope of the exclusion in § 1040.3(b)(4).

provisions of section 1027(a)(2)(B) that appeared in the proposal to a new subparagraph (B) of § 1040.3(b)(4)(i). As a result, merchants extending consumer credit with no finance charge would know that, even if they were not eligible for the exemption in § 1040.3(b)(4)(i) as proposed, they may still be excluded from coverage of the rule. However, the Bureau disagrees with the commenter that merchants extending consumer credit with a finance charge, or in an amount that significantly exceeds the value of the nonfinancial goods or services being financed, should only be covered if these circumstances are established with "clear and convincing evidence." Such an approach would set a higher standard for applying the Bureau's rule than for underlying statutes whose compliance the Bureau is seeking to ensure. For example, if a TILA claim were asserted against a merchant extending consumer credit on the basis of a finance charge being present, such a claim would not necessarily be subject to a "clear and convincing evidence" standard. Setting such a standard for the scope of the rule would therefore reduce consumer protections the rule is seeking to enhance.

The Bureau is also adding comment 3(b)(4)-1 to clarify that the exemption in § 1040.3(b)(4)(ii) applies not only to the purchase or acquisition itself, but also to any servicing or collection by the merchant purchaser or acquirer.

The Bureau also reaffirms the statement that it made in the proposal concerning the ineligibility of third parties for the statutory exclusion in Dodd-Frank section 1027(a)(2).

*3(b)(5) and (b)(6)*

*The Bureau's Proposal*

The proposal would not have applied 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 proposed to make this limitation an explicit exemption in proposed

§ 1040.3(b)(5). Proposed § 1040.3(b)(5) thus would have clarified that part 1040 would not have applied 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).

As the Bureau noted in the proposal, the Bureau had intended that proposed § 1040.3(b)(5) would only restrict application of proposed § 1040.4 with regard to those parties for which the Bureau's authority is constrained by Dodd-Frank sections 1027 and 1029. Accordingly, while merchants and automobile dealers who are not subject to the Bureau's rulemaking authority due to sections 1027 and 1029 would not have been subject to proposed § 1040.4, the Bureau explained that it has Dodd-Frank section 1028 rulemaking authority over other providers who assume or seek to use arbitration agreements entered into by such merchants or automobile dealers. Notably, entities excluded from Bureau rulemaking authority under Dodd-Frank sections 1027 and 1029 may still be covered persons as defined by Dodd-Frank section 1002(6). Thus, the Bureau stated that 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 have applied 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 have been 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) described above, for example, hospitals, doctors, and

other service providers extending incidental ECOA credit would not have been 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 have applied 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 automobile dealer is excluded from Bureau rulemaking authority under Dodd-Frank section 1029.

*Comments Received*

A consumer advocate stated in its comments that the final rule should clarify that the rule applies to buy-here-pay-here automobile lenders, which this commenter described as dealers who provide their own financing to consumers and require the consumers to return to the lot to make payments. This commenter believed that this clarification would help address what, in its view, was a general misimpression held by some in the marketplace that the Bureau did not regulate buy-here-pay-here automobile lenders.

An industry trade association for automobile dealers stated in its comment that, in its view, proposed §1040.3(b)(5) would be inadequate to truly exempt automobile dealers from the rulemaking and instead that the proposal would conflict with the exclusion in Dodd-Frank section 1029 for certain automobile dealers. The commenter focused specifically on the proposed requirement in § 1040.4(a)(2) that providers include in their pre-dispute arbitration agreements mandatory language explaining that the provisions would not prohibit consumers from participating in class actions. Although proposed § 1040.3(b)(5) would have excluded many automobile dealers from this requirement, the commenter argued that the rule would still effectively require automobile dealers making loans that are assigned to unaffiliated third parties to include the mandatory contract provisions that the unaffiliated third parties would be required

to have under the rule. This commenter asserted that automobile dealers are generally required to use the forms created by indirect automobile finance companies. Because indirect lenders would be required to use the Bureau's contract provision, the commenter predicted that they would require as a matter of contract that the dealers include that provision on their standard forms, rather than satisfying the rule either by sending consumers notice of the restriction on use of pre-dispute arbitration agreements or amending the agreement at the time that the indirect lenders acquire the loan contracts.

In addition, an industry commenter sought an express exemption providing that the rule would not apply to employer compensation agreements that relate to consumer financial products and services for employees, for example, employer-provided assistance with the down payment for a home. The commenter asserted that Dodd-Frank section 1027(g) excluded any employee benefit or compensation plan or arrangement from Bureau rulemaking authority, and expressed concern that even if some employer-provided consumer financial products or services were covered by the rule, the rule should not reach broader employment agreements concerning other aspects of the employment relationship. The commenter suggested that an exclusion for employer-provided products and services also would be consistent with the Bureau's decision not to propose covering consumer reports provided by employers under proposed § 1040.3(a)(4). On the other hand, a consumer advocate commenter expressed concerns about certain practices by employers, such as compelled use of a payroll card account, in violation of Regulation E.[1013]

[1013] *See also* Bureau of Consumer Fin. Prot., "Payroll Card Accounts (Regulation E)," *CFPB Bulletin* No. 2013-10 (Sept. 12, 2013), *available at* http://files.consumerfinance.gov/f/201309_cfpb_payroll-card-bulletin.pdf.

*The Final Rule*

The Bureau has considered the comments and is adopting proposed § 1040.3(b)(5) with minor technical changes for clarity,[1014] renumbering it as § 1040.3(b)(6), and creating a new § 1040.3(b)(5) to provide an exemption for employer-provided products and services as described further below.

As the Bureau had explained in the proposal, automobile dealers extending consumer credit that is assigned to unaffiliated third parties are generally excluded from the rulemaking authority of the Bureau in the circumstances described in Dodd-Frank section 1029. These automobile dealers are not subject to this rule, as reaffirmed by the explicit reference to section 1029 in § 1040.3(b)(6), and would thus not be obligated to include in their consumer contracts the provisions mandated in the rule. The class rule also would not require indirect automobile finance companies to mandate that automobile dealers with whom they work use contracts with consumers that include the provisions mandated in the rule. Rather, the indirect automobile finance company could amend the contract to include the mandated provisions or send the consumer a notice about the rule at the time the company purchases the credit.[1015] The Bureau therefore disagrees with the commenter's suggestion that the rule would conflict with Dodd-Frank section 1029.

At the same time, the Bureau acknowledges the possibility that, as a business decision and of their own volition, indirect automobile finance lenders may include an arbitration provision consistent with the rule in a form contract they provide to the automobile dealer to use

[1014] Proposed § 1040.3(b)(5) referred to an exclusion for persons and their products or services to the extent "limitations" in Dodd-Frank sections 1027 or 1029 "apply." Exclusions from the rulemaking authority of the Bureau, such as exclusions for automobile dealers in certain circumstances, are the type of exclusions that are relevant to this rulemaking. The Bureau is therefore clarifying that § 1040.3(b)(6) excludes persons to the extent providing products or services in circumstances that are excluded from the rulemaking authority of the Bureau.
[1015] *See* § 1040.4(a)(2)(iii).

with the consumer. However, even if this were to occur, as discussed below in connection with § 1040.4(a)(2)(iii)(A), these lenders would be free to include in their contracts language to clarify that the rule would not apply to the dealers (to the extent that the dealers are excluded from Bureau rulemaking authority by Dodd-Frank section 1029).

The Bureau does not believe it is necessary in this rule, in either regulation text or commentary, to provide interpretations of the scope of provisions in Dodd-Frank sections 1027 or 1029. With regard to buy-here-pay-here automobile lenders, the Bureau did receive a number of comments on behalf of automobile lenders or automobile dealers, and none suggested the type of confusion that the consumer advocate commenter suggested may exist. The Bureau does not believe it is necessary to restate the statute in this rule.[1016]

With regard to the industry commenter concerned with potential coverage of employers under the rule, the Bureau notes that Dodd-Frank section 1027(g) generally excludes Bureau rulemaking authority over consumer financial products or services that relate to a "specified plan or arrangement."[1017] Whether a consumer financial product or service covered by § 1040.3(a) would be excluded pursuant to section 1027(g), when provided under an employment agreement, therefore would depend on whether the product or service relates to a specified plan or arrangement as defined in the statute. Accordingly, section 1027(g) does not preclude rulemaking authority over employer-provided consumer financial products or services that do not relate to a specified plan or arrangement.

[1016] *See, e.g.*, Press Release, Bureau of Consumer Fin. Prot., "CFPB Takes First Action Against 'Buy-Here Pay-Here' Auto Dealer," (Nov. 19, 2014), *available at* http://www.consumerfinance.gov/about-us/newsroom/cfpb-takes-first-action-against-buy-here-pay-here-auto-dealer/.
[1017] *See* 12 U.S.C. 5517(g)(4) (defining the phrase "specified plan or arrangement" as including certain plans, accounts, or arrangements under the Internal Revenue Code of 1986, any employee benefit or compensation plan or arrangement, including a plan that is subject to title I of the Employee Retirement Income Security Act of 1974, and a prepaid tuition program offered by a State). *See also id.* 5517(g)(3)(A) (generally excluding Bureau authority over consumer financial products or services that "relate to" any specified plan or arrangement, absent specified interagency proceedings with the IRS and the Department of Labor).

Nonetheless, the Bureau recognizes that employee benefits may be subject to employment arbitration agreements and that employment arbitration and the regulation of employment arbitration agreements may function differently from those the Bureau analyzed in the Study, for example because they do not necessarily follow rules designed for consumer arbitration. Thus, the Bureau is adopting an exemption in § 1040.3(b)(5) to exclude employers to the extent they are offering or providing a product or service to an employee as an employee benefit. The Bureau is adopting this approach at this time for the reasons discussed herein, but notes that it also expects to monitor these products and services and could adjust the scope of the rule to reach any that are not excluded from the Bureau's rulemaking authority under Dodd-Frank section 1027(g).

For the sake of clarity, because the term "employer" is not defined in the Dodd-Frank Act, § 1040.3(b)(5) incorporates a well-recognized definition of employer from Federal law, in section 203(d) of the Fair Labor Standards Act (FLSA).[1018] The Bureau believes that this well-established definition of an "employer," has been extensively interpreted by courts and is familiar to a wide range of employers. While the rule incorporates the case law interpreting the definition of employer, it does not incorporate other size or industry related restrictions on the coverage of FLSA that are separate from the definition of employer.

The exemption includes two important limitations, however. First, the exemption would only apply to the employer. If, for example, an employer were to partner with a third party that may extend consumer credit to the employee, the employer may be exempt with respect to its activity of referring its employees to the third party (which otherwise may be covered by

[1018] The FLSA defines the term "employer" as "includ[ing] any person acting directly or indirectly in the interest of an employer in relation to an employee, and includes a public agency, but does not include any labor organization (other than when acting as an employer) or anyone acting in the capacity of officer or agent of such labor organization." 29 U.S.C. 203(d). "Employ" is in turn defined as "includ[ing] to suffer or permit to work." 29 U.S.C. 203(g).

§ 1040.3(a)(1)(iii) in certain circumstances). The third-party lender, however, generally would be covered by § 1040.3(a)(1)(i). Similarly, if an employer extended credit to the employee but hired a third party to administer the loan, that third party generally would still be covered by § 1040.3(a)(1)(v). Likewise, if an employer partners with an unaffiliated bank to provide a network-branded payroll card to its employees that is covered by § 1040.3(a)(6) because it is an account, then the consumer's agreement with the bank generally would be covered because it is entered into by the bank, even if the payroll card also may be part of a general suite of employee benefits such that the employer may be exempt under § 1040.3(b)(5).[1019]

Second, the exemption only applies when the consumer financial product or service is an employee benefit. Whether the product or service is an employee benefit will depend on the facts and circumstances. As clarified in comment 3(b)(5)-1, however, if an employer offers or provides a consumer financial product or service to its employee on terms and conditions that it makes available to the general public, that is not an employee benefit for purposes of the exemption. To the extent that an employer is in the general business of providing covered consumer financial products and services, the Bureau does not believe that employees should be treated differently from other consumers who receive those products and services on the same terms and conditions.

[1019] *See* Prepaid Accounts Final Rule, 81 FR 83934, 83940 (Nov. 22, 2016) (explaining that payroll card accounts are issued to consumers by financial intuitions that partner with employers). In addition, a consumer advocate commenter urged the Bureau to apply the rule to claims against employers for violating the Regulation E prohibition against compulsory use of payroll accounts, 12 CFR 1005.10(e)(2), which applies to persons other than the financial institution where an account is held. Employers are not subject to § 1040.3(a)(6)'s coverage of providers of accounts subject to EFTA and Regulation E, which generally applies to financial institutions where the accounts are held. *See* 12 CFR 1005.2(b)(1) (defining an "account" as one "held by a financial institution"). As a result, the employer exemption in § 1040.3(b)(5) would not reduce the coverage of these claims, as employers are not subject to this rule in connection with the provision of accounts under Regulation E in the first place. Consistent with the Bureau's approach in adopting § 1040.3(b)(5), the Bureau declines to expand the scope of § 1040.3(a)(6) to apply to more parties at this time, although it expects to continue to monitor employer activities in this regard.

*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 any such rule be consistent with the Study conducted under Dodd-Frank section 1028(a). Dodd-Frank section 1028(d) 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 regulation's effective date. (The final rule refers to this date – the date after the end of the 180-day period beginning on the effective date – as the "compliance date."[1020]) Pursuant to this authority and the findings set forth in greater detail in Part VI above, the Bureau is finalizing § 1040.4, which sets forth conditions or limitations on the use of pre-dispute arbitration agreements between providers and consumers entered into on or after the compliance date.[1021]

Section 1028(b) of the Dodd-Frank Act allows the Bureau to regulate the "use" of the pre-dispute arbitration agreements covered by this rule. The Bureau believes that, under the ordinary meaning of this provision, a provider's "use" of a pre-dispute arbitration agreement broadly encompasses the inclusion of such an agreement in an agreement for a consumer financial product or service, the content of such an agreement, and the reliance on or invocation of such an agreement (for example, a motion to compel arbitration of a claim filed as a class action). To the extent that the term "use" in Section 1028(b) is ambiguous, the Bureau believes

[1020] For additional discussion regarding the compliance date provision, see the section-by-section analysis for § 1040.5(a) below.
[1021] Under § 1040.5(a), compliance with part 1040 is required for any pre-dispute arbitration agreement entered into "on or after" the compliance date. In this section-by-section analysis, the Bureau uses the phrases "on or after the compliance date" and "after the compliance date" interchangeably.

that interpreting it to cover all these circumstances would promote the consumer protection, fair competition, and other objectives of the Dodd-Frank Act. As explained in Part VI.C, the Bureau's rule – which prohibits a provider from including a pre-dispute arbitration agreement in a consumer contract that would allow it to block a class claim and also prohibits a provider from relying on a pre-dispute arbitration agreement to block such a claim – is for the protection of consumers and in the public interest.

Accordingly, final § 1040.4 contains three provisions. Final § 1040.4(a)(1) prohibits providers from relying on pre-dispute arbitration agreements entered into after the compliance date in class actions concerning consumer financial products covered by § 1040.3.[1022] Final § 1040.4(a)(2) requires providers, upon entering into pre-dispute arbitration agreements for covered products 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 or provide notices to consumers when they enter into a pre-existing agreement. Final § 1040.4(b) requires providers that include pre-dispute arbitration agreements in their consumer contracts or enter into existing contracts with pre-dispute arbitration agreements after the compliance date to submit specified arbitral and court records to the Bureau.

The Bureau notes that providers may respond to the Bureau's rule by removing these provisions and adopting provisions in the agreement for the covered financial product or service that waive consumers' rights to participate in a class action. Providers could attempt to block consumers from pursuing class actions by including them in product agreements. Of course, the Bureau's rule would not apply to such waivers because they would not be part of a contract with

[1022] While Dodd-Frank section 1028 refers to "consumer financial products or services," the Bureau uses the term "products" in this section for the sake of brevity.

a pre-dispute arbitration agreement and outside the scope of Section 1028. The Bureau will actively monitor consumer financial markets for this practice – and for other practices that might function in such a way as to deprive consumers of their ability to meaningfully pursue their claims – and will assess whether such practices could constitute unfair, deceptive, or abusive acts or practices under Dodd-Frank section 1031.

*4(a)(1) Use of Pre-Dispute Arbitration Agreements in Class Actions*

*The Bureau's Proposal*

The Bureau proposed § 1040.4(a)(1) in accordance with its authority under section 1028(b) of the Dodd-Frank Act and in furtherance of its goal to ensure that class actions are available to consumers who are harmed by providers of consumer financial products and services. Proposed § 1040.4(a)(1) would have stated that a provider shall not seek to rely in any way on a pre-dispute arbitration agreement entered into after the rule's 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 review on an interlocutory basis, the time to seek such review has elapsed or the review has been resolved.[1023]

Proposed § 1040.4(a)(1) would have barred providers from relying on a pre-dispute arbitration agreement entered into after the compliance date, as described above, even if the agreement did not include the provision required by proposed § 1040.4(a)(2). In the preamble to the proposal, the Bureau gave several examples of such scenarios, such as where a third-party

[1023] In the proposal, the Bureau noted that the prohibition in proposed § 1040.4(a)(1) would apply to providers when relying on provisions in pre-dispute arbitration agreements, as well as on the overall agreement.

debt collector obtained the right to collect on an agreement entered into after the compliance date by a creditor that was covered by proposed § 1040.3(a) but excluded from coverage under proposed § 1040.3(b). The proposal's section-by-section analysis for proposed § 1040.3(a)(10) contained additional examples, specific to debt collection by merchants, of scenarios where proposed § 1040.4(a)(1) would have applied even where the pre-dispute arbitration agreement itself was not required to contain the provision outlined in proposed § 1040.4(a)(2).

Proposed § 1040.4(a)(1) would have prevented providers from relying on a pre-dispute arbitration agreement in a class action unless and until the presiding court ruled that the case may not proceed as a class action, and, if the ruling may have been subject to interlocutory appellate review, the time to seek such review elapsed, or the review was resolved. For example, if a case was filed as a putative class action and a court had not yet ruled on a motion to certify the class, proposed § 1040.4(a)(1) would have prohibited a motion to compel arbitration that relied on a pre-dispute arbitration agreement. If the court denied a motion for class certification and ordered the case to proceed on an individual basis, and the ruling may have been subject to interlocutory appellate review – pursuant to Federal Rule 23(f) of the Federal Rules of Civil Procedure or an analogous State procedural rule – proposed § 1040.4(a)(1) would have prohibited a motion to compel arbitration based on a pre-dispute arbitration agreement until the time to seek appellate review elapsed or appellate review was resolved. If the court denied a motion for class certification – and the ruling was either not subject to interlocutory appellate review, the time to seek review elapsed, or the appellate court determined that the case could not proceed as a class action – proposed § 1040.4(a)(1) would have no longer prohibited a provider from relying on a pre-dispute arbitration agreement.

Proposed comment 4(a)(1)-1 would have provided a non-exhaustive list of six examples of impermissible reliance under proposed § 1040.4(a)(1). Proposed comments 4(a)(1)-1.i through iii would have described conduct by a defendant in a class action lawsuit, and proposed comments 4(a)(1)-1.iv through vi described conduct in arbitration. In the preamble to the proposal, the Bureau stated that one purpose of proposed comments 4(a)(1)-1.iv through vi was to prevent providers from evading proposed § 1040.4(a)(1) by filing an arbitration claim against a consumer who had already filed a claim on the same issue in a putative class action in order to resolve that issue in arbitration and stop the class action. The Bureau noted that proposed § 1040.4(a)(1) would not have prohibited a provider from continuing to arbitrate a "first-filed" arbitration claim – *i.e.*, an arbitration claim that was filed before the consumer filed a class action – although the provider would not be permitted to invoke the pre-dispute arbitration agreement to block the class action.

Proposed comment 4(a)(1)-2 would have stated that where a class action concerns multiple products or services, and only some of the products or services were covered by proposed § 1040.3, the prohibition in proposed § 1040.4(a)(1) applied only to claims that concern the covered products or services.

*Comments Received*

The Bureau received a wide range of comments on proposed § 1040.4(a)(1). Some of the comments addressed whether the Bureau's attempt to restrict the use of arbitration agreements in proposed § 1040.4(a)(1) was authorized by section 1028(b) – specifically, whether proposed § 1040.4(a)(1) was in the public interest, for the protection of consumers, and consistent with the Study. The Bureau responds to these comments in Part VI, above, and finds that § 1040.4(a)(1), as discussed below, satisfies the requirements of section 1028(b). Below, the Bureau responds to

the remaining comments, which generally addressed technical aspects of the regulatory text and commentary.

Commenters recommended changes to the regulatory text that they thought would clarify when providers may rely on pre-dispute arbitration agreements in class actions. A consumer advocate commenter suggested that the Bureau add the phrase "such that a class action may not proceed" to the end of proposed § 1040.4(a)(1) in order to clarify that the prohibition on reliance applies until interlocutory appellate review has been resolved "such that a class action may not proceed" – and that providers may *not* rely on pre-dispute arbitration agreements where review has been resolved such that a class action *may* proceed. An industry commenter suggested that the Bureau add the word "interlocutory" prior to each use of the word "review" in the final clause of proposed § 1040.4(a)(1) to help clarify that the waiting period being imposed relates to interlocutory review by the court.

Several commenters requested that the Bureau revise proposed § 1040.4(a)(1) to accomplish different policy outcomes based on various objectives. An individual commenter requested that the Bureau revise proposed § 1040.4(a)(1) to permit providers to block class actions as long as they allow for class arbitration. This commenter believed class arbitration might provide a lower-cost option in some cases. An industry commenter suggested that the Bureau further evaluate whether class arbitration could achieve the objectives of the rule and suggested that such an inquiry might lead the Bureau to formulate a rule permitting providers to block class actions as long as class arbitration is available. This commenter also believed that class arbitration might be more cost effective than class litigation. Another industry commenter stated that, because the proposal would "prohibit an institution from inserting a class waiver in its arbitration provision," the proposal represents an endorsement of class arbitration. An

individual commenter suggested that the Bureau extend proposed § 1040.4(a)(1) to ban providers from relying on pre-dispute arbitration agreements in individual lawsuits brought by military servicemembers and spouses of servicemembers. The commenter noted that the MLA bars many types of creditors from enforcing arbitration agreements against members of the armed forces on active duty or active Guard and Reserve duty (and their families); however, the commenter pointed out that the Bureau's rule would cover a wider range of consumer financial products and services than the MLA and its implementing regulations.[1024]

A few commenters requested that the Bureau clarify the application of proposed § 1040.4(a)(1). A trade association of defense lawyers stated that the Bureau should clarify whether invoking arbitration against an absent class member would constitute impermissible reliance under proposed § 1040.4(a)(1). In the commenter's view, if invoking arbitration under these circumstances would be impermissible, providers would face great difficulty complying with the rule, because class action complaints often include vague class definitions that can make it hard to know, at the outset of a case, which consumers are part of the proposed class. The same commenter also requested that the Bureau clarify whether, in the case of a first-filed arbitration – *i.e.*, where there is an ongoing arbitration regarding the same issue when the consumer files a class action – a provider can plead that arbitral award as binding under the FAA and raise res judicata and mootness defenses to seek a dismissal of the class action. An industry commenter asked the Bureau to confirm that proposed § 1040.4(a)(1) would only preclude a broker-dealer from enforcing an arbitration agreement in a class action against a consumer to the extent that the relevant class action "related to" a covered consumer financial product or service. Another industry commenter asked the Bureau to clarify whether a provider would be required to

[1024] *See* MLA, 10 U.S.C. 987, and its implementing regulations, 32 CFR part 232.

comply with proposed § 1040.4(a)(1) where a pre-dispute arbitration agreement does not apply to a covered product or service, but where the pre-dispute arbitration agreement was part of a transaction that involved some covered products or services. The commenter expressed concern that proposed § 1040.4(a)(1)'s prohibition on reliance on a pre-dispute arbitration agreement in a class action "related to any of the consumer financial products or services covered by § 1040.3" could include pre-dispute arbitration agreements for non-covered products that were entered into as part of a transaction involving some covered products. An individual commenter requested that the Bureau clarify that the rule would not preclude a consumer from filing an individual arbitration if the consumer so desires.

In addition, a trade association of defense lawyers asserted that proposed § 1040.4(a)(1) would exceed the Bureau's legal authority. According to the commenter, the prohibition in proposed § 1040.4(a)(1) would raise separation-of-powers concerns under the Constitution, because it could be viewed as regulating a defendant's conduct in court, and would also exceed the Bureau's authority under the Dodd-Frank Act, because the Act does not grant the Bureau authority to regulate parties' conduct in judicial proceedings.

An industry commenter requested that the final rule state that a company does not violate the rule simply by pursuing its legal rights in good faith. The commenter expressed concern that if a company moves to compel arbitration based on a good faith belief that the relevant product is not covered, and the court determines that the product is covered, the company will have violated proposed § 1040.4(a)(1) – and could face penalties under title X of the Dodd-Frank Act – for doing nothing more than asserting what it believed to be its legitimate interpretation of the rule and the Act. The commenter expressed concern that the proposal would chill defendants from invoking arbitration agreements where they had a good faith basis to believe they could do so

without violating part 1040. Similarly, the trade association of defense lawyers stated that, under the proposal, it was unclear whether a defendant would violate the rule by moving to compel arbitration or seeking to plead its right to arbitrate in the event that class certification is ultimately denied. The commenter also expressed concern that arguing, in opposition to class certification, that individual arbitration is a superior alternative to class litigation for resolving the dispute could be construed as "relying" on an arbitration agreement in a class action and therefore would be a violation of the rule.[1025] The commenter did not cite to examples of such pleadings.

Finally, a consumer advocate commenter expressed support for comment 4(a)(1)-1 – the non-exhaustive list containing examples of conduct that would constitute impermissible reliance on a pre-dispute arbitration agreement under § 1040.4(a)(1) – as drafted.

*The Final Rule*

Pursuant to the Bureau's authority under Dodd-Frank section 1028(b) to impose conditions or limitations on the use of pre-dispute arbitration agreements between covered persons and consumers for consumer financial products and services, the Bureau is finalizing § 1040.4(a)(1) with limited modifications as described below. For the reasons described above in Part VI, the Bureau finds that § 1040.4(a)(1) satisfies the requirements of section 1028(b) because it is in the public interest and for the protection of consumers, and because the related findings are consistent with the Study that the Bureau conducted pursuant to section 1028(a).

Similar to what was proposed, the Bureau is finalizing § 1040.4(a)(1) to state that a provider shall not rely in any way on a pre-dispute arbitration agreement entered into after the

[1025] To certify a case as a class action, a Federal court must find, among other things, that a class action is superior to other available methods for fairly and efficiently resolving the controversy. *See* F.R.C.P. 23(b)(3).

rule's compliance date with respect to any aspect of a class action concerning 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 such review has been resolved such that the case cannot proceed as a class action.

Final § 1040.4(a)(1) differs from proposed § 1040.4(a)(1) in several respects. First, instead of using the phrase "related to" to describe the nexus between the class action and the covered consumer financial service or product that triggers application of the rule, the final rule uses the phrase "concerning." The Bureau is making this change for consistency with other provisions in the rule that use the phrase "concerning" to describe this nexus, including in § 1040.2(c) (definition of pre-dispute arbitration agreement), § 1040.4(a)(2) (contract provisions), and § 1040.4(b) (monitoring rule). Second, the Bureau has added the phrase "such that the case cannot proceed as a class action" to the end of proposed § 1040.4(a)(1). In the Bureau's view, the prohibition in proposed § 1040.4(a)(1) would have applied if review had been resolved such that a case may proceed as a class action. However, the Bureau agrees with the consumer advocate commenter's assertion that this phrase more precisely conveys the scope of the provision's prohibition on reliance in a class action. Third, in response to the industry commenter that requested that the Bureau clarify that both uses of the word "review" in the final clause of proposed § 1040.4(a)(1) refer to interlocutory review, the Bureau has revised the phrase "or the review has been resolved" to read "or such review has been resolved." Fourth, instead of prohibiting seeking to rely on an arbitration agreement in a class action, the rule prohibits relying on the arbitration agreement in a class action. The Bureau believes the term "seek" is not

needed. A motion that seeks to compel arbitration, for example, relies on an arbitration agreement, as clarified in comment 4(a)(1)-1.i.

The commentary to the final rule also includes new comment 4(a)(1)-1.ii, which contains an example of conduct that does not constitute reliance. The comment 4(a)(1)-1.ii states that reliance on a pre-dispute arbitration agreement does not include seeking or taking steps to preserve a class action defendant's ability to seek arbitration after the trial court has denied a motion to certify the class and either an appellate court has affirmed that decision on an interlocutory appeal of that motion, or the time to seek such an appeal has elapsed. This comment is intended to address the concern raised by the trade association of defense lawyers' comment that a defendant could violate the rule by moving to compel arbitration, or seeking to assert its contingent right to arbitrate in the future in the event that the case cannot proceed as a class action (*e.g.*, because class certification is denied).

The commentary to the final rule also includes new comment 4(a)(1)-2. This comment is intended to address the industry commenter's concern that § 1040.4(a)(1) would chill defendants from moving to compel arbitration when they have a good faith basis to believe that they could do so without violating the rule. The Bureau believes that, in the vast majority of cases, providers will know whether the rule applies – particularly because the Bureau has defined coverage primarily in relation to existing statutes and, where applicable, their implementing regulations. However, the Bureau acknowledges that, at the margins, some cases will raise questions about whether the rule covers particular persons, particular agreements, or particular consumer financial products and services. In some instances, a person may be genuinely uncertain about the rule's application in a particular class action case. New comment 4(a)(1)-2 clarifies that a class action defendant does not violate § 1040.4(a)(1) by, for example, relying on

a pre-dispute arbitration agreement where it has a genuine belief that either it is not a provider pursuant to § 1040.2(d) or that none of the claims asserted in the class action concern any of the consumer financial products or services covered pursuant to § 1040.3.

The Bureau intends comment 4(a)(1)-2 to mirror the *Noerr-Pennington* doctrine and therefore is using the term "genuine" to reflect the meaning of that term in the context of the *Noerr-Pennington* doctrine. Under the *Noerr-Pennington* doctrine, where a statute does not provide otherwise, it is presumed not to penalize conduct that implicates the protections afforded by the First Amendment's Petition Clause. But parties do not enjoy immunity for "sham" petitioning, that is, petitioning that is not "genuine."[1026] The Court has held that litigation is a "sham" when (1) it is objectively baseless in the sense that no reasonable litigant could realistically expect success on the merits, and (2) the litigant's subjective motivation conceals an attempt to use the governmental process in a manner that violates the relevant Federal law.[1027] Comment 4(a)(1)-2 mirrors the *Noerr-Pennington* doctrine in clarifying that a class action defendant does not violate § 1040.4(a)(1) where it relies on a pre-dispute arbitration agreement – such as by filing a motion to compel arbitration – in a manner that constitutes "genuine" petitioning under this two-part *Noerr-Pennington* test. However, where a defendant relies on a pre-dispute arbitration agreement (such as by filing a motion to compel arbitration) in a manner that constitutes "sham" petitioning – because the motion is objectively baseless and subjectively in bad faith – a *Noerr-Pennington* defense does not apply and the defendant violates § 1040.4(a)(1).

[1026] *See BE & K Const. Co.* v. *N.L.R.B.*, 536 U.S. 516, 524-26 (2002) ("The right of access to the courts is . . . but one aspect of the right of petition . . . [yet] while genuine petitioning is immune from antitrust liability, sham petitioning is not."), quoting *California Motor Transport Co.* v. *Trucking Unlimited*, 404 U.S. 508 (1972).

[1027] *See BE & K Const. Co.*, 536 U.S. at 526, *quoting Professional Real Estate Investors, Inc.* v. *Columbia Pictures Industries, Inc.*, 508 U.S. 49, 60-61 (1993).

The Bureau has also made a technical corrections to comment 4(a)(1)-1 including to conform the language more closely to the regulation text in § 1040.4(a)(1) and (a)(2).[1028]

The Bureau declines to revise proposed § 1040.4(a)(1) to permit providers to block class actions as long as they allow for class arbitrations. The Bureau believes that allowing consumers to seek class action relief is in the public interest, for the protection of consumers, and consistent with the Study.[1029] Consumers have brought consumer financial class actions under Federal Rule 23 of the Federal Rules of Civil Procedure for approximately 50 years, and they are a proven mechanism by which consumers can enforce their legal rights and obtain redress when those rights are violated. In contrast, the Bureau has not seen – and commenters did not offer – evidence to demonstrate that class arbitration would be able to accomplish these objectives as effectively. The Bureau believes that, compared with consumer finance class actions, consumer finance class arbitration is less proven, and may even be characterized as mostly untested, as a procedure for adjudicating consumer finance disputes. The Study identified only two consumer finance class arbitrations filed between 2010 and 2012; one was still pending on a motion to dismiss as of September 2014, and the other class arbitration contained no information other than the arbitration demand that followed a State court decision granting the company's motion seeking arbitration.[1030] Further, as the proposal noted, industry groups have heavily criticized class arbitration on the ground that it lacks procedural safeguards. For example, arbitrator decisions in class arbitrations – such as decisions to certify a class or award damages – are

[1028] To reflect the fact that the provisions specified in § 1040.4(a)(2) now use the term "rely on," the prefatory sentence for comment 4(a)(1)-1 now states that both § 1040.4(a)(1) and (a)(2) use the term "rely on." Comment 4(a)(1)-1.i also is revised to clarify that the conduct that constitutes reliance is in relation to a pre-dispute arbitration agreement.
[1029] *See supra* Part VI (the Bureau's findings that the final rule is in the public interest and for the protection of consumers).
[1030] *See* Study, *supra* note 3, section 5 at 86–87.

generally subject to limited judicial review.[1031] Consumer advocates have also criticized several aspects of class arbitration, including its lack of procedural safeguards.[1032] The Bureau received similar feedback from stakeholder groups during the extensive outreach the Bureau conducted during the Study process and during the pre-proposal stage of the rulemaking process.[1033] Without further evidence, the Bureau cannot conclude that class arbitrations provide a viable alternative to class actions. For this reason, the Bureau is not revising proposed § 1040.4(a)(1) to allow providers to block class actions as long as they allow for class arbitration.

The Bureau notes, however, that § 1040.4(a)(1) would not preclude the use of class arbitration as a forum. Final § 1040.4(a)(1) would permit an arbitration agreement that allows for class arbitration, if it also allowed a consumer the option of pursuing class litigation instead. 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. The Bureau expects that, if class arbitration proves to be an efficient procedure through which consumers can enforce their rights and obtain redress, providers will make the option available to consumers and consumers will choose it over class litigation in court. Additionally, as with individual arbitration and as discussed in greater detail below in the section-by-section analysis of § 1040.4(b), the Bureau will monitor any class arbitrations that do occur.

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[1031] In an 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." Brief of the Chamber of Commerce of the United States of America as Amicus Curiae in Support of Plaintiffs-Appellants at 9, Marriott Ownership Resorts, Inc. v. Sterman, No. 15-10627 (11th Cir. Apr. 1, 2015).

[1032] For example, a consumer advocate commenter asserted that all arbitrations, including class arbitrations, are unfair due to – among other things – the alleged repeat-player bias among arbitrators, the more-limited discovery rights of the plaintiff compared to court, and the limited judicial review of arbitrators' decisions.

[1033] *See supra* Parts III.A and III.C (describing stakeholder outreach the Bureau conducted as part of the Study process) and Part IV (describing stakeholder outreach the Bureau conducted following the release of the Study).

With respect to the industry commenter's assertion that the proposal represents an endorsement of class arbitration because it would prohibit institutions from inserting class waivers into their arbitration agreements, the Bureau believes the commenter misunderstood the proposal. Final § 1040.4(a)(1) – like proposed § 1040.4(a)(1) – would prohibit providers from relying on pre-dispute arbitration agreements in class action lawsuits. It would not prohibit providers from adopting terms preventing class arbitration.

With respect to the trade association of defense lawyers' comment that requesting clarification of the application of the rule to a litigant's possible opposition to class certification on the grounds that individual arbitration is superior, the Bureau disagrees that such a clarification is needed. The Bureau does not understand from the comment how a company could assert that individual arbitration pursuant to an arbitration agreement is superior to a class action if the company could not actually, under the rule, be permitted to compel individual arbitration in a class action. Because individual arbitration of the named plaintiff's claims in a class action could not be compelled under the arbitration agreement, it appears speculative that a company could assert superiority of such a method of dispute resolution in the context of a class action governed by the Bureau's rule. In any event, the Bureau's rule does not prohibit a defendant from arguing that a class action would not be superior to individual resolution generally based on the facts at issue in a particular case. The Bureau therefore does not believe the issue warrants clarification in the final rule. The Bureau intends to monitor any specific practices that may emerge in this regard, however, and may exercise its statutory authorities as appropriate to clarify the rule or to take other appropriate action in order to prevent circumvention or evasion of the rule.

In response to the individual commenter's request regarding the MLA, the Bureau notes, as an initial matter, that the final rule will not supersede the MLA's protections because the final rule and the MLA's prohibition on enforcing arbitration agreements do not conflict. The MLA bans certain categories of creditors from using pre-dispute arbitration agreements in certain consumer credit agreements and from enforcing existing pre-dispute arbitration agreements.[1034] Because those consumer credit agreements are prohibited from having pre-dispute arbitration agreements going forward, there would be no such agreements that would trigger application of the Bureau's rule. Thus, where a particular agreement is covered by both part 1040 and the MLA's prohibition, providers need not be concerned that the two legal regimes create conflicting obligations because the MLA bars the provider from using a pre-dispute arbitration agreement altogether.

The Bureau declines to prohibit the enforcement of pre-dispute arbitration agreements against servicemembers and the spouses of servicemembers in the final rule, as requested by the commenter. As described elsewhere in this final rule, the Bureau considered and rejected an alternative under which the Bureau would have prohibited altogether the enforcement of covered pre-dispute arbitration agreements against consumers.[1035] Neither the Study nor the commenters offered evidence demonstrating that individual arbitrations involving servicemembers and their families are inferior to individual litigation in terms of remedying consumer harm or unique from arbitration involving non-servicemembers. Consistent with the Bureau's current consumer protection work involving servicemembers and their families, the Bureau will continue to

[1034] 10 U.S.C. 987(e)(3) and (f)(4); 32 CFR 232.8(c) and 232.9(d).
[1035] The potential alternative of a complete ban on arbitration agreements is discussed in the Bureau's Section 1022(b)(2) Analysis.

monitor the offering and provision of consumer financial products and services to servicemembers and their families.

In response to the industry commenter that requested clarification as to whether § 1040.4(a)(1) would ban reliance on a pre-dispute arbitration agreement for a non-covered product or service, where the original transaction involved some covered products or services, the Bureau notes that a provider that offers or provides non-covered products or services must comply with part 1040 only for the products and services it provides that are covered under § 1040.3. The Bureau explains this issue further in comment 2(d)-1.

Regarding the trade association of defense lawyers' comment that requested that the Bureau clarify the rule's application in relation to absent class members of a putative class action, the commenter appears to envision a scenario in which a provider moves to compel arbitration in an individual lawsuit against a plaintiff who is also a putative class member in a pending class action against the provider relating to the same dispute. The commenter asked whether such a motion to compel would constitute impermissible reliance under proposed § 1040.4(a)(1), especially in light of proposed comment 4(a)(1)-1.ii, which would have stated that reliance on an arbitration agreement under § 1040.4(a)(1) includes "seeking to exclude a person or persons from a class in a class action." The Bureau disagrees with the commenter that that comment was ambiguous. That comment refers to exclusions of persons from a class "in a class action." For example, defendants may file motions in a pending class action to strike or reform or narrow the class definition to exclude persons who have pre-dispute arbitration agreements. The example in the comment clarifies that such exclusions are not permitted by the rule. The example does not reach parallel individual litigation. In particular, that example does not apply to individual litigation with consumers who may or may not be covered by alleged

class definitions in a pending class complaint or class definitions in a certified class or preliminarily or finally approved class settlement. If a consumer elects to file an individual lawsuit against a provider, that consumer's individual lawsuit will be subject to the rule on the same basis as any individual lawsuit (*i.e.*, a motion to compel arbitration may be permitted and the monitoring rule will apply), without regard to the existence of parallel class litigation that may or may not affect that consumer.

The trade association of defense lawyers' comment also requested clarification as to the preclusive effect of an arbitral award under a "first-filed" arbitration – *i.e.*, an arbitration that is ongoing when a consumer files a class action relating to the same dispute. As the Bureau stated in the preamble for proposed § 1040.4(a)(1), where a consumer files a class action, and there is already a pending arbitration claim relating to the same dispute, proposed § 1040.4(a)(1) would not prohibit the provider from continuing with the arbitration, but it *would* prohibit the provider from using an arbitration agreement to block the class action claim. However, if the provider wins the first-filed arbitration, the provider could plead the arbitral outcome as binding under the FAA on any consumer who was a party in the arbitration pursuant to applicable res judicata and claim preclusion law. Final § 1040.4(a)(1) would not prohibit the provider from "relying on" the award in this context.

In response to the individual commenter that requested that the Bureau clarify that the rule would not preclude a consumer from filing an individual arbitration, the Bureau confirms that nothing in the rule would preclude this. And in response to the industry commenter that requested that the Bureau confirm that proposed § 1040.4(a)(1) would only preclude a broker-dealer from enforcing an arbitration agreement in a class action against a consumer to the extent that the relevant class action "related to" a covered consumer financial product or service, the

Bureau notes that the final rule contains an exemption for broker-dealers.[1036] Persons covered by this exemption are not providers and are therefore not subject to any of the requirements of part 1040.[1037]

Finally, the Bureau disagrees with the trade association of defense lawyers' comment asserting that proposed § 1040.4(a)(1) would raise separation-of-powers concerns under the U.S. Constitution and would exceed the Bureau's authority under the Dodd-Frank Act by regulating a defendant's conduct in court (*i.e.*, by limiting a defendant's ability to enforce a pre-dispute arbitration agreement in a class action). The Bureau is not aware of, and the commenter did not provide a legal basis for such a concern. In addition, the Bureau is issuing part 1040 pursuant to a direct grant of statutory authority: Dodd-Frank section 1028(b). That statute authorizes the Bureau to prohibit or impose conditions or limitations on the use of pre-dispute arbitration agreements in contracts for consumer financial products and services. Because parties frequently enforce such agreements through the judicial process, the authority to prohibit or impose conditions or limitations on their use necessarily includes the authority to regulate a defendant's conduct in court.[1038]

*4(a)(2) Provision Required in Covered Pre-Dispute Arbitration Agreements*

*The Bureau's Proposal*

The Bureau proposed § 1040.4(a)(2) in accordance with its authority under Dodd-Frank section 1028(b) and in furtherance of its goal to ensure that class actions are available to consumers who are harmed by providers of consumer financial products and services. Proposed

[1036] *See* § 1040.3(b)(1)(i).
[1037] In general, however, as to entities that *are* providers, the commenter's understanding is correct. Section 1040.4(a)(1)'s prohibition applies only with respect to a class action that concerns any of the consumer financial products or services covered by § 1040.3(a). So even where a provider is providing a product or service covered by § 1040.3(a), the provider may still rely on arbitration agreements in class actions that do not concern a product or service covered by § 1040.3(a).
[1038] *See supra* section-by-section analysis of § 1040.4(a)(1) (describing new comment 4(a)(1)-2 clarifying that the rule does not burden conduct protected by the First Amendment's Petition Clause).

§ 1040.4(a)(2)(i) would have generally required providers, upon entering into a pre-dispute arbitration agreement for a covered product or service after the compliance date, to ensure that the agreement contained a specified provision stating that neither the provider nor anyone else would use the agreement to stop the consumer from being part of a class action. Proposed § 1040.4(a)(2)(ii) would have contained an optional, alternative provision that providers could use where a pre-dispute arbitration agreement applied to both covered and non-covered products and services. Where a pre-dispute arbitration agreement existed previously between other parties and did not contain either of these two required provisions, proposed § 1040.4(a)(2)(iii) would have required providers entering into such agreements to either amend them to add a specified provision or send the consumer a notice with specified language. The Bureau summarizes proposed § 1040(a)(2)(i) – (iii) in greater detail below.

Proposed § 1040.4(a)(2)(i) would have stated 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 consumer financial product or service covered by proposed § 1040.3 after the compliance date, 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.

As noted in the proposal, the Bureau designed this requirement to make consumers, courts, and other relevant third parties (including potential purchasers) aware that the agreement may not be used to prevent a consumer from pursuing a class action. The Bureau intended this provision to be limited to class action cases concerning a consumer financial product or service covered by proposed § 1040.3. In addition, the Bureau intended the phrase "neither we nor anyone else shall use this agreement" to inform consumers that the provision also bound third parties that may seek to rely on the agreement.

The proposal noted that the Bureau intended the phrase "contains the following provision" in proposed § 1040.4(a)(2)(i) to clarify that the specified text should be included as a contractual provision within the pre-dispute arbitration agreement – as, for instance, the Federal Trade Commission's Holder in Due Course Rule also requires.[1039] Providers would not have been permitted, for example, to include the required language as a separate notice or consumer advisory, except in certain circumstances under proposed § 1040.4(a)(2)(iii). The proposal also noted that, similar to the Bureau's understanding of the provision required by the Holder in Due Course Rule, the Bureau intended 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 expected that the provision required by proposed § 1040.4(a)(2)(i) would have had a substantially similar legal effect through the operation of applicable contract law.

As the proposal stated, the Bureau designed the § 1040.4(a)(2)(i) provision – as well as the § 1040.4(a)(2)(ii) and (iii)(A) provisions and the § 1040.4(a)(2)(iii)(B) notice – to use plain language. While the Bureau did not believe that disclosure requirements or consumer education could materially increase the filing of individual claims in arbitration or litigation, the Bureau believed that consumers who consulted their contracts should be able to understand their dispute resolution rights.

Where a pre-dispute arbitration agreement was in a contract for multiple products or services, only some of which were covered under proposed § 1040.3, proposed § 1040.4(a)(2)(ii) would have permitted (but not required) providers to include the following alternative contract provision in place of the one required by proposed § 1040.4(a)(2)(i):

[1039] 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.

> 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.

As the proposal stated, where providers use a single contract for both covered and non-covered products and services, the Bureau believed that the alternative provision would have improved consumer understanding by alerting consumers that the provision may not apply to non-covered products or services.

Proposed § 1040.4(a)(2)(iii) would have set forth how to comply with proposed § 1040.4(a)(2) in circumstances where a provider entered into a pre-existing pre-dispute arbitration agreement that did not contain either the provision required by proposed § 1040.4(a)(2)(i) or the alternative permitted by proposed § 1040.4(a)(2)(ii), presumably because the original agreement was entered into by person that was not a provider and thus was not subject to any of those provisions or because the original agreement was entered into before the compliance date. Under proposed § 1040.4(a)(2)(iii), within 60 days of entering into the pre-dispute arbitration agreement, providers would have been required either to ensure that the agreement was amended to contain the provision specified in proposed § 1040.4(a)(2)(iii)(A) or to provide any consumer to whom the agreement applied with the written notice specified in proposed § 1040.4(a)(2)(iii)(B). For providers that chose to ensure that the agreement is amended, the provision specified by proposed § 1040.4(a)(2)(iii)(A) would have been 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 chose to provide consumers with a written notice, the required notice provision specified by § 1040.4(a)(2)(iii)(B) would have been 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.

As the proposal stated, the Bureau believed that the notice option afforded by proposed § 1040.4(a)(2)(iii)(B) would have reduced the burden to providers for whom amendment may be impossible, challenging, or costly while preserving the consumer awareness benefits of § 1040.4(a)(2)(iii)(A). The Bureau also noted that, whether the provider elected to ensure that the agreement is amended, chose to provide the required notice, or violated proposed § 1040.4(a)(2)(iii) by failing to do either, the provider would still have been required to comply with proposed § 1040.4(a)(1).

The proposal also described how buyers of medical debt would have needed to perform due diligence, in some cases, to determine how the rule would have applied to the debts they buy. In cases involving incidental credit that is subject to ECOA, debt buyers may have faced additional impacts from the rule from additional due diligence to determine which acquired debts arise from credit transactions[1040] or 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 described these impacts in detail in the proposal's Section 1022(b)(2) Analysis.

*Proposed commentary.* To clarify the application of proposed § 1040.4(a)(2), the proposal contained three proposed comments. Proposed comment 4(a)(2)-1 would have

[1040] As the proposal noted, 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* 77 FR 65775, 65780 (Oct. 31, 2012).

highlighted an important distinction between proposed § 1040.4(a)(2) and proposed § 1040.4(a)(1). In general, proposed § 1040.4(a)(1) would have applied to providers 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, if a debt collector had not entered into a pre-dispute arbitration agreement that applied to the debt, proposed § 1040.4(a)(1) would still have prohibited the debt collector from moving to compel a class action case against it to arbitration on the basis of that agreement, so long as the agreement was entered into after the compliance date by a creditor who extended consumer credit as described in § 1040.3(a)(1)(i). This would be the case without regard to whether the creditor was excluded from the rule by § 1040.3(b). In contrast, proposed § 1040.4(a)(2) would have applied to providers only when they entered into a pre-dispute arbitration agreement for a product or service.[1041] Thus, proposed § 1040.4(a)(2) would not have applied to the debt collector in the example cited previously; but it would have applied to a debt buyer that acquired or purchased a product covered by proposed § 1040.3 after the compliance date and became a party to the pre-dispute arbitration agreement.[1042] Proposed comment 4(a)(2)-1 would have clarified 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 have provided an illustrative example clarifying how proposed § 1040.4(a) applied in the context of portfolio mergers and acquisitions. The comment described a hypothetical scenario in which Bank A acquired Bank B after the compliance date and Bank B had entered into pre-dispute arbitration agreements before the compliance date. The

[1041] *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).
[1042] *See* proposed comment 4-1.i (providing examples of entering into a pre-dispute arbitration agreement).

comment stated that if, as part of the acquisition, Bank A acquired products of Bank B's that were subject to pre-dispute arbitration agreements (and thereby entered into such agreements), proposed § 1040.4(a)(2)(iii) would have required 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 have clarified that providers may provide the notice in any way the provider communicates with the consumer, including electronically. The proposed comment would have further explained that providers may either provide the notice as a standalone document or include it in another notice that the customer receives, such as a periodic statement, to the extent permitted by other laws and regulations. The Bureau stated in the proposal that it believes that giving providers a wide range of options for furnishing the notice would accomplish the goal of informing consumers while reducing the burden on providers.

For ease of reference, in this section-by-section analysis, the Bureau refers to the contract provision that would be required by proposed § 1040.4(a)(2)(i) as the "required 4(a)(2)(i) provision"; the optional, alternative provision permitted by § 1040.4(a)(2)(ii) as the "optional 4(a)(2)(ii) provision"; and the provisions specified in § 1040.4(a)(2)(iii) as the "4(a)(2)(iii) amendment" and the "4(a)(2)(iii) notice." The Bureau also refers to the provisions specified in § 1040.4(a)(2) collectively as the "4(a)(2) provisions" or simply "the provisions."

*Comments Received*

The Bureau received a wide range of comments on proposed § 1040.4(a)(2). Several comments addressed the 4(a)(2) provisions as a whole, while the other comments concerned individual provisions.

Several commenters addressed the Bureau's overall approach to § 1040.4(a)(2). An industry commenter requested that the Bureau give providers the flexibility to disclose the provisions "in substance" rather than verbatim (as required by the proposal). The commenter argued that providers need such flexibility because the provisions' terminology may not conform to the rest of the provider's agreement. The commenter also stated that such flexibility would also avoid class actions over typographical errors and other minor issues. Another industry commenter expressed concern that plaintiffs could construe the provisions as a waiver by the defendant of its right to assert certain defenses in a class action, such as defenses to class certification. A State regulator commenter requested that the Bureau clarify whether the provisions would apply only to class actions brought under Federal and State consumer protection laws or also to class actions brought under other Federal and State laws. A consumer advocate commenter suggested that the provisions be reframed as a relinquishment of the provider's right to rely on the pre-dispute arbitration agreement in a class action (rather than merely as a binding agreement not to do so).

A trade association of lawyers who represent investors praised the provisions for conveying the consumer's rights in plain language, stating that the proposed language is much simpler than similar language required by FINRA for securities contracts.[1043] This commenter also suggested that the Bureau require that the relevant provision be included in all pre-dispute arbitration agreements; that a separate notice containing the provision be sent to consumers with existing agreements; that the Bureau mandate that the provision be conspicuously placed and not in a smaller font size or otherwise diminished in importance relative to the rest of the agreement; and that covered firms be required to include the provision on their websites. A consumer

[1043] *See* FINRA, "Requirements When Using Predispute Arbitration Agreements for Customer Accounts," at Rule 2268(f).

advocate commenter emphasized that, in its opinion, the phrase "neither we nor anyone else" in each of the proposed provisions is vital because it would bind third parties who may be assigned the contract.

A consumer advocate commenter requested that the Bureau revise proposed § 1040.4 to include additional sanctions on providers that violate § 1040.4(a)(2). The commenter requested that the Bureau forbid providers from relying on an arbitration agreement in an individual (*i.e.*, non-class) suit if the provider failed to include the required 4(a)(2)(i) provision. The commenter also requested that the Bureau state that non-compliant agreements may not be severed or reformed after litigation has commenced. In the commenter's view, these provisions would help deter providers from intentionally omitting the required provision. The commenter stated that providers may omit the provision in the hope that plaintiffs or courts may be unaware of the Bureau's rule or with the expectation that, if caught omitting the provision, courts would merely require the provider to reform the agreement, leaving the provider no worse off than if it had initially complied with the rule. The commenter additionally requested that the Bureau add a provision stating that non-compliant arbitration agreements – *e.g.*, agreements that do not include a provision required by § 1040.4(a)(2) – are null and void.

Other commenters raised issues specific to automobile lending. An industry commenter expressed concern that automobile finance companies would include one of the 4(a)(2) provisions in retail installment sales contract or lease forms, and that, as a result, the provision would bind dealers otherwise exempt from the Bureau's jurisdiction pursuant to Dodd-Frank section 1029. The commenter suggested that the final rule state expressly that proposed § 1040.4(a)(2) does not apply to any transaction originated by an excluded person pursuant to proposed § 1040.3(b). Another industry commenter stated that, in its view, proposed

§ 1040.4(a)(2) would require the use of two different contractual provisions (the § 1040(a)(2)(i) provision and the § 1040.4(a)(2)(ii) provision), so lenders would need to use two separate loan agreements: one for loans the lender makes directly and one for loans obtained from dealers or other financial institutions. The commenter asked the Bureau to replace the 4(a)(2)(i) and 4(a)(2)(ii) provisions with a single provision that lenders in its predicament could use. The commenter also asserted that replacing the proposed 4(a)(2)(i) and (ii) provisions with a single provision would reduce consumer confusion.

Further, several Tribal commenters expressed concerns about proposed § 1040.4(a)(2) related to sovereign immunity.[1044] Tribal commenters and participants in the Tribal consultation on the proposal expressed concern that this provision could be misconstrued by plaintiffs, their attorneys, and courts as a waiver of a Tribal government's sovereign immunity from private suit, insofar as they explicitly state that consumers may file class actions even if, notwithstanding that statement, the Tribal government enjoys sovereign immunity from class actions. The commenters stated that requiring Tribal governments to use the proposed provision was an affront to their sovereign immunity. These commenters stated that the rule should, at the very least permit Tribes to use different language that does not impinge on or potentially waive their sovereign immunity claims. One Tribal commenter suggested specific language.[1045]

In addition to comments about § 1040.4(a)(2) generally, the Bureau received numerous comments about specific provisions. The Bureau received one comment specific to the proposed 4(a)(2)(i) provision. A public-interest consumer lawyer commenter recommended that, to improve readability, the Bureau revise the provision to read: "No one can use this agreement to

[1044] For a more detailed summary of Tribal comments on sovereign immunity, see the section-by-section analysis for § 1040.3(b)(2), above.
[1045] "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; provided, however, this shall not be deemed nor constitute a waiver of the rights, privileges and immunities of the Tribe, its Tribal government or any affiliate of its Tribal government."

stop you from being part of a class action case in court. You can file a class action in court or you can be a member of a class action filed by someone else."

Numerous commenters addressed the optional 4(a)(2)(ii) provision specifically. Many of these commenters expressed concern that the provision would confuse consumers and suggested that the Bureau modify the provision in various ways to make it more understandable. Some commenters requested that, where agreements are for both covered and non-covered products, the Bureau require providers to indicate, in their agreements, which products the Bureau's rule covers and which it does not cover. A consumer advocate commenter requested that the Bureau require providers to furnish two separate product agreements, one for covered products and one for non-covered products. A trade association of consumer lawyers suggested that the Bureau either require providers to identify which products are covered or to provide separate terms for each product. An industry commenter recommended that the Bureau give providers the option to disclose which products are subject to the provision and which are not. A public-interest consumer lawyer commenter requested that, where contracts are for both covered and non-covered products, the optional 4(a)(2)(ii) provision instead be mandatory, because allowing the provider to use the 4(a)(2)(i) provision, which implies that all products are covered, would mislead the consumer.

Commenters expressed additional concerns about the provision that would be required by proposed § 1040.4(a)(2)(ii) apart from concerns related to the potential for consumer confusion. A consumer advocate commenter argued that the provision would hurt class action plaintiffs by highlighting that the rule's coverage was limited in scope, which, according to the commenter, would create a "roadblock" in the consumer's prosecution of a class action.

Several comments addressed proposed § 1040.4(a)(2)(iii) specifically. A consumer

advocate commenter argued that the phrase "who later becomes a party" in the proposed 4(a)(2)(iii)(A) amendment unduly limits the amendment's binding effect, relative to the proposed 4(a)(2)(i) provision, which states that neither the contracting party "nor anyone else" may stop the consumer from being part of a class action. The commenter suggested that the Bureau require providers entering into pre-existing contracts that do not contain the required provision to simply insert the proposed 4(a)(2)(i) provision via an amendment. Two commenters – a consumer advocate and a public-interest consumer lawyer – argued that the Bureau should require amendments in certain scenarios where the proposal would otherwise allow providers to send notices. According to the consumer advocate commenter, the Bureau should only allow providers to send the notice where the provider cannot amend the contract unilaterally, while the other commenter similarly thought the Bureau should only permit the notice when amendment is "contractually impossible." These commenters argued that amendments are superior to notices from a consumer protection standpoint because amendments, unlike notices, would bind third parties. An industry commenter expressed concern that proposed § 1040.4(a)(2)(iii) would cause the Bureau's rule to apply to contracts originally entered into before the compliance date when they are assigned after the compliance date. The commenter asserted that this is problematic because if a pre-dispute arbitration agreement was valid at origination, it should remain valid in perpetuity.

Other commenters suggested revisions that they believed would increase the binding effect of the proposed 4(a)(2)(iii)(B) notice on third parties. Two public-interest consumer lawyer commenters expressed concern that the notice, unlike the amendment, does not contain the phrase "neither we nor anyone else" and therefore lacks a prohibition against successors to the contract from blocking consumer involvement in a class action. One of these commenters

suggested that the phrase "neither we nor anyone else" be included in the notice. The other commenter suggested that the Bureau revise the first sentence of the notice to read: "No one can use this agreement to stop you from being part of a class action case in court. You can file a class action in court or you can be a member of a class action filed by someone else." The commenter also contended that these revisions would improve the notice's readability and, for this reason, the amendment should use the same language. A consumer advocate commenter asked the Bureau to require contracts between providers and third parties to waive the third parties' right to rely on pre-dispute arbitration agreements in class actions; to require providers to consider the notice to be part of the agreement and supply the notice whenever the agreement is requested by a third party; to require providers to store a record of the notice in the same way it would store an amendment, so that the documents, together, would be considered to be the complete agreement; and to add language to the notice stating that the provider considers its promise to not stop the consumer from being part of a class action to be binding on third parties.

*The Final Rule*

In furtherance of the Bureau's goal to ensure that consumers can seek relief through class actions when they are harmed by providers of consumer financial products and services, and based on the findings discussed above in Part VI made pursuant to the Bureau's authority under section 1028(b), the Bureau is finalizing § 1040.4(a)(2) with the modifications described below.

Final § 1040.4(a)(2)(i) states that, except as permitted by § 1040.4(a)(2)(ii) and (iii) and § 1040.5(b), providers shall, upon entering into a pre-dispute arbitration agreement for a product or service covered by § 1040.3 after the compliance date, ensure that the agreement contains the following provision:

> We agree that neither we nor anyone else will rely on 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 filed by someone else.

The Bureau has made three minor revisions to § 1040.4(a)(2)(i) and the required 4(a)(2)(i) provision, compared with the proposal. First, the Bureau replaced the term "use" with the term "rely on" to more closely mirror the language in § 1040.4(a)(1).[1046] As such, use of the term "rely on" clarifies that the conduct prohibited by § 1040.4(a)(1) and the conduct specified by § 1040.4(a)(2) are the same.[1047] Second, in response to the public-interest consumer lawyer commenter's suggested revisions to improve readability, the Bureau has revised the final sentence of the required 4(a)(2)(i) provision to state "You may file a class action in court or you may be a member of a class action filed by someone else" rather than "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."[1048] Third, the Bureau has corrected a reference to § 1040.5(b) (the temporary exception for providers of pre-packaged general-purpose reloadable prepaid card agreements).

Final § 1040.4(a)(2)(ii) permits providers, where a pre-dispute arbitration agreement is in a contract that applies to multiple products or services, and only some of those products or services are covered under § 1040.3, to include the following alternative contract provision in place of the one required by § 1040.4(a)(2)(i):[1049]

> 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. The following provision applies only to class action claims concerning the products or services covered by that Rule: We agree that neither we nor anyone else will rely on 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 filed by someone else.

[1046] For the same reasons discussed here, the Bureau has made this same revision to the optional 4(a)(2)(ii) provision and the 4(a)(2)(iii) notice, both discussed below.
[1047] *See also* comment 4(a)(1)-1 (provides a non-exclusive list of examples of "reliance" within the meaning of § 1040.4).
[1048] For the same reasons discussed here, the Bureau has made this same revision to the optional 4(a)(2)(ii) provision and the 4(a)(2)(iii) notice.
[1049] In this provision, the Bureau has moved the limiting sentence concerning applicability of the rule to covered products. This sentence now appears as the second sentence. The Bureau believes this will improve readability because this sentence is more directly related to the first sentence in the provision.

Final § 1040.4(a)(2)(iii) sets forth how to comply with § 1040.4(a)(2) where a pre-dispute arbitration agreement existed previously between other parties and does not contain either the required 4(a)(2)(i) provision or the optional 4(a)(2)(ii) provision. Final § 1040.4(a)(2)(iii)(A) states that providers entering into such agreements shall either ensure the agreement is amended to contain the provision specified in paragraph (a)(2)(i) or (a)(2)(ii) of this section or provide any consumer to whom the agreement applies with the following written notice:

> We agree not to rely on 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 filed by someone else.

The provider may add to the written notice the following optional language when the pre-dispute arbitration agreement applies to multiple products or services, only some of which are covered by § 1040.3: "This notice applies only to class action claims concerning the products or services covered by the Arbitration Agreements Rule issued by the Consumer Financial Protection Bureau." The Bureau is permitting this optional language in the written notice so that the notice may be structured similarly to the optional contract provision in § 1040.4(a)(2)(ii). Final § 1040.4(a)(2)(iii)(B) states that the provider shall ensure that the pre-dispute agreement is amended or provide the notice to consumers within 60 days of entering into it.

Final § 1040.4(a)(2)(iii) differs from the proposal in one other key respect: while proposed § 1040.4(a)(2)(iii)(A) included specified language for the required amendment that was different from the § 1040.4(a)(2)(i) and (2)(ii) provisions, final § 1040.4(a)(2)(iii)(A) requires providers to ensure their agreements are amended to contain either the § 1040.4(a)(2)(i) or (2)(ii) provisions. The proposed § 1040.4(a)(2)(iii)(A) amendment differed from the proposed § 1040.4(a)(2)(i) and (2)(ii) provisions because it contained the phrase "who later becomes a party." The Bureau had intended for this phrase to prevent the amendment from binding original

contracting parties who would not otherwise have been covered by the rule – such as providers who contracted with the consumer before the compliance date or providers excluded under § 1040.3(b). However, the Bureau agrees with the consumer advocate commenter that the phrase "who later becomes a party" is unduly limiting, given that the rule could, in some cases, prevent non-parties from relying on pre-dispute arbitration agreements.[1050]

Rather than mandating unique language for the amendment containing the phrase "who later becomes a party," the Bureau is allowing providers to use the § 1040.4(a)(2)(i) or 4(2)(ii) provisions in any amendment pursuant to § 1040.4(a)(2)(iii) and is separately finalizing § 1040.4(a)(2)(iv) – described in greater detail below – which would allow providers to add sentences to the required contract provision stating, for example, that the provision does not apply to parties that entered into the agreement before the compliance date and that the provision does not apply to persons excluded under the rule. The final rule's approach also benefits providers entering into pre-existing agreements for both covered and non-covered products and services, because they can amend the agreement to include the optional § 1040.4(a)(2)(ii) provision. The contractual amendment that would have been required by proposed § 1040.4(a)(2)(iii)(A), in contrast, included no language pertaining to agreements for both covered and non-covered products.

The Bureau also notes that, where a provider is entering into a pre-dispute arbitration agreement that existed previously between other parties and does not contain either the § 1040.4(a)(2)(i) or (2)(ii) provisions, the Bureau expects the provider to comply with § 1040.4(a)(2)(iii) by amending the agreement or providing a notice. For example, where

[1050] For example, where a provider and consumer enter into a pre-dispute arbitration agreement after the compliance date, § 1040.4(a)(1) prohibits a debt collector from relying on that agreement in a class action, even though the debt collector would not be a party to the arbitration agreement.

Lender X enters into a loan agreement subject to a pre-dispute arbitration agreement before the compliance date, then sells the account to Buyer A after the compliance date, and Buyer A chooses to provide the notice (instead of amending the agreement), Buyer B – who subsequently purchases the account from Buyer A – must either amend the agreement or send the notice under § 1040.4(a)(2)(iii). This applies to any subsequent buyers as well.

As in the proposal, providers are required to use the exact language of the required 4(a)(2)(i) provision, the optional 4(a)(2)(ii) provision, and the 4(a)(2)(iii) notice as applicable. The final rule, however, contains three limited exceptions to this general rule. Three new provisions – § 1040.4(a)(2)(iv) through (vi) – describe these limited exceptions.

Final § 1040.4(a)(2)(iv) specifies three sentences that providers are allowed to add at the end of the 4(a)(2)(i) and 4(a)(2)(ii) provisions. Final § 1040.4(a)(2)(iv)(A)(*1*) authorizes providers to include the sentence, "This provision does not apply to parties that entered into this agreement before [the compliance date]."[1051] The Bureau is allowing providers to use this sentence to make clear that the 4(a)(2)(i) and 4(a)(2)(ii) provisions do not bind parties that entered into the agreement before the compliance date. One scenario, among others, in which providers may wish to use this sentence is when they are entering into a pre-dispute arbitration agreement that existed previously between the consumer and another party, and where the other party entered into that agreement with the consumer before the compliance date. For example, where a creditor and a consumer enter into a loan agreement that includes a pre-dispute arbitration agreement before the compliance date, and a debt buyer purchases the loan agreement after the compliance date, the debt buyer may choose to add the sentence permitted by § 1040.4(a)(2)(iv)(A) to clarify that the phrase "neither we nor anyone else" in the 4(a)(2)(i) or

[1051] The Bureau will instruct the Office of the Federal Register to insert a date certain upon *Federal Register* publication.

4(a)(2)(ii) provisions does not refer to the original creditor.

The Bureau also is adding § 1040.4(a)(2)(iv)(A)(*2*), which authorizes providers to include the sentence, "This provision does not apply to products and services first provided to you before [the compliance date] that are subject to an arbitration agreement entered into before that date."[1052] The Bureau believes this sentence may be useful to align the scope of the 4(a)(2) provision with the reach of the rule as described in comment 4-1.i.A. As that comment clarifies, if a provider became party to a pre-dispute arbitration agreement with a consumer before the compliance date, and then provides the consumer with any new products or services after the compliance date, the rule applies only to these new products or services. The Bureau therefore is allowing providers to use the sentence in § 1040.4(a)(2)(iv)(A)(*2*) to clarify that the rule does not apply to other products and services that are not newly provided after the compliance date.

Final § 1040.4(a)(2)(iv)(B) authorizes providers to also include the sentence, "This provision does not apply to persons that are excluded from the Consumer Financial Protection Bureau's Arbitration Agreements Rule." The Bureau is allowing providers to use this sentence to clarify that the 4(a)(2)(i) or 4(a)(2)(ii) provisions do not bind persons that are excluded under § 1040.3(b). One scenario, among others, in which providers may wish to use this sentence is when entering into a pre-dispute arbitration agreement along with excluded persons. The sentence will clarify that the phrase "neither we nor anyone else" in the 4(a)(2)(i) and 4(a)(2)(ii) provisions does not refer to excluded persons.

Final § 1040.4(a)(2)(iv)(C) authorizes providers to also include the sentence, "This provision also applies to the delegation provision." As discussed above, comment 2(d)-2 to the final rule clarifies that a delegation provision is itself a pre-dispute arbitration agreement.

[1052] *Id.*

However, if a provider has included the 4(a)(2) contract provision in its pre-dispute arbitration agreement already with this additional sentence, the Bureau does not believe it is necessary for the 4(a)(2) provision to be included separately in the related delegation provision. The added sentence already clarifies that the 4(a)(2) provision applies to the delegation provision as well as the broader pre-dispute arbitration agreement. Accordingly, § 1040.4(a)(2)(iv)(C) states that a provider using the sentence specified in paragraph (a)(2)(iv)(C) as part of the 4(a)(2)(i) or 4(a)(2)(ii) provisions in a pre-dispute arbitration agreement is not required to separately insert the 4(a)(2)(i) or 4(a)(2)(ii) provisions into a delegation provision that relates to such a pre-dispute arbitration agreement. Otherwise, as explained in comment 4(a)(2)-4, if the provider uses a delegation provision and does not include the additional sentence in § 1040.4(a)(2)(iv)(C), then the provider would be required to include the 4(a)(2) provision both in the delegation provision as well as in the broader pre-dispute arbitration agreement to which it relates.

Further, the Bureau has added § 1040.4(a)(2)(v) in response to the industry commenter that requested that providers be permitted to disclose the required contract provisions in substance rather than verbatim. The Bureau believes that allowing providers to disclose the required provisions in substance would undermine the consumer protection benefits of the rule. The Bureau has designed the language of the required provisions carefully to convey the consumer's rights accurately and, to the extent possible, in plain language. The Bureau is concerned that slight linguistic changes that may seem innocuous to a provider could dramatically alter the provisions' effect. However, the Bureau also recognizes that the provisions' use of pronouns could cause confusion if they are inconsistent with the way a particular provider uses pronouns in the rest of the contract. For this reason, § 1040.4(a)(2)(v) states that, in any provision or notice required under § 1040.4(a)(2), if the provider uses a

standard term in the rest of the agreement to describe the provider or the consumer, the provider may use that term instead of the term "we" or "you." The Bureau also notes that one commenter's concern about class action liability for typographical errors in compliance with this provision is misplaced because there is no private right of action for violations of this part. The Dodd-Frank Act authorizes only the Bureau, State attorneys general, and prudential regulators to bring enforcement actions for non-compliance with regulations issued pursuant to section 1028(b).

In response to concerns about Tribal sovereign immunity, the Bureau has also added § 1040.4(a)(2)(vi), which provides that, in any provision or notice required under § 1040.4(a)(2), if a person has a genuine belief that sovereign immunity from suit under applicable law may apply to any person that may seek to assert the pre-dispute arbitration agreement, then the provision or notice may include, after the sentence reading "You may file a class action in court or you may be a member of a class action filed by someone else," the following language: "However, the defendants in the class action may claim they cannot be sued due to their sovereign immunity. This provision does not create or waive any such immunity." The word "notice" may be substituted for the word "provision" if the language is included in a notice. The Bureau notes that, even without this optional language, none of the 4(a)(2) provisions would limit a Tribe's sovereign immunity from class action lawsuits. Nevertheless, the Bureau is adopting § 1040.4(a)(2)(vi) to address the Tribal government commenters' concern that plaintiffs and courts could misconstrue the 4(a)(2) provisions in this fashion.

As noted above, the Bureau is clarifying that the optional language in § 1040.4(a)(2)(vi) may be used when there is a genuine belief that sovereign immunity under applicable law may apply. This standard – "genuine belief" – is derived from case law governing certain rights to

petition a court, which are discussed further in the section-by-section analysis of comment 4(a)(1)-2 above. By using this standard to describe when the optional provision may be used, the Bureau is providing an avenue for persons who may not be certain whether they are eligible for the exemption in § 1040.3(b)(2) to preserve any sovereign immunity to which they may ultimately be entitled. For example, a person may not be certain that that they are entitled to immunities under applicable law (such as an entity that works with a State or Tribe but might not meet the common law test for being an arm of the State or arm of the Tribe), or their immunity might not be based on their status as an arm of the Tribe or arm of the State (such as a local government in circumstances when it is not an arm of the State).

Finally, the Bureau is adding § 1040.4(a)(2)(vii) to clarify that a provider may provide any provision or notice required by § 1040.4(a)(2) in a language other than English if the pre-dispute arbitration agreement is also written in that other language. This clarification is to ensure consumers reading other languages are able to understand the required provision or notice.

The Bureau did not receive comment on proposed comments 4(a)(2)-1 through 4(a)(2)-3, but the Bureau is making three technical corrections to these provisions to improve clarity. First, the Bureau has added the phrase "after the compliance date set forth in § 1040.5(a)" to the first sentence of comment 4(a)(2)-1, so the comment now provides that § 1040.4(a)(2) sets forth requirements only for providers that enter into pre-dispute arbitration agreements for a covered product or service after the compliance date set forth in § 1040.5(a). 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." This edit ensures that the comment accurately reflects the requirements of the Rule by noting that providers are subject to § 1040.4(a)(2) only with respect to pre-dispute arbitration agreements that they enter into after the compliance date.

Second, the Bureau has revised the first sentence of comment 4(a)(2)-2 to reflect that § 1040.4(a)(2)(iii)(A) requires providers to amend existing agreements to include either the 4(a)(2)(i) or the 4(a)(2)(ii) provisions – rather than to include an amendment with language unique from those two provisions, as specified in the proposal. Third, the Bureau has removed the phrase "stating the provision" from the first sentence of proposed comment 4(a)(2)-3, so the sentence in the comment now provides that § 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." This revision reflects the fact that the written notice contains different language than the 4(a)(2)(i) and 4(a)(2)(ii) provisions.

Additionally, the Bureau is adding comment 4(a)(2)-4 to clarify the relationship between comment 2(c)-2, which explains that delegation provisions are pre-dispute arbitration agreements within the meaning of § 1040.2(c), and § 1040.4(a)(2), which requires providers to include specified language in their pre-dispute arbitration agreements. Comment 4(a)(2)-4 clarifies that if a provider has included in its pre-dispute arbitration agreement the language required by § 1040.4(a)(2), and the provider's pre-dispute arbitration agreement contains a delegation provision, the provider must include the language required by § 1040.4(a)(2) in the delegation provision itself. Thus the 4(a)(2) provision must be included in two places – in both the delegation provision and the pre-dispute arbitration agreement to which it relates – unless the latter pre-dispute arbitration agreement includes the 4(a)(2) provision and the optional sentence specified in § 1040.4(a)(2)(iv)(C) discussed above. In that case, the provider need not include the 4(a)(2) provision separately within the delegation provision.

As described above, the Bureau received several comments on proposed § 1040.4(a)(2) generally (as opposed to comments on its individual provisions). In response to the State regulator commenter that requested clarification, the Bureau affirms that, based on the plain meaning of the regulatory text, the 4(a)(2) provisions apply not only to class actions brought under Federal and State consumer protection laws, but to any class actions brought against providers concerning covered products and services. In response to the industry commenter's concern, the Bureau affirms that inclusion of a 4(a)(2) provision in a pre-dispute arbitration agreement should not constitute a waiver of any defenses that a company may assert in a class action, including defenses to class certification, that are unrelated to the pre-dispute arbitration agreement.

In response to the industry commenter that requested that the final rule state expressly that proposed § 1040.4(a)(2) does not apply to any transaction that originated with an excluded person pursuant to proposed § 1040.3(b), the Bureau declines to revise § 1040.4(a)(2) in this manner because it would be inconsistent with the overall framework of the rule. Under the rule, agreements that initially originated between a consumer and an excluded person can become subject to § 1040.4 generally in two situations: first, where an agreement was initially entered into by an excluded person before the compliance date and then entered into by a provider after the compliance date, and second, where an agreement was initially entered into by an excluded person after the compliance date and then relied on by a provider.[1053]

The Bureau also declines, in response to the consumer advocate's comment, to reframe the 4(a)(2) provisions as express relinquishments of a provider's right to use the contract to stop

[1053] The Bureau addresses the commenter's broader comment – that the Bureau is exceeding its authority by effectively regulating automobile dealers – in the section-by-section analysis of § 1040.3(a) above.

the consumer from being part of a class action. The Bureau notes that it has not framed the required contract provisions in the proposal and final rule in terms of rights; instead, the provisions constitute an agreement not to undertake specified conduct. The Bureau believes that the framing of the rule affords consumers the intended protections and allows for those protections to be stated in plain language.

The Bureau further declines to adopt additional disclosure requirements in response to the comment from the trade association of lawyers who represent investors. In response to the association's recommendations that the Bureau require providers to include a 4(a)(2) provision in all pre-dispute arbitration agreements and send a separate notice containing the language to consumers with existing agreements, the Bureau believes that this requirement would impact some pre-dispute arbitration agreements that are beyond the scope of agreements covered by section 1028. Moreover, the Bureau does not believe that specific disclosure requirements (*e.g.*, for font size) would better protect consumers.[1054] Furthermore, the Bureau has not observed a trend of providers using contract design to diminish the importance of consumer-friendly provisions in arbitration agreements. The Bureau also declines to impose a general requirement that providers include the relevant 4(a)(2) provision on their websites. The Bureau believes inclusion of the provision in pre-dispute arbitration agreements is sufficient to effectuate the purposes of § 1040.4(a)(2). Of course, if the provider's pre-dispute arbitration agreement is on a website, the rule still applies to a pre-dispute agreement that is posted on a website. As explained in comment 2(c)-3, the term pre-dispute arbitration agreement is not specific to any particular form or structure.

The Bureau also declines to require providers to identify in their agreements which

[1054] *See infra* Part VIII (responding to comments on potential alternatives suggested by commenters).

products are covered or to provide separate contracts for covered and non-covered products. The Bureau believes that these requirements would be significantly more burdensome than inserting a provision supplied by the Bureau. At the same time, the benefits to consumers from such requirements would be limited. The Bureau acknowledges that, where a contract is for both covered and non-covered products, it may not be immediately apparent to most consumers which products are subject to the provision. However, the Bureau believes that consumers can obtain this information, for example, by reviewing any information the provider voluntarily provides in the agreement about these products (as discussed below), by contacting their provider or by checking the Bureau's website for more information about the scope of the rule. The Bureau also notes that the 4(a)(2)(ii) provision is intended to communicate the consumer's dispute resolution rights not only to the consumer, but also courts and third parties such as potential purchasers, which are likely to either know which products are covered or conduct an appropriate analysis to make an informed determination.

The Bureau also declines to make use of the 4(a)(2)(ii) provision mandatory when a contract is for both covered and non-covered products and services. The Bureau believes that most providers will have a strong incentive to use the optional 4(a)(2)(ii) provision instead of the 4(a)(2)(i) provision, because it will make clear to consumers, attorneys, and judges that the provision applies only to class action claims concerning covered products. A provider of a covered and a non-covered product could use the language in 4(a)(2)(i). Although that would not be required by the rule, if they did so, that language may apply to the non-covered product as well. As a result, the Bureau believes that most providers providing covered and non-covered products will use the optional 4(a)(2)(ii) provision.

The Bureau further notes, in response to the industry commenter's recommendation that

providers be given the option to disclose which products are subject to the provision and which are not, nothing in § 1040.4(a)(2) would prevent providers from including this information in their arbitration agreements; indeed, the Bureau encourages providers to do so.

The Bureau also declines to replace the 4(a)(2)(i) and 4(a)(2)(ii) provisions with a single provision, as an industry commenter suggested. The Bureau believes that, where a contract is for both covered and non-covered products, the rule should permit providers to use the optional 4(a)(2)(ii) provision because that language is consistent with the scope of the rule as well as the scope of section 1028. The Bureau also does not believe, as the commenter suggested, that § 1040.4(a)(2) would effectively require lenders to use separate loan agreements for loans that lenders make directly and loans obtained from dealers or other financial institutions.

In response to the consumer advocate commenter's concern that the optional 4(a)(2)(ii) provision would create additional hurdles for consumers in class actions by explicitly addressing the issue of coverage, the Bureau disagrees. The Bureau would not characterize the question of coverage as a hurdle for consumers as application of a law or regulation can be an appropriate threshold question in any litigation. Providers may raise it to the extent they deem it relevant and courts will address it regardless of which provision the contracting party uses.

With respect to proposed § 1040.4(a)(2)(iii), the Bureau declines to require providers to amend their agreements – instead of sending the optional notice – wherever providers have the authority to amend their agreements unilaterally or wherever amending the agreement is not "contractually impossible." The Bureau believes this approach would be burdensome to providers, because it may not be clear whether a provider can unilaterally change the terms. The Bureau further notes that, even where providers send the notice instead of amending the agreement, many third parties – such as debt collectors – would still be subject to the prohibition

in § 1040.4(a)(1). In addition, the Bureau declines to revise proposed § 1040.4(a)(2)(iii) in response to an industry commenter's concern that the requirement to amend contracts or provide the notice effectively makes the rule "retroactive." This rule has no retroactive effect; § 1040.4(a)(2)(iii) would only apply once a provider enters into an agreement after the compliance date.

Additionally, the Bureau declines to take additional steps that several commenters suggested would increase the binding effect of the notice on third parties. The Bureau declines to use the phrase "neither we nor anyone else" or "no one" in the notice because it is not possible for a notice to bind third parties and it would be misleading to suggest otherwise to consumers. The Bureau also declines to require contracts between providers and third parties to waive the third parties' right to rely on pre-dispute arbitration agreements in class actions, because Dodd-Frank section 1028(b) authorizes the Bureau to regulate the use of an agreement "between a covered person and a consumer." The Bureau further declines to require that providers "consider the notice to be part of the agreement;" supply the notice whenever the agreement is requested by a third party; store a record of the notice in the same way the provider would store an amendment so that the documents together would be considered the complete agreement; or add language to the notice stating that the provider considers its promise to not stop the consumer from being part of a class action to be binding on third parties. Such requirements would effectively transform the notice into an amendment, and, for the reasons described in the previous paragraph, the Bureau declines to require providers to amend the agreement in situations where it has permitted a notice.

The Bureau also declines to forbid providers from relying on arbitration agreements in individual suits if the provider has not included the required contract provision or to state that

non-compliant arbitration agreements may not be severed or reformed after litigation has commenced. Because the Bureau's Study showed that providers rarely face individual suits, the Bureau does not believe that banning reliance on non-compliant arbitration agreements in such suits would meaningfully change providers' incentives to include the required contract provision. Further, the Bureau believes that title X penalties – which the Bureau and State attorneys general may seek for violations of the rule, including failure to include the required provision – will adequately deter potential violations.[1055]

Finally, the Bureau declines to add a provision stating that non-compliant arbitration agreements are null and void. Where a provider fails to comply with the rule by omitting the contract provision required by § 1040.4(a)(2), § 1040.4(a)(1) still prevents the provider from relying on an arbitration agreement in a class action. For this reason, declaring that a non-compliant pre-dispute arbitration agreement is null and void, and thus unenforceable, would not be necessary because pursuant to § 1040.4(a)(1), the agreement is already unenforceable with respect to class actions. Further, the Bureau believes that providers will be deterred from intentionally omitting the required contract provision because such an omission would violate the rule and subject the provider to title X penalties.

*Comments on the Bureau's Interpretation of "Entered Into"*

*The Bureau's Proposal*

Dodd-Frank section 1028(d) states that any rule prescribed by the Bureau under section 1028(b) shall apply to any pre-dispute arbitration agreement "entered into" after the compliance date. Consistent with section 1028(d), proposed § 1040.4(a)(1), § 1040.4(a)(2), and § 1040.4(b) used the term "entered into" or "entering into" to describe when the requirements

[1055] *See* 12 U.S.C. 5565.

imposed by those provisions would begin to apply to a particular agreement.[1056] To aid interpretation of proposed § 1040.4, the Bureau proposed a series of examples in comment 4-1 of what would have and would not have constituted "entering into" a pre-dispute arbitration agreement for purposes of the proposal. The Bureau also stated in the proposal that it interpreted the phrase "entered into" in section 1028(d) generally to include any circumstance in which a person agrees to undertake obligations or gains rights in an agreement. The Bureau stated in the proposal that it believed that this interpretation best effectuated the purposes of section 1028, was practical and clear in its meaning, and was reasonable.

Proposed comment 4-1.i would have provided three illustrative examples of when a provider enters into a pre-dispute arbitration agreement. First, proposed comment 4-1.i.A would have explained that a provider enters into a pre-dispute arbitration agreement where it provides to a consumer a new product that is subject to a pre-dispute arbitration agreement, and the provider is a party to the agreement. The Bureau stated in the proposal that it did not interpret this example to include new charges on a credit card covered by a pre-dispute arbitration agreement entered into before the compliance date. Second, proposed comment 4-1.i.B would have explained 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 have explained that a provider enters into a pre-dispute arbitration agreement where it adds a pre-dispute arbitration agreement to an existing product. The Bureau stated in the proposal that it

[1056] As later noted, the phrase "entered into an agreement" as used in section 1028 could be interpreted more broadly than the Bureau has proposed to interpret the phrase for purposes of the proposal.

interpreted Dodd-Frank section 1028(b) to authorize 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 comment 4-1.ii would have provided two illustrative examples of when a provider *does not* enter into a pre-dispute arbitration agreement. First, proposed comment 4-1.ii.A would have stated that a provider does not enter into a pre-dispute arbitration agreement where it modifies, amends, or implements the terms of a product that is subject to a pre-dispute arbitration agreement entered into before the compliance date. In the proposal, the Bureau stated that it believed that the phrase "entered into an agreement" as used in section 1028 could 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, the Bureau proposed to interpret the phrase more narrowly for purposes of the proposal. The Bureau solicited 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.

The Bureau noted in the proposal that comment 4-1.ii.A would include a provider's modification, amendment, or implementation of the terms of a pre-dispute arbitration agreement itself. The Bureau also stated, however, that a provider enters into a pre-dispute arbitration agreement where the modification, amendment, or implementation constituted the provision of a new covered product.[1057]

[1057] *See* proposed comment 4-1.i.A (stating 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).

Second, proposed comment 4-1.ii.B would have stated 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 agreement but does not become a party to that agreement.

Proposed comment 4-2 would have clarified that § 1040.4(a)(1) applies to a provider even where the provider itself does not enter into a pre-dispute arbitration agreement. Proposed comment 4-2.i would have explained that, under § 1040.4(a)(1), a provider cannot rely on a pre-dispute arbitration agreement entered into *by another person* after the compliance date with respect to any aspect of a class action concerning a covered product.[1058] The comment would have then clarified that, under § 1040.4(b), such providers may be required to submit certain specified records related to claims filed in arbitration pursuant to pre-dispute arbitration agreements. The comment then would have cross-referenced comment 4(a)(2)-1, which would have noted that § 1040.4(a)(2) does not apply to providers that do not enter into pre-dispute arbitration agreements.

Proposed comment 4-2.ii would have illustrated comment 4-2.i with an example. The proposed comment would have stated that, where 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 after the compliance date with respect to any aspect of a class action filed against the debt collector concerning its covered debt collection products or services. The comment would have then noted that, similarly, § 1040.4(a)(1) prohibits the debt collector from relying with respect to any aspect of such a class action on a pre-dispute

[1058] Proposed comment 4-2 referred to the effective date rather than the compliance date. As discussed below, the Bureau has corrected this error in the final rule.

arbitration agreement entered into by a merchant creditor who was excluded from coverage by § 1040.3(b)(5) after the compliance date.

*Comments Received*

The Bureau received several comments on proposed comment 4-1. More than two dozen commenters – primarily consumer advocates, consumer law firms, public-interest consumer lawyers, and nonprofits – urged the Bureau to expand its interpretation of "entered into" such that product agreements entered into before the compliance date would be subject to § 1040.4 if modified after the compliance date.[1059] The primary rationale offered by commenters was that this approach would benefit consumers by increasing the number of agreements that would be subject to the rule over time, relative to the approach the Bureau proposed. Commenters offered numerous examples of contractual modifications that they believed should trigger the rule's application, including, among other things, amendments to the pre-dispute arbitration agreement, pricing changes, and the addition of language regarding class actions. Some commenters stated that "material" modifications should trigger the rule's coverage, while other commenters referred to contractual modifications generally.[1060] Another commenter, a consumer law firm, requested that the Bureau interpret "entered into" such that a provider enters into an agreement when it modifies a pre-dispute arbitration agreement, but not when it modifies the other terms of the contract. The commenter stated that this approach would deter providers from amending their pre-dispute arbitration agreements after the compliance date to add class actions waivers.

[1059] Commenters used a variety of terms to refer to the contractual change, including "modification," "amendment," and "material change." Although each of these terms may have discrete meanings under contract law, for the purposes of this rule, the Bureau views these terms as interchangeable and is using the term "modification" in this section for the sake of simplicity.

[1060] Commenters offered numerous examples of contractual changes they believed would be "material," including pricing changes, the addition of language regarding class actions, the addition of requirements that the consumer waive legal rights, changes to the State law governing the agreement, and the addition of a new party or co-signer (not just an authorized user). One consumer advocate commenter suggested that the Bureau add to the commentary a non-exhaustive list of amendments that would be considered material.

A nonprofit commenter and a consumer advocate commenter recommended that the Bureau interpret "entered into" yet more expansively. The nonprofit commenter recommended that the Bureau subject all agreements to the rule, regardless of when they were entered into. The consumer advocate commenter stated that after a period of no more than one year, all existing contracts should be subject to the rule.

In contrast, an industry commenter stated that the final rule should adopt the proposal's approach to this issue by retaining comment 4-1.ii.A as proposed. Another commenter, a public-interest consumer lawyer, recommended that the Bureau remove proposed comment 4-1.ii.A and leave the question of whether modifications constitute "entering into" to the courts when they have occasion to interpret part 1040.

In addition, a number of commenters addressed the relationship between proposed comments 4-1.i.A and 4-1-ii.A,[1061] including the Bureau's statement in the proposal's section-by-section analysis that a provider enters into a pre-dispute arbitration agreement where a contractual modification constitutes the provision of a new covered product. Some industry commenters asserted that contractual modifications should not cause the rule to apply even if they constitute the provision of a new product. These commenters also asked the Bureau to clarify its view as to what types of contractual modifications would constitute the provision of a new product. One of these industry commenters stated that agreements should not be subject to the rule as long as the underlying product continues to serve the purpose for which the consumer originally entered into the agreement. (The commenter also asserted that, for this reason, agreements should not be subject to the rule when they are sold or assigned, even when modified

[1061] Proposed comment 4-1.i.A would have stated 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 such an agreement, and the provider is a party to that agreement. Proposed comment 4-1.ii.A would have stated 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.

in a manner that constitutes the provision of a new product.) Further, one industry commenter and one consumer advocate commenter asked the Bureau to clarify whether, if a contract is amended in a manner that constitutes the provision of a new product, the rule would apply only with respect to the new product or whether it would also apply to the existing product. The industry commenter stated that, in this scenario, the rule should apply only with respect to the new product, while the consumer advocate commenter stated that the rule should apply with respect to existing products as well.

Other commenters addressed the proposal's application to acquirers and purchasers of covered products. An industry commenter stated that a provider who was not a party to the original agreement between a company and a consumer should not be subject to the rule, even if the provider acquires or purchases a covered product after the compliance date or if the product agreement states that third parties (such as purchasers and assignees) may enforce the agreement. According to the commenter, such a third party already had rights in the arbitration agreement before the compliance date; therefore, the agreement is not newly entered into as to that third party. Another industry commenter stated that pre-dispute arbitration agreements originally entered into by excluded persons, such as automobile dealers, should not be subject to the rule when entered into by providers after the compliance date because, according to the commenter, the enforceability of a contract provision cannot depend on the identity of the party enforcing it. An industry commenter asked the Bureau to clarify how the rule would apply where a bank acquires another institution after the compliance date and account holders might receive a new account agreement from the acquiring institution. A trade association of consumer lawyers stated that the rule should cover providers that receive assignments of contracts. Another trade

association of consumer lawyers stated that it supported the Bureau's proposed application of the rule to acquirers and purchasers.

Other commenters expressed concerns about comment 4-1.ii.B.[1062] Two public-interest consumer lawyers expressed concern that comment 4-1.ii.B would exempt non-party acquirers from § 1040.4 altogether, even though such entities seek to enforce pre-dispute arbitration agreements. A consumer advocate commenter expressed concern that comment 4-1.ii.B would enable acquirers and purchasers to evade coverage where the original provider "de-coupled" its product agreements and arbitration agreements – *e.g.*, by providing the arbitration agreement in a separate document – and transferred only the product agreement to the acquirer or purchaser. The commenter argued that an acquirer or purchaser in this type of transaction could still rely on the pre-dispute arbitration agreement, if the product agreement would remain subject to it. But, the commenter asserted that under proposed comment 4-1.ii.B, the acquirer or purchaser would not enter into the arbitration agreement because it would not become a party to the arbitration agreement – enabling the acquirer or purchaser to avoid coverage (at least where the contract had been entered into before the compliance date).

Finally, a consumer advocate commenter expressed concern about the first sentence of proposed comment 4-1, which prefaced the comment's examples of when providers do and do not enter into agreements for purposes of proposed § 1040.4 by stating, "Section 1040.4 applies to providers that enter into pre-dispute arbitration agreements after the [compliance date]." The commenter asserted that this sentence is inaccurate because proposed § 1040.4(a)(1) would have

[1062] Proposed comment 4-1.ii.B would have stated that a party does not enter into a pre-dispute arbitration agreement where it acquires or purchases a product that is subject to such an agreement but does not become a party to that agreement.

applied to providers that do not themselves enter into pre-dispute arbitration agreements.[1063] The commenter suggested that the Bureau remove the phrase "providers that enter into" from this sentence. The same commenter also requested that the final rule adopt each of the examples in proposed comments 4-1.i and 4-2. Additionally, a public-interest consumer lawyer stated that it agreed with the Bureau's statement in the proposal's preamble that 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 Final Rule*

Having considered the issues raised by commenters, the Bureau is finalizing comments 4-1 and 4-2, containing its interpretation of the term "entered into" in this Part with certain modifications as described below.

The Bureau continues to interpret the phrase "entered into" in Dodd-Frank section 1028(d) as generally including circumstances in which a person agrees to undertake obligations or gains rights in an agreement. However, the Bureau notes that the rule does not treat every conceivable circumstance in which a person gains rights in a pre-dispute arbitration agreement to constitute entering into the agreement. For example, a person who is not a party to an agreement but is entitled to use the agreement may gain third-party beneficiary rights, but as discussed in the section-by-section analysis of comments 4-1 and 4-2 below, that person would not generally be entering into the pre-dispute arbitration agreement for purposes of the rule

The Bureau is adopting the examples in comment 4-1 largely as proposed, but with some additional clarifications as described below. As in the proposal, comment 4-1.i provides three

[1063] *See* proposed comment 4-2 (describing how proposed § 1040.4 would have applied to providers that do not enter into pre-dispute arbitration agreements).

illustrative examples of when a provider enters into a pre-dispute arbitration agreement after the compliance date for purposes of § 1040.4. Comment 4-1.i.A explains that a provider enters into a pre-dispute arbitration agreement when it provides to a consumer, after the compliance date, a new product or service covered by § 1040.3(a) that is subject to a pre-existing agreement to arbitrate future disputes between the parties, and the provider is a party to that agreement, regardless of whether that agreement predates the compliance date.[1064] The comment further clarifies that, in such cases, § 1040.4 applies only with respect to the new product or service. Comment 4-1.i.B explains that a provider enters into a pre-dispute arbitration agreement where it acquires or purchases a covered product or service after the compliance date that is subject to a pre-dispute arbitration agreement and becomes a party to that pre-dispute arbitration agreement or to the agreement for the consumer financial product or service, even if the seller is excluded from coverage under § 1040.3(b) or the pre-dispute arbitration agreement was entered into before the compliance date. Comment 4-1.i.C explains that a provider enters into a pre-dispute arbitration agreement where it adds a pre-dispute arbitration agreement after the compliance date to an existing product or service.[1065]

Further, as in the proposal, comment 4-1.ii provides two illustrative examples of when a provider does not enter into a pre-dispute arbitration agreement for purposes of § 1040.4. Comment 4-1.ii.A states 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 without engaging in the conduct described in comment 4-1.i after the compliance date. The comment clarifies that a provider does enter into a pre-dispute

[1064] As the Bureau stated in the proposal, it does not interpret this example to include new charges on a credit card covered by a pre-dispute arbitration agreement entered into before the compliance date.
[1065] *See also* comment 2(c)-2 (clarifying that a delegation provision is a pre-dispute arbitration agreement). If a provider adds a delegation provision to a pre-existing pre-dispute arbitration agreement, the rule would apply to the delegation provision.

arbitration agreement, however, when the modification, amendment, or implementation constitutes the provision of a new product or service. Comment 4-1.ii.B states that a provider does not enter into a pre-dispute arbitration agreement where it acquires or purchases a product or service that is subject to a pre-dispute arbitration agreement but does not become a party to any pre-dispute arbitration agreement that applies to the product or service.

Final comment 4-1 differs from the proposal in several respects. First, the Bureau has deleted the first sentence of proposed comment 4-1 ("Section 1040.4 applies to providers that enter into pre-dispute arbitration agreements after the [compliance date]."). The Bureau agrees with the consumer advocate commenter that the sentence would be inaccurate, given that § 1040.4(a)(1) applies to providers that do not themselves enter into pre-dispute arbitration agreements.[1066]

Second, the Bureau is adding additional clarifying language to comments 4-1.i.A and 4-1.i.B. This language clarifies an important aspect of the rule: that, for purposes of the rule, a provider enters into an agreement in the scenarios described in those comments even if the arbitration agreement was originally entered into before the compliance date. Therefore, final comment 4-1.i.A explains that when a person, before the compliance date, enters into an agreement to arbitrate future disputes with a consumer, and then provides the consumer with a new product that is subject to that agreement after the compliance date, the provider would be considered to be entering into that arbitration agreement for the new product after the compliance date for purposes of § 1040.4. Similarly, under final comment 4-1.i.B, when a person and consumer enter into a pre-dispute arbitration agreement for a product described in § 1040.3(a) before the compliance date, and a provider acquires or purchases the product after the

[1066] *See* Comment 4-2 (describing how § 1040.4 applies to providers that do not enter into pre-dispute arbitration agreements).

compliance date (and becomes a party to that arbitration agreement), the acquiring or purchasing provider would be considered to be entering into the pre-dispute arbitration agreement for purposes of § 1040.4.

The Bureau is adopting these interpretations to clarify that providers cannot avoid application of the rule after the compliance date by linking new products or newly-acquired or newly-purchased products with arbitration agreements that predate the compliance date and purport to govern the provider's future relationship with the consumer. This language clarifies that when providing new products after the compliance date, providers will need to review their product agreements that predate the compliance date to determine whether the new product agreement is subject to a pre-existing pre-dispute arbitration agreement that was not subject to the rule. The Bureau notes that providers can alleviate any burden with respect to this review either by inserting language in the new product agreement stating that the new product agreement is not subject to arbitration, or by including the rule's required contract provision with respect to that new product so that, in effect, the provider is amending the application of any earlier arbitration agreement to the new product or service.

Third, the Bureau has revised comment 4-1.ii.A to clarify the relationship between comments 4-1.i.A and 4-1.ii.A. In the preamble to the proposal, the Bureau noted that, even though a provider does not enter into a pre-dispute arbitration agreement where it modifies the terms of a product, a provider *does* enter into a pre-dispute arbitration agreement where the modification constitutes the provision of a new product. The Bureau believes this explanation would better aid compliance if it is in the commentary because it addresses what some commenters viewed as an apparent conflict between two other provisions of the commentary. To address concerns raised by commenters, final comment 4-1.i.A also includes an additional

sentence clarifying that, where a contractual modification constitutes the provision of a new product, § 1040.4 applies only with respect to the new product. The Bureau believes this interpretation strikes the appropriate balance between preserving the consumer protections available for new products and preserving reliance and expectations with respect to existing products.

The Bureau declines to adopt commenters' recommendation that contractual modifications should not constitute "entering into" even if they constitute the provision of a new product. The Bureau does not agree with the industry commenter that stated that agreements originally entered into before the compliance date should always continue to be exempt, even if modified after the compliance date, as long as the underlying product continues to serve the purpose for which the consumer originally entered into the agreement. Dodd-Frank section 1028(d) authorizes any regulation issued by the Bureau under section 1028(b) to apply to any agreement between a consumer and covered person entered into after the compliance date. The Bureau believes that, when a provider provides a new product or service after the compliance date, the pre-dispute arbitration agreement for that product is entered into at that time with respect to that new product or service, regardless of whether the pre-dispute arbitration agreement had been entered into previously with respect to other products or services. Thus, section 1028(d) authorizes the Bureau to apply the rule, as to that new product or service, at that time. Further, the approach recommended by the industry commenter would undermine coverage of new agreements. Were the Bureau to adopt the approach recommended by the three industry commenters, providers could potentially evade the rule in perpetuity, with respect to existing consumers, by providing new products to their existing consumers through what such providers would assert are modifications of existing contracts. With respect to the comments

that asked the Bureau to clarify what types of contractual modifications would, in its view, constitute the provision of a new product, the Bureau believes that such modifications include, without limitation, those that result in the provision of a new account (such as a deposit account or credit card account) or a new closed-end credit transaction.[1067]

Fifth, to conform to the rest of the regulatory text and commentary, the Bureau has revised comment 4-1.i.B and 4-1.ii.B to use the term "product or service" – not simply "product," as in the proposal.

The Bureau declines to expand its interpretation of "entered into" for purposes of § 1040.4 to include situations where a provider purchases or acquires a product that is subject to a pre-dispute arbitration agreement, but does not become party to the pre-dispute arbitration agreement. The Bureau recognizes that sellers of loans may place two separate agreements into two different documents – a product agreement and a pre-dispute arbitration agreement. The Bureau understands this "de-coupling" may be common in automobile finance, for example. The Bureau also recognizes that buyers may purchase or acquire the product agreement and become a party to that agreement, without purchasing the pre-dispute arbitration agreement or becoming party to that agreement. In these circumstances, the buyer may become a third-party beneficiary to the pre-dispute arbitration agreement. However, the Bureau disagrees that, by not treating such a buyer to be entering into the pre-dispute arbitration agreement, the rule encourages evasions. Such a buyer does not, in fact, evade the rule. The buyer, though not entering into the pre-dispute arbitration agreement, nonetheless remains subject to the rule against reliance in a class action in § 1040.4(a)(1), which generally applies to a provider

[1067] For instance, Regulation Z sets out rules for when a new closed end consumer credit transaction occurs for purposes of determining whether new disclosures are required. *See, e.g.*, 12 CFR 1026.20(a) and comment 20(a)-1 ("A refinancing is a new transaction requiring a complete new set of disclosures. Whether a refinancing has occurred is determined by reference to whether the original obligation has been satisfied or extinguished and replaced by a new obligation, based on the parties' contract and applicable law.").

regardless of whether it has entered into the pre-dispute arbitration agreement. The provider would also be required to submit certain specified records concerning claims filed in arbitration pursuant to such pre-dispute arbitration agreements. While such a buyer would not be subject to the contract provision or notice requirements in § 1040.4(a)(2), the Bureau does not believe that is an evasion of the rule. That outcome is, rather, a natural reflection of the position the buyer is in vis-à-vis the pre-dispute arbitration agreement. Moreover, making the buyer subject to § 1040.4(a)(2) in these circumstances would be inconsistent with the rule's overall approach to coverage of third parties, such as debt collectors who are hired by a creditor and may acquire third-party beneficiary rights under a pre-dispute arbitration agreements.

The Bureau also declines to expand its interpretation of "entered into" for purposes of § 1040.4 such that agreements entered into before the compliance date would become subject to the rule if modified in ways that do not constitute the provision of a new product. As discussed above, numerous commenters asserted that that this approach would benefit consumers by increasing the number of agreements that would be subject to the rule over time, relative to the Bureau's proposed approach. The Bureau believes, however, that this would not yield such significant consumer protection benefits to warrant the additional complexity and uncertainty that such a standard would create.

First, this approach would not benefit consumers in markets for most covered products. The Bureau understands that product agreements for many covered products are not typically modified after they are entered into. (For example, agreements for closed-end credit products are rarely modified, and products that are provided on a one-time basis do not allow for an opportunity to amend the agreement). For the remaining products – among which credit cards and checking accounts are the most significant in terms of market size – the Bureau lacks data on

the frequency of contractual modifications (and commenters did not cite any such data). However, regardless of how frequently modifications occur, the Bureau believes that the rule will apply to a significant majority of consumer agreements within a relatively brief period, even if the Bureau does not expand its interpretation of "entered into" to include modifications, due to the frequency of account turnover in these markets.[1068] Further, the Bureau believes that even those consumers who maintain older accounts to which the rule does not apply will benefit from the rule because of the rule's deterrent effect. Due to the frequency of account turnover, it often will not be long before a critical mass of a provider's consumers would be able to participate in any class actions relating to a given product line. The Bureau believes that, once this occurs for a given product line, the provider will have the incentive provided by class exposure to avoid potentially illegal practices in relation to that product, and that these actions will generally benefit all consumers, even those who cannot participate in a class action.

For these reasons, the Bureau believes that expanding its interpretation of "entered into" for purposes of § 1040.4 to include modifications generally (even when there is no provision of a new product) would not yield significant consumer benefit. At the same time, such an approach would increase the rule's complexity and uncertainty by requiring providers, the Bureau, other regulators, and the courts to determine, for purposes of the rule, what types of modifications of existing products constitute entering into and which do not. For example, determining what

[1068] For example, in the credit card market, the number of new accounts opened per year since 2011 has ranged from approximately 80 million to approximately 100 million, and the number of open credit card accounts has held steady since 2011 at approximately 600 million. *See* Bureau of Consumer Fin. Prot., "The Consumer Credit Card Market," at 89 fig. 2 (Dec. 2015), *available at* http://files.consumerfinance.gov/f/201512_cfpb_report-the-consumer-credit-card-market.pdf (number of new accounts opened per year) and at 33 fig. 4 (number of open accounts over time). As a result, the Bureau estimates that, within five years, about 80 percent of credit card accounts would be covered by the rule, even if contractual modifications do not subject an agreement to the rule. In the checking account market, attrition data indicate that consumers close about half of all checking accounts within three years and two-thirds of all accounts within five years. *See* Harland Clarke, "State of the Industry 2012 Financial Services Benchmarking Analysis," (2012), *available at* http://harlandclarke.com/solutions/docs/industry-benchmarking-report. Thus, assuming that consumers continue to open new accounts at about the same rate, the Bureau estimates that, within five years, about two-thirds of checking accounts will be covered by the rule, even if contractual modifications do not subject an agreement to the rule. (If consumers open new accounts at a higher rate than the rate at which they close old accounts, an even higher share of accounts would be covered by the rule.).

modifications are sufficiently "material" would be a complicated line-drawing process. For these reasons, the Bureau is not expanding its interpretation of "entered into" for the purposes of § 1040.4 to include modifications of existing contracts after the compliance date that do not represent the provision of a new product or service.

Similarly, the Bureau declines to expand its interpretation of "entered into" for purposes of § 1040.4 such that agreements entered into before the compliance date would be subject to the rule if the provider modifies the pre-dispute arbitration agreement (but not the overall product agreement after the compliance date). As described above, a commenter asserted that this approach would deter providers from amending their pre-dispute arbitration agreements after the compliance date to add class actions waivers and thus expand the reach of the proposal. The Bureau believes that some of the same considerations about complexity and uncertainty, described above, that warranted not expanding its interpretation of "entered into" to include modifications to product agreements also apply in the context of modifications to arbitration agreements themselves. Additionally, in response to the consumer law firm's comment that interpreting "entered into" to include modifications to arbitration agreements would deter providers from amending their pre-dispute arbitration agreements after the compliance date to add class action waivers, the Bureau does not believe that providers covered by the rule will have an incentive to add class action waivers to their arbitration agreements, because part 1040 will render such provisions ineffective.

The Bureau also declines to subject all agreements to the rule regardless of when they were entered into (as requested by the nonprofit commenter) and to subject all existing contracts to the rule after a period of one year (as requested by the consumer advocate commenter). Section 1028(d) requires that any regulation prescribed by the Bureau shall apply to agreements

entered into after the compliance date, and both of these approaches would cause the Bureau's rule to apply to some agreements not entered into after the compliance date. The Bureau also declines to adopt the public-interest consumer lawyer's recommendation to delete comment 4-1.ii.A. The Bureau believes the comment promotes a uniform approach to the application of the rule, which will thus facilitate compliance and reduce burden and uncertainty.

Moreover, the Bureau declines to adopt the interpretation requested by industry commenters that a provider does not enter into a pre-dispute arbitration agreement where, after the compliance date, it acquires or purchases a covered product that predated the compliance date. The Bureau disagrees with the industry commenter's assertion that an agreement is not entered into in this scenario because the acquirer or purchaser already had rights under the agreement. Even where an agreement states that it is enforceable by a purchaser, a *particular* purchaser generally does not gain rights in a product agreement until it actually purchases – or enters into – the product agreement. That is, such a person does not become a purchaser until it engages in purchasing.[1069] If the industry commenter was asserting that a particular third party could acquire some rights in a pre-dispute arbitration agreement before the compliance date, and then additional rights after the compliance date, it provided no concrete details as to when such a scenario would occur. If such a third party is engaged in providing the same product or service, such as debt collection, to the same consumer on the same consumer credit account before and after the compliance date, then the rule generally would not apply.

With respect to the assertion by a different industry commenter that acquirers or purchasers should not be subject to the rule because the enforceability of a contract provision

[1069] For instance, where there is a contract between a lender and a consumer, a debt buyer cannot enforce an arbitration agreement in that product agreement before it acquires or purchases the product agreement, even if the product agreement confers rights on third-party beneficiaries.

cannot depend on the identity of the party enforcing it, the Bureau does not believe that this is accurate. Different parties to a contract may be subject to different regulatory requirements, some of which may limit their ability to enforce certain provisions. Thus, if a party has in fact entered into a contract after the compliance date, then that party may be subject to this rule, even if a different person entered into the contract before the compliance date and is not subject to the rule.

In response to the industry commenter that requested that the Bureau clarify how the rule applies in the context of bank acquisitions, the Bureau notes that, as comment 4-1.i.B explains, an acquiring bank enters into an acquired bank's pre-dispute arbitration agreements for purposes of § 1040.4 where it becomes a party to the acquired bank's arbitration agreements (or product agreements subject to arbitration agreements) after the compliance date, even if the agreements were entered into by the acquired bank before the compliance date.[1070] As comment 4-1.ii.B clarifies, the acquiring bank does not enter into the acquired bank's pre-dispute arbitration agreements for purposes of § 1040.4 where it does not become a party to the acquired bank's pre-dispute arbitration agreements or product agreements, even if the agreements were entered into before the compliance date. In response to the trade association of consumer lawyers' comment that the final rule should state expressly that assignees enter into pre-dispute arbitration agreements (in addition to acquirers and purchasers), the final rule uses the terms acquiring and purchasing because those are the terms used in the Dodd-Frank Act's definition of financial product or service.[1071] The Bureau believes that whether a particular assignment constitutes an

[1070] *See also* comment 4(a)(2)-2 (explaining how § 1040.4(a)(2) applies in the context of bank acquisitions).
[1071] *See* 12 U.S.C. 5481(15)(A).

acquisition or purchase will depend on the particular facts and circumstances of the relevant transaction.

The Bureau is finalizing comment 4-2 largely as proposed. The Bureau has revised comment 4-2 to refer to the compliance date (instead of the effective date) and has made other minor modifications to improve readability.

*4(b) Submission of Arbitral Records*

As discussed above in Part VI, while proposed § 1040.4(a) would have prevented providers from relying on pre-dispute arbitration agreements in class actions, it would not have prohibited covered entities from maintaining pre-dispute arbitration agreements in consumer contracts generally; nor would it have prevented providers from still invoking such agreements to compel arbitration in cases not filed as putative class actions. Thus, the Bureau separately considered in the proposal 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. The Bureau ultimately decided not to propose to prohibit specific practices in individual arbitration, but rather to propose an ongoing monitoring regime in light of historical precedent suggesting that there could be risks to consumers in certain circumstances from biased arbitration administrators or other practices.

Accordingly, pursuant to its authority under sections 1028(b) and 1022(c)(4) of the Dodd-Frank Act, the Bureau proposed § 1040.4(b), which would have required providers to submit copies of certain arbitral records to the Bureau. Specifically, proposed § 1040.4(b)(1) would have required providers, for any pre-dispute arbitration agreement entered into after the compliance date, to submit copies to the Bureau of claims, judgments or awards, and certain

other records concerning specific arbitration proceedings, as well as certain decisions by an arbitration administrator concerning the fairness of the underlying arbitration agreements. The Bureau explained in the proposal that it intended to develop, implement, and publicize an electronic submission process before the compliance date if proposed § 1040.4(b) were adopted. Proposed § 1040.4(b)(2) addressed the timing of records submissions, while proposed § 1040.4(b)(3) would have set forth the information that providers shall redact before submitting records to the Bureau.[1072]

Using the records collected and other sources, the Bureau stated that it intended to continue to evaluate the impacts on consumers of arbitration and arbitration agreements and draw upon all of its statutorily authorized tools to address conduct that harms consumers to the extent necessary and appropriate. The Bureau also noted its willingness to consider conducting additional studies on consumer arbitration pursuant to Dodd-Frank section 1028(a) to evaluate whether further rulemaking would be in the public interest and for the protection of consumers,[1073] improving its consumer education tools, or, where appropriate, undertaking enforcement or supervisory actions.

Proposed comment 4(b)-1 would have clarified that providers are not required to submit 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, but that the obligation to comply with § 1040.4(a) nevertheless remains on the provider. The provider must ensure that the person submits the records in accordance with § 1040.4(b).

[1072] Pursuant to Dodd-Frank section 1022(c)(4)(C), the Bureau may not obtain information under its section 1022(c)(4) authority "for the purposes of gathering or analyzing the personally identifiable financial information of consumers."
[1073] 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.

Proposed comment 4(b)(3)-1 would have clarified that 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).

As set forth in more detail below, the Bureau is finalizing § 1040.4(b)(1) through (b)(3) largely as proposed with the addition of two additional categories of records. In addition the Bureau is finalizing new provisions § 1040.4(b)(4) through (b)(6), which require the Bureau to redact and then publish to the internet the records received by the Bureau pursuant to § 1040.4(b)(1) through (b)(3).

The Bureau finalizes comment 4(b)-1, having received no comments on this specific commentary. The Bureau also finalizes proposed comment 4(b)(3)-1, renumbered as 4(b)-2, having received no comments on this specific commentary.

*4(b)(1) Records to be Submitted*

As stated above, proposed § 1040.4(b) would have required 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.[1074] Proposed § 1040.4(b)(1) would have listed the arbitral records that providers would be required to submit to the Bureau. Compliance with this provision would have been required for pre-dispute arbitration agreements entered into after the compliance date. The Bureau received a number of comments on the structure and content of the various subparts of proposed § 1040.4(b)(1) (from proposed § 1040.4(b)(1)(i) through new § 1040.4(b)(1)(iii)),

[1074] The Bureau stated in the proposal that it anticipated that it would separately provide technical details pertaining to the submission process.

which are addressed further below. The Bureau also received several comments on proposed § 1040.4(b)(1) more generally.

An industry commenter pointed to a reference in the proposal to section 1021(b) of the Dodd-Frank Act, which defines the Bureau's objectives to include "ensuring … [that] Federal consumer financial law is enforced consistently." The commenter asserted that this section may grant the Bureau the authority to determine if Federal consumer financial law is being applied consistently, but does not grant the Bureau authority to determine whether arbitrators are applying Federal consumer financial law consistently thus this part of the proposal exceeded the Bureau's authority. Some commenters argued that the Bureau lacked authority to collect arbitration materials. One industry commenter argued that the monitoring proposal created a new and direct "channel" of supervision by the Bureau for small entities, which are generally not subject to the Bureau's examination authority. Another industry commenter expressed doubts over whether the Bureau could collect documents from financial institutions for which it was not the primary regulator. Another industry commenter argued that arbitration is not a consumer financial product or service and, therefore, cannot be regulated by the Bureau under its authority under section 1022(c), which permits market monitoring as to the "offering or provision of" consumer financial products.

Section 1040.4(b)(1) is largely finalized as proposed, with several additions set out below in § 1040.4(b)(1)(i) through (b)(1)(iii).

As to the comment that Dodd-Frank section 1021(b) does not give the Bureau authority to determine whether arbitrators are enforcing consumer financial laws consistently, the Bureau disagrees with the comment's premise. The Bureau cites provisions other than section 1021(b)

as legal authority for the monitoring requirement.[1075] Here, the Bureau cites section 1021(b) because it expresses one of several public interest goals that the Bureau is charged with furthering. The Bureau finds that monitoring enables more consistent enforcement of the consumer financial laws by permitting the Bureau and public to review provider behavior in arbitration proceedings and business practices that may give rise to such proceedings.

As to various commenters that challenged the Bureau's authority to adopt the rule, the Bureau relies on sections 1028 and 1022 of the Dodd-Frank Act as set out in greater detail in the Parts V and VI.D, above. Those provisions authorize the Bureau to collect documents from providers of consumer financial products, even with regard to entities for which it does not exercise supervisory authority under sections 1024 through 1026. The Bureau finds that its market monitoring authority under section 1022 encompasses the dispute resolution mechanisms that providers of consumer financial products adopt to resolve conflicts with their customers. Contrary to the commenters' assertions, monitoring does not create a new de facto "channel" for examining small entities not subject to the Bureau's larger participant rulemakings. Monitoring simply permits the Bureau to understand fairness and quantity of the specific arbitration proceedings that arise. In any case, many providers that are not subject to the Bureau's supervision authority otherwise are subject to the Bureau's market monitoring authority and the Bureau's enforcement authority for unfair, deceptive, and abusive acts and practices. The Bureau believes consumers will benefit if records pertaining to individual arbitration proceedings are submitted to the Bureau. Further, as to the industry comment that arbitration is not a consumer financial product for purposes of collecting data under 1022(c) of the Dodd-Frank Act,

[1075] As set out above in Part V, the Bureau relies on sections 1028(b) and 1022 of the Dodd-Frank Act as legal authority to promulgate a rule requiring the submission and publication of documents.

the Bureau interprets its market monitoring under 1022(c)(1)), which authorizes "monitor[ing] for risks to consumers in the offering or provision of consumer financial products or services" (emphasis added) by the Bureau, broadly to include documents that assist the Bureau in understanding markets and mechanisms (such as dispute resolution tools) that providers use to administer consumer financial products. In any case, the Bureau is not using its authority to monitor arbitrators or arbitration administrators, but rather the providers that use arbitration.

With regard to the commenter that expressed doubts over whether the Bureau could collect documents from financial institutions for which it was not the primary regulator, the Bureau disagrees, given the affirmative grant of authority to the Bureau under sections 1022 and 1028 of the Dodd-Frank Act. The Bureau has routinely interpreted its section 1022 market monitoring authority to reach all entities covered by the Dodd-Frank Act.

*4(b)(1)(i)*

Proposed § 1040.4(b)(1)(i) would have required, 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.

Specific comments relating to each of the individual proposed categories of records are discussed separately below. Separately, the Bureau received several general comments that suggested expansions in the categories of records subject to the submission requirement of

proposed 1040.4(b)(1)(i) and urged the Bureau to exclude some providers from complying with the proposed requirement.[1076]

One consumer advocate commenter suggested that the Bureau should require providers to submit a number of other documents or data related to the timing of arbitration proceedings (including the date on which the statement of claim was filed, the date on which the provider paid administration or arbitration fees, the date on which the arbitration hearing was held, and the date on which the award was issued) to permit the Bureau to understand how often providers delayed arbitration proceedings. The consumer advocate commenter also suggested that the Bureau should require providers to submit information on the relationship of the administrator with the parties, including any *ex parte* communications between a provider and an arbitrator or arbitral administrator to see if the provider made any attempts to influence the outcome of arbitration proceedings,[1077] and records of any financial relationship between a provider and the arbitrator or arbitral administrator, citing NAF's conflict issues as an example.[1078] This consumer advocate commenter suggested that these materials would help the Bureau and other groups monitor the extent of specific arbitration harms, including the use of delay as a tactic in arbitration proceedings to prevent consumers from obtaining relief, and the use of influence or pre-existing financial connections with arbitrators and administrators by providers to change the outcome of arbitration awards.

[1076] The Bureau addressed comments regarding its preliminary finding that the monitoring proposal was in the public interest and for the protection of consumers above in Part VI.B.

[1077] Specifically, the consumer advocate commenter referred to an example outside of the context of consumer finance in which a company put pressure on the arbitration administrator to overrule or reverse an arbitrator who had determined that the relevant pre-dispute arbitration agreement permitted classwide arbitration. According to the commenter, such communications between the company and the arbitration administrator were not disclosed to the consumer.

[1078] Specifically, the consumer advocate referred to the example, discussed above, of the relationship between the NAF and a debt collection company, both of which were owned by the same parent company.

Another consumer lawyer commenter suggested that the Bureau should require providers to submit information to the Bureau on the protected group status of consumers – including race, ethnicity and gender – subject to pre-dispute arbitration agreements, whether or not the consumers were parties to an arbitration proceeding, so that the Bureau and others can analyze the disparate impact of such agreements on protected groups. The consumer lawyer commenter noted that, in its experience, pre-dispute arbitration agreements are used to deter formal claims by consumers before they are raised generally, that this deterrence has a disparate impact on protected groups, and that the Bureau should thus collect data on protected group status to analyze this. The commenter suggested that such data on the protected group status of consumers should be collected in such a way that it is not disclosed inappropriately to the arbitrator, such that the arbitrator could make decisions without access to the protected group status of consumer participants to arbitrations. The commenter admitted that it was unsure, practically, how the Bureau could collect this information and avoid disclosure to the arbitrator.

A Tribal commenter requested that the Bureau exclude Tribal entities from complying with the formal aspects of the monitoring proposal and suggested instead that the Bureau could receive similar information by collaborating with Tribal regulatory bodies to potentially engage in information sharing.

Based on the Bureau's responses to more general comments on arbitral records, and for the more specific reasons set out below in the section-by-section analyses of § 1040.4(b)(1)(i)(A) through (i)(E), the Bureau is finalizing § 1040.4(b)(1)(i). Section § 1040.4(b)(1)(i) sets forth what arbitration related documents providers must submit, largely as proposed, with the addition of one new category of arbitration-related record in new (b)(1)(i)(B), which requires the submission of answers to initial claims and counterclaims.

The Bureau disagrees that the final rule should require providers to submit additional types of documents suggested by commenters, other than one category of document set out in § 1040.4(b)(1)(i)(B) below. The Bureau believes that the documents required by § 1040.4(b)(1)(i) capture significant data on the timing of arbitration proceedings and any delays. Specifically, the documents the Bureau will receive – claims, answers to claims, and awards – will themselves show dates and permit the Bureau to determine the time between filing and awards in many cases. The submission of additional documents on timing would likely increase burden on providers without a clear benefit to consumers, the policymaking of the Bureau, or others.

The Bureau also disagrees with the consumer advocate commenter that the final rule should require the submission of records, information or *ex parte* communications pertaining to potential conflicts of interests (including financial relationships between providers and an arbitrator or arbitral administrator), or attempts to influence arbitrators or administrators. The Bureau believes such requirements would be redundant in that attorneys and arbitrators in arbitral proceedings are already subject to ethical or professional rules requiring the disclosure of any relationships or communications that may create the appearance of a conflict of interest or unfairness.[1079] The Bureau believes that the commenter's suggestion could involve complicated questions as to what types of records fall within the scope of the requirement and heighten burdens on all providers subject to the monitoring rule. The Bureau believes that § 1040.4(b)(i) will substantially increase transparency into arbitration proceedings. The Bureau intends to

[1079] *See, e.g.*, American Bar Ass'n, "Model Rules of Professional Conduct," at Rule 3.5 (A lawyer shall not: (a) seek to influence a judge . . . or other official by means prohibited by law; (b) communicate *ex parte* with such a person during the proceeding unless authorized to do so by law or court order . . . ."); AAA, "Code of Ethics for Arbitrators in Commercial Disputes," at Canon II ("An arbitrator should disclose any interest or relationship likely to affect impartiality or which might create an appearance of partiality."); JAMS, "Arbitrator Ethics Guidelines," at V.A. ("An Arbitrator should promptly disclose, or cause to be disclosed all matters required by applicable law and any actual or potential conflict of interest or relationship or other information, of which the Arbitrator is aware, that reasonably could lead a Party to question the Arbitrator's impartiality.").

continue to monitor arbitration proceedings going forward for conflicts of interest, and other issues, and may consider further measures or requirements as needed.

The Bureau agrees with a consumer advocate commenter that the receipt of information on the protected group status of consumers subject to pre-dispute arbitration agreements, whether or not the consumers were parties to an arbitration proceedings, could be potentially useful in analyzing the disparate impact of such agreements on protected groups. However, the Bureau views the collection of such data about consumers that were deterred from making claims at all as impracticable in the context of this rulemaking. The consumer lawyer admitted in its comment the difficulties of devising a practicable means to obtain such information without drawing the attention of arbitrators to the protected group status of the consumer.

The Bureau disagrees with the comment that Tribal entities should be excluded from the monitoring proposal because the Bureau could instead collaborate with Tribal regulatory bodies to engage in information sharing. The Bureau believes that practically speaking, this part of the proposal should have no or minimal impact on most Tribal entities, given that the final rule's exemption. The Bureau also believes that those entities that do use arbitration agreements should find it simpler and less time-consuming to comply with the relatively simple provisions of the rule, rather than waiting for collaborations between different Tribal regulatory bodies and the Bureau to develop *ad hoc* information-sharing schemes with each Tribal regulator and lender subject to that regulator.

*4(b)(1)(i)(A)*

Proposed § 1040.4(b)(1)(i)(A) would have required providers to submit any initial claims filed in arbitration pursuant to a pre-dispute arbitration agreement and any counterclaims. By

"initial claim," the Bureau meant the filing that initiates the arbitration, such as the initial claim form or demand for arbitration.

One industry commenter suggested that proposed § 1040.4(b)(1)(i) should be modified to require that providers submit only the "substance of" initial statements of claims and any counterclaim in arbitration. The industry commenter reasoned that consumers often submit additional documents as attachments to statements of claim, such as bank statements, that would require extensive and burdensome redactions.

Section 1040.4(b)(1)(i)(A) is finalized as proposed. The Bureau concludes that a statement of claim is necessary to understand the nature of a dispute. As discussed in detail above, the Bureau believes that collecting claims will permit the Bureau to 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 will also help the Bureau identify business practices that harm consumers.

The Bureau disagrees that providers should be permitted to summarize the "substance of" initial statements of claims simply because consumers may attach additional documents to statements of claim that may require redaction before submission. The Bureau believes that any redaction burden will be limited in cost, even for lengthier additional documents, based on its experience of having reviewed statements of claim in the course of the Study,[1080] and that writing a summary could be more burdensome than redacting text. Further, the Bureau believes that a provider's summary of a consumer's statement of claim may not fully express the consumer's

[1080] *See* Study, *supra* note 3, section 5 at 19-32 (analyzing 1,847 individual consumer arbitration claims before the AAA).

understanding of a dispute. In any case, new § 1040.4(b)(1)(i)(B), described below, requires providers to submit answers to statements of claim, giving providers the opportunity to address any potentially erroneous or misleading statements made by consumers.

*4(b)(1)(i)(B)*

In the final rule, the Bureau is adopting new § 1040.4(b)(1)(i)(B) (proposed § 1040.4(b)(1)(i)(B) is renumbered as § 1040.4(b)(1)(i)(C)), which requires that providers should also submit answers to arbitration statements of claim.

The Bureau is adopting § 1040.4(b)(1)(i)(B) in response to several commenters' concern that the original proposal, which only required the submission of initial claims and counterclaims, could result in a one-sided presentation of the facts in an arbitration proceeding, especially where no award was issued. Specifically, the Bureau adopts the suggestion by one Tribal commenter that providers be required to submit answers to initial claim filings.

As the Study demonstrated, most arbitration proceedings do not result in a final award or judgment issued by a neutral arbitrator.[1081] Under the Bureau's original proposal, in the absence of an award, the only information on the substantive dispute at issue in most arbitration proceedings would have been the initial claims and counterclaims. The Bureau believes that requiring providers to submit answers to initial claims and counterclaims will result in a more balanced understanding of arbitration proceedings and that the additional burden will be minimal. The Bureau believes that § 1040.4(b)(1)(i)(B) should alleviate the concerns of industry commenters noted above. Section 1040.4(b)(1)(i)(B) also requires the submission of consumers'

[1081] *Id.* section 5 at 11 ("As with other systems of dispute resolution, only a minority of consumer financial arbitrations reached the point where there was a decision on the merits of the parties' claims. Specifically, arbitrators resolved less than a third (32.2 percent) of the consumer financial arbitration disputes on the merits.").

answers to statements of claim filed against them. This will similarly help offer a more balanced view of provider-filed statements of claims (or counterclaims).

*4(b)(1)(i)(C)*

Proposed § 1040.4(b)(1)(i)(B) would have required 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 noted in the proposal that, due to concerns relating to burden on providers and the Bureau itself, the Bureau did not propose to collect all pre-dispute arbitration agreements that are provided to consumers. Instead, it proposed only to require submission in the event an arbitration filing occurs.[1082] By collecting the pre-dispute arbitration agreement in such situations, the Bureau would have been 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 awards pursuant to proposed § 1040.4(b)(1)(i)(C) – would have permitted the Bureau to gather information on whether clauses specifying that the parties waive certain substantive rights when pursuing the claim in arbitration affect outcomes in arbitration.

A nonprofit commenter and a consumer advocate commenter suggested that all entities covered by the rule should submit all pre-dispute arbitration agreements covered by the rule to the Bureau. The same nonprofit commenter suggested that all amendments to pre-dispute arbitration agreements should also be subject to the submission requirement, and that any information on pre-dispute arbitration agreements that require hearings in fora inconvenient to consumers should be submitted to the Bureau. Another consumer advocate suggested that entities supervised by the Bureau that are also providers under the rule be required to submit all

[1082] As noted below, credit card and prepaid account issuers are already required to submit their consumer agreements to the Bureau.

of their covered pre-dispute arbitration agreements to the Bureau. These commenters argued that such additional steps were warranted because they believed that individual arbitration proceedings themselves were problematic and unfair to consumers, that smaller providers were not likely to drop their pre-dispute arbitration agreements, and that pre-dispute arbitration agreements themselves could be reviewed for unfairness to consumers.

Proposed § 1040.4(b)(1)(i)(B), renumbered in this final rule as § 1040.4(b)(1)(i)(C), is finalized as proposed. By collecting the pre-dispute arbitration agreement in filed arbitrations, the Bureau will be able to monitor the impact that particular clauses in an agreement have on the conduct of arbitrations. The Bureau disagrees with consumer advocate commenters that this provision should be expanded to require all providers to submit pre-dispute arbitration agreements to the Bureau. The Bureau noted in its proposal that, due to concerns relating to burden on providers and the Bureau itself, the Bureau did not propose to collect all pre-dispute arbitration agreements that are provided to consumers. None of the comments suggested ways to mitigate such burdens. Further, the Bureau believes that many providers that use pre-dispute arbitration agreements, but will not be required by § 1040.4(b)(1)(i)(C) to submit such agreements to the Bureau because they are not a party to an arbitration proceeding, may be required by other Bureau regulations to submit pre-dispute arbitration agreements in any case. Pursuant to Regulation Z, credit card issuers are already required to submit their consumer agreements to the Bureau. *See* 12 CFR 1026.58. The Bureau also will require the collection of prepaid account agreements. *See* 12 CFR 1005.19(b) (effective October 1, 2018). Further, the Bureau may monitor the arbitration activities and review the arbitration records of the providers subject to the Bureau's supervision authority in examinations.

*4(b)(1)(i)(D)*

Proposed § 1040.4(b)(1)(i)(C) would have required 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 was intended to reach only awards issued by an arbitrator that resolved an arbitration and not settlement agreements that 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.

An industry commenter suggested that the Bureau should not collect awards or judgments for a number of reasons, including that the proposal would discourage arbitrators from making explicit findings, knowing that the Bureau might subject the provider to further scrutiny, and that the proposal would put the onus on arbitrators to assess the fairness of arbitration agreements when it is the role of courts to analyze the fairness of such agreements.

Proposed § 1040.4(b)(1)(i)(C), renumbered as § 1040.4(b)(1)(i)(D), is finalized as proposed. As discussed in detail in Part VI.D, the Bureau disagrees with the industry commenter that argued that this provision of the rule may disincentivize arbitrators from making certain findings. Indeed, the Bureau believes publication will make arbitrators more deliberative in their decision-making, and that this is in the public interest and for the protection of consumers. The Bureau agrees with the commenter that suggested that this provision may also subject some providers to further Bureau scrutiny, especially if they are repeatedly involved in arbitrations. The Bureau believes that such an outcome is a potential benefit. The Bureau believes that it is in the public interest and for the protection of consumers to subject certain providers – especially those that have multiple final awards against them from consumers on the same issue – to further

scrutiny from the Bureau, other regulators, and the public regarding the providers' business and compliance practices. Overall, the Bureau believes that the submission of awards will aid the Bureau in its ongoing review of arbitration and help the Bureau assess whether arbitrations are being conducted fairly and without bias.

*4(b)(1)(i)(E)*

Proposed § 1040.4(b)(1)(i)(D) would have applied 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 were to occur, proposed § 1040.4(b)(1)(i)(D) would have required the provider to submit any communication the provider receives from the arbitration administrator related to such a refusal or dismissal. As the proposal explained 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.[1083] Pre-dispute arbitration agreements often mandate that the provider, rather than the consumer, pay some of the consumer's arbitration fees.[1084]

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 in either forum. The Study identified at least 50 instances of such nonpayment of fees by companies in cases filed by consumers.[1085] The Bureau had proposed § 1040.4(b)(1)(i)(D) to permit it to monitor nonpayment of fees by providers whose consumer

[1083] *See* AAA, Consumer Arbitration Rules, *supra* note 137, at 32; JAMS Streamlined Arbitration Rules, *supra* note 139, at 9.
[1084] Study, *supra* note 3, section 5 at 58.
[1085] *Id.* section 5 at 66 n.110. The Bureau has similarly received consumer complaints involving entities' alleged failure to pay arbitral fees.

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 had further expected that requiring submission of communications related to nonpayment of fees would discourage providers from engaging in such activity.

Proposed § 1040.4(b)(1)(i)(D) would have required 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 believed this requirement would have prevented providers who engage in strategic nonpayment of arbitration fees to claim, in bad faith, ongoing settlement talks to avoid the disclosure to the Bureau of communications regarding their nonpayment. The Bureau had anticipated 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 have required submission of the underlying settlement agreement or a notification that a settlement has occurred.

One consumer advocate commenter suggested that the Bureau should require providers to submit a number of other documents or data related to costs and fees in arbitration proceedings, including documents on the arbitration and administrative costs paid by providers and consumers in arbitration to ensure that the Bureau would be aware of general cost levels, documents relating to requests or grants of a reduction in arbitration costs for the consumer to see how often providers helped make arbitration proceedings affordable for consumers.

Proposed § 1040.4(b)(1)(i)(D), renumbered as § 1040.4(b)(1)(i)(E), is finalized as proposed. The Bureau believes this provision will provide transparency as to fee practices generally, and that companies submitting communications pursuant to final § 1040.4(b)(1)(i)(E) can indicate in their submission that nonpayment resulted from settlement. The Bureau believes that the general attention to this issue will discourage providers from claiming in bad faith that the nonpayment of fees is due to ongoing settlement talks when in fact they are engaged in a tactical maneuver to prevent a consumer from pursuing the consumer's claim.

The Bureau disagrees with consumer advocate commenters that it should require that providers submit additional records on the cost of the arbitration. The Bureau does not believe that the additional data commenters have suggested collecting would be useful enough to justify the additional burden it would pose to collect and analyze such documents. The final rule already addresses the most serious cost-related issue identified in the Study and § 1040.4(b)(1)(i)(E) requires the submission of records pertaining to a party's refusal to pay required arbitrator or administrator costs or fees. There may be some incremental benefit to receiving further documents detailing costs, such as documents on *in forma pauperis* applications or hardships requests consumers make to arbitration administrators for exceptions from paying filing fees. However, the Bureau believes that § 1040.4(b)(1)(i)(E) will alert the Bureau to certain cost-related issues identified in the Study that can stop consumers from pursuing claims completely while keeping the burden on providers of submitting records relatively low.[1086] The Bureau further believes that it may be possible to estimate such cost data from arbitration administrator rules and documents it will collect, including pre-dispute arbitration agreements and arbitrators' awards, which will inform the Bureau on general cost

[1086] *See id.* section 5 at 76.

structures, indicate whether fee-shifting is allowed, and document fee awards. The Bureau understands that the cost structure of many arbitration provisions is potentially burdensome on many consumers, and that other cost provisions such as fee-shifting can exacerbate this potential burden. The collection of many pre-dispute arbitration agreements giving rise to specific arbitration proceedings pursuant to § 1040.4(b)(1)(i)(C) will permit the Bureau to review fee structures and fee-shifting provisions faced by consumers while limiting additional burden on providers.

*4(b)(1)(ii)*

*The Bureau's Proposal*

Proposed § 1040.4(b)(1)(ii) would have required providers to submit to the Bureau any communication from an arbitrator or arbitration administrator related to a determination that a provider's pre-dispute arbitration agreement does not comply with the administrator's fairness principles, rules, or similar requirements. The Bureau was concerned about providers' use of arbitration agreements that may violate arbitration administrators' fairness principles or rules. Several of the leading arbitration administrators maintain such principles or rules, which the administrators use to assess the fairness of the company's pre-dispute arbitration agreement.[1087] These administrators may refuse to hear an arbitration if the company's arbitration agreement does not comply with the relevant fairness principles or rules.[1088] At least one administrator will also review a company's agreement preemptively – before an arbitration claim has been filed – to determine if the agreement complies with the relevant fairness principles or rules.[1089]

[1087] *See* AAA Consumer Due Process Protocol, *supra* note 142; JAMS Policy on Consumer Arbitrations, *supra* note 140.
[1088] *See* AAA Consumer Arbitration Rules, *supra* note 137, at 10; JAMS Streamlined Arbitration Rules, *supra* note 139, at 6.
[1089] *See* AAA Consumer Arbitration Rules, *supra* note 137, at 16.

The Bureau believed 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 believed 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 or rules.

Proposed comment 4(b)(1)(ii)-1 would have clarified 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 have required 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 have stated 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 proposed this comment because it had understood that providers may submit pre-dispute arbitration agreements to administrators before incorporating the agreements into actual contracts.[1090] The proposed comment would have stated 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 by a consumer and thus submission to the Bureau of communication related to a

[1090] 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 137, at 16.

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 have clarified that what constitutes an administrator's fairness principles or rules pursuant to proposed § 1040.4(b)(ii)(B) should be interpreted broadly. Further, that comment would have provided 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.[1091]

*Comments Received*

The Bureau did not receive specific comments addressing the requirement in proposed § 1040.4(b)(1)(ii) that providers submit communications related to non-compliance with an arbitration administrator's fairness protocols. The Bureau received comments that implicated proposed § 1040.4(b)(1)(ii) from a consumer advocate that argued that the Bureau should promulgate specific due process or fairness standards for the content of pre-dispute arbitration agreements or the actual actions of providers in the course of arbitration proceedings rather than relying on the administrators to do so. The consumer advocate commenter asserted that individual arbitration itself is unfair and systematically favors providers and urged that if the Bureau is not going to prohibit arbitration altogether it should prescribe minimum standards for arbitration.

[1091] AAA Consumer Due Process Protocol, *supra* note 138; JAMS Policy on Consumer Arbitrations, *supra* note 140. The Bureau notes that it would be offering these specific principles or rules merely to assist providers with compliance; this comment does not represent an endorsement by the Bureau of these specific principles or rules.

*The Final Rule*

The Bureau finalizes § 1040.4(b)(1)(ii) as proposed. For the reasons set out above in Part VI.B, the Bureau disagrees that it should adopt due process or fairness standards or should otherwise regulate provider conduct in arbitration proceedings. In the absence of additional data presented by commenters showing systematic unfairness in individual arbitrations, the Bureau believes that requiring providers to submit correspondence from administrators on the non-compliance of pre-dispute arbitration agreements with administrator due process or fairness rules will aid the Bureau in identifying potential widespread unfairness to consumers while imposing minimal burden. In addition, the Bureau expects to use its supervisory function and may review other data – including credit card agreements and prepaid account agreements that providers are or will be required to submit to the Bureau[1092] – to further aid its efforts to review providers' pre-dispute arbitration agreements for potential fairness issues.

The Bureau is also finalizing comments 4(b)(1)(ii)-1 and -2 as proposed, having received no comments on this specific commentary.

*4(b)(1)(iii)*

Prior to the publication of the monitoring proposal, consumer advocates and some other stakeholders had 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 had expressed concern that pre-

[1092] *See* 12 CFR 1026.58; 12 CFR 1005.19(b).

dispute arbitration agreements discourage consumers from filing claims in court or in arbitration and discourage attorneys from representing consumers in such proceedings.

After the publication of proposed § 1040.4(b), other consumer lawyer and consumer advocate commenters suggested that the Bureau require providers to submit records anytime they rely on a pre-dispute arbitration agreement, specifically in the context of court filings in which, for instance, a party invokes a pre-dispute arbitration agreement to compel arbitration. The commenters asserted that requiring providers to submit litigation filings that rely on pre-dispute arbitration agreements would be an important means of monitoring the extent to which providers were using such filings to block individual litigation from proceeding (insofar as they could no longer be used to block class actions). More specifically, commenters suggested that the addition of such data would make it clear whether providers filed such motions to move consumers to arbitration as a preferred forum for formal dispute settlement instead of litigation, or whether providers were filing motions to compel arbitration to discourage consumers from proceeding at all. According to commenters, the absence of arbitration proceedings corresponding to motions made in litigation to compel arbitration would suggest that providers may have used arbitration agreements as a means to suppress claims outright, thus discouraging consumers from filing any type of formal claim.

In response to these comments and other concerns, the Bureau adopts new § 1040.4(b)(1)(iii), which requires providers to submit certain records that providers file in court. Specifically, new § 1040.4(b)(1)(iii)(A) requires that a provider submit to the Bureau any motion or filing sent by that provider to a court that relies on a pre-dispute arbitration agreement. Pursuant to this provision, providers are required to submit motions attempting to dismiss, defer, or stay any aspect of a case in court where such motions rely in whole or in part on an arbitration

agreement. The Bureau believes that collecting materials related to the invocation of an arbitration agreement will aid it in determining the frequency with which providers compel arbitration in response to individual litigation claims, the content of such motions to compel, and whether such claims actually end up being heard in arbitration rather than simply disappearing. The Bureau also agrees with the concern expressed by consumer advocates and some other stakeholders that a requirement like proposed § 1040.4(b) would not have permitted the Bureau to monitor or quantify the claims that consumers may have been deterred from filing because of the existence of a pre-dispute arbitration agreement. The Bureau believes that the collection of motions to compel arbitration, in conjunction with the other arbitral records it will receive, will help track whether such claims are ultimately heard in arbitration rather than being dropped entirely, which could in turn shed more light on the extent to which consumers are deterred from pursuing individual claims more generally because of arbitration agreements.

The Bureau also finalizes new § 1040.4(b)(1)(iii)(B), which requires that the provider submit to the Bureau the pre-dispute arbitration agreement relied on in the provider's motion to dismiss, defer or stay a case, which the provider is required to submit pursuant to § 1040.4(b)(1)(iii)(A). The Bureau believes that § 1040.4(b)(1)(iii)(B) is needed to capture all pre-dispute arbitration agreements relied on in documents responsive to new § 1040.4(b)(1)(iii)(A). While such pre-dispute arbitration agreements are often attached to motions to dismiss or stay that are filed to compel arbitration, the Bureau has noted, in reviewing such records during the course of the Study, that occasionally some documents are simply cross-referenced to other documents filed in the litigation. The Bureau believes that it is important to gather data on the frequency of filings relying on pre-dispute arbitration agreements, and whether

the content of such arbitration agreements discourages or induces a consumer (or her attorney) to file the same claim against the provider in arbitration rather than litigation.

The Bureau also adopts new commentary to clarify the application of § 1040.4(b)(1)(iii). Comment 4(b)(1)(iii)-1 clarifies that § 1040.4(b)(1)(iii)(A) requires the submission of court filings only if they rely on pre-dispute arbitration agreements entered into after the compliance date set forth in § 1040.5(a). Providers are only required to submit the initial motion relying upon a pre-dispute arbitration agreement; they need not submit later response documents, such as a consumer's opposition to the motion, or a provider's reply.[1093]

New comment 4(b)(1)(iii)-2 sets out examples of certain types of court documents that do not trigger the obligation under § 1040.4(b)(1)(iii)(A) to submit records to the Bureau because they are not relying upon an arbitration agreement in support of an attempt to seek dismissal, deferral, or stay of any aspect of a case.[1094] New comment 4(b)(1)(iii)-2.i clarifies that § 1040.4(b)(1)(iii)(A) does not require providers to submit to the Bureau objections to discovery requests or motions seeking a protective order in response to a discovery request if either relies on an arbitration agreement, since such motions would not shed light on whether individual litigation claims are refiled in arbitration or are dropped completely. New comment 4(b)(1)(iii)-2.ii clarifies that under § 1040.4(b)(1)(iii)(A), providers are not required to submit answers to a complaint or the answers to a counterclaim if those materials only refer to an arbitration agreement. New comment 4(b)(1)(iii)-2.iii clarifies that under § 1040.4(b)(1)(iii)(A), providers

[1093] To limit the potential burden on providers, the Bureau will only require providers to submit the initial motion relying on an arbitration agreement. The Bureau expects to be able to collect other related documents, such as the order ruling on the motion or opposition or reply briefs by taking the docket number set out in the initial motion and searching for other documents in public sources or databases available to the Bureau. By contrast, the Bureau cannot obtain arbitration records on its own.

[1094] The comment is intended in part to emphasize that the focus of inquiry under § 1040.4(b)(1)(iii) is whether a provider is relying upon an arbitration agreement in support of an attempt to seek dismissal, deferral, or stay of any aspect of a case, in order to assist the Bureau in tracking whether such individual cases are eventually refiled in arbitration. In contrast, § 1040.4(a) focuses on whether providers rely on arbitration in any aspect of class litigation, which is a broader focus for different purposes.

are not required to submit motions or filings that have as attachments a consumer's contract that contains a pre-dispute arbitration agreement if the provider does not rely on or cite to the arbitration agreement in the motion.

*4(b)(2) Deadline for Submission*

Proposed § 1040.4(b)(2) would have stated 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 proposed 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 proposed what it believed to be a relatively lengthy deadline because it expected that providers would continue to face arbitrations infrequently,[1095] and, as a result, might not have a regularized process for redacting and submitting the required records. 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.

A group of State attorneys general commenters agreed generally with proposed § 1040.4(b)(2), stating that some manner of timing obligation was needed to ensure that providers did not delay submitting required records to the Bureau. The group of State attorneys general also suggested that the Bureau establish a penalty regime for providers that fail to

[1095] *See* Study, *supra* note 3, section 5 at 9 (stating that, from 2010 to 2012, 1,847 individual AAA cases, or about 616 per year, were filed for six consumer financial product markets).

comply with proposed § 1040.4(b)(2). An industry commenter requested a good cause exception from proposed § 1040.4(b)(2) in the event of natural disasters or unforeseen technical errors, on the grounds that any inadvertent non-compliance would result in further class action liability.

The Bureau finalizes § 1040.4(b)(2) as proposed. The Bureau does not agree with the group of State attorneys general that a new penalty regime is necessary to obtain the compliance of providers. The Bureau believes that the Dodd-Frank Act already contains sufficient penalty mechanisms to incentivize compliance with the deadlines set by § 1040.4(b)(2).[1096]

The Bureau also disagrees with the industry commenter that said that an explicit "good cause" exception is necessary given the time providers have to submit records required by § 1040.4(b)(1). The commenter did not explain why a 60-day period was insufficient to cope with unexpected delays in complying with a relatively simple requirement – to electronically send a small quantity of documents to the Bureau. As to the industry commenter's concern that late-filing records in violation of § 1040.4(b)(2) could lead to class action liability, there is no private right of action for a provider's failure to comply with this Part.

*4(b)(3) Redaction*

*The Bureau's Proposal*

Proposed § 1040.4(b)(3) would have required 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 had proposed § 1040.4(b), in part, pursuant to its authority under Dodd-Frank section 1022(c)(4), which

[1096] *See* Dodd-Frank Act Section 1055(a)(1) ("The court (or the Bureau, as the case may be) in an action or adjudication proceeding brought under Federal consumer financial law, shall have jurisdiction to grant any appropriate legal or equitable relief with respect to a violation of Federal consumer financial law, including a violation of a rule or order prescribed under a Federal consumer financial law").

provides that the Bureau may not obtain information "for purposes of gathering or analyzing the personally identifiable financial information of consumers." The Bureau stated that it had no intention of gathering or analyzing information that directly identifies consumers. At the same time, the Bureau sought to minimize the burden on providers by providing clear instructions for redaction.

Accordingly, the Bureau had proposed § 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 believed 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 have clarified 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 have required 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 noted 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 have been required to be redacted pursuant to proposed § 1040.4(b)(3)(i) through (v). This would have included 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 have required redaction of street addresses of individuals, but not cities, States, and zip codes. 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 could 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 information 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 have required 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 have been 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 noted that it did not broadly propose to require providers to redact all types of information that could be deemed to be personally identifiable financial information (PIFI). Because Federal law prescribes a broad definition of PIFI,[1097] the Bureau believed that generally 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 proposed

[1097] 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).

to require. As such, the list of items in proposed § 1040.4(b)(3)(i) through (ix) identified the examples of PIFI that the Bureau anticipated were likely to exist in the arbitral records that would be submitted under § 1040.4(b)(1). The Bureau's preliminary view was that the list of items struck the appropriate balance between protecting consumer privacy and imposing a reasonable redaction burden on providers, particularly given that the Bureau proposed to conduct further review and redaction prior to any public release as discussed in the proposal and what is now new § 1040.4(b)(5).

*Comments Received*

The Bureau did not receive comments that addressed the specific categories of redactions set out in § 1040.4(b)(3)(i) through (ix). Some comments expressed more general privacy concerns about the Bureau's proposed collection of materials, although these comments did not explicitly acknowledge that the Bureau had proposed to require redactions or state whether the proposed redactions actually addressed their concerns. Some industry commenters expressed general concerns that the submission of arbitration records would expose consumers to a risk of privacy and data security violations. These comments did not detail the nature of this risk. Another industry commenter expressed concern that the Bureau was forcing the exposure of the private data of consumers without their consent. Another industry commenter argued that the submission requirement compromised the privacy of the provider's employees.

*Final Rule*

The Bureau finalizes § 1040.4(b)(3)(i) through (ix) as proposed. The more general comments concerning privacy, data security, and employee confidentiality are addressed in Part VI.D. No comments suggested specific additional redactions to further minimize privacy risks to consumers or other parties, or suggested that additional categories of PIFI are likely to be

included in records submitted under § 1040.4(b)(1). The Bureau continues to believe that the redaction requirements substantially reduce privacy and data security risks. To address the concern one industry commenter expressed about the privacy of its employees' names, the Bureau affirms that § 1040.4(b)(3)(i), which requires the redaction of the names of all individuals other than the arbitrator or the provider, applies to the names of providers' employees.

The Bureau also finalizes proposed comment 4(b)(3)-1, now renumbered as comment 4(b)-2, as set out above. The Bureau received no comments on whether providers should be permitted to have another entity perform redactions, such as an arbitration administrator or an agent of the provider.

*4(b)(4) Internet posting of arbitration-related records.*

*The Bureau's Proposal*

The Bureau stated in the proposal that it intended to publish arbitral records collected pursuant to proposed § 1040.4(b)(1). The Bureau had considered whether to publish such records individually or in the form of aggregated data. Prior to publishing such records, the Bureau stated that it would have ensured that they had been redacted, or that the data was 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] or any other provision of law[] is not made public under this title."

The Bureau sought comment on the publication of the records that would have been required to be submitted by proposed § 1040.4(b)(1), including whether it should limit publication of particular items even after redaction based on particular consumer privacy

concerns or whether commenters had other confidentiality concerns. Along similar lines, in the past some plaintiff's attorneys had noted their frustration with arbitral privacy. Some plaintiff's attorneys had noted in the past, for example, that arbitration did not allow them to file cases that can develop the law (because the outcomes are usually private and do not have precedential effect). [1098] In addition, the Bureau sought comment on whether it should publish arbitral records individually or in the form of aggregated data. The Bureau also sought comment on whether there were alternatives to publication by the Bureau – such as publication by other entities – that would have furthered the purposes of publication described above.

*Comments Received*

A number of commenters expressed general support for the Bureau's stated intention to publish the records it would receive. Academic, State attorneys general, and nonprofit commenters agreed that the Bureau should publish records it received. Specifically, academic commenters supported the publication of arbitration-related records and noted the importance of the publication of such records to academic research on consumer arbitration, which otherwise relied on the limited amount of data that arbitral administrators permitted non-parties to review. Academic, State attorneys general, and consumer advocate commenters also noted that the importance of such records to help regulators, including the Bureau and other State and Federal entities, analyze the impact of arbitration agreements on consumers. Consumer advocate commenters also suggested that the transparency created by publishing records would improve the quality of arbitrator decisions because arbitrators would know that their decisions would be

[1098] *See, e.g.*, "Arbitration: Is It Fair When Forced?," Hearing before the S. Comm. on the Judiciary, 112th Cong. 177 (2011) (Prepared Statement of F. Paul Bland, Senior Attorney, Public Justice), at 81-82.

scrutinized, would help providers that were not parties to the arbitration understand what activities might run afoul of the law, and might help consumers themselves learn to avoid harms.

A number of other commenters generally opposed the Bureau's stated intention of publishing records received. Several industry commenters expressed the concern that plaintiff's attorneys would review the published arbitration-related records and file frivolous claims, including class action litigation and individual arbitration proceedings regarding the claims made in the published records. A commenter that is an association of State regulators opposed the publication of records on the grounds that it would lead to more class action cases, which would exacerbate the difficulties of regulators' assessing the risks posed by class actions to providers. An industry commenter expressed the concern that the published records themselves would be the subject of class action litigation against providers that made any errors in redacting submitted records as required by proposed § 1040.4(b)(1), or that failed to include the language required by proposed § 1040.4(a)(1) in pre-dispute arbitration agreements. The commenter also suggested that the Bureau itself pursue any important information derived from the records rather than permitting third parties to review and exploit such information.

Another industry commenter suggested that the Bureau should not publish arbitral records because the Bureau's existing consumer complaint database already serves a similar function in publishing data on consumer disputes.

A commenter that is an association of State regulators opposed the Bureau's publication of records on the grounds that such a rule may conflict with State laws regarding the confidentiality of arbitral records. Industry commenters opposed the publication of records on the grounds that the rule would disregard confidentiality as a standard feature of arbitration.

Finally, some industry commenters requested an additional round of notice and comment on the Bureau's intent to publish records, especially to comment on the particulars of the process by which the Bureau intends to collect, secure, and disseminate arbitration data.

*The Final Rule*

The Bureau is finalizing new § 1040.4(b)(4), under which the Bureau shall establish and maintain on its website a central repository of the records collected pursuant to § 1040.4(b)(1). Section 1040.4(b)(4) requires that the Bureau make the arbitration-related records it collects from providers easily accessible and retrievable by the public on its website. In practice, the Bureau expects to comply with this rule by publishing the records, further redacted, if necessary, in accordance with new § 1040.4(b)(5), as discussed below, as PDF files. The Bureau expects that such records will be made searchable by the text of the records, as well as by date, the name of the arbitration administrator, the name of the provider and the type of consumer financial product or service at issue.

As discussed in detail in Part VI.D, the Bureau continues to believe it is important to publish the records it collects, with appropriate redactions. The Bureau believes that its experience with the Study and other market monitoring efforts has clarified the importance of publishing arbitration records to assist research (by academics and policymakers) on consumer finance arbitration and to help regulators, including the Bureau and other State and Federal bodies, to analyze consumers' experiences with arbitration and determine if further action is needed. The Bureau agrees that the publication of these records – including records on the resolution of arbitrations (many of which will not be available in published litigation records) – will also assist parties in arbitration and litigation more accurately determine whether their claims or defenses are likely to succeed or fail. The Bureau understands from the Study that

most records pertaining to consumer financial arbitrations are kept private. However, such privacy is not inherent to arbitration, given that other arbitration fora publish individual arbitration records by default (such as FINRA), and that AAA has begun to publish records of some consumer arbitrations.[1099]

As discussed above in connection with final § 1040.4(b)(1)(i)(D), the Bureau agrees with consumer advocate commenters that suggested that collecting and publishing records might improve the quality of some arbitrators' decisions because they know that their decisions may be more broadly scrutinized. The records that the Bureau reviewed in the Study suggested that arbitration awards were short or summary in nature at least compared to reasoned decisions in litigation; the Bureau believes that if publication results in more fulsome arbitrator decisions, this would be an added benefit of the rule.

The Bureau further agrees with the consumer advocate commenter that suggested that the publication of records will likely help providers understand what activities might run afoul of the law, and would help consumers learn about certain harmful practices resulting in arbitral awards for consumers. For example, the AAA consumer arbitration records the Bureau reviewed in the course of its Study contained filings on subjects that were not found in individual litigation. The Bureau agrees with industry commenters that the publication of records may lead to some class action litigations, but the Bureau disagrees that any increase is necessarily detrimental, as set out in its analysis of class actions in the findings section above. The Bureau disagrees that the act of producing the records themselves would be the subject of class action litigation against providers. While providers may make errors in redacting records as required by § 1040.4(b)(3) or may make errors in inserting into pre-dispute arbitration agreements the language required

[1099] FINRA, "Awards," at Rule 12904(h) ("All awards shall be made publicly available."); AAA Consumer Arbitration Statistics, *supra* note 804.

under § 1040.4(a)(1), the rule is not privately enforceable and the Bureau will further review and redact records before publishing. In any event, the Bureau does not expect such class actions could occur given the low number of arbitrations per company. The Bureau agrees that it should pursue and further investigate important information derived from the records it receives. The Bureau disagrees however that this information should be limited to the Bureau alone rather than to the public and other enforcement agencies. Making arbitration records transparent via publication would permit third parties – including private litigants and other regulators – to also monitor arbitration for fairness issues.

The Bureau disagrees with the industry commenter that suggested that the Bureau's existing consumer complaint database can serve the same function as a dedicated page or area on the Bureau's website focused on arbitral records and that an arbitration database would be duplicative of the complaint database. The complaint database is not designed to receive or publish the variety of arbitration records that providers are required to submit pursuant to this rule.

The Bureau disagrees with industry commenters as it does not believe that the Bureau's publication of records would conflict with State laws on the confidentiality of arbitral records. Published records will be redacted, by providers and by the Bureau, and thus the Bureau will take steps to appropriately reduce re-identification risk to individuals who are parties to the arbitrations. The Bureau also disagrees with industry commenters that confidentiality is standard in consumer arbitration. As noted above, many other arbitration administrators publish their decisions, most notably AAA and FINRA, which publishes records in all arbitrations without redacting the names of individuals. The AAA, further, already publishes some case-level

information on individual consumer arbitrations.[1100] Further, prevailing parties in arbitrations routinely make such awards public in their filings to enforce them in court.[1101] In any event, to the extent that there is a conflict with State law and the rule, the Bureau finds that rule would govern and would be in the public interest.

The Bureau disagrees with the industry commenter that an additional round of notice and comment is necessary to detail the process by which the Bureau intends to collect, secure and disseminate arbitration data. The proposal specifically solicited comments on the Bureau's intention to publish arbitration-related records, and sought comments on how the Bureau should publish arbitration-related records it received.[1102] Many providers offered comments on the scope of the Bureau's monitoring proposal, as summarized above. Further, new provisions discussed below offer details on the collection and submission of documents, including deadlines for providers to submit documents, deadlines for the Bureau to publish documents, and the address where redacted records will be posted.

The Bureau expects to release details of how providers should comply with the requirements of § 1040.4(b) in due course. The Bureau expects that such instructions will be published in the *Federal Register*, the Bureau's website, and in a small business compliance guide the Bureau will publish to assist companies redact and submit in accord with the final rule.

[1100] AAA Consumer Arbitration Statistics, *supra* note 804.
[1101] *See, e.g.*, 9 U.S.C. 9 (Federal Arbitration Act provision setting out procedures for the enforcement of awards).
[1102] 81 FR 32830, 32893 (May 24, 2016) ("[T]he 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."); *see also id.* ("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.").

*4(b)(5) Further redaction prior to Internet posting.*

The Bureau sought comment on the publication of the records that would have been required to be submitted by proposed § 1040.4(b)(1), including whether it should limit publication of particular items even after redaction based on particular consumer privacy concerns or whether commenters had other confidentiality concerns.

Industry commenters asserted that the collection of both public and non-public information by financial regulators poses a threat to consumer privacy. One industry commenter argued that the collection of even redacted records, combined with other publicly available information, could be used to re-identify consumers. One industry commenter expressed skepticism about permitting government regulators to collect data because of data security issues at financial regulators and reports about data security at the Bureau.[1103]

For the reasons provided below, the Bureau is finalizing new § 1040.4(b)(5), which will require the Bureau to make such further redactions as are needed to comply with applicable privacy laws. In particular the Bureau will review records submitted by providers to ensure that providers' redactions were made in compliance § 1040.4(b)(3). In addition, before publishing records pursuant to § 1040.4(b)(4), the Bureau will, to the extent necessary, make further redactions to records to appropriately reduce the risk of re-identification.

The Bureau disagrees with the industry commenter that said that the Bureau's collection of public and non-public information by financial regulators poses a threat to consumer privacy. Section 1040.4(b)(3) will require providers to redact personal and financial information before

[1103] The commenter referred to an Office of the Inspector General report on the security of the Bureau's complaints database. *See* Office of the Inspector General, "Security Control Review of the CFPB's Data Team Complaint Database," (July 23, 2015), *available at* https://oig.federalreserve.gov/reports/cfpb-dt-complaint-database-summary-jul2015.htm (finding overall that the Bureau had taken steps to secure the Complaint Database, identifying needed improvements, and acknowledging that the Bureau agreed with OIG's recommendations and would take steps to make improvements).

the records ever reach the Bureau. In addition, the Bureau will employ the same data security measures that it employs for other sensitive data that it currently maintains.

*4(b)(6) Deadline for Internet posting of arbitral and court records.*

The Bureau adopts final § 1040.4(b)(6), under which the Bureau shall begin to make records submitted to the Bureau by providers under final § 1040.4(b)(1) accessible and retrievable by the public on the Bureau's website no later than July 1, 2019, and at least annually each year thereafter for documents received by the end of the prior calendar year.

The Bureau believes that making records available on a timely basis will make them most useful to third parties. For instance, State and Federal regulators may need access to recent records if they are to be effectively responsive to potentially problematic business practices or unfairness in arbitration proceedings early in their existence. Similarly, private attorneys may need access to recent records to more effectively guide their forecasting of the success of claims and defenses in arbitration and litigation. Were the Bureau to delay such action, the information could become stale and less useful. The Bureau believes based on its experience with other data posting that an annual cycle strikes an appropriate and practicable balance in light of Bureau resources.

*Section 1040.5 Compliance Date and Temporary Exception*

Proposed § 1040.5 would have 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. Below, the Bureau addresses the comments received on these proposed provisions.

*5(a) Compliance Date*

Dodd-Frank section 1028(d) 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, as established by the Bureau." As the proposal stated, the Bureau interprets this language to mean that the rule may begin to apply on the 181st day after the effective date, as this day would be the first day "after the end of" the 180-day period starting on the effective date as is required by section 1028(d). Given that the Bureau proposed an effective date of 30 days after publication of the rule in the *Federal Register*, compliance with the proposal would have been required starting on the 211th day after publication of the rule in the *Federal Register*. Proposed § 1040.5(a) would have adopted the term "compliance date" to refer to this date and would have stated that compliance with part 1040 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*.[1104]

The Bureau proposed a 30-day effective date based on Administrative Procedure Act (APA) section 553(d), 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.[1105] As the Bureau explained in the proposal, the Bureau did not believe that a longer period for the effective date was needed to facilitate compliance, given that section 1028(d) mandates an additional 180-day period between the effective date and the compliance date. The Bureau stated in the proposal that it believes that a 211-day period between *Federal Register* publication

[1104] Proposed § 1040.5(a) would have instructed the Office of the Federal Register to insert a specific date upon publication in the *Federal Register*.
[1105] 5 U.S.C. 553(d).

and the compliance date (referred to herein as the "compliance period") would afford providers sufficient time to comply.[1106]

Three commenters – a consumer advocate, an individual, and a research center – urged the Bureau to adopt § 1040.5(a) as proposed. An industry trade association commenter stated that it supported § 1040.5(a) as long as the rule "is not retroactive to accounts opened prior to the implementation date." Other commenters requested that the Bureau modify the compliance period. Two industry commenters urged the Bureau to adopt a longer compliance period. One of these industry commenters, a trade association representing the consumer credit industry, requested a compliance period of 18 months, which would be an additional 11 months beyond what the Bureau had proposed. The commenter asserted that the Bureau had underestimated how time-consuming the required contractual changes would be for some providers. For example, according to the commenter, many States have a single document rule that limits the ability of vehicle finance companies to modify contracts with an addendum or side letter, so that such companies need sufficient time to modify the agreements themselves and provide them to dealers well before the effective date. The commenter also stated that one of its members had more than 200 forms that the provider would need to revise, check, correct, review, and approve. According to the commenter, finance companies typically modify contracts in batches; each batch can take three to five months; and that printing, distribution, and implementation would take additional time. The commenter also asserted that removing a "Notice of Arbitration" signature box would cause programming issues for automobile dealers. Additionally, the commenter also stated that if the Bureau does not extend the compliance date, it should adopt a

[1106] Proposed § 1040.5(b) would have created a limited, temporary exception for certain pre-packaged general-purpose reloadable prepaid card agreements.

safe harbor within which providers would not face potential consequences for having non-compliant agreements so long as the provider does not enforce the arbitration agreements in a class action.

The other industry commenter, a small-dollar lender, requested a compliance period of 452 days. This commenter stated that it would need to revise its agreements to include the contract provision required by proposed § 1040.4(a)(2) and that it may also remove its arbitration provisions. The commenter noted that it had at least 113 separate consumer agreements or disclosure documents containing arbitration agreements. According to the commenter, 211 days is not enough time to program, test, and deploy 113 new agreements, especially given that it uses four different point-of-sale software systems (in addition to its primary software package). The commenter also noted that it would need to destroy non-complaint hard-copy agreements at each of its storefronts and replace them with new hard-copy agreements. Additionally, one consumer advocate commenter urged the Bureau to shorten the compliance period to 90 days or 180 days.

The Bureau is finalizing § 1040.5(a) as Proposed except that it is extending the effective date by an additional 30 days, to 60 days after publication in the *Federal Register*, and is making one technical correction. While the proposal stated that compliance with part 1040 is required for any pre-dispute arbitration agreement entered into *after* the compliance date, the final rule states that compliance with part 1040 is required for any pre-dispute arbitration agreement entered into *on or after* the compliance date.[1107] The Bureau intended proposed § 1040.5(a) to

[1107] Like the proposal, final § 1040.5(a) would instruct the Office of the Federal Register to insert a specific date upon publication in the *Federal Register*.

convey that providers would be required to comply starting on the compliance date. The Bureau believes the phrase "on or after" the compliance date better captures this intent.[1108]

Regarding the industry trade association's comment about retroactivity, the Bureau notes that the rule would not have retroactive effect. As is explained above in the section entitled "Comments on the Bureau's Interpretation of *Entered Into*," this part will only apply to agreements entered into after the compliance date. Regarding the consumer advocate's comment that urged the Bureau to adopt a shorter compliance period, the Bureau declines to adopt a compliance period of 90 or 180 days because it believes that a compliance period that includes a 180-day period after the effective date is most consistent with its authority under section 1028(d) of the Dodd-Frank Act and the APA.[1109]

The Bureau is adopting a compliance period that is one month longer than the compliance period in the proposal, for a total of approximately eight months, and declines to adopt a longer compliance period because the Bureau does not believe that the contractual change required by this rule will take more than eight months to implement (except for certain prepaid providers, as is discussed below). The Bureau acknowledges – as noted by the industry trade association commenter and small-dollar lender commenter – that some providers will need to implement revisions to a large number of consumer agreements and related forms. However, the Bureau believes that the revisions required for each document will be modest, and the Bureau notes that providers do not provide evidence to the contrary. The rule requires only that providers insert either the provision mandated by § 1040.4(a)(2)(i) or the alternative provision permitted by § 1040.4(a)(2)(ii) – and the Bureau has already provided the specific language for these

[1108] In this preamble, the Bureau uses the terms "on or after the compliance date" and "after the compliance date" interchangeably.
[1109] *See* Dodd-Frank section 1028(d) (stating that any rule prescribed by the Bureau under section 1028(b) shall apply to agreements entered into after the end of the 180-day period beginning on the effective date of the regulation) and APA section 553(d) (stating that, in general, the required publication or service of a substantive rule shall be made not less than 30 days before its effective date).

provisions with a view toward reducing burden. Because both of these revisions are modest, the Bureau believes that making them will not impose a substantial burden, even where providers have multiple agreements. And by making the effective date 30 days later than it had proposed, the Bureau is providing additional time for this to be completed. The Bureau believes that providers can make these modest revisions and update their software or deliver hard copies of agreements, as needed, within 241 days.[1110]

The Bureau has carefully considered whether providers of certain products may have difficulty complying within 241 days and is adopting a temporary exception for pre-packaged general-purpose reloadable prepaid card agreements under § 1040.5(b). In addition, the Bureau expects that the vast majority of 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. The Bureau is aware, as the industry trade industry commenter noted, that providers subject to a single-document rule will not be able to use a separate notice or amendment. For this reason, the Bureau has considered whether such providers should be eligible for the temporary exception in § 1040.5(b). The Bureau has decided not to make such providers eligible for the § 1040.5(b) exception, because the Bureau believes – for the reasons stated in the paragraph above – that the compliance period affords enough time to update consumer agreements while complying with applicable single-document rules. As a result, the Bureau does not believe a safe harbor is needed.

[1110] Regarding the industry trade association's comment that removing a "Notice of Arbitration" signature box would cause programming issues for automobile dealers, the rule does not require providers to remove it, because the rule does not ban the use of pre-dispute arbitration agreements.

*5(b) Exception for Pre-Packaged General-Purpose Reloadable Prepaid Card Agreements*

As described above, § 1040.5(a) states that compliance with part 1040 is required starting on the 241st day after publication of the final rule in the *Federal Register*. As of this date, providers would, among other things, be required to ensure that their pre-dispute arbitration agreements contain the provision required by § 1040.4(a)(2)(i) or the alternative provision permitted by § 1040.4(a)(2)(ii). As stated above, the Bureau believes this period generally affords providers sufficient time to comply.

As the proposal stated, however, the Bureau assessed whether this compliance period may pose special difficulties for providers of certain types of products. The Bureau was concerned that providers of certain types of GPR prepaid cards may not be able to ensure that only compliant products are offered for sale or provided to consumers after the compliance date. Prepaid providers typically enclose cards in a package that contains a card and a cardholder agreement.[1111] Providers typically print these packages well in advance of sale and are distributed to consumers through third-party retailers such as drugstores, check cashing stores, and convenience stores. To comply with the rule by the compliance date, providers of such products would need to search each retail location that sells their products for any non-compliant packages; remove them from the shelves; and print new packages. The Bureau believes that this process would involve considerable expense and that this represents a unique situation not present with other products and services that proposed part 1040 would have covered.

For these reasons, proposed § 1040.5(b) would have established a limited exception from proposed § 1040.4(a)(2)'s requirement that the provider's pre-dispute arbitration agreement contain a specified provision by the compliance date. Proposed § 1040.5(b) would have stated

[1111] *See* 81 FR 83934 (Nov. 22, 2016).

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 provider that could not contact the consumer in writing, proposed § 1040.5(b)(1) would have set forth the following conditions: (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 had the ability to contact the consumer in writing, proposed § 1040.5(b)(2) would have imposed the previous three conditions as well as one additional requirement: Within 30 days of obtaining the consumer's contact information, the provider would have been required to provide to the consumer an amended pre-dispute arbitration agreement that is compliant with proposed § 1040.4(a)(2). Proposed comment 5(b)(2)-1 would have clarified that the 30-day period would not begin to elapse until the provider is able to contact the consumer and would also have stated that a provider is able to contact the consumer when, for example, the provider has the consumer's mailing address or email address.

As the proposal stated, this exception would have permitted 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 proposal also noted that proposed § 1040.5(b)(2) would not have imposed on providers an obligation to obtain a consumer's contact information. Where providers *are* able to contact the consumer in writing, the Bureau expected that they could satisfy proposed § 1040.5(b)(2) by, for example, sending the compliant agreement to the consumer when the consumer called to register the account and provided a

mailing address or e-mail address; sending the revised terms when the provider sent a personally-embossed card to the consumer; or communicating the new terms on the provider's website.

In the proposal, the section-by-section analysis clarified that providers availing themselves of the exception in proposed § 1040.5(b) would still have been required to comply with proposed § 1040.4(a)(1) and proposed § 1040.4(b) as of the compliance date. Pursuant to proposed § 1040.4(a)(1), such providers would still have been 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. The amended pre-dispute arbitration agreement submitted by providers in accordance with proposed § 1040.5(b)(2)(ii) would have been required to include the provision required by proposed § 1040.4(a)(2)(i) or the alternative permitted by proposed § 1040.4(a)(2)(ii). In addition, providers would still have been 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. The Bureau also stated in the proposal that it did 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 GPR prepaid product (although the Bureau would expect that corresponding product websites would contain an accurate arbitration agreement).

The Bureau received several comments on proposed § 1040.5(b). A consumer advocate commenter urged the Bureau not to adopt proposed § 1040.5(b), expressing concern that the provision would give providers an incentive to package a large supply of cards before the compliance date in an effort to use misleading agreements for as long as possible after the

compliance date. The commenter requested that, if the Bureau adopts § 1040.5(b), the Bureau should (1) add commentary stating that, even for providers covered by § 1040.5(b), proposed § 1040(a)(1) continues to apply; (2) limit the exception to GPR prepaid cards not in the provider's possession after the compliance date (as opposed to GPR prepaid cards packaged before the compliance date); (3) limit the exception to GPR prepaid cards packaged 60 days after *Federal Register* publication, not 211 days; and (4) require providers to deactivate non-compliant card packages that have not been activated six months after the compliance date. The commenter also stated that it supported proposed § 1040.5(b)(2)(ii)'s requirement that providers able to contact the consumer in writing provide the consumer with an amended pre-dispute arbitration agreement.

Additionally, a research center commenter stated that the Bureau should craft the exception narrowly and apply it only where necessary. The commenter pointed out that, even though proposed § 1040.4(a)(1) would still apply, it may be unclear whether a given agreement is covered by § 1040.4(a)(1), as there may not be evidence of whether the consumer purchased the prepaid card (and thereby entered into the agreement) before or after the compliance date.

The Bureau also received a comment from an industry trade association representing prepaid card providers. This commenter expressed concern that the proposal would be burdensome for providers in combination with the Bureau's prepaid account rule (which, after the close of the comment period for this rule, the Bureau published in November 2016).[1112] The commenter asserted that, even with the proposed temporary exception, providers would "incur the double expense" of having to update their disclosures and related materials a second time to comply with the Bureau's arbitration rule. The commenter also stated that GPR prepaid

[1112] 81 FR 83934 (Nov. 22, 2016).

providers may have to pull products off retail store shelves on multiple occasions within a relatively short period.

The Bureau adopts § 1040.5(b) and comment 5(b)(2)-1 as proposed with a minor revision to comment 5(b)(2)-1 for clarity.[1113] As stated above, the Bureau believes the exception is warranted because it would allow prepaid card providers to avoid the considerable expense of pulling and replacing packages at retail stores.[1114] At the same time, the impact of the exception on consumers would be limited, because § 1040.4(a)(1) would continue to apply, and because § 1040.5(b)(2)(ii) would require providers to provide amended agreements to consumers where feasible.

The Bureau is persuaded that adding a comment clarifying that § 1040.4(a)(1) remains in effect, even where the temporary exception applies, would help consumers better understand their rights, and providers better understand their obligations, under the rule. For this reason, the final rule includes new comment 5(b)-1, which states that, where § 1040.4(a)(2) does not apply to a provider that enters into a pre-dispute arbitration agreement on or after the compliance date by virtue of the temporary exception in § 1040.5(b)(2), the provider must still comply with § 1040.4(a)(1), which generally prohibits reliance on a pre-dispute arbitration agreement in a class action related to a covered consumer financial product or service. The Bureau declines to limit the exception to GPR prepaid cards not in the provider's possession after the compliance date. The Bureau believes that when an agreement is packaged is a clearer compliance standard than whether a package is in the provider's possession. Further, the Bureau believes that any incentive to package large quantities of cards before the compliance date (a form of potential

[1113] The comment gives a more specific example of when the provider has the consumer's mailing or email address, referring to when the consumer registers the card and gives that information to the provider.
[1114] In the Prepaid Rule, the Bureau similarly adopted a disclosure regime that does not require providers to pull non-compliant materials from store shelves. *Id.*

evasion suggested by one commenter) will be limited because the incremental benefit of doing so is limited, as § 1040.4(a)(1) would continue to apply; and because many providers will be required to contact their customers and provide the consumer an amended agreement (pursuant to § 1040.5(b)(2)(ii)).

The Bureau also declines to limit the exception to GPR prepaid cards packaged no more than 60 days after publication in the *Federal Register*. This approach could be construed to impose a 60-day compliance period on GPR prepaid card providers after which they would have to pull-and-replace non-compliant agreements at significant expense, and the Bureau does not believe a shorter compliance period for GPR prepaid card providers – compared with the 241 days afforded other providers – is legally permissible under section 1028(d). In addition, the Bureau declines to require providers to deactivate non-compliant, un-activated card packages six months after the compliance date. Such a requirement would be quite costly and the Bureau does not believe such a requirement is necessary, because limiting the exception to cards packaged before the compliance date will have the same overall effect; once that stock of agreements dissipates, only compliant agreements will be available on store shelves. Further, such a rule would effectively require providers to identify non-compliant products at retail locations and remove them – the very burden that the temporary exception was designed to alleviate.

The Bureau disagrees with the research center's comment that it may be unclear whether a given prepaid card agreement is subject to § 1040.4(a)(1) because there may not be evidence of when the consumer purchased the card (and, consequently, whether the consumer entered into it before or after the compliance date). Based on its knowledge of the prepaid card market, the Bureau believes that, while the provider may not know the identity of the consumer unless the

card is registered, the provider does know, for a particular card, when the consumer purchased it (and, accordingly, whether that occurred before or after the compliance date).

Regarding the industry trade association commenter's concern about compliance burden due to the Bureau's final prepaid account rule, the Bureau believes these concerns are misplaced. As stated above, the Bureau recognizes that compliance with part 1040 may be more difficult or costly for some prepaid providers because of the way some prepaid products are packaged and sold. For this reason, the Bureau is adopting § 1040.5(b). However, the Bureau does not believe that compliance with part 1040 will impose a substantial burden on prepaid providers in conjunction with the Bureau's finalization of the prepaid account rule. Both rules require revisions to account agreements. However, both rules also contain lengthy compliance periods (approximately 18 months for the prepaid account rule, including an additional six months the Bureau provided industry to give it sufficient time to implement the rule,[1115] and approximately eight months for part 1040). Further – for the reasons described in detail in the section-by-section analysis for § 1040.5(a), above – the Bureau believes that the contractual change required by part 1040 is modest, especially because the Bureau is providing the language for the required contract provision. The Bureau also notes that, contrary to the commenter's assertion, part 1040 would not require providers to pull and replace products from store shelves (indeed, as stated above, the purpose of § 1040.5(b) is to prevent providers from having to do so).

[1115] Prepaid Accounts Under the Electronic Fund Transfer Act (Regulation E) and the Truth in Lending Act (Regulation Z). 82 FR 18975 (Apr. 25, 2017).

## VIII. Dodd-Frank Act Section 1022(b)(2) Analysis

*A. Overview*

In developing this final rule, the Bureau has considered the potential benefits, costs, and impacts as 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, 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.

In the proposal, the Bureau set forth a preliminary analysis of these effects, and the Bureau requested comments and submissions of additional data that could inform the Bureau's analysis of the benefits, costs, and impacts of the proposal. In response, the Bureau received a number of comments on the topic. 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. Commodity Futures Trading Commission, the U.S. Securities and Exchange Commission, and the Federal Communications Commission. The consultations regarded 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 final provisions as compared to the status quo in which some, but not all, consumer financial products or services providers in the affected markets (see § 1040.2(c), defining the entities covered by this rule as "providers") use arbitration

agreements.[1116] The baseline considers economic attributes of the relevant markets and the existing legal and regulatory structures applicable to providers. The Bureau requested comment on this baseline, and did not receive any suggesting an alternative.

The Bureau invited comment on all aspects of the data that it has used to analyze the potential benefits, costs, and impacts of the proposed provisions.[1117] 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 final rule are especially limited. As a result, portions of this analysis rely in part on general economic principles and the Bureau's experience and expertise in consumer financial markets to provide a qualitative discussion of the benefits, costs, and impacts of the final rule.

The Bureau also discussed and requested comment on several potential alternatives, including ones that would be applicable to larger entities as well as smaller entities, which it listed in the proposal's Initial Regulatory Flexibility Analysis (IRFA) and also referenced in its Section 1022(b)(2) Analysis. A further detailed discussion of potential alternatives considered is

[1116] 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 documented a slight but gradual increase in the adoption of arbitration agreements by industry in particular markets. *See generally* Study, *supra* note 3, 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. Nonetheless, for simplicity and transparency, the Bureau assumed that, in the absence of a final rule, the prevalence of arbitration agreements would remain constant. As a result, the baseline that the Bureau used assumes that a significant amount of class litigation would remain regardless of whether the proposal was finalized. If the Bureau had instead used the hypothetical future state of universal adoption of arbitration agreements as the baseline, the estimated impact, both of benefits and costs would be significantly larger.

[1117] The estimates in this analysis are based upon data obtained and statistical analyses performed by the Bureau. This included much of the data underlying the Study and some of the Study's results. The collection of the data underlying the Study was 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 was 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 was discussed further below in Parts VIII and IX.

provided in Section G of this Section 1022(b)(2) Analysis and in the Final Regulatory Flexibility Analysis (FRFA) in Part IX below.

In this analysis, the Bureau focuses on the benefits, costs, and impacts of the two major elements of the final rule: (1) the requirement that providers with arbitration agreements include a provision in the arbitration agreements they enter into 180 days after the effective date of the rule stating that the arbitration agreement cannot be invoked in class litigation, and the related prohibition that would forbid providers from relying on such an agreement in a case filed as a class action; and (2) the requirement that providers using pre-dispute arbitration agreements submit certain records relating to arbitral proceedings and certain court records to the Bureau.

The impact of submitting arbitral and court records to the Bureau is expected to be minor, as identified in this analysis and the Bureau's PRA analysis further below. This impact is slightly higher than the PRA impact estimated in the proposal, principally due to the addition of § 1040.4(b)(1)(i)(B) and (b)(1)(iii), which requires providers to submit answers to arbitration claims and arbitration motions filed in court to the Bureau.

Given that the Bureau takes the status quo as the baseline, the analysis below focuses on providers that currently have arbitration agreements. 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 enter into with consumers. For these providers, which constitute the vast majority of providers using arbitration agreements, the Bureau believes that the final class rule will 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 use arbitration agreements contained in consumers' contracts entered into by another covered person, such as another provider. 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 final rule will be somewhat less than 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 contain arbitration agreements and from consumers whose contracts do not contain arbitration agreements. Thus, these debt collectors already face class litigation risk, but this risk will increase, at most, in proportion to the fraction of the providers' consumers whose contracts contain arbitration agreements.[1118] The actual magnitude by which debt collectors' risk will increase is likely to 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.[1119]

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 providers.

[1118] 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 under the final rule.

[1119] A research center commenter asserted that debt collectors are never able to rely on arbitration agreements between consumers and creditors. In fact, the Study contradicted this assertion, as 17 of 94 putative class cases with motions to compel arbitration involved FDCPA claims. *See* Study, *supra* note 3, section 6 at 56 n.94. *See also* SBREFA Report, *supra* note 419, at 17 (summarizing comments from representatives of debt collectors who stated that, in some instances, debt collectors can rely on arbitration agreements). As is further noted below, at least one trade association representing debt collectors also said the ability of debt collectors to rely on creditor arbitration agreements was more uncertain.

*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 provided the economic framework through which it considered those factors in order to more fully inform the rulemaking, and in particular to describe the market failure that is the basis for the final rule.[1120] This framework is set forth below, followed by a discussion of related comments.

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 finalizing both the class proposal and the requirement to submit arbitral records, the Bureau is focusing on a related market failure: reduced incentives for providers to comply with the underlying laws, due to an insufficient level of enforcement.

While the Bureau assumes that the underlying laws address 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. In addition, there are costs associated with establishing a compliance management system which, *e.g.*, trains

[1120] Although Dodd-Frank 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.

and monitors employees, reviews communications with consumers, and evaluates new products or features.

The Bureau believes, based on its experience and expertise in overseeing consumer finance markets, that in general the current incentives to comply are weaker than the economically efficient levels. That is, in general, the economic costs of increased compliance are currently less than the economic benefits stemming from compliance. Thus, increased compliance due to the additional incentives provided by the final rule would, in general, be justified by the economic benefits of this increased compliance. It may be, however, that in some particular cases or particular markets compliance is already at or above the optimal level, such that the increased compliance due to the final rule will lower economic welfare. The data and methodologies available to the Bureau do not allow for an economic analysis of the optimal level of compliance on a law-by-law or market-by-market basis.[1121] However, for purposes of this discussion, the Bureau assumes that the current level of compliance in consumer finance markets is generally sub-optimal.

The Bureau also believes it may be useful to clarify what this rulemaking is not intended to address. In particular, contrary to the view expressed by several commenters, the Bureau is not attempting to address any lack of transparency surrounding arbitration agreements per se. The Bureau is in general concerned about consumer awareness of contract terms and the ability of consumers to make informed choices about consumer financial products and services. However, the Bureau does not at this time have a basis to believe that any such lack of transparency leads to harm for consumers in this specific context, as it does not have a basis to

[1121] The Bureau sought comment and data that would allow further analysis of how to determine the point at which strengthening incentives might become inefficient. While some commenters asserted that current levels of compliance (and thus incentives) are efficient, they did not provide data nor any means of analyzing that assertion.

believe that individual arbitration is inferior to individual litigation. As discussed in Part VI, the data on this issue from the Study was inconclusive. Instead, the Bureau in this rulemaking is focused on a concern that the lack of an effective class mechanism inherent in arbitration agreements provides insufficient deterrence, which the Bureau believes leads to sub-optimal levels of compliance.[1122]

A research center commenter argued that the Bureau does not have an empirical basis to conclude that current levels of deterrence are sub-optimal. An association of State regulators also stated that it was troubled by the fact that the Bureau had not quantified current levels of providers' investment in compliance in order to determine whether those investments are inadequate, and believed a study of that issue would provide a stronger foundation for rulemaking. A debt collection industry trade association asserted that its members already have substantial incentives to comply with the law, in part because there is uncertainty as to whether they can rely upon creditors' arbitration agreements.

The Bureau acknowledged in the proposal and acknowledges again here that the existing degree of compliance is difficult to quantify, and the Bureau does not have data available to quantify the level of compliance or the current level of investments in compliance. The Bureau requested data on these subjects, but commenters did not provide additional data as to either of these. The Bureau recognizes that existing compliance incentives may be stronger in markets where providers do not contract directly with consumers and thus there may be uncertainty as to whether providers can rely on a given creditor's arbitration agreements. At the same time, to the extent certain markets already have greater incentives to comply, the impact of the final rule on

[1122] In addition to the comments discussed here, an industry trade association commenter argued that the rule was unnecessary because consumers could switch providers if they did not want to be bound by an arbitration agreement, noting that not all providers have arbitration agreements in most markets. Even if some consumers are aware of arbitration agreements and decided to switch providers, this still would not resolve the market failure described here, as providers would still be insufficiently deterred with respect to the consumers who do not switch.

those markets will be correspondingly less. In any event, as noted above in the section 1028 findings, from its own experience and expertise the Bureau believes the level of compliance is generally less than optimal, despite the fact that providers face existing consequences for illegal behavior separate from class action exposure.

The Bureau likewise acknowledges that it does not have data to quantify the level of investment in compliance across the 50,000 firms affected by this rule. As discussed further below, the Bureau's experience indicates that quantifying compliance costs is challenging for any individual firm as these costs tend to be diffused across multiple parts of financial institutions and are also hard to distinguish from costs that are incurred to enhance customer service, mitigate reputational risks, and related activities. The Bureau does not believe it is feasible to quantify these costs across all of the affected firms. The Study showed 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.[1123] 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.[1124] 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

[1123] As discussed further below, if class litigation is generally meritless then it does not provide an incentive for providers to comply with the law.
[1124] *See generally* Study, *supra* note 3, 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" at 785-92 (Wolters Kluwer L. & Bus. 2011). 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."

by consumers.[1125] Individual consumer finance lawsuits filed in State courts (other than small claims courts) add some additional modest volume, but the Bureau 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 before 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 credit card holders.[1126] In economic terms, these legal claims have negative expected value (*i.e.*, the costs of pursuing a remedy do not justify the potential rewards). The Bureau refers to such legal claims as "negative value claims" below. When thousands or millions of consumers may have individual negative-value claims, class

[1125] *See* Study, *supra* note 3, 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. An industry commenter cited a study that found more individual litigation per year than the Bureau's Study, which was focused on specific markets. For more discussion of this study and how it relates to the Bureau's Study, see Part VI above. The Bureau notes that even if the volume of cases cited by the commenter is more reflective of the overall level of individual litigation involving providers covered by the final rule, it is still several orders of magnitude less than the number of consumers who are members of a putative class each year.

[1126] *See generally* Study, *supra* note 3, 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 initiate legal proceedings, without mentioning an attorney. *Id.* section 3 at 18.

actions can provide a vehicle to combine these negative-value claims into a single lawsuit worth bringing.[1127]

An automotive dealer industry commenter argued that the market failure described here does not apply to large-value transactions, such as motor vehicle sales, because the amount of alleged injury in such markets is large enough that consumers' claims will not be negative-value. It is true that individual claims are less likely to have a negative expected value in arbitration if the consumer harm is larger. However, in the Bureau's experience, small dollar claims can arise even for larger-balance loans, and in other markets, such as deposits, the balance in the account is not necessarily correlated with the amount of harm. For example, misconduct involving miscellaneous fees on a loan or deposit account may create a large number of negative-value claims, regardless of the size of the underlying account balance. Commenters did not provide support for the claim that disputes concerning automobile finance transactions are for significantly higher dollar amounts than other credit products. In any event, even a claim valued at several thousand dollars may not be positive-value, depending on the costs in time and legal fees of bringing an action and the probability of success.[1128] Moreover, even with a larger claim, consumers may still be unaware that they have a claim at all.

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

[1127] *See, e.g.*, Posner, *supra* note 1124, at 785-92. *See also* Louis Kaplow & Steven Shavell, "Fairness versus Welfare," 114 Harv. L. Rev. 961, 1185 n.531 (2001) ("[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).").

[1128] In the specific context of automobile sales, the Bureau notes the recent Volkswagen Clean Diesel case, where despite wide publicity and very large individual injury caused by Volkswagen's conduct, only a few hundred of the more than 500,000 affected consumers filed individual claims. *See* In re: Volkswagen "Clean Diesel", No. 15-2672.

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 showed, many consumers might consider switching to a competitor if the consumer is not satisfied with a particular provider's performance.[1129] Partly, in response to this and to other reputational incentives (including publicly accessible complaint databases), many providers have developed and administer internal and informal dispute resolution mechanisms.[1130] 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.[1131] 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.

More specifically, reputational 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.[1132] Thus, there is an incentive for firms to underinvest in compliance if consumers

[1129] The survey in the Study focused specifically on the credit card market. *See* Study, *supra* note 3, section 3 at 18. The survey findings might not be generalizable to any market where consumers face a significantly higher cost of switching providers.
[1130] The Bureau notes that an incentive to act to preserve a 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.
[1131] *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 1124, at 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 Pol. 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).
[1132] 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.

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.[1133] The Bureau discusses the limitations of reputation effects more fully in Part VI above.

Economic theory also suggests that regardless of whether relief is warranted under the law, the provider has an 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 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

[1133] *See* Shapiro, *supra* note 1131. 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 legal basis, than for consumers that are not profitable but whose claims have a legal basis. A research center commenter agreed that firms do this, but argued that this is rational for them to do so. As discussed above in Part VI, this is precisely the market failure the rule is intended to address – that it is not always in the providers' private interest to avoid harming consumers without external enforcement of some kind. By reducing the collective action problem inherent in small claims, class actions provide a source of external enforcement that is currently missing for providers using arbitration agreements.

Public enforcement could theoretically bring some of the same cases that would not be brought by private enforcement absent the 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).[1134] In addition, other factors may be at play; public prosecutors could be more cautious or have other, non-consumer finance priorities. For all these reasons, public enforcement cannot and will not entirely fill the void left by a lack of private enforcement. The Study's analysis was consistent with this prediction, indicating that there is limited overlap between the two types of enforcement.[1135]

An industry commenter argued that individual arbitration itself can solve the market failure by strengthening incentives to resolve disputes informally before providers have to pay arbitration filing fees. The commenter noted that such agreements generally contain fee-shifting provisions that require providers to pay consumers' upfront filing fees, and that this gives providers an incentive to provide an informal resolution to claims below the value of the filing

[1134] *See* Part VI.
[1135] *See generally* Study, *supra* note 3, section 9.

fee. The Bureau notes that such incentives would only be relevant if consumers have an incentive to file arbitration claims in the first place. The commenter did not assert that consumers would have such incentives,[1136] but theoretically it is possible that the ease and low upfront cost of arbitration may change some negative-value individual legal claims into positive-value arbitrations, which in turn create an additional incentive for providers to resolve matters internally.[1137] In principle, if arbitration agreements had the effect of transforming enough negative-value claims into positive ones, that would affect not just providers' incentives to resolve individual cases 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,[1138] and the Bureau is unaware that providers have routinely concluded that considerably more consumers were likely to file absent taking action to resolve informal complaints. Neither did any commenter provide empirical evidence supporting this claimed linkage.

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. As discussed in more detail in Part VI, above, consumers weigh several other costs besides filing

[1136] A research center commenter made a related argument that some providers have clauses in their arbitration agreements that provide a bonus payment to consumers who receive a favorable arbitration judgment in excess of the provider's last settlement offer. The commenter argued that such payments could increase consumer's incentives to file arbitration claims. However, the commenter acknowledged that these clauses are not commonly in use in consumer finance. In addition, as the Bureau discusses further below in Section G of this 1022(b)(2) Analysis, such clauses are unlikely to materially affect consumers decisions, as the *ex ante* expected value of the bonus payments is significantly lower than the face value.

[1137] 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.

[1138] *See generally* Study, *supra* note 3, section 5.

fees 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. Accordingly, the Bureau is not convinced that the difference in upfront filing fees makes a substantial difference to consumers' overall evaluation. As discussed above, consumers' incentive to pursue an individual claim depends upon the expected value of the claim – the net payoff from success or failure adjusted for the probability of success or failure respectively – not just the payoff from a successful claim.

Some industry trade association commenters expressed doubt that class actions would resolve any market failure of the type described here, due to the small average payments to consumers. In the view of these commenters, consumers will not have sufficient incentive to file claims in class actions because of the small average monetary recovery involved for class members. As discussed in more detail in the section 1028(b) findings, a significant portion of cases resulting in settlements lead to automatic distributions.[1139] Moreover, whether automatic or claims-made, class settlements also lead to costs for companies, including defense costs and plaintiff's attorney fees, which magnify the deterrent effect.

One industry association also pointed to low claims rates in claims-made settlements, and a low proportion of filed class actions that result in class settlements, as a basis for concern that the rule will not address the market failure. The Bureau has not stated, and does not believe, that cases filed as class actions but which are not resolved in class settlements would address the market failure. The Bureau believes that the market failure is addressed by the availability of classwide relief through the class mechanism, which, as the Study showed, does produce

[1139] *See also* Study, *supra* note 3, section 8 at 23-29.

outcomes providing substantial aggregate relief for consumers. In addition, the Bureau notes that the amount of monetary relief and other relief paid in these cases acts as a deterrent, even if some of these class settlements are structured on a claims-made basis with relatively lower percentage of potential class members filing claims. Further, a provider also cannot generally know, ex ante, whether the class exposure it may face would result in an automatic or claims-made settlement (nor how many claims will be submitted). Thus, the prospect of the latter may still serve as a deterrent in many situations.

In general, if the extant laws were adopted to solve some 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 that lowers providers' incentive to follow these laws, in this case arbitration agreements, that can be invoked in class litigation, would be a market failure since it would allow the underlying market failures to persist or reappear. The providers, and the market in general, would be unable to resolve this market failure for the same reasons that the providers would not be able to solve the underlying market failures in the first place.[1140]

*Overview of Effects of the Final Rule*

[1140] 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' 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.

The final rule requires 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 final rule and prohibits providers from invoking such an agreement in a case filed as a class action with respect to those consumer financial products and services. The final rule also prohibits third-party providers facing class litigation from relying on such arbitration agreements. Finally, the final rule requires that providers using pre-dispute arbitration agreements redact and submit certain records relating to arbitral proceedings to the Bureau.

The Bureau believes that the final class rule will have three main effects on providers with arbitration agreements: (1) they will have increased incentives to comply with the law in order to avoid exposure to class litigation; (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 will ultimately result in additional litigation expenses and potentially additional class settlements; and (3) they will 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 refers to these three effects of the final class rule as, respectively, the deterrent effect, the additional litigation effect, and the administrative change effect. In addition, the final monitoring rule may have some effect on compliance through reputational effects, as is discussed in greater detail in Part VI, above.

In this Section 1022(b)(2) Analysis, the Bureau has elected not to discuss further any benefits from certain abstract considerations which the Bureau considers above in Part VI, such

as promoting the rule of law. To the extent that individuals value any such impacts to society from the final rule, this would be a part of the benefits of the rule to consumers; however, the Bureau is not in a position to quantify these impacts for purposes of this Section 1022(b)(2) Analysis. The Bureau did not receive any comments disagreeing with this approach. Accordingly, while as discussed in Part VI above**,** the Bureau believes that the final rule is in the public interest due, in part, to reinforcing the rule of law, the discussion in this section focuses in particular on more concrete impacts on individual consumers and providers for purposes of this Section 1022(b)(2) Analysis.

*The Deterrent Effect*

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 always brought randomly without regard to the merits of the individual case, such that higher levels of compliance will result in fewer class action lawsuits), providers would want to ensure more compliance than if there were no threat of class litigation.[1141] As discussed in more detail in Part VI above, even if some class actions were random and without merit, as long as meritorious class claims can be asserted, the threat of those class actions will deter conduct that would give rise to such claims. Leaving aside whether the filing of class actions is random, class action exposure would still incentivize providers to ensure appropriate levels of compliance if the probability of a suit's dismissal, or the finding of merit, is affected by the level of compliance. Given the Bureau's assumptions outlined above, economic

[1141] *See, e.g.*, Kaplow & Shavell, *supra* note 1127, 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.").

theory suggests that providers who are immune from class litigation currently under-comply from an economic welfare perspective, and therefore this additional deterrence is beneficial.[1142] For this purpose, both the cost of class relief and the cost of related litigation are counted as contributing to the size of the strengthened compliance incentives.[1143]

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.

An industry commenter asserted that most class action claims are frivolous and that this reduces the potential deterrent effect of the rule because if claims are frivolous, no amount of increased compliance could eliminate the risk that a provider would be sued. Many consumer advocate and consumer law firm commenters took the opposite position, arguing that class actions serve to redress real consumer injury from illegal conduct. The Bureau acknowledges that some class actions filed may be frivolous in nature, but believes this would only be true in general if providers were always in full compliance with the law. This is because the ability of class actions to recover for consumers, and reward class action attorneys, bears a relationship to the merits of the cases. Defendants are more likely to procure the dismissal of frivolous claims,

[1142] *See* Gary Becker, "Crime and Punishment: An Economic Approach," 76 J. Pol. Econ. 169 (1968). *See also* Shapiro, *supra* note 1131; Posner, *supra* note 1124. See the 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.
[1143] *See* Kaplow & Shavell, *supra* note 1127.

and less likely to settle such claims, than meritorious claims. Further, even where frivolous claims are settled, the settlements are likely to be smaller than for meritorious claims. For these reasons and those discussed in Part VI above, a meritorious case is more likely to be pursued than a frivolous one. The fact that class actions can be filed (and are more likely to be filed) for meritorious claims therefore creates a disincentive to break the law.

*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.[1144] This payment from the provider to consumers in and of itself is, in economic terms, a transfer,[1145] 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

[1144] 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.

[1145] "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." Memorandum to the Heads of Exec. Agencies & Establishments from Off. of Mgmt. & Budget, at 38 (Sept. 17, 2003), *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 Legal Studies 1153, at1155 ("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.").

impact, which the Bureau discuses in the below) economically inefficient.[1146] These transaction 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 individual basis, although the magnitude of the costs will vary depending upon how and when in the process a case is resolved.[1147] 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. The Bureau notes that, as in many cases of economic policy, there may be a trade-off between efficiency and equity, that is, between total output and the distribution of that output. A policy of allowing wrongdoers to keep ill-gotten gains might be efficient in that it avoids costly transfers, but might also lead to a distribution of resources that is inequitable. Although the Bureau's 1022(b)(2) analysis here, in cataloguing the costs and benefits of the rule, abstracts from equity concerns, as a general matter a policy of allowing transfers to compensate injured parties might be justified on equity grounds despite being inefficient absent a deterrent effect or other benefits.

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

[1146] As noted above, these other costs still contribute to the deterrence incentive.
[1147] 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.

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 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.[1148] The same can be true in principle for in-kind relief, although the Bureau believes that the benefits to consumers of such relief are more limited. Thus in some cases involving substantial injunctive relief, litigation could be viewed as efficient from the perspective of economic theory independent of any deterrent effect.

*The Administrative Change Effect*

The final class rule will 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 will require providers to incur expenses to change their contracts going forward, and amend contracts they acquire or provide a notice.[1149] The Bureau acknowledges that, as some industry commenters noted, some providers have a substantial number of distinct agreements, all of which would need to be modified to comply with the rule.

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[1148] 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 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).

[1149] As discussed further below, providers like debt buyers or indirect automobile lenders will need to provide notices to consumers upon purchase of consumer debt with an arbitration agreement that adheres to the proposal's mandated provision.

*Effects of the Requirement to Submit Arbitral and Court Records*

The final rule will also require that providers using pre-dispute arbitration agreements submit certain records relating to arbitral and certain court proceedings to the Bureau. This will require providers to incur additional expenses when such an agreement is invoked, with some one-time expense of establishing a procedure for accomplishing such a task and some recurring expense for each incidence.

*B. Potential Benefits and Costs to Covered Persons*

*Overview*

Given that providers using arbitration agreements have chosen to do so and will be limited in their ability to continue doing so by the final rule, these providers are unlikely to experience many notable benefits from the Bureau's final rule.[1150] Rather, the benefits of the final rule will 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 final class rule and to the fourth effect, which arises from the final monitoring rule: (1) providers will experience costs to the extent they act on additional incentives for ensuring more compliance with the law; (2) providers will spend more to the extent that the exposure to additional class litigation actually materializes; (3) providers will incur a one-time administrative change cost or ongoing amendment or notices costs; and (4) providers will incur ongoing administrative costs from the requirement to submit arbitral and certain court records to the Bureau. The Bureau

[1150] The Bureau believes that it is possible that some providers without arbitration agreements will benefit from the final rule. Their rivals' costs will increase, and thus providers without arbitration agreements will 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 will 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.

considers each of these effects in turn. To the extent providers pass these costs through to consumers, providers' costs will be lower. Providers' pass-through incentives are discussed further below.

*Covered Persons' Costs Due to Additional Compliance*

Persons exposed to class litigation have a significant monetary incentive to avoid class litigation. The final rule prohibits 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 ways. All of these ways of lowering class litigation exposure will 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 competitors, as well as actions by regulators. Providers will 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 data on compliance costs.[1151] 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 would be difficult to isolate the

[1151] *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 (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.).

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 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, or reasonably available to it, the Bureau is unable to quantify these costs. The Bureau requested comment and data on this subject, but no commenters provided relevant data (as opposed to data on overall cost and impact of compliance generally, which one credit union industry commenter estimated).

An association of State regulators expressed concern that the compliance costs of the proposal could be substantial, and that requiring institutions to incur those costs could pose safety and soundness concerns for the depository institutions that the association's members supervise. The commenter urged the Bureau to engage in a more rigorous analysis of current and future compliance costs before finalizing the rule. The Bureau notes that arbitration agreements are not universal, such that for the markets covered by the final rule and that are subject to the authority of State regulators, there are depository institutions that do not currently employ such agreements. Indeed, as discussed below, the Bureau estimates that the majority of depository institutions do not use arbitration agreements. It is evident that depository institutions without arbitration agreements are able to remain safe and sound despite their exposure to class action liability. The Bureau has no reason to believe that depository institutions with arbitration agreements are less financially sound than those without or that requiring certain depository institutions to amend their agreements will cause them to become less financially sound. For the reasons above the Bureau believes that increasing class action exposure for depository

institutions currently using arbitration agreements will not pose safety and soundness risks. In addition, as discussed in Part III, no class action in the Study went to trial. As further discussed in the findings in Part VI, courts are generally able to consider the financial condition of the defendant when evaluating the reasonableness of class settlements and litigated judgments. In addition, under CAFA, prudential regulators are afforded notice and the opportunity to comment on the proposed class settlement before the court makes a final approval decision. These mechanisms allow for consideration of safety and soundness concerns into the class settlement approval process.

A credit union industry commenter disagreed with the Bureau's analysis of the costs of additional compliance. In the view of this commenter, the costs to credit unions of complying with existing laws and regulations are excessive, and the increase in class action liability for those that now employ arbitration agreements would make these costs worse for credit unions. However, as the commenter noted and as the Study showed, most credit unions currently do not use pre-dispute arbitration agreements. The class provision will not impose costs on entities that do not currently use arbitration agreements.[1152] With respect to those credit unions that do use arbitration agreements, the Bureau does not believe the impact of the rule will be significantly different for them than any other provider whose products have a similar level of compliance with applicable laws.

As noted, the Bureau believes that, as a general matter, the final rule will increase at least some providers' incentives to invest in additional compliance. The Bureau believes that the

[1152] Credit union industry commenters also argued that their member-owned structure creates incentives to be more consumer-friendly than other financial institutions. The commenters did not generally dispute the Bureau's view that credit unions generally do not use arbitration agreements for most products and services. However, credit union industry commenters also asserted that the rule would impose costs on their members because even though they do not currently use arbitration agreements, they are currently considering doing so. As noted above, any such cost is likely minimal – if the option of adding an arbitration agreement had substantial value for credit unions, presumably more credit unions would have already adopted them.

additional investment will be significant, but cannot predict precisely what proportion of firms in particular markets will 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 invests in compliance will 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 and the ability of the provider to mitigate the legal risk. 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 extreme case, 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 deterrent effect is going to be absent. However, as discussed above, if success in a class action is related to the merit of the claim, there will be an incentive on the part of attorneys to bring claims with merit and therefore an incentive on the part of providers to

invest in compliance. Indeed, 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.[1153] 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 may take a variety of specific actions with different cost implications. First, providers may spend more on general compliance management. For example, upon the effective date of the rule, a provider may 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 may 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 could create exposure to class litigation.[1154] Moreover, there may 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.

In addition, providers may incur costs due to changes in the consumer financial products or services themselves. For example, a provider may conclude that a particular feature of a

[1153] This is hard to measure empirically and the Bureau requested comments on or submissions of any empirical studies that have measured the merit of class actions involving consumer financial products or services. The Bureau did not receive any comments relevant to this question. 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).

[1154] The providers that already have a compliance management system with an audit function could, for example, increase the frequency and the breadth of audits.

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 may 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 may 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 FDCPA, 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 consumer.[1155] 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, among other reasons discussed more fully in Part VI, 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

[1155] 15 U.S.C. 1692(a).

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.[1156] 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.[1157] 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 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 he or she is not able to access credit. However, a creditor could invest in improving its notice procedures and content.

*Providers' Costs Due to Additional Class Litigation: Methodology and Description of Assumptions Behind Numerical Estimates*

Additional investments in compliance are unlikely to eliminate additional class litigation completely, at least for some providers.[1158] Thus, those providers that are sued in a class action will also incur expenses associated with additional class litigation. The major expenses to

[1156] The law requires that a bank stop such payments in at most three business days after a consumer's request. *See* 15 U.S.C. 1693e(a).
[1157] A creditor would have to send such a notice. *See* 15 U.S.C. 1681m(a).
[1158] For example, as noted above, some providers might choose to forgo sufficient additional investment in compliance.

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 proposal, the Bureau developed preliminary estimates using the data underlying the Study's analysis of Federal class settlements over five years (2008 to 2012), 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 markets during the development of the proposal.[1159] After considering the comments discussed below, the Bureau is finalizing the estimates from the proposal, which it discusses again here.

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. The Bureau had classified each case in the Study by the North American Industry Classification System (NAICS) code that

[1159] *See generally* Study, *supra* note 3, 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 to 20 percent]; (2) some providers but fewer than half use arbitration agreements [20 percent to 50 percent]; (3) more than half but not the vast majority use arbitration agreements [50 percent to 80 percent]; and (4) the vast majority use arbitration agreements [80 percent to 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 to 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) will 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.

most closely corresponded to the consumer financial product or service at issue in the case.[1160] 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 proposal going forward in each market if the providers who currently have arbitration agreements were no longer insulated from class actions.

The Bureau's estimate 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 scope of the proposal, which was somewhat narrower.[1161] Specifically 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. Due to the narrower scope of both the proposal and the final rule, the Bureau's Section 1022(b)(2) Analysis focuses only on the impact on covered entities when they offer products and services subject to the rule, rather than the broader scope of the research of Federal class actions in the Study. Additionally, the class rule will 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.[1162] The set of Federal class settlements the Bureau used to estimate the impacts of the rule therefore excludes 117 Federal class settlements analyzed in Section 8 of the

[1160] *See* U.S. Census Bureau, "North American Industry Classification System," http://www.census.gov/eos/www/naics/ (last visited June 1, 2017).
[1161] 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 3, 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.* The Bureau notes that although the scope of the final rule differs slightly from that of the proposal, the changes in scope did not affect the estimates presented here.
[1162] Persons offering or providing similar products or services might be covered by the final rule in some circumstances; the Bureau's estimates are not a legal determination of coverage.

Study.[1163] In addition, to avoid underestimating the effects, the estimates in this section also include 10 additional class settlements identified through the Section 8 search methodology which are within the scope of the final rule 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 proposal on Federal class litigation, as well as the 117 excluded cases described above, were listed in the proposal. The Bureau notes that the total amount of payments and 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 419 cases 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.[1164]

Many of the cases not used to estimate the impact of the rule in the Bureau's Section 1022(b)(2) Analysis were EFTA ATM "sticker" cases, in which noncustomers had sued ATM operators for failing to comply with the historical requirement in EFTA to post a "sticker" on the ATM disclosing certain information concerning ATM fees. A research center commenter argued that a consistent approach would have been to also exclude FDCPA claims against debt collectors, which the Bureau did not exclude. In the commenter's view, both types of cases are not subject to arbitration, and the commenter believes that including FDCPA cases and excluding EFTA ATM sticker cases biases the Bureau's estimates in favor of the rule. The Bureau disagrees with this comment. The Bureau believes that it is not appropriate to include EFTA

[1163] *See* Appendices A and B hereto for additional details on adjustments in three other cases.
[1164] 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.

ATM sticker cases in its analysis because those cases concerned rights of persons using an ATM machine who were not holders of an account at the institution offering the ATM (and which in some cases may have been a merchant). A financial institution providing ATM services to noncustomers is not a product or service covered by the rule. The commenter's analogy between that service and debt collection is not apposite because debt collection is specifically covered by the rule.[1165] *See* 1040.3(a)(10). Furthermore, regarding FDCPA cases, as noted above in its section 1028 findings, and as a number of SERs stated in the SBREFA Panel process[1166] and debt collection industry comments confirmed, the Bureau believes that debt collectors who are subject to class action lawsuits often do rely on arbitration provisions included in contracts between the original creditor and consumers, which specifically provide for the debt collector to be a beneficiary of the arbitration agreement. In contrast, the Bureau is not aware of any cases in which an arbitration clause has been invoked to try to block an ATM sticker case.[1167]

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 than 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 will 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

[1165] 81 FR 32830, 32929-30 (May 24, 2016).
[1166] SBREFA Report, *supra* note 419, at 21 and appendix A (debt collection industry letters).
[1167] Specifically, the Bureau is not aware of any deposit agreement whose arbitration agreement makes a foreign ATM operator a beneficiary. Nor has the Bureau seen an example of a financial institution seeking to rely on an arbitration agreement to block an EFTA ATM "sticker" class action.

either chose not to invoke or failed to invoke successfully, in which event the Bureau's incidence estimates 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 final rule will affect, the estimates of costs to providers and the benefits to consumers going forward will 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 two class settlements per year (10/5).[1168] The Bureau performs similar calculations for the monetary exposure in terms of payments to class members and plaintiff's attorney fees.

In the Study, the Bureau reported 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).[1169] The Bureau documented about $2 billion in gross cash relief and about $1.09 billion in payments.[1170] 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 was 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 and final rule results in the aggregate payment amount changing from $1.09 billion to $1.07 billion.[1171]

[1168] 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 Report, *supra* note 419, 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 3, 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 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).

[1169] *See* Study, *supra* note 3, section 8 at 3-5 and 23-29.

[1170] 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 Id.* section 8 at 12, 16, 24, 27.

[1171] 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 Study documented relief provided to consumers and attorney's fees paid to attorneys for the consumers,[1172] but the Study did 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 fees with appropriate adjustments.[1173] 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 salaried basis, and face considerably lower risk. As discussed at greater length in Part VI, 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.[1174] 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 fees.

[1172] These fees included other litigation costs such as expert report costs as well as amounts paid for settlement administrator costs. *See* Study, *supra* note 3, appendix B at 137.

[1173] A research center commenter asserted that the Bureau's calculation in the proposal did not account for the costs of discovery and staff time on the part of the provider. The commenter did not provide data on these costs and the Bureau believes that discovery in class actions prior to certification may be limited. In any event the Bureau disagrees that the proposal did not account for any such costs – discovery costs in particular will be borne by plaintiffs' attorneys as well and reflected in the plaintiff's attorney fees that the Bureau used to calculate defense costs. In addition, discovery costs are not necessarily greater for defendants than for plaintiffs, and the commenter provided no data on this subject. With regard to staff costs, the Bureau believes these costs are often fixed costs and is not aware of evidence indicating that companies add staff to defend class actions.

[1174] 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's 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 Empirical Legal Studies 27 (2004); Fitzpatrick, *supra* note 709.

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.[1175] The Bureau assumes that in all cases the plaintiff's attorney 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. Based on that assumption, and the further assumption that the defense costs were equal to the lodestar (prior to multiplication), the Bureau estimated defense costs.

The Bureau also notes that the estimates provided below are exclusively for the cost of additional Federal class litigation filings and settlements. The Bureau did 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;[1176] however, the Bureau generally believes that the amounts at stake are not nearly as large in State courts.[1177] 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.[1178] For example, there might be considerably more putative State class actions

[1175] Despite the small sample, this number is consistent with the finding by Professor Fitzpatrick of a 1.65 average. *See* Fitzpatrick, *supra* note 709, at 834.
[1176] 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 3, section 6 at 16-17. Note that the Federal and State data in Section 6 of the Study includes size markets, and not all the markets that would be affected.
[1177] Especially due to the CAFA, 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.
[1178] *See* Study, *supra* note 3, section 6 at 19 tbl. 4.

filed against automobile 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.

An industry commenter argued that some laws result in many more cases being pursued at the State level than the Federal level. The Bureau agrees that some claims involving some laws may be more commonly asserted in one forum or another, but disagrees that this means that the total number of State court class actions is likely to be higher than the total number of Federal class actions. In the Study, the Bureau sampled three States and several additional counties to examine the level of class action litigation in courts in those jurisdictions, and, extrapolating from the sample, found the State class actions were approximately as common as Federal class actions.[1179] Given that the Bureau does not have nationwide data to estimate the number of additional State class actions as a result of the class provision, the Bureau believes that its assumption that there might be a similar number of Federal and State cases remains appropriate in the aggregate; commenters provided no data to the contrary.

The same industry commenter also asserted that State class actions can have more variable litigation costs than Federal class actions. The commenter argued that State courts lacked controls, expertise, and oversight to create consistent outcomes, and this may lead to unpredictable costs. The commenter did not cite data on this point. Congress adopted CAFA to address many of the concerns raised by the commenter. To assess whether CAFA was sufficient to address these concerns, the Bureau would need data post-dating the adoption of CAFA, as CAFA limited the cases that could be maintained in State court. The Bureau is not aware of any

[1179] *See id.* section 6 at 15.

data that post-dates the adoption of CAFA. Further, even if costs are more variable, this does not mean that on average they are higher.[1180]

A State regulator commenter argued that State court class actions are more costly to litigate than Federal class actions of similar size. The commenter asserted that differences in State laws regarding the procedure used for class actions could increase the length and complexity of the process to certify a class action under a particular State's laws. The commenter provided no evidence to support this assertion. Moreover, this would only be relevant in cases where the parties are litigating the issue of certification. The commenter also provided no reason to believe that costs would be higher if the matter is resolved in any of a number of other ways, including a class settlement, a non-class settlement, or litigating a dispositive motion. In light of the requirements of CAFA, which generally limit the amount of relief available in multi-state class action claims in State courts to $5 million, the Bureau believes that State court class actions may be more expensive relative to the size of the injury involved, but mainly because there are fixed costs involved in litigating a class action, and State court class actions are likely less complex and involve fewer consumers.[1181] It is likely that Federal cases of similar size are similarly costly to litigate. This is supported by data publicly reported in the Federal Judicial Center survey of defense counsel finding that cost was not a common factor in the decision to remove a case from State court to Federal court.[1182]

[1180] In addition, the Study (Section 6 at 36 tbl. 3) showed that those cases that were brought in and remained in State courts (which are the basis for the Bureau's estimate of State court defense costs, since the removed cases are treated as Federal cases), were more likely to include State law claims and no significant Federal claims. The State court judiciary may have even greater expertise on State law than the Federal judiciary. In any event, as the Study (Section 6 at 45 fig. 14) indicated, State class actions took slightly longer to resolve than non-MDL class actions in Federal court, but considerably less time than MDL class actions in Federal court.

[1181] The Bureau discusses the issue of fixed costs in class action litigation more fully in Part VI, above.

[1182] Thomas E. Willging & Shannon R. Wheatman, "An Empirical Examination of Attorneys' Choice of Forum in Class Action Litigation," Federal Judicial Center, at 21 tbl. 3 (2005), *available at* http://www.uscourts.gov/file/clact05pdf.

A research center commenter made several criticisms of the methodology described above, all relating to the ratio of attorney's fees to consumer recovery in class actions. First, the commenter argued that the Bureau's approach for calculating the average ratio of attorney's fees to consumer payments is flawed because it overweights the impact of certain large settlements involving litigation over depositories' overdraft programs. Second, the commenter questioned the results of the Bureau's aggregate calculation, pointing to a study by one of the comment's authors that found much higher ratios. Finally, the commenter argued the Bureau's decision to include FDCPA cases in its analysis but not EFTA ATM sticker cases, discussed above, biases its calculations.

The Bureau disagrees with the commenter's specific critiques,[1183] but more broadly the Bureau believes that the commenter's focus on the ratio of attorney's fees to consumer payments is misplaced. The relative split of costs between consumers and their attorneys is not relevant to evaluating the overall burden of new class actions on providers, who must pay all costs.[1184] Even considering the effectiveness of the class action procedure for providing monetary redress to

[1183] Regarding the use of an aggregate average the Bureau disagrees that the aggregate average is an inappropriate metric. In the context of class action litigation, where different cases may have wildly different numbers of consumers involved and similarly variable total claimed injury, taking a case-by-case average will produce misleading results because it weights all cases equally, regardless of the magnitude of the case, thus placing arbitrary significance on a case count instead of on counts of dollars and class members. The Bureau discusses this further, including the effect of the overdraft settlements, above in Part VI.
Regarding the much higher ratios of attorney's fees to consumer payments in the study conducted by the one of the authors of the comment compared the Bureau's estimates, the Bureau disagrees that this is due to problems with its analysis. The main portion of the discrepancy between the Bureau's analysis and that of the commenter is in the set of cases used for analysis. As noted above in Part VI, if the study cited by the commenter had used the same definition of relevant cases as the Bureau's impacts analysis, it would have obtained substantially similar results to those of the Bureau.
Regarding the specific choice to include FDCPA cases in its analysis, the Bureau disagrees with the commenter that this creates a bias. Removing debt collectors from the Bureau's analysis would not make the Bureau's estimates – the ratio of class action attorney's fees to consumer recovery – more favorable to class actions. Debt collection cases make up a majority of the new class action lawsuits the Bureau estimates will occur as a result of the rule, as illustrated in Table 1. Removing them would reduce the count of cases by about half. Debt collection cases on average involve lower fees but also lower payments to consumers; however, the ratio of attorney's fees to consumer payments is higher for debt collection cases than class actions in other industries, and so the overall ratio of attorney's fees to consumer recovery would be somewhat lower if debt collectors were excluded.

[1184] In Part VI above, the Bureau considers whether class action plaintiff's attorney fees are excessive and thus against the public interest. The Bureau finds above that plaintiff's attorney fees are not generally excessive. However, the Bureau notes again that the primary effect of the rule, and the source of the important costs and benefits, is from deterrence, and thus the question of whether attorney's fees are excessive is not in and of itself relevant to the Bureau's Section 1022(b)(2) Analysis. Moreover, the ratio of attorney's fees to consumer redress is not even necessarily informative as to whether fees are excessive. Consumers could benefit greatly from injunctive relief while receiving little monetary compensation (perhaps due to capped statutory damages), leading to a very high ratio of fees to redress regardless of the reasonableness of the attorney's compensation.

consumers, which as discussed above is a transfer in economic terms with no direct effect on welfare, the ratio of attorney's fees to consumer payments may be misleading.[1185] Under some Federal consumer protection laws, the maximum recovery for the class is capped. In other cases, plaintiff's attorney fees are not negotiated or awarded by a court until after a consumer settlement amount has been reached. And in cases with injunctive relief, the court takes into account that relief when considering the reasonableness of attorney's fees, even if the value of that relief cannot be quantified.

*Covered Persons' Costs Due to Additional Class Litigation*

The Bureau estimates that the final class rule will create class action exposure for about 53,000 providers (those who fall within the coverage of the final rule and currently have an arbitration agreement).[1186] Based on the calculation described above, the Bureau's model estimates that this class action exposure will 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 will be paid out to consumers, an additional $66 million will be paid out to plaintiff's attorneys, and an additional $39 million will be spent by providers on their own attorney's fees and internal staff and management time.[1187]

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

[1185] The Bureau discusses the relative size of attorney's fees above in Part VI, the section 1028 findings, addressing comments asserting that plaintiff's attorneys are unjustly enriched by class action litigation. As discussed above, the Bureau finds plaintiff's attorneys are not in general unjustly enriched.

[1186] See the FRFA below for the data used to arrive at this estimate.

[1187] 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 fees, and an additional $67 million for defendant's attorney 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.

Many cases also feature in-kind relief.[1188] 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 in some cases result in substantial forgone profit (and a corresponding substantial benefit to the consumers), but cannot be easily quantified.[1189] Commenters generally did not dispute the numbers discussed above, although some industry commenters disputed whether it was appropriate to compare overall litigation costs to the number of consumer accounts involved. These industry commenters expressed the view that the overall costs were substantial. However, they did not provide an alternative point of comparison beyond the number of consumer accounts covered by the proposal. The Bureau still believes that it is relevant to compare the overall costs of additional class action litigation to the size of the markets covered by the rule.[1190]

In addition to the costs of Federal class actions as discussed above, the Bureau assumes that providers who become subject to class actions as a result of the rule will 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.

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[1188] *See* Study, *supra* note 3, 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.

[1189] 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. *Id.* 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 noted in the Study, behavioral relief is seldom quantified in case records, and thus the Bureau does not quantify it. *Id.* section 8 at 5 n.10.

[1190] One industry commenter disputed the validity of this comparison of estimated additional costs incurred by sued firms to the overall universe of firms affected by the rule, arguing instead that the Bureau ought to compare the class action defense costs to only those firms that would incur these costs, and the number of accounts at only those firms. However, the Bureau does not believe it would be appropriate to ignore the *probability* that any one firm would be sued when evaluating the scale of the additional litigation costs.

The Bureau performed a similar analysis to estimate the number of cases that will be filed as putative class actions but 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.[1191] 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 was precisely because of an arbitration agreement. Nonetheless, on this assumption and extrapolating from the estimated 103 additional Federal cases that will be settled on a classwide basis each year, the Bureau estimates that there will be 501 additional Federal court cases filed as class actions that will end up not settling on a classwide basis, assuming no change in filing behavior by plaintiff's attorneys.[1192] 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.[1193] The Bureau discusses two potential estimates below and presents the more conservative one in the table below. The cost to providers from a putative

[1191] 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. *Id.* section 6 at 7, 36.
[1192] 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).
[1193] *See* Study, *supra* note 3, section 6 at 46 tbl. 7.

class case that is not resolved as a class case is almost entirely from defense costs – the Bureau believes the compensation to a single consumer is likely to be trivial by comparison, and any plaintiff's attorney fees – if paid by the provider at all – will be of a similar magnitude.[1194]

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) as much to litigate. Therefore, the Bureau estimated that these additional 501 Federal class cases that do not settle on a class basis will 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 (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 will 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 will likely be significantly cheaper for providers.[1195]

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

[1194] One industry commenter expressed concern that the Bureau had significantly undercounted the costs of putative class actions that resulted in individual settlements. The commenter mistakenly interpreted the additional fees listed in the last column of Table 1 in the Section 1022(b)(2) Analysis in the proposal as excluding defense costs. In fact, the figures are almost entirely defense costs.

[1195] 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.

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 Bureau also calculated the impact of making the opposite assumption 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 class cases cost as much to defend as 501 individual cases. Using $15,000 per individual case as a defense cost estimate, the cost of these 501 cases would be approximately $8 million per year.[1196] 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.[1197] These low estimates could reflect some combination of the following three possibilities. First, as noted above, in some markets class actions may be more commonly filed in State courts. Second, 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. Finally, in some markets

[1196] 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 Report, *supra* note 419, at 18.

[1197] 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.

the current prevalence of arbitration agreements is so high (over 80 percent) that any estimates regarding future class action activity in the absence of such agreements are especially imprecise because currently so few firms are subject to class action exposure.

| 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 Resolved on a Non-Class Basis (estimate) | Additional Fees Due to Federal Class Cases Resolved on a Non-Class Basis (estimate) |
| 522298 | Other nondepository credit, Pawnshops | 0 | $ - | $ - | 0.1 | 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 | 1288 | $ 36,156,100 |
| 522110 | Depository Institutions (including credit unions), 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 Payemnt 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 | 6 | $ - | $ 5,428,000 | 0.65 | 11 | $ - | $ 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 | 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 | 7 | $ 29,775 | $ 8,991,981 | 0.9 | 63 | $ 267,975 | $ 80,927,826 | $ 47,447,173 | 308 | $ 92,661,538 |
| *Total* | | *312* | *$ 1,070,391,768* | *$ 388,319,802* | | *514* | *$ 1,710,188,164* | *$ 331,767,308* | *$ 194,511,847* | *2,506* | *$ 379,870,197* |
| *Per year* | | | | | | *103* | *$ 342,037,633* | *$ 66,353,462* | *$ 38,902,369* | *501* | *$ 75,974,039* |

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 final rule. During the Small Business Review Panel, these 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. These 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.[1198]

Regarding the total costs to providers over a five year period, three industry trade associations asserted that accounting for State class actions could as much as double the total costs to providers from additional class action litigation, to $5.2 billion. The commenters apparently were extrapolating from the Bureau's observation in the proposal that the incidence of additional State class litigation might be similar to the incidence of additional Federal class litigation.[1199] The commenters essentially characterized that aspect of the Bureau's analysis from the proposal as bounding the cost of State class actions between zero and the full cost of additional Federal class actions.

[1198] Related to this discussion, an insurance industry trade association commenter asserted that litigation insurance rates would be higher for providers who do not have or cannot rely on an arbitration agreement. The Bureau acknowledges that this is likely true simply as a matter of basic economic theory, but the Bureau cannot quantify the size of this effect, nor did the commenter provide any information or data indicating the magnitude of any potential change in insurance premiums.
[1199] 81 FR 32830, 32907 (May 24, 2016).

The Bureau acknowledges again that the total additional litigation costs to providers will exceed costs from Federal class actions presented in Table 1, as they do not account for the costs of State class actions. The Bureau also acknowledges again that it does not have reliable data to estimate the cost of additional State class actions. However, as discussed above, the Bureau disagrees that the cost of State class actions are likely to be anywhere near the full cost of Federal class action litigation. Most State court class actions will seek smaller amounts of monetary relief than Federal court class actions, sometimes considerably so, due to the fact that class actions seeking more than $5 million in relief generally can be removed to Federal court under CAFA.[1200] As already noted, the Bureau expects that payments to consumers from State court class actions will be markedly lower than in cases settled in Federal court, due to the limits imposed by CAFA. No commenters disputed this assertion. Given that the vast majority of the Bureau's estimate of the costs of additional litigation comes from payments to consumers, which vary by the size and nature of the case and are likely to be higher in Federal litigation, the Bureau does not believe that a cost equal to that of the additional Federal class actions is a reasonable upper bound for the cost of additional State class actions.

Several industry commenters expressed the view that the Bureau should have generally considered costs to additional firms beyond those considered in the Section 1022(b)(2) Analysis in the proposal. Specifically, automobile dealer industry commenters expressed the view that the rule would have a significant impact on them because increased suits against indirect automobile lenders would increase the costs on dealers, who would be obligated to reimburse the indirect automobile lenders pursuant to indemnification clauses that are included in many contracts

[1200] While claims under many Federal consumer protection statutes have damages caps, those claims also generally can be moved to Federal court if State court claims do not predominate in the case. *See* 28 U.S.C. 1331.

between dealers and indirect automobile lenders. An industry trade association commenter expressed a related view that merchants would be affected by the rule despite the exemption for merchants providing interest-free credit for their own nonfinancial goods or services because the rule would apply to servicers, collectors, and debt buyers (both initial and downstream). The increased costs incurred by those providers, in the view of the industry trade association, would be passed along to the merchants. As a result, the rule would impose costs on merchants "indirectly," in the view of this commenter.

In its Section 1022(b)(2) Analysis, the Bureau analyzes costs and benefits to covered persons whose conduct is regulated by the rule. Although automobile dealers and merchants who originate consumer credit transactions are covered persons under Dodd-Frank section 1002(6), they are not subject to the Bureau's rulemaking authority in circumstances described in sections 1027 and, in the case of automobile dealers, section 1029 of the Dodd-Frank Act. *See* Part VI for further discussion. As a result, their conduct is expressly not regulated by this rule. *See generally* section 1040.3(b)(6) (incorporating Dodd-Frank exemptions into the scope of the rule). This Section 1022(b)(2) Analysis has already accounted for costs of additional class actions that would result from the class rule, and the Bureau acknowledges here that these costs may be passed through to automobile dealers and merchants by the providers who are subject to the rule.[1201] Based on the data available and information supplied by commenters, the Bureau is not able to estimate the amount of pass-through that would occur from these third parties covered by the rule to automobile dealers and merchants that are not covered by the rule. In any event,

[1201] Related to this point, two credit union industry commenters noted that credit unions may bear some burden of class actions due to conduct on the part of dealers who contract with such credit unions for indirect automobile lending. As noted, the Bureau believes that it has already accounted for any such burden through its estimates of new class action lawsuits in the indirect automobile lending market.

this impact would be indirect, as the industry trade association commenter noted, and thus is not relevant to the discussion of impacts on small entities under the Regulatory Flexibility Act as discussed below in Part IX.

*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) will 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 will 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 may 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 final rule becomes effective), they will 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 final rule will 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 will 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 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,[1202] the final rule's required contractual change will result in a one-time cost of $19 million, or about $4 million per year total for all providers if amortized over five years. Alternatively, providers may choose to drop arbitration agreements altogether, potentially resulting in lower administrative costs.

Some industry commenters asserted that their costs from the required administrative changes would be higher than the Bureau's estimates, as described above and in the proposal. A small dollar credit industry commenter asserted that it had more than 100 separate consumer agreements that would need to be updated across multiple systems, in addition to hardcopies at retail storefronts. A trade association for installment lenders argued that the addition of the Bureau-required contract language would require conforming changes throughout its members' consumer agreements. The Bureau acknowledges that some providers may have particular

[1202] *See* the Regulatory Flexibility Act analysis below at Part IX. The Bureau estimates that 4,500 debt collectors are 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.

circumstances that will lead to above average costs, even if they do not fall into the third category of providers above, with highly customized contracts. The Bureau noted in the proposal that some providers have multiple contracts: for example, some credit card issuers have filed dozens of contracts with the Bureau.[1203] However, given that many providers will have no or negligible costs, the Bureau continues to believe that its average estimate is appropriate.

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. Section 1040.4(a)(2)(iii) will 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 § 1040.4(a)(2) to amend the agreement to include that provision, or send the consumer a notice indicating that the acquirer will not invoke that pre-dispute arbitration agreement in a class action.[1204] Various markets may incur different costs due to this requirement.

For example, buyers of medical debt could incur additional costs as a result of additional due diligence they undertake to determine which acquired debts arise from consumer credit transactions (that will be subject to final 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 will 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 FDCPA

[1203] *See* Bureau of Consumer Fin. Prot., "Credit Card Agreement Database," http://www.consumerfinance.gov/credit-cards/agreements/ (last visited June 1, 2017). Presumably, the marginal cost of changing each additional contract is minimal, as long as each of the contracts used the same dispute resolution clause.
[1204] The Bureau believes that medical debt buyers would be the most affected by this provision.

requirements in 15 U.S.C. 1692(g), when applicable. The Bureau believes that these debt buyers could attach the additional notice that will be required by the final rule to this required FDCPA notice with a minimal increase in costs.

A prepaid card industry commenter argued that the Bureau should have further considered the administrative burden of the proposal in concert with the burden imposed by the Bureau's recent Prepaid Accounts Rule. The commenter asserted without explanation that prepaid card providers would be compelled to revise their card packaging and disclosures twice in a short space of time. The Bureau disagrees that it should account for the costs of the Prepaid Accounts Rule, which itself accounts for its own costs.[1205] As the Bureau explained in the proposal and again in this final rule, the rule does not require prepaid card providers to revise packaging and disclosures. Specifically, § 1040.5(b) of the rule allows providers of general purpose reloadable prepaid cards to continue to sell their pre-existing stock as long as they give the consumer notice of the update to the arbitration agreement at the time they communicate with the consumer concerning registration of the card.

Comments from automobile dealers asserted that the proposed class rule would lead to inclusion of the mandated language in form retail installment sale contracts and lease forms by exempt motor vehicle dealers. These dealers expressed concern that the Bureau's proposal did not allow for the use of the language that would preserve the arbitration agreement of the dealers because given that they typically sell their loans to entities that would be providers under the proposal, those providers will in effect mandate dealers' use of compliant arbitration agreements even if the Bureau does not apply its rule to dealers. As noted in the section-by-section analysis

[1205] 81 FR 83934 (Nov. 22, 2016).

of the rule, the Bureau has updated the contract provision that can be used in this situation to further clarify that it does not result in the coverage of, or impact on, excluded persons.[1206] While some automobile dealers might incur some costs in updating their contracts if the indirect automobile lenders they deal with do not do so automatically, the Bureau believes that these costs will be minimal, and will not be incurred by most dealers.

*Costs to Covered Persons from the Requirements Regarding Submission of Arbitral and Certain Court Records*

There will also be a minor cost related to the final rule's requirements regarding sending records to the Bureau related to providers' arbitrations and certain court cases. In the Study, the Bureau documented significantly fewer than 1,000 individual arbitrations per year in the markets analyzed.[1207] The Bureau believes it is unlikely that the transmittal requirement will 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 will 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, 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.[1208] Thus, the total cost of the arbitration submission requirements is unlikely to reach $1 million per year

[1206] *See* § 1040.4(a)(2)(iv)(B).
[1207] *See generally* Study, *supra* note 3, section 5. Relatedly, JAMS (the second largest provider of consumer arbitrations) reported about 114 consumer financial products or services arbitrations in 2015.
[1208] One of the SERs on the SBREFA Panel projected two to six hours of staff time. *See* SBREFA Report, *supra* note 419, at 25. Meanwhile, one commenter suggested the burden of redacting records to a level that sufficiently protected consumers' privacy would be highly burdensome, but did not provide any quantitative estimates of the amount of time and staff required.

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.

With regard to the cost of submitting arbitral and certain court records generated by the final rule, some commenters disputed as low the amount estimated by the Bureau, suggesting that there would be additional unaccounted for burden of redacting records and ensuring privacy. As discussed in more detail in Part VI, however, the Bureau expects that the rule will not lead to additional burden because the Bureau provides a specific list of information types that must be redacted. Providers will not have to make additional redactions to ensure privacy in general. The Bureau, rather than providers, will bear any further cost of redacting information beyond those types listed in the rule to ensure privacy.

In addition to the costs of submission of records listed above, one commenter asserted that the private nature of arbitration benefits all parties involved, and as such publication of arbitral records will act as a cost toward both parties. For firms, this takes the form of a reputational cost from the details of their disputes with consumers being made public. (The commenter's arguments regarding benefits to consumers are discussed separately below.) The Bureau acknowledges that publication of arbitral awards with rulings adverse to firms may have some impact on the reputation of those firms, although the Bureau notes that the number of arbitration cases that results in such awards is so small – 36 per year in the markets analyzed in the Study[1209] – that the impact on any given firm or in the aggregate is likely to be slight and may be offset by reputational benefits from the publication of awards that favor companies. In particular, firms should only face a negative cost from this effect when they have arbitral claims

[1209] *See* Study, *supra* note 3, section 5 at 13 (reporting 32 disputes resolved with monetary relief and 41 non-overlapping disputes with debt forbearance awarded, over a two-year period).

found in customers' favor. Providers who comply with the law and face a claim without merit will experience this cost to a much lesser extent, if at all.

Some commenters asserted that publication of arbitral records will provide an opportunity for plaintiffs to find companies susceptible to litigation, and thus indirectly impose a heavy cost burden on those firms. The Bureau again notes that the number of arbitral awards favoring individual consumers is miniscule relative to the size of the various markets covered by the rule. Moreover, as one commenter asserted, publication of arbitral records could actually create a more efficient private enforcement market, as consumers may be more likely to realize they have a valid claim if they see that an arbitral decision was made in favor of consumers with similar claims.

*Potential Pass-Through of Costs to Consumers*

As also discussed in Part VI, the Bureau acknowledges that most providers will 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.[1210]

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.[1211]

[1210] 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.

[1211] 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

Conversely, a pass-through rate of 0 percent would mean that consumers would not see a price increase or a diminution in the quality of products or services due to the final rule. As noted above, the monetized estimates of additional Federal class actions above amount to less than one dollar per account per year when averaged across markets, although it is possible that the number is higher for some markets; the monetized estimates of additional State class actions is even less. Also, as noted below in the Paperwork Reduction Act analysis, the direct cost of submission of arbitral and certain court records is estimated at approximately $500,000 per year. Given the extremely high volume of accounts covered under the final rule, the monetized cost of this provision is miniscule when averaged across 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, although particular markets or providers might see larger changes.

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

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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).

lowering margin) and (2) full pass-through (completely preserving the margin at the expense of lowering volume).[1212] 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 lower depending on how demand elasticity and economies of scale change with higher prices and lower outputs.[1213] 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.[1214]

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 final rule. The Bureau believes that providers might treat the administrative costs of the class rule as fixed, while the administrative costs for submission of arbitral and certain court records will primarily have a marginal component for each actual submission. 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

[1212] 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 Pol. 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).

[1213] In other words, these rates depend on curvatures (concavity/convexity) of cost and demand functions.

[1214] Some industry commenters asserted that all costs of the class provision would be passed through to consumers, but none provided evidence or specific figures. Thus, the Bureau's conclusion remains that pass through will likely occur, but that it cannot estimate whether the level of pass through will be closer to zero or 100 percent. Economic theory predicts that pass through will be lower in industries that are less competitive.

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.[1215]

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.[1216] More recently, researchers have analyzed the effects of regulation that effectively imposed price ceilings on late payment and over-limit fees on credit cards and interchange fees on debit cards. These researchers, by and large, found evidence consistent with low to nonexistent pass-through rates in these markets.[1217] However, these findings do not necessarily imply low pass-through in other markets that will be affected by the final 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.[1218] 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 nonexistent 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

[1215] *See, e.g.*, RBB Economics, "Cost Pass-Through: Theory, Measurement, and Potential Policy Implications," (2014), *available at* https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/320912/Cost_Pass-Through_Report.pdf.
[1216] *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," (Geo. Mason Sch. of L., Working Paper No. 00-22, 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.
[1217] *See* Sumit Agarwal et al., "Regulating Consumer Financial Products: Evidence from Credit Cards," 130 Q. J. of Econ. 1 (2015); Benjamin Kay et al., "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 et al., "Price Controls on Payment Card Interchange Fees: The U.S. Experience," (Geo. Mason L. & Econ., Res. Paper No. 14-18, 2014).
[1218] *See generally* Study, *supra* note 3, section 10.

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).[1219] The result also might not be representative for other issuers.

Several commenters stated that the class rule would increase costs beyond the Bureau's estimates in the proposal's Section 1022(b)(2) Analysis. In general, these commenters asserted that various costs, including litigation discovery, costs of State court actions, and the costs of non-class settlements would all be passed on to consumers. As the commenters did not directly take issue with any of the Bureau's estimates of these costs, the Bureau interprets these comments as asserting that all such costs will be passed through. As neither the Bureau nor other researchers or commenters have been able to develop a quantitative model to estimate a specific pass-through rate in markets for consumer financial products and services, the commenters' view, if true, would not be inconsistent with the Bureau's assumption that pass-through will be between 0 and 100 percent.

An industry commenter asserted that the potential for pass-through of costs to consumers must be analyzed by focusing on individual companies facing class actions, not averaging across an entire market of consumer accounts. The commenter asserted that individual companies facing class actions may be forced out of business by the additional class action litigation exposure if they cannot pass the costs through to consumers and stay in business. The Bureau disagrees, as this would ignore the issue of pass-through of compliance costs incurred by providers that are not subject to such a suit. As discussed above, the Bureau also believes that it is important, given the size of the markets at issue, to evaluate cost estimates relative to the

[1219] *See id.* (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).

number of accounts and consumers. More specifically, the Bureau recognizes that the rule will have the greatest impact on those providers whose compliance is least robust, as those providers will either spend more to bring their compliance up to an appropriate level to avoid class liability or are more likely to be subject to class liability. The Bureau does not agree that, to the extent that the pass-through of these costs occurs or that some individual providers exit the market, it will substantially restrict access to financial products or services as a whole.

Credit union industry commenters asserted that the risk or magnitude of pass-through costs to consumers is effectively greater for credit unions, because unlike traditional banks, credit unions are owned by their members. The Bureau agrees that, at least for any credit unions that use arbitration agreements, this may be true, if somewhat tautological. In general, a cost to a firm must either be passed on to consumers through higher prices or to the owners of the firm through reduced profits. To the extent that credit union customers are also owners, such costs will ultimately fall to consumers one way or another. Nonetheless, given that the Bureau's preliminary conclusion was only that pass-through was likely greater than zero, and given that most credit unions currently do not use arbitration agreements and so will not be affected by the rule, the Bureau's analysis is not meaningfully altered by this comment.

Some industry commenters argued that pass-through would be especially high in their specific industry. For example, a small dollar lending industry commenter argued that profit margins in that industry are so thin that costs would have to be passed on, or else firms would go out of business. Again, the Bureau acknowledges that full pass-through is possible, but the Bureau believes that even full pass-through will not impose substantial burden on individual consumers.

A research center commenter asserted that large financial services firms adjust price more slowly than smaller firms and firms in other sectors, and that this explains the lack of price response from the issuers studied by the Bureau. The Bureau has no evidence to suggest that price responses by credit card issuers are so slow that they would not have been captured by the analysis in the Study, and the commenter did not provide any evidence to support this assertion; nor did any credit card issuer or other provider come forward with such evidence, even anecdotally.[1220] However, the Bureau acknowledges that this is another reason that the lack of a price response observed in the Study may not reflect the industry-wide level of pass-through.

*C. Potential Benefits and Costs to Consumers*

*Potential Benefits to Consumers*

Consumers will benefit from the class rule to the extent that providers will 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 consumers experience as a result of injunctive relief in a settlement or as a result of changes in practices that a provider adopts in the wake of the settlement to avoid future litigation.[1221] In addition, consumers will benefit from the monitoring rule to the extent that the rule provides transparency into the arbitration process.

As noted above and in Part VI, the primary effect of the rule on consumers will be to provide a deterrent against harmful conduct on the part of providers, resulting in additional investments in compliance. Consumer benefits due to providers' larger incentive to comply with

[1220] The only empirical data any commenters provided on the issue of arbitration agreements and pricing was an anecdote from the 1990s where a credit card issuer offered its existing customers an APR discount of 2 percent if they accepted a new arbitration agreement. While little conclusion can be drawn from one such dated example, the Bureau notes that in that case, the price difference was not delayed.
[1221] *See* Part VI for a related discussion.

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 institution 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 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 such 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 requested comment on any representative data sources that could assist the Bureau in both of these quantifications, but did not receive any responses.

The Bureau also believes consumers will benefit from the reporting requirement via improved monitoring for potential biases in administration of arbitration (as was alleged in the case of NAF, discussed in Part II above), as well as other potential harms in the use of arbitration agreements. Some commenters disputed this, arguing that the Bureau's existing database of complaints serves as a direct substitute. That is, in their view, the public already has access to consumers' complaints about providers, and more information through the submission of arbitral awards is unnecessary. However, the Bureau believes that the monitoring proposal would produce different and supplemental information that is important. Perhaps most importantly, the monitoring provision will provide the Bureau and the public insight into how the arbitration process is serving consumers who enter into it. In addition, while the Bureau's complaint process serves as an effective avenue through which a consumer can complain to a provider, the Bureau does not adjudicate claims. The Bureau does not decide on the merits of a complaint, and firms are not required to provide any response to consumer complaints submitted through the portal. Absent settlement by the affected entities, arbitration features legally binding decisions on the merits of a case by a third party that can serve as a means by which the public can better understand potential areas of non-compliance.

Consumers will 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.[1222]

[1222] 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.

Moreover, as noted above as well, the Bureau believes that there will also be significant benefits to consumers when settlements include injunctive relief.[1223] 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 injunctive relief from the approximately 103 additional Federal class settlements per year and a similar number of additional State class settlements.[1224] The Bureau requested comment on whether the extent of this benefit, and the associated cost to providers, could be monetized, and if so how, but did not receive any responses.

Consumers may also benefit to the extent that they prefer to engage in disputes through the court system, rather than through arbitration. A research center's comment provided the results of its survey which they stated indicated that 89 percent of 1,008 consumers surveyed would like to be able to participate in class actions against a bank who had charged them for a fee or services they did not request. An industry association comment criticized the research center survey for, among other things, not asking about arbitration as an alternative, and several industry association comments asserted the Bureau should survey consumer preferences for arbitration. The latter, the Bureau believes, is less relevant given the infrequent use of arbitration and its potential to continue under the rule. Other industry commenters asserted that consumers prefer arbitration, although they only cited the purportedly attractive features of arbitration,

[1223] 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.

[1224] 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.

rather than empirical data on actual consumer preferences. In any event, the research center survey concerning class actions focused on a particular example in a particular market, and its results may not extend to other situations in other markets.

*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 and in Part VI. 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, and the Bureau believes it is unlikely that many, if any, providers will do so.[1225] Assuming that some providers will remove these agreements, some consumers who can currently resort to arbitration for filing claims against providers will no longer be able to do so if the provider is unwilling to engage in post-dispute arbitration. Conversely, some consumers who currently cannot resort to individual litigation will be able to do so if an arbitration agreement is removed in toto.

As discussed in detail in Part VI, the Bureau continues to believe that the results of the Study were inconclusive as to the benefits to consumers of individual arbitration versus individual litigation.[1226] However, given that the Study found only several hundred individual

[1225] See Part VI for more discussion of this issue.

[1226] *See* Study, *supra* note 3, 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. Resol. 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 3, section 6 at 2-5.

arbitrations per year involving consumer financial products or services, the Bureau 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.[1227] 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.[1228]

The Bureau requested comment on both providers' incentives to drop arbitration agreements altogether and on quantification of consumer benefit or cost of individual arbitration over and above individual litigation. A number of industry commenters asserted that providers would drop individual arbitration agreements.

Commenters made two points. First, they asserted that companies subsidized individual arbitration, requiring significant upfront expenses on filing fees and other costs, for the purpose of avoiding class action exposure. Thus, in their view, it would be unprofitable to subsidize individual arbitration if companies cannot in turn prevent class actions. Second, the commenters asserted that the decision to drop arbitration agreements would occur because it is not cost-

[1227] Similarly, it is possible that the consumer would fare somewhat worse in individual arbitration than in individual litigation.
[1228] If anything, the Study showed considerably more individual litigation (in Federal and in small claims courts) than individual arbitration. *See generally*, Study, *supra* note 3, sections 5 and 6.

effective to support a dual-track system of litigation (on a class or putative class basis) and individual arbitrations. However, this reasoning conflicts with available facts.

As discussed above in Part VI findings, the upfront costs of individual arbitration are likely more than offset by the reduced cost compared to litigating in court.[1229] Thus, even without the ability to block class actions, companies would still have an incentive to retain their arbitration agreements. Further, the Study showed that providers often do not invoke arbitration agreements in individual lawsuits,[1230] and thus providers are already operating in such a dual-track system. In addition, since most individual firms do not face even one arbitration claim in any given year, it seems unlikely that firms are paying substantial fixed costs to maintain an individual arbitration program nor did commenters submit evidence to the contrary. Thus, the Bureau lacks sufficient information to determine that most providers would drop arbitration agreements altogether rather than adopting the Bureau's language if the rule is finalized as proposed.

A third possible cost to consumers could arise if, as discussed above, some providers decide 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. 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-compliance with respect to this particular decision. The Bureau is not aware of any data showing this theoretical phenomenon (over-compliance) to be prevalent among providers who currently

[1229] Some commenters asserted that the cost savings were less significant compared to small claims court. However, a large portion of the arbitration claims in the Study were for amounts exceeding the small claims court limits in many States, so this comparison is not entirely apt.
[1230] Study, *supra* note 3, section 1 at 15.

do not have an arbitration agreement or any reason to believe this would be likely among providers who will be required to forgo using their arbitration agreement to block class actions. The Bureau requested comment on the extent of this phenomenon in the context of the proposal but did not receive any responses.[1231]

A nonprofit commenter and some industry commenters posited a fourth possible cost to consumers, arguing that consumers value the private nature of individual arbitration, and that the monitoring provision of the rule could compromise this. These commenters also asserted that consumers' private financial information could be released as a result of this provision if the arbitral records are made public and consumers are re-identified using public information. Taking the second argument first, the Bureau notes that several measures will sufficiently reduce re-identification risk. While providers must submit records redacted of certain personal identifiers, the Bureau will take the primary responsibility, prior to publication, for redacting any additional information needed to minimize the risk of re-identification.[1232] The Bureau has extensive experience in redacting such information from its consumer complaints database. With regard to the first argument, the Bureau is not aware of any evidence that consumers who are particularly privacy sensitive currently seek out arbitration to handle formal disputes.

*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.[1233] Moreover, while more than 90 percent of depository institutions have no more than $10 billion in assets, about one in five of the class

[1231] Some commenters made a general assertion that the rule would stifle innovation. Although somewhat related, innovation of new products and services is not the same thing as the over-compliance phenomenon described here. In any event, as described above in Part VI (the findings), the Bureau believes the rule is as likely to suppress harmful innovations as those beneficial to consumers.
[1232] *See* § 1040.4(b)(5).
[1233] *See generally* Study, *supra* note 3, section 2.

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 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. Similarly, while the requirement that providers using pre-dispute arbitration agreements submit certain records relating to arbitral proceedings to the Bureau will, in relative terms, cost more for a small firm than a large firm, given the small number of overall arbitral proceedings, and the smaller relative likelihood of a small depository entity invoking an arbitration agreement, this cost will not be disproportionately borne by smaller entities. Additionally, even if a small depository entity would need to submit records of arbitral and certain court proceedings to the Bureau, the overall administration cost burden, as stated above, is relatively small.

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 final rule will 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 after the class rule takes effect.

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.[1234] 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.

[1234] *See, e.g.*, Clifford Smith & René Stulz, "The Determinants of Firms' Hedging Policies," 20 J. Fin. & Quantitative Analysis 391 (1985).

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.[1235] 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 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 proposal, it would be lower in rural areas.[1236]

[1235] 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).
[1236] *See* Weyl and Fabinger, *supra* note 1212; Alexandrov and Koulayev, *supra* note 1212.

*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 Bureau expects the additional marginal costs due to additional Federal class settlements to providers 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 final rule will 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 will be diminished due to effects on providers' continued 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 were 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 customers. 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 or other consumer financial products or services.

A Congressional commenter also stated his view that the class rule would likely cause financial institutions to increase their cash reserves held to mitigate litigation risk. The commenter stated that this increase in cash reserves, in turn, could reduce the amount of cash that institutions have available to lend to consumers and small businesses, or to invest in technology upgrades and employee retention. The commenter referred to this effect as creating "dead capital." To the extent that financial institutions self-insure in this fashion, the Bureau does not believe it will substantially impact consumers' access to credit, as the overall costs of the rule are small relative to the size to the relevant markets.

*G. Potential Alternatives Considered by the Bureau in Lieu of the Class Action Rule*

In developing the proposal and the final rule, the Bureau considered several potential alternative approaches in light of whether these potential alternatives would achieve the goals of the rulemaking with less burden on industry. The Bureau discussed some of these potential alternatives in the IRFA included in the proposal, and noted in the Section 1022(b)(2) Analysis that it also considered them in that context. The Bureau discusses potential alternatives further here, both in general and in light of comments received regarding potential alternatives.[1237] Commenters suggested and the Bureau considered four general classes of potential alternatives to the proposed class rule: (1) measures to increase consumer choice with respect to entering into arbitration agreements; (2) measures to improve consumers' access to and the conduct of

[1237] The proposal also discussed the potential for a total ban on the use of arbitration agreements. Consumer advocate commenters generally urged that option as an alternative to the individual monitoring proposal, as discussed in Part VII above. In any event, as compared to the class rule, such an approach would not reduce burden as explained in the proposal. 81 FR 32830, 32921(May 24, 2016), and the Bureau does not discuss it further here.

individual arbitrations; (3) an exemption from the proposed class rule for potentially actionable conduct that providers report to regulators; and (4) an exemption from the rule for small businesses.[1238] The fourth alternative, because it relates to small entities, is discussed in more detail in the FRFA in Part IX below.

Beyond these general classes of potential alternatives, commenters suggested other limitations to the class rule, which the Bureau has discussed in Part VII. Some commenters suggested exempting claims under specific statutes, discussed in Part VI and Part VII,[1239] while others raised the possibility of excluding arbitration agreements from the class rule if they allow for class arbitration.[1240] Some other potential alternatives suggested by commenters would be infeasible or in conflict with the goals of the rulemaking, such as excluding consumers from participating in a class action unless they have exhausted informal dispute resolution[1241] or excluding class claims where the attorney did not state the fees sought would be below a certain amount, discussed in more detail immediately below.

For these reasons, and for the reasons discussed below for the other potential alternatives, the Bureau concludes that none of these potential alternatives would accomplish the goals of the

[1238] Some commenters that suggested a small entity exemption requested that this exemption cover the monitoring proposal as well as the class rule. The Bureau discusses this potential alternative in the FRFA, below.

[1239] For discussion of claims under statutes providing for statutory damages or attorney's fees generally, see Part VI (Bureau findings that the class rule is warranted for these claims). For further discussion of claims under the Credit Repair Organization Act (CROA) in particular, see the section-by-section analysis of § 1040.3(a)(4) above (Bureau decision not to exclude providers potentially subject to these claims from coverage). A nonprofit commenter criticized EFTA ATM "sticker" class actions and stated these cases demonstrate that the rule should exclude claims under statutes that do not explicitly authorize class remedies. Yet the Bureau notes that EFTA does provide for class remedies in 15 U.S.C. 1693m(a)(2)(B), and in any event, the EFTA ATM "sticker" requirements have been repealed, as noted in Part VI above. To the extent the commenter was asserting that statutes authorizing statutory damages in individual actions provide sufficient deterrence without allowing for class actions under Federal Rule 23 of the Federal Rules of Civil Procedure, this comment is addressed in Part VI above, which finds that application of the rule to class actions, including those seeking statutory damages, is in the public interest and for the protection of consumers.

[1240] One industry commenter and an individual commenter suggested the Bureau examine class arbitration as a potential alternative to the class rule. The industry commenter stated that consumers might be able to receive higher recoveries in class arbitration, but recognized the "little or no data available," and did not explain why consumers might be able to receive higher recoveries. This is discussed in detail in the section-by-section analysis of § 1040.4.

[1241] Two industry associations suggested that the Bureau allow arbitration agreements to block consumers from participating in class actions unless they had exhausted an internal dispute resolution process. This approach, however, would not only make it more difficult for consumers who recognize that they have been harmed to obtain legal relief to which they are entitled, but would foreclose relief on behalf of consumers who do not recognize that harm has occurred. Even if such a system would result in equal amounts of redress for consumers who recognize their injuries, the Bureau believes it would result in far less deterrent effect and therefore produce far less benefit than the final rule.

class rule of promoting more effective compliance and remediation for non-compliance with laws providing for a private right of action applicable to covered consumer financial products and services, while minimizing any significant burden on providers.

One Member of Congress suggested the Bureau consider limiting the percentage of attorney's fees that an attorney can demand "in a lawsuit." However, the Bureau does not believe that lawsuit complaints typically state the amount of attorney's fees sought. Thus, such an alternative would amount to introducing a new pleading requirement on consumer class actions or a cap on the fees that could be awarded at the settlement stage – something that is the province of Congress and the courts and would not be appropriate for the Bureau to regulate. Moreover, the Bureau does not believe information needed to estimate the attorney's fees sought is reliably available at the outset of a case. As the Study showed, the dollar value of consumer harm and the size of the class are rarely pleaded in consumer class complaints.[1242] The Bureau believes this is because this information is generally not reliably available at the outset of a case. The size of the class often is not determined until the settlement approval and administration process. Finally, in most consumer protection statutes that allow for recovery of attorney's fees, the rules for attorney's fees do not specify a cap. The Bureau believes there would be little basis for identifying a generic cap that would apply across all cases that are impacted by this rule. For these reasons, this policy option seems infeasible.

*Potential Alternatives Involving Disclosure, Consumer Education, Opt-in, or Opt-out Requirements*

[1242] *See* Study, *supra* note 3, section 6 at15 n.36 and 23 n.42.

Several industry commenters suggested that instead of prohibiting firms from using pre-dispute arbitration agreements to bar class actions, the Bureau should instead require firms to give consumers more choice regarding whether and how they enter into arbitration agreements. These proposals took a variety of forms, including requiring firms to allow consumers to either to opt in to or opt out of pre-dispute arbitration agreements, a mandated disclosure of the existence and details of an arbitration agreement, and consumer education initiatives.

The Bureau discusses its concerns with each of these variations in turn below. However, the fundamental problem with this class of potential alternatives is that it does not address the market failure that the rulemaking is intended to address – the fact that consumers often lack awareness that they have a legal claim and, moreover, that when they are aware of such claims, many are negative-value claims that cannot practicably be pursued in any formal dispute resolution forum (whether litigation or arbitration) on an individual basis. Both of these factors reduce firms' incentives to comply with the laws (and thereby correct the market failures the laws were enacted to address).

Moreover, because the market failure identified in this rule relates to what happens when a claim does arise (and the consequences for compliance and remedies), it cannot be ameliorated by increasing consumers' knowledge and understanding *ex ante* of entering into arbitration agreements before these claims arise. The weak individual incentives for consumers to pursue these claims lead to weakened incentives for firms to comply with the law. While the Study revealed that many consumers lack awareness of arbitration agreements, and it is likely true that consumers are rarely able to make an informed choice to avoid entering into an arbitration agreement if they wish to, remedying this problem would not be sufficient to correct the market failure which is the focus of this rulemaking. Increased information and choice about arbitration

agreements cannot increase consumers' knowledge of their claims, change the small value of the claims, or reduce the effort consumers must exert to pursue these claims in a way that would render them positive value, and thus address the market failure.[1243] Class actions, in contrast, take these net negative costs, centralize them with one entity already familiar with the legal process who pursues the claim, and distributes net proceeds if the valid claim provides a net positive return. Consumers who are class members need to expend virtually no time in this process. The class attorneys may pass their fees on to consumers, but even when doing so, that does not render the claims net negative; consumers still receive positive payout amounts after accounting for legal fees, with little or no expenditure of their own time or money.

None of the commenters that suggested these potential alternatives articulated how the proposed alternatives would accomplish the Bureau's goals.[1244] As such, the Bureau believes that none of the suggested alternatives aimed at improving consumer choice will achieve the goals of the rulemaking.[1245]

With respect to the specific alternatives suggested, the Bureau received some comments that suggested the rule could mandate opt-out agreements that could allow consumers to remove themselves from the obligation to pursue individual arbitration in lieu of participating in a class

[1243] Indeed, the value of the time necessary for consumers to learn about the arbitral process, learn enough about consumer law to understand when they have a valid claim, and finally initiate and pursue the arbitral process to completion will likely often exceed the value of the claims discussed in the market failure section. A common way to measure the value of consumers' time is using their wages. At the 2015 U.S. median wage of $17.40, a process requiring several hours of time will be more costly than forgoing a claim with expected value of $100 or less.

[1244] One industry commenter stated that its proposed alternative would allow consumers to choose for themselves whether they prefer arbitration or litigation. As noted above, consumers' preferences over the forum for individual dispute resolution are not the focus of the rulemaking – the market failure in question is a problem of collective action. Other commenters simply said that the Bureau should have considered the suggested alternative without further explanation.

[1245] The Bureau is in general concerned about consumer awareness of contract terms and the ability of consumers to make informed choices about consumer financial products and services. Several industry commenters have noted certain public statements about transparency and consumer choice in the context of arbitration agreements. Nonetheless, as the rulemaking record reflects, the lack of transparency and choice regarding pre-dispute arbitration agreements is not the rationale for the class action provision of the final rule.

action.[1246] One credit union industry commenter argued that consumers should have this opportunity as a right, while a credit union trade group also promoted it under the rubric of providing consumers with more choices. Another industry commenter offered that opt-outs make sure consumers are not "forced" into arbitration. An industry trade association commenter, under similar logic, maintained that the Bureau did not adequately consider the potential of a combination of consumer education and opt-outs. Another industry trade association commenter argued that knowledgeable consumers might choose not to opt out because they decide that arbitration is superior to individual or class action litigation. Finally, an industry commenter and a research center cited an example from the 1990s where a provider offered a price discount to existing customers who chose not to opt out of a new arbitration agreement. These commenters suggested that this could allow consumers to choose what is more important to them: price or non-arbitration dispute options.

For many of the same reasons already discussed, the Bureau believes that requiring opt-out arrangements would not meet the objectives of the proposal because they would not alleviate the market failure that the class rule seeks to address. Opt-out agreements will not make consumers aware they have a legal claim in the future, nor will such agreements make negative-value claims worth pursuing. The timing of decisions becomes a factor as well – consumers generally choose whether to be part of an arbitration agreement at the outset of their customer

[1246] In an opt-out agreement, the default for consumers is that they would be subject to the arbitration agreement if they become a party to the contract. However, the provider would allow consumers to "opt out" of the arbitration agreement so that that part of the contract would not apply to them. If the arbitration agreement could be used to block a class action, only those consumers who opted out would be able to file or participate in a class action. Any class settlement would not apply to those consumers who did not take the affirmative step to opt out of the arbitration agreement.

relationship, while firms make compliance decisions continually over time.[1247] As such, there is no reason to believe that opt-out provisions would materially influence firms' compliance decisions, nor did commenters suggest that they would. Further, a number of providers in markets for consumer financial services used opt-out agreements in the course of adopting their current arbitration agreements, but the Study showed that very few consumers are aware whether they have arbitration agreements in their contracts. This suggests that such regimes are subject to many of the same awareness and effectiveness issues discussed below with regard to disclosures.

Furthermore, even if the Bureau's goals in this rulemaking was to enhance informed consumer decision-making with respect to the potential risks and benefits of entering into adhesion contracts that contain arbitration agreements, there is reason to doubt that mandated opt-out provisions would be effective in promoting informed consumer decision-making, even if coupled with consumer education or improved or additional disclosures. Although there is limited evidence specific to the context of arbitration, there is extensive academic literature showing that consumers frequently do not opt to leave a default option, even if it would be advantageous for them to do so.[1248] In this respect an opt-out regime would only marginally increase firms' class action exposure relative to the *status quo*.[1249] The commenters that suggested that mandatory opt-out provisions did not provide any evidence that consumers would

[1247] An exception would be if firms add an arbitration clause to their existing contracts and notify consumers of the opportunity to opt out at that time. Even then, the provider's compliance decisions are made over time after the opportunity to opt out.
[1248] *See* Stefano DellaVigna, "Psychology and Economics: Evidence from the Field," 47 J. Econ. Lit. 2 (2009) (for a review of this literature).
[1249] For instance, auction site eBay engineered its opt-out provision specifically as a means of shielding the company from class action liability, and achieved a very low opt-out rate. Ted Frank, "Class Actions, Arbitrations and Consumer Rights: Why Concepcion is a Pro-Consumer Decision," MI Report (Feb. 19, 2013). One commenter cited this report as an example of consumers being happy with arbitration clauses, an argument that is at odds with the source material.

be any more likely to opt-out of arbitration agreements, compared to opt-outs in other contexts, offering only that consumers sometimes take advantage of existing opt-out provisions.[1250]

In a related series of comments, industry commenters, trade associations and a nonprofit commenter also suggested that the Bureau mandate new disclosures to accompany arbitration agreements that block class actions as an alternative to the class rule. These commenters focused on the problem of lack of consumer awareness about the possible future consequences of entering into an arbitration agreement. In support, these commenters cited to the Bureau's lack of consumer education on arbitration and the Bureau's support of improved disclosure in other contexts. The Bureau's primary focus in this rulemaking, however, is not the problem that improved disclosure purports to fix. Thus, the market failure this rule seeks to address would remain even if the Bureau mandated the best possible form of disclosure proposed by some commenters, including, among other features, plain language and large, clear fonts on pages separate from the rest of the financial contract, coupled with increased consumer education efforts (whether by the providers, regulators, or both). Moreover, as discussed in Part VI, above, the disparity in numbers between the few hundred consumers who currently pursue individual claims in arbitration and the tens of millions annually who are part of a putative class makes it difficult to imagine that any kind of information intervention could bridge the difference.

In any event, there is reason to doubt that disclosures would be very effective in raising consumer awareness, even coupled with consumer education or mandated opt-out provisions. The Study indicated that current consumer understanding of arbitration agreements is low.[1251]

[1250] The Bureau acknowledges that mandatory opt-in or opt-out policies have been set by regulation in consumer financial regulation, most notably Regulation E's opt-in regime for overdraft services. 12 CFR 1005.17(b).
[1251] Despite contract language and placement that is not dramatically different from that of other contract provisions.

The Bureau believes that even with the most effective disclosures and education it is unlikely that many consumers could, at the outset of a customer relationship, anticipate that the provider will act unlawfully not only to the consumer but to a putative class, and accurately assess the value of these dispute-resolution rights in a hypothetical future scenario.[1252]

In sum, the Bureau believes it is unlikely that firms would be able to implement an opt-out program that is effective at enabling informed choices. But more importantly, as noted above, a lack of consumer awareness and choice regarding pre-dispute arbitration clauses is not the market failure that the rule is trying to address, and even without the problems detailed above, disclosures or opt-in/opt-out provisions will not address the market failure of insufficient deterrence.

*Potential Alternatives Involving Features of the Arbitration Process*

Some commenters suggested alternatives aimed at making individual arbitration easier, cheaper, or more desirable to consumers. These included proposals intended to lower the costs of arbitration, reduce barriers to entry, or increase the potential value of consumers' claims. The premise of these alternatives is that small dollar claims would be easier for consumers to prosecute as a result of these changes, the demand for individual arbitration would increase, and class action litigation would not be necessary.

[1252] *See* Study, *supra* note 3, section 3 at 16-23. Two individual commenters suggested the rule could mandate opt-in arbitration agreements that could be used to block class actions only for consumers who actively consented to be a part of that agreement. Neither commenter seemed to envision that many consumers would actually opt in. An industry commenter suggested that the rule should allow companies to offer either opt out or opt in. A State attorney general commenter noted that consumers generally lack awareness of opt-out regimes, and also observed opt-in regimes are fair and reasonable but did not actually suggest that the Bureau adopt such a rule. Because the Bureau believes that it is unlikely that many consumers would actively opt in to a pre-dispute arbitration agreement absent inducement, in principle such an alternative could achieve much of the benefits of the final rule. However, the Bureau believes that consumers will face the same difficulties in making an informed decision to opt in as they would to opt out. The Bureau is also concerned that providers would raise prices and offer equivalent small incentives to induce consumers to opt in. Because of the difficulty in making an informed decision to opt in or opt out of pre-dispute arbitration agreements, such incentives might have sufficient take-up to effectively shield providers from class action exposure, undermining the goals of the rule.

Specifically, the commenters suggested that the Bureau mandate that providers incorporate certain features into their arbitration agreements such as advancement of filing fees and legal costs to consumers when they bring a claim; improving consumers' knowledge and understanding of the arbitration process for purposes of enabling them to file a claim in the event of a dispute; requiring easily accessible venues for arbitrations such as online forums and online filing of documents; and providing for rapid adjudication. These features all would, in the view of the commenters, lower the costs of entry to arbitration, so that fewer claims are negative-value claims. For purposes of this analysis, the Bureau considers all of these cost-reducing alternatives jointly as one alternative.

As an initial matter, even if demand for individual arbitration increased enough to be as strong a deterrent to illegal behavior as class action litigation, it is far from clear that this would reduce the burden to industry as compared to the class rule. The Study found only a few hundred claims related to consumer financial products filed each year by consumers, compared to millions who were part of a putative class. Even if only a small fraction of affected consumers filed arbitration claims, this would be several orders of magnitude more than firms currently face. A thousand-fold increase in individual arbitration claims could be more expensive to defend against than class actions. Moreover, even under ideal circumstances individual arbitration is not suited to providing prospective conduct relief.[1253]

That being said, the Bureau believes that reducing the costs of individual arbitration, while a laudable goal, would not increase demand for individual arbitration enough to provide a

[1253] In principle, a firm might change its general practices in the face of a large number of successful arbitration claims. In practice, a firm is likely to have a substantial number of informal complaints about a practice, either made to the firm's customer service or through other venues such as the Bureau's complaint database, well before any large number of individual arbitration claims accrue. The Bureau believes it is unlikely that there are a substantial number of firms that would voluntarily change their practices in response to a large volume of arbitrations but would not already do so in response to the previous volume of informal complaints.

deterrent that would substitute for class action exposure. First, improved access to individual arbitration does nothing for consumers who are not aware that they have a legal claim. Second, the Bureau notes that many of the features suggested by commenters are already relatively common in arbitration agreements,[1254] yet the Bureau's Study showed that there were few individual claims filed in arbitration. This suggests that there is a systemic limit to what consumers acting on their own will be willing or able to do to address their concerns, even when they are aware of a problem and have access to a low-cost means of pursuing redress.

The Bureau also considered, in combination with the cost-reducing potential alternatives discussed above, an intervention suggested by an industry commenter and a nonprofit commenter that, in their view, would increase the perceived value of claims brought in individual arbitration. Specifically, commenters suggested that the Bureau mandate that arbitration agreements include clauses that provide for some additional payment to consumers in cases in which four conditions are satisfied: a company makes a settlement offer to the consumer, the consumer rejects the offer, an arbitrator makes an award in favor of the consumer, and the award provides for relief that exceeds the amount of the settlement offer. The premise of this intervention is that it would shift the balance of costs and benefits for consumers with a claim, increasing the demand for arbitration. However, although the commenters pointed to examples of these types of policies in existing agreements, they did not identify evidence that consumers actually pursue individual arbitration more often in response to the presence of such clauses, nor is the Bureau aware of any.

[1254] Study, *supra* note 3, section 2 at 31.

As with the cost-reducing options discussed above, the Bureau notes that conditionally increasing the payout to consumers from individual arbitration will not make consumers aware that they have a claim if they were not otherwise aware. Moreover, and for similar reasons as in the discussion regarding statutory damages in Part VI (whether providing for minimum recovery or punitive damages), the Bureau disagrees that the additional incentives would be large enough to persuade large numbers of consumers to pursue claims that they are aware of and that today they decline to pursue. In order for these incentives in arbitration agreements to make an impact, consumers must both be aware that they have a claim and believe an otherwise small claim also presents a meaningful opportunity for additional recovery. As to the latter, the Bureau does not believe these contract awards meaningfully increase the expected value of claims at the time consumers decide whether to pursue them. First, consumers must evaluate the potential likelihood of an arbitrator finding in their favor. Second, they must condition their expected additional payout on the likelihood that the firm will provide a settlement offer before judgment. Third, they must evaluate the likelihood that the firm will provide a settlement offer lower than the payout that might in the future be awarded by the arbitrator. Thus, any supplemental payout is contingent on decisions made by the consumer, the firm, and the arbitrator, and the actual expected supplemental payout is the value of that supplemental payout times these three separate probabilities, since a specific contingent outcome must occur in each of the conditions. That expected award, as it is a factor of several values less than or equal to one, is likely to be very small and difficult to accurately estimate. Because the resulting expected payout will still be small, it is unlikely that a low probability of a supplemental payment will make an otherwise negative-value claim positive even for a risk-neutral consumer. This expected payout is also only considered by the subset of consumers who understand they have a pursuable claim. Thus,

the Bureau does not believe that conditional contract awards would increase the demand for arbitration beyond the other options already described above, which also are insufficient to replace class actions for the reasons discussed above.

*Safe Harbor for Conduct Reviewed by, or Self-Reported to, Government Regulators*

The Bureau generally considered potential alternatives related to public enforcement in the proposal, but received comments only on one particular potential alternative.[1255] Three industry commenters and their trade associations urged the Bureau to adopt a safe harbor or exemption from the class rule for conduct that has been reviewed by, or been self-reported to, government regulators as promoted by the Bureau's Bulletin on Responsible Business Conduct.[1256] Under this potential alternative, the class rule would not apply to a class action concerning such conduct. As a result, an arbitration agreement could be used to block such a class action.

These comments stated that this potential alternative would reduce firms' exposure to unmeritorious cases because unlike class action attorneys, public regulators bring more meritorious cases. These commenters also stated consumers would benefit more because public regulators achieve more meaningful relief for consumers than class action attorneys, and do not charge their attorney's fees to providers. Accordingly, in the commenters' view, as long as a public regulator is aware of an issue, there is no need for class actions.

The commenters further argued that this alternative would address the market failure this rule seeks to address (reduced incentive to comply with the law) because it would not allow

[1255] 81 FR 32830, 32922 (May 24, 2016).
[1256] Bureau of Consumer Fin. Prot., "Responsible Business Conduct: Self-Policing, Self-Reporting, Remediation, and Cooperation," *CFPB Bulletin*, No. 2013-06 (June 25, 2013) (calling upon companies to take responsible conduct including "promptly self-report[ing] to the Bureau when [they] identif[y] potential violations").

arbitration agreements to eliminate exposure. Rather, it would only allow companies to eliminate class exposure if they were willing to create public enforcement exposure (by self-reporting) or already are subject to public enforcement exposure (by virtue of a regulatory review of their conduct). The commenters also asserted that the alternative would accomplish the Bureau's goals with a reduced burden because providers would be able to block class actions which assert non-meritorious claims that public enforcement was not willing to assert, as well as follow-on class actions that in the commenters' view are unnecessary when public enforcement has already resolved the problem.

The Bureau acknowledges that public enforcement can be more efficient than private actions at achieving redress for consumers, compared to private actions. However, as discussed in Part VI above, due to resource constraints and limits on legal authority there are a number of reasons that a regulator may not pursue an action, or may achieve less than full redress, in spite of the merits of the underlying claims. This may particularly occur for violations with relatively low aggregate harm, as a regulator should reasonably prioritize a case with harm to thousands of consumers over one with harm to hundreds, even if consumers in both groups suffer equal individual harm. In addition, regulators are only authorized to bring certain types of legal claims. As such, providing a broad safe harbor for conduct self-reported to or investigated by public regulators would undermine the goals of the rule by removing the deterrent effect of class actions for such claims that public regulators cannot bring or reasonably prioritize.

Even if this were not true, the Bureau believes that the safe harbor articulated by the commenters would be infeasible in practice. Below the Bureau describes the problems with implementing the potential alternative suggested by the commenters. The Bureau also considered a more limited version of a safe-harbor for self-reporting, described below, but

concludes that this would not provide a substantial reduction in burden, and would also be inconsistent with the goals of the rule.

Considering the version of the potential alternative proposed by commenters, the essential problem is that the mechanism to trigger the safe harbor is unworkable. To begin with, allowing a safe harbor to be raised in private litigation for conduct that is the subject of a regulatory investigation is incompatible with the procedures of such investigations.[1257] The broad exemption for self-reporting envisioned by the commenters is problematic as well. The commenters seem to intend that a self-report of any conduct involving any potential legal claims to any regulator would suffice to trigger the safe-harbor. However, the Bureau believes this level of flexibility would in practice undermine the goals of the rulemaking, effectively giving the provider an option for drastically reducing the deterrent effect of class actions by terminating private claims that could not legally or practicably be brought by the agency that receives the self-report. Providers could choose to report a violation to a regulator that does not enforce the relevant law, does not have jurisdiction, or does not prioritize enforcement of that law. For instance, the final rule will apply to all financial institutions, but pursuant to Dodd-Frank section 1026 the Bureau does not have enforcement authority over depository institutions with assets of $10 billion or less and its supervisory authority with respect to such institutions is limited to information gathering, and would be unable to act on a self-report from such an entity. Similarly, it is possible that a provider facing a class action in State court regarding treatment of

[1257] In order for a provider to invoke the suggested safe harbor, the regulatory action and its scope would have to be disclosed to the court in the motion to compel arbitration. However, it is difficult to understand how a provider could accurately describe the scope of a regulator's investigation to a court, as regulators do not typically explain the full scope of their investigations to the targets of those investigations. Nor would it be appropriate to put the regulator in the position of providing information about its confidential investigations in the context of a private lawsuit. This would further place a strain on their limited resources and thus may interfere with their enforcement priorities. Further, the investigations of many regulators besides the Bureau are confidential to preserve the integrity of the investigation. In many cases this confidentiality is required by statute. Thus, the Bureau does not believe that it would be feasible for a safe-harbor to be based upon ongoing investigation activity.

a class of consumers in that jurisdiction could report to that State's regulator only upon receiving the lawsuit, effectively removing its national liability in the process. It is also possible that a provider could report a violation to a regulator with a mission that is primarily focused on its safety and soundness and not on the protection of consumers.

Given the difficulties with a broad exemption for conduct self-reported to regulators, the Bureau also considered a more limited potential alternative. Specifically, the Bureau considered a safe-harbor for conduct violating a Federal consumer financial law (FCFL) enforced by the Bureau against the reporting person, which is reported to the Bureau. This potential alternative would avoid the issues discussed above that make the version proposed by commenters infeasible. Confidential investigations would not be implicated, and the Bureau would have legal authority to pursue an enforcement action if warranted. However, the Bureau's practical ability to pursue enforcement actions would still be subject to resource and prioritization constraints. Moreover, in light of the more limited scope of the safe harbor, the Bureau believes that this narrower safe-harbor would not provide a substantial reduction in burden to providers, while at the same time harming the goals of the rule by reducing deterrence for some violations of FCFLs.

Specifically, the Bureau believes that a safe harbor for conduct reported to it might decrease but would not minimize the burden of the rule on providers. While under the potential alternative making a self-report would shield a firm from class-action liability for FCFLs, it would not shield the firm from class-action liability under other claims. As the Study noted, more than 63 percent of Federal court class actions in selected markets asserted State law

claims.[1258] The fact that such residual exposure would exist suggests that in a substantial majority of cases, companies could not block a class action as a result of the exclusion, but instead could only block certain claims in a class action (*i.e.*, claims of FCFL violations). As a result, at best the exclusion would only allow providers to gain leverage over certain potential class claims, rather than avoid class litigation entirely.[1259] Indeed, the benefits would probably be the smallest from frivolous class action lawsuits, as, all else equal, these are more likely to be brought with a variety of claims.

As a result, rather than reducing the burden to providers from frivolous lawsuits, the potential safe-harbor would instead compromise the deterrent effect of the rule. The Bureau believes this would primarily occur for law violations with relatively low aggregate harm. The Bureau's enforcement resources are limited, and the Bureau may not be able to bring enforcement actions in cases with low aggregate harm, even if an action would be justified in a world with unlimited resources. The proposed safe-harbor would thus block class actions with limited countervailing risk of public enforcement, lowering deterrence. In contrast, for violations with large aggregate harm, a self-report would also increase the likelihood of public enforcement by the Bureau, perhaps substantially. As a result, the Bureau believes that firms would only make an additional self-report if the avoided risk of class action liability outweighed the increased risk of Bureau action. Given these competing risks, the Bureau does not believe

[1258] Study, *supra* note 3, section 6 at 19.

[1259] The Bureau also notes that to the extent that the proposed alternative reduces firms' class action liability, the need to litigate over the applicability of the exemption counteracts some of the reduction in burden. Parties would likely incur new costs and time delays in litigating arbitration motions, trying to figure out whether the subject of a class action (and the related size and scope of the class) matched the subject, size, and scope of the defendant's self-report. Currently, it already takes companies a significant amount of time to persuade a court to grant a motion to compel arbitration terminating a class action. According to the Study (Section 6 at table 7), this took on average almost 500 days. Under the potential alternative, courts would need to determine several additional complex issues, extending the time and cost of litigating a motion to compel arbitration. Moreover, uncertainty over how courts would make these determinations would only reduce the potential for increased self-reporting in the first place. Finally, resolution of any claims that were not compelled to arbitration would have been delayed, potentially substantially, which would not serve the consumer protection goals of the rule.

most providers would see sufficient benefit from the alternative to outweigh the costs of exercising it for serious violations of the law, save for cases where the provider would self-report anyway.[1260] On balance, the Bureau believes that the potential alternative at best would have no effect on overall deterrence and compliance with the law, and at worst will have a deleterious effect on compliance.[1261]

To summarize, after further consideration and for the reasons outlined above, the Bureau does not believe that a self-reporting exemption, including the one suggested by commenters, would be workable or promote the goals of this rulemaking. And while the Bureau has considered a narrower alternative that might be more workable as a practical matter, that alternative does not appear likely to reduce burden without compromising the ability of the rule to provide deterrence for certain violations, and thus also seems unlikely to accomplish the Bureau's goals.

## 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

[1260] The Bureau also notes that potentially even this narrow exemption could be abused by firms who "self-report" information they accurately believe is already known to the Bureau. Such superfluous self-reports would not have any effect on firms' compliance decisions, nor on public enforcement – in such cases the Bureau's decision of whether or not to bring a case would not be altered by the nominal self-report. While in principle the potential alternative could carve out information that is already known to the Bureau or publicly available, this would require the Bureau to become involved in the court's decision whether to allow the arbitration agreement to block the class action, by verifying that the self-report contained new information or was otherwise made in good faith. For example, under the Bureau's Responsible Conduct Bulletin, it assesses whether the company "voluntarily disclosed material information not directly requested by the Bureau or that otherwise might not have been uncovered." The Bureau does not believe it should be required to make this assessment in the context of private litigation.

[1261] One industry commenter suggested that the Bureau could make the safe harbor temporary, *i.e.*, until the Bureau completed its investigation. However, the Bureau does not believe that approach would be feasible. Arbitration agreements are used to obtain stays or dismissal of class actions in favor of arbitration. Thus, there is currently no procedure for using an arbitration agreement as a basis for obtaining a general stay on the class litigation, without also proceeding to arbitration. Yet if arbitration of the named plaintiff's claim on an individual basis proceeded, this would not preserve the status quo of the class action during the pendency of the Bureau's investigation. Alternatively, if the arbitration agreement were used to dismiss the class claims during the temporary period, this would raise complex questions under statute of limitations laws, which could preclude refiling of the case after the Bureau's investigation.

any rule subject to notice-and-comment rulemaking requirements.[1262] These analyses must "describe the impact of the proposal on small entities."[1263] An IRFA or FRFA is not required if the agency certifies that the proposal will not have a significant economic impact on a substantial number of small entities.[1264] 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.[1265]

In the proposal, the Bureau did not certify that the proposal 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 SBREFA to consider the impact of the proposal on small entities that would be subject to the rule and to obtain feedback from representatives of such small entities. The Small Business Review Panel for the proposal is discussed in the SBREFA Report. The proposal also contained an IRFA pursuant to section 603 of the RFA, which among other things estimated the number of small entities that would be subject to the proposal. In this IRFA, the Bureau described the impact of the proposal on those entities, drawing on the proposal's Section 1022(b)(2) Analysis. The Bureau also solicited comment on any costs, recordkeeping requirements, compliance requirements, or changes in operating procedures arising from the application of the proposal to small businesses; comment regarding any Federal rules that would duplicate, overlap, or conflict

[1262] 5 U.S.C. 601, *et seq.*
[1263] 5 U.S.C. 603(a). For purposes of assessing the impacts of the proposal 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 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).
[1264] 5 U.S.C. 605(b).
[1265] 5 U.S.C. 609.

with the proposal; and comment on alternative means of compliance for small entities. Comments that addressed the impact on small entities are discussed below. Many of these comments implicated individual provisions of the final rule or the Bureau's Dodd-Frank Act Section 1022(b)(2) Analysis discussion and are also addressed in those parts.

Similar to its approach in the proposal, the Bureau is not certifying that the final rule will not have a significant economic impact on a substantial number of small entities. Instead, the Bureau has completed a FRFA as detailed below. However, the Bureau continues to believe that the arguments and calculations outlined both in the Section 1022(b)(2) Analysis and the FRFA below, as well as the comments received on the IRFA, strongly suggest that the final rule will not have a significant economic impact on a substantial number of small entities in any of the covered markets.

*1. Statement of the Need for, and Objectives of, the Final Rule*

As the Bureau outlined in the SBREFA Report and discussed above, the Bureau considered a rulemaking because it was concerned that by blocking class actions, arbitration agreements reduce deterrent effects and compliance incentives in connection with the underlying laws. The Bureau was also concerned that consumers do not have sufficient 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. Finally, the Bureau was concerned about the potential for systemic harm if arbitration agreements were to be administered in biased or unfair ways. Accordingly, the Bureau considered 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. The 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.[1266]

*2. Statement of the Significant Issues Raised by the Public Comments in Response to the IRFA, a Statement of the Assessment of the Agency of Such Issues, and a Statement of Any Changes Made as a Result of Such Comments*

In accordance with section 603(a) of the RFA, the Bureau prepared an IRFA. In the IRFA, the Bureau estimated the possible compliance costs for small entities with respect to each major component of the rule against a pre-statute baseline. The Bureau requested comment on the IRFA.

Very few commenters specifically addressed the IRFA. A number of commenters suggested potential alternatives, some but not all of which were intended to reduce the burden of the rule on small entities. The Bureau discusses comments relating to a small entity exemption below, in section 6 of this FRFA. The Bureau discusses comments relating to other potential alternatives in Part VIII, above. As noted in those sections, the Bureau has decided not to adopt any of the potential alternatives suggested by commenters, as the Bureau believes that these potential alternatives will not substantially reduce burden to providers without compromising the objectives of the rule.

[1266] 12 U.S.C. 5518(b).

Several insurance industry commenters and their trade associations and an association of State insurance regulators expressed concern regarding whether, in the IRFA, the Bureau had even considered potential effects of the proposal on life insurers that may offer other consumer financial products or services. As is explained above in the section-by-section analysis of § 1040.3(a)(1), although an insurance company could be covered by the rule to the extent that it offers consumer financial products that are not part of the business of insurance, the Bureau believes it is unlikely that there are many, or even any, such firms.

*3. Response to the Small Business Administration Chief Counsel for Advocacy*

In the FRFA, the Bureau has taken into account feedback received in interagency communications with the SBA.

*4. Description of and Estimate of the Number of Small Entities to Which the Final Rule Will Apply*

As noted in the SBREFA Report, the Panel identified 22 categories of small entities that may be subject to the proposal. 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:

**Table 2: SBA Small Entity Thresholds**

| **NAICS Description** | **NAICS Code** | **SBA Small Business Threshold** |
|---|---|---|
| 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<br>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 will be covered. 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).[1267] 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.[1268]

NAICS numbers were taken from the 2012 Economic Census, the most recent version available from the Census Bureau. The data provided employment, average size, and an estimate

[1267] The Bureau also used data from the Census Bureau, including the Census Bureau's Statistics of U.S. Businesses.
[1268] *See* Small Bus. Admin. Off., "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.

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 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.[1269] For the markets covered in Section 2 of the Study

[1269] 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

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.[1270]

The table below sets forth affected markets (and the associated NAICS codes) in which it appears reasonably likely that more than a few small entities use arbitration 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.

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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, and Cable Television. The Bureau also started work on a few other markets before determining that the results were unlikely to be sufficiently representative for the purposes of this analysis.

[1270] 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, GPR 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 to 20 percent, 20 to 50 percent, 50 to 80 percent, and 80 to 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 to 20 percent).

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 final rule will 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.[1271] However, the Bureau believes that arbitration agreements are not prevalent in the consumer mortgage market.[1272] With respect to brokering of credit more broadly, the Bureau also 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 requested these data and data on the use of contracts and on the prevalence of arbitration agreements by these providers, but did not receive any responses.

Merchants are not listed in the table because merchants generally will not be covered by the final rule, 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

[1271] NAICS 522292 is similarly excluded from estimates.
[1272] Since 2013, Bureau regulations have prohibited using PDAAs in most types of consumer mortgages. *See* 12 CFR 1026.36(h)

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.[1273] In those rare circumstances (for example, acting as a TILA creditor due to lending with a finance charge), then the merchants will be covered by the final rule 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 requested comment and data on the frequency of these transactions, by industry, but did not receive any response.

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 final 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 that are immune from suit as an arm of the State will 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.[1274]

[1273] However, the Bureau includes buy-here-pay-here automobile dealers in the table below.
[1274] 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).

Further, the final rule will 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 will 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.[1275]

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 automobile lenders with the Sales Financing category (NAICS 522220).

This analysis 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).

Small government entities at the State and local level, in theory, also could be affected to the extent they use arbitration agreements and are not an arm of the State. The Bureau does not

[1275] *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.*

have data indicating such use of arbitration agreements by such small government entities is widespread, however, and the Bureau did not receive any comments from these governmental providers, even though the proposal did not call for their complete exemption.[1276]

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. The Bureau requested comment on this issue, and no commenters disputed this assertion.

Some merchants extending consumer credit with no finance charge may use third parties to service these transactions, as an industry trade association noted in its comment. Whether affiliated with the merchant or not, those persons may be covered by § 1040.3(a)(1)(v). When the merchant uses a pre-dispute arbitration agreement, there is a possibility that agreement could apply to third parties such as a servicer, depending on the facts and applicable law. The commenter did not provide data on how often such credit is extended, how often the merchants extending such credit use third parties to service it, how often the merchants use pre-dispute arbitration agreements, or how often the servicers may be covered by such agreements. The Bureau is not in a position to estimate how many third-party merchant servicers may be included in this coverage and as such does not include them in the table below.

[1276] The Bureau received a number of comments from Tribal government entities involved in the small-dollar credit industry. The impact on those entities is captured in the table below. Note, however, that the figures in the table may somewhat overstate the number of such entities, as the final rule exempts entities that are an arm of a Tribal government, which may include some small-dollar credit providers.

Finally, the final rule expanded the scope from the proposal to include providers of credit repair services even when these services were unrelated to debt settlement (which was covered by the proposal). However, the Bureau believes that these credit repair providers were already counted in the table below under NAICS code 541990, and no update to the table is needed in that respect.[1277]

[1277] According to a GAO report, in 2015 there were about 50 to 60 companies providing identity theft services, including credit monitoring. (GAO Report. No. 17-254 (Mar. 2017) at 6-7. As the GAO noted, no agency or trade association collects comprehensive data on the industry and census data classifies identity theft protection services in a catch-call category (NAICS 812990) for "other personal services" that includes about 50 different types of services ranging from astrology services to wedding planning. Accordingly, both because of the number of providers estimated by GAO and because of the inability to estimate the number using Census data, credit monitoring is not separately listed on the table below, except for the counting of consumer reporting agencies, which are significant participants in this market.

| 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** | **Estimated Midpoint of Businesses Using Arbitration Agreements** |
| All Other Nondepository Credit Intermediation | 522298 | Other Personal Loans, Pawnshops | 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 (including credit unions), Student Loan Servicing | 13,303 | 11,608 | $550m 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, Credit Monitoring, Homeowners Insurance | 3,383 | 3,063 | $15m in revenue (Credit Bureaus)/1500 Employees (Direct Property and Casualty Insurance Carriers) | 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 | 9,156 | 8,966 | $25m in revenue | 80-100% | 8,069 |
| Wired and Wireless (except Satellite) Telecommunications Carriers | 517110 and 517210 | Telephone - landline, Cable Television, Cable Providers (First Party), Cell Phones | 7,756 | 7,528 | 1500 employees | 80-100% | 6,775 |
| Note: Some of the counts in this table may be over inclusive. For more precise descriptions of many of these NAICS codes and which entities covered by the codes are subject to the rule see the accompanying text. | | | | | | | |

*5. Projected Reporting, Recordkeeping, and Other Compliance Requirements of the Proposal, 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*

As discussed above in the Section 1022(b)(2) Analysis, the providers that use arbitration agreements will 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.[1278] 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 entity'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 entities that use arbitration agreements.

Additionally, as discussed above, debt buyers and other consumer financial services 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 § 1040.4(a)(2), which will 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 will also be minimal since many of these providers typically send out notices for FDCPA purposes to consumers whose contracts these providers just acquired.

[1278] 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.

The final 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 identified in the markets covered by 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 Study were frequent repeat players.[1279] Each instance of reporting consists of sending the Bureau already existing documents, potentially redacting specified categories of personally identifiable information pursuant to the final rule. As discussed above, the Bureau believes that fulfilling the requirement would not require any specialized skills and would require minimal time.

The Bureau requested comment on whether there are any additional costs or skills required to comply with reporting, recordkeeping, and other compliance requirements of the proposal that the Bureau had not mentioned in the IRFA. Although a number of commenters discussed the reporting, recordkeeping, and other compliance requirements of the proposal, as discussed in the Bureau's Section 1022(b)(2) Analysis above and the Bureau's PRA analysis below, none stated that there were additional costs or skills required beyond those described above. As noted in its Section 1022(b)(2) Analysis above, the Bureau believes that the vast majority of the final 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, including foregone profit from products or services that might lead to class action exposure. The

[1279] *See* Study, *supra* note 3, section 5 at 59.

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.

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,[1280] the Bureau estimates that the final rule will 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 fees, and an additional $1 million for defendant's attorney 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. This 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.

[1280] 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 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 likely classified as large, and other debt collectors that were not SBA small at the time of the settlement were likely classified as small.

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 at 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 will 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 will not experience any of these effects.

As discussed above, these entities will also face increased exposure to State class litigation. While the Study's Section 6 reported 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 final rule will not have a significant economic impact on a substantial number of small entities within the meaning of the RFA.

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 will 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.

*6. Description of the Steps the Agency Has Taken To Minimize the Significant Economic Impact on Small Entities*

The Bureau described several potential alternatives above in the Section 1022(b)(2) Analysis. For the reasons discussed above, 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. The Bureau discussed these alternatives both for SBA small providers and for larger providers as well. In addition to the general alternatives discussed above, the Bureau further considered an exemption for small entities, which the Bureau discusses here. In the proposal, the Bureau requested comment on whether to exempt smaller entities from

the rule, including comment on how to structure any such exemption, and received a number of comments both for and against such an exemption.

A small business advocacy organization stated that the Bureau should exclude all small businesses from the class rule because, in its view, data concerning defense costs outlined in the SBREFA Report[1281] demonstrates that it is particularly costly for a small business to defend a class action lawsuit, even when the small business has not violated the law, and the Bureau has not adduced data to demonstrate that small entities are under-complying with the law. The commenter also noted observations by small businesses that they have greater incentives to comply with laws due to a greater need to retain customers.[1282]

Two credit union and community bank industry commenters also urged an exemption from the class rule for depository institutions with $10 billion or less in assets. In their view, the duty to consider the impact on these institutions under Dodd-Frank section 1022(b)(2)(A)(ii) feeds into the criteria for considering total assets of an institution for purposes of an exemption under Dodd-Frank section 1022(b)(3). These commenters stated that, in their view, institutions of this size are less likely to harm customers because of their relationship-based business model, and added that they are not subject to Bureau supervision or enforcement under Dodd-Frank. They further stated that institutions of this size have little choice but to settle class actions filed against them, because they cannot afford high attorney's fees and fear the imposition of crippling statutory damages on a classwide basis. Credit union industry commenters also emphasized that because credit unions are member owned, such costs also are passed on them

[1281] The commenter noted, for example, that SERs estimated it costs between $15,000 and $50,000 to defend a class action, that employee time is diverted, and business reputation can suffer, even when the company has done nothing wrong. *See* SBREFA Report, *supra* note 419, at 18-19 and appendix A.
[1282] *Id.* at 34.

not only as customers, but also in their capacity as owners. One credit union industry commenter also stated that exposure to class actions can lead smaller depository institutions to curtail product and service offerings. Finally, one community banking industry commenter stated that an exemption for smaller depository institutions should be adopted, since these are the institutions that are supervised and have ongoing customer relationships with incentives to treat customers fairly and, unlike certain nonbank markets such as payday lending, these institutions are not saturated already with arbitration agreements.

A consumer advocate urged against a small entity exemption because, in its view, an exemption would encourage businesses to structure their operations to avoid coverage under the class rule.

Considering the comments received and its own analysis and experience, the Bureau concludes that an exemption to the class rule for small entities would not reduce burden by any significant degree for most of the over 50,000 small entities covered by the rule because their burden is already relatively low given their low exposure to class actions. The Bureau is also concerned that such an exemption would potentially create significant unintended market distortions. Of course, any exemption to the class rule would reduce burden by allowing the exempted providers to shield themselves from class action liability. However, the Bureau has found that the rule is for the benefit of consumers and is in the public interest even after factoring in the costs that would be associated with the rule (see Part VI). In light of these findings, and the nature of the costs and benefits of the class rule, the Bureau evaluated a potential exemption

to the class rule for small entities by considering whether such entities will be disproportionately burdened by the rule, compared to large entities.[1283]

The Bureau believes that the burden to small entities from the rule will be smaller relative to their size than the burden to larger providers. First, the Bureau estimated in the proposal that the vast majority of new class actions against small entities filed per year due to the class rule would be filed against small debt collectors.[1284] The Bureau notes that an exemption for small entities would not necessarily provide a reduction in burden for small debt collectors. Debt collectors and other service providers such as payment processors typically do not enter into arbitration agreements with consumers, but instead rely upon agreements made by the original creditor. Thus, unless small debt collectors work only for small creditors, a small entity exemption would not necessarily benefit such debt collectors absent a special rule allowing small debt collectors to invoke a large creditor's arbitration clause to block a class action even though the creditor itself, or its larger service providers, could not. The Bureau believes that large firms' arbitration agreements should not have a loophole that allows small service providers to avoid the rule. To do otherwise would distort incentives in the marketplace, as large firms could outsource potential sources of liability to small subcontractors. Therefore, the Bureau believes that there is no way to exempt small debt collectors without creating a market distortion that undermines the goals of the rule.

[1283] In general, an exemption for small entities to a regulation might be justified if the benefits of applying a rule to small entities were disproportionately smaller. In the case of the class rule, the costs and benefits are inextricably linked, as the burden of class action exposure provides the primary benefit of the rule – deterrence.

[1284] As discussed above, the Bureau estimated the number of additional class actions for small entities using the same methodology as was used in its Section 1022(b)(2) Analysis. That is, the rate of class action settlements with small entities in the Study was assumed to be the same for firms with arbitration agreements. Because few class actions in the Study were filed against small entities who were not debt collectors, the Bureau correspondingly estimated few additional cases against these entities due to the proposal. The underlying low rate of class actions against small entities may reflect better practices of these entities, or reduced incentives by class counsel to bring cases, or some combination.

At the same time, in the proposal the Bureau estimated just three additional Federal class action settlements per year against small entities that are not debt collectors. Assuming the same number of State class action settlements, and four times more class actions that do not settle on a class basis, this would mean 30 cases filed against the roughly 45,000 small entities that are not debt collectors. By comparison, the Bureau estimated that there would be 22 additional Federal class action settlements against small debt collectors, the same number of State class action settlements and four times more cases that are not settled on a class basis. This would mean 220 total Federal and State Class actions filed against about 4,300 small debt collectors.

Based on the Bureau's estimate of 30 additional Federal and State class action cases against roughly 45,000 small non-debt collectors, all else being equal (and the Bureau does not assume that is the case), there is only a 1-in-1,500 chance that any given firm would face an additional class action lawsuit each year. This is substantially lower than the risk for large firms that are not debt collectors. The Bureau estimates that there are 1,740 firms affected by the rule that are not small and that are not debt collectors, and that there would be roughly 560 additional putative Federal and State class actions lawsuits filed against these firms in a typical year, or a roughly 1-in-3 annual risk of an additional putative class action lawsuit.[1285]

The Bureau acknowledges that, as some commenters and SBREFA participants asserted, it may be that the occurrence of a class action lawsuit harms small entities more than large ones. Although damage claims and payments to consumers are presumably a direct function of a firm's size in most cases, those few small entities that do face a lawsuit could feel a greater impact than

[1285] The number of additional cases for large entities follows from the Bureau's estimates in table 1, in the Section 1022(b)(2) Analysis above, and the firm counts presented in table 3. The Bureau estimated there that there would be 514 additional class action settlements across all industries over a five-year period. Deducting the 264 settlements affecting debt collectors and then dividing by five yields 50 cases. Deducting the three cases affecting small entities leaves 47 class settlements. With the Bureau's assumption of five times more cases settled on an individual basis, this makes 282 total putative Federal class cases. Assuming and equal number of putative State class cases yields 564.

any given large business that faces such a suit given that there are likely fixed costs to defending a class action lawsuit (*i.e.*, the time it takes to resolve a class action costs a certain amount in defense costs). Small entities could have fewer cash reserves to pay a judgement, or as commenters suggested, small entities may be more likely to settle because they do not have the resources to fight the class action.[1286] Nevertheless, to the extent this is true, the Bureau believes it is unlikely that small entities on net would have greater expected costs from the class rule than large entities. For this to be true, the cost to small entities from defending a class action would have to be not just larger, but large enough to account for the difference between the 1-in-1,500 annual risk of a new class action for small entities and the 1-in-3 annual risk for larger entities, or 500 times larger.

Considering the facts available to it, the Bureau does not believe the differences in burden justify an exemption for small entities. In addition, the Bureau has other concerns regarding the small entity exemption suggested by commenters.

First, the risk of a class action lawsuit, while relatively low for small entities, will nonetheless provide a measure of deterrence. In particular, small entities with poor compliance practices are more likely to be the target of a class action, but might continue their poor practices or reduce compliance further if shielded from class action liability. Moreover, as discussed above in Parts VI and VIII, due to resource constraints, regulators will tend to prioritize public enforcement actions against violations of the law with larger aggregate harms. To the extent that this entails targeting larger entities, this potentially leaves class actions as the only feasible means of redress for customers of small entities that violate the law. At the same time, the

[1286] As noted in Part VI above, courts can take into account the financial condition of the defendant both in approving settlements and imposing judgements. Thus, it is unlikely that a firm would actually become bankrupt as a result of a putative class action.

Bureau believes that consumers have no effective means of avoiding the increased risk of harm that a small entity exemption would create when dealing with small providers. The size of particular institutions and their affiliates is not generally a matter of public record let alone known to individual consumers and the Study showed consumers already do not take arbitration agreements into account when selecting providers. Thus, consumers would have little means to avoid the greater risks they may be exposed to by small providers who are not covered by the rule.

Second, the Bureau also is concerned with the potential for market distortions or unfair or potentially arbitrary distinctions that a small entity exemption could create for market participants. The Bureau does not agree with the community bank industry commenter that suggested it would be appropriate to exempt smaller depository institutions even if the Bureau does not exempt providers of the same products who are nonbanks. Such differential exposure to legal risk based on the same conduct could create market distortions of the sort that the Bureau is charged with minimizing.

Third, even if all types of market participants were eligible for a small exemption, any such exemption still would be problematic. The Bureau believes that fashioning an appropriate threshold for a small-entity exemption would impose substantial complexity, particularly around how such a threshold would address the various markets covered by the final rule. As noted, other than a request for a threshold specific to depository institutions, the Bureau received no comments on how to adopt a broad threshold that could apply to providers that provider multiple different types of products and services only some of which are covered by the rule and with a variety of corporate structures. Furthermore, the Bureau is concerned that any threshold would be difficult to apply to small entities that are service providers to larger entities. In addition,

complex legal questions would arise in situations in which a provider crossed over or dropped under the threshold after the rule takes effect.

Finally, with regard to the member-ownership structure of credit unions, the Bureau does not believe that issue pertains to the size of the credit union. Therefore, the concern expressed by commenters that credit unions already have sufficient incentives for compliance does not seem relevant to the specific issue of a potential small entity exemption.

*7. Description of the Steps the Agency has Taken To Minimize Any Additional Cost of Credit for Small Entities*

Although SERs expressed concern that the proposal 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 will not be impacted by the final rule. The Bureau did not receive any comments on this subject in response to the proposal. Although the Bureau estimates a higher likelihood that a smaller debt collector would be subject to incremental class litigation at any given time, most of these entities are already subject to class litigation due to the fact that they may or may not be able to rely on an arbitration agreement from their clients. As such, the Bureau believes it is unlikely that these firms will experience an adverse impact on their cost of credit. In any event, the Study indicated that the majority of cases filed as class actions are resolved within a few months, such that any adverse impact is likely to be only temporary.

As noted in the SBREFA Report, SERs expressed concerns about how the proposals under consideration would affect their borrowing costs. 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.

## X. Paperwork Reduction Act

Under the Paperwork Reduction Act of 1995 (PRA) (44 U.S.C. 3501 *et seq*.), Federal agencies are generally required to seek the Office of Management and Budget (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. OMB has tentatively assigned control #3170-0064 to these collections of information, however this control number is not yet active.

This final rule contains information collection requirements that have not yet been approved by the OMB and, therefore, are not effective until OMB approval is obtained. The unapproved information collection requirements are listed 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.

The Bureau believes that this final rule will 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.[1287]

The first information collection requirement relates to disclosure requirements. The final rule will require providers that enter into arbitration agreements with consumers to ensure that

[1287] *See* § 1040.5(a).

these arbitration agreements contain a specified provision, with two limited exceptions as described below.[1288] 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.[1289] The Bureau proposed this language and providers will be required to use it unless an enumerated exception applies. The Bureau will also 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 final rule.[1290] The Bureau will further permit providers to include optional adjustments to these provisions, where applicable.[1291]

The final rule contains two exceptions to this first information collection requirement. Under the first exception, if a provider enters into an arbitration agreement that existed previously (and was entered into by another person after the compliance date),[1292] and the agreement does not already contain the provision required by § 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.[1293] Under the second exception, the requirement to ensure that an arbitration agreement entered into after the compliance date contains the provision required by

[1288] *See* § 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 § 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.
[1289] *See* § 1040.4(a)(2)(i).
[1290] *See* § 1040.4(a)(2)(ii).
[1291] *See* § 1040.4(a)(2)(iv)-(vi).
[1292] *See* comment 4(a)(2)-2 for an example of when this could occur.
[1293] *See* § 1040.4(a)(2)(iii).

§ 1040.4(a)(2)(i) (or the alternative provision permitted by § 1040.4(a)(2)(ii)) will 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 § 1040.4(a)(2) by providing an amended arbitration agreement to the consumer.[1294]

The second information collection requirement relates to reporting requirements. The provision will require providers to submit specified arbitral and court records to the Bureau relating to any arbitration agreement entered into after the compliance date.[1295] The rule will require the submission of three general categories of documents to the Bureau. The first category will require providers to submit any submission to a court that relies upon an arbitration agreement in support of the provider's attempt to seek dismissal, deferral, or stay of a case.[1296] The second category will require providers to submit certain records in connection with any claim filed in arbitration by or against the provider concerning a covered consumer financial product or service. In particular, providers will 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 answer to any initial claim and/or counterclaim, if any; (C) the arbitration agreement filed with the arbitrator or arbitration administrator; (D) the judgment or award, if any, issued by the arbitrator or arbitration administrator; and (E) if an arbitrator or arbitration

[1294] *See* § 1040.5(b).
[1295] *See* § 1040.4(b).
[1296] *See* § 1040.4(b)(1)(iii).

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.[1297] The third category will 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 final rule does not comply with the administrator's fairness principles, rules, or similar requirements.[1298]

The Bureau received no comments specifically addressing the PRA notice, although some industry commenters made general comments regarding the expected burden of the proposal, including burdens accounted for in the PRA. As explained in detail in the Supporting Statement filed with this rule and available at Regulations.gov or Reginfo.gov, the Bureau believes that the burden estimates contained in the Supporting Statement with the ICR that the Bureau has submitted to OMB under the requirements of the PRA are sufficiently conservative, such that even if all of the assertions of the commenters were entirely supported by data, they would still point to a burden less than or equal to the Bureau's estimates.

Pursuant to 44 U.S.C. 3507, the Bureau will publish a separate notice in the *Federal Register* announcing the submission of this these information collection requirements to OMB as well as OMB's action on this these submissions, including the OMB control number and expiration date.

The Bureau has a continuing interest in the public's opinion of its collections of information. At any time, comments regarding the burden estimate, or any other aspect of the

[1297] *See* § 1040.4(b)(1)(i).
[1298] *See* § 1040.4(b)(1)(ii).

information collection, including suggestions for reducing the burden, may be sent to the Consumer Financial Protection Bureau (Attention: PRA Office), 1700 G Street NW., Washington, D.C. 20552, or by email to CFPB_Public_PRA@cfpb.gov.

**List of Subjects in 12 CFR 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 adds 12 CFR 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 and purpose.
1040.2 Definitions.
1040.3 Coverage and exclusions from 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.

**Authority:** 12 U.S.C. 5512(b) and (c) and 5518(b).

**§ 1040.1 Authority and purpose.**

(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 Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) (12 U.S.C. 5512(b)(1) and (c) and 5518(b)).

(b) *Purpose*. The purposes of this part are 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, and also 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.

**§ 1040.2 Definitions.**

(a) *Class action* means a lawsuit in which one or more parties seek or obtain 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) *Pre-dispute arbitration agreement* means an agreement between a covered person as defined by 12 U.S.C. 5481(6) and a consumer providing for arbitration of any future dispute concerning a consumer financial product or service covered by § 1040.3(a).

(d) *Provider* means:

(1) A person as defined by 12 U.S.C. 5481(19) that engages in an activity 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 (d)(1) of this section when that affiliate is acting as a service provider to the provider with which the service provider is affiliated consistent with 12 U.S.C. 5481(6)(B).

**§ 1040.3 Coverage and exclusions from coverage.**

(a) *Covered products and services.* Except for persons when excluded from coverage pursuant to paragraph (b) of this section, this part applies to the offering or provision of the following products or services when such offering or provision is a consumer financial product or service as defined by 12 U.S.C. 5481(5):

(1)(i) Providing an "extension of credit" that is "consumer credit" when performed by a "creditor" as those terms are defined in Regulation B, 12 CFR 1002.2;

(ii) "Participat[ing] in [] credit decision[s]" within the meaning of 12 CFR 1002.2(l) when performed by a "creditor" with regard to "consumer credit" as those terms are defined in 12 CFR 1002.2;

(iii)(A) Referring applicants or prospective applicants for "consumer credit" to creditors when performed by a "creditor" as those terms are defined in 12 CFR 1002.2; or

(B) Selecting or offering to select creditors to whom requests for "consumer credit" may be made when done by a "creditor" as those terms are defined in 12 CFR 1002.2;

(C) Except that this paragraph (a)(1)(iii) does not apply when the referral or selection activity by the creditor described in paragraphs (a)(1)(iii)(A) or (B) of this section is incidental to a business activity of that creditor that is not covered by this section;

(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;

(2) Extending automobile leases as defined by 12 CFR 1090.108 or brokering such leases;

(3)(i) 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;

(ii) Providing products or services represented to remove derogatory information from, or improve, a person's credit history, credit record, or credit rating;

(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, as defined by 15 U.S.C. 1681g(f)(2)(A), or other information specific to a consumer derived from a consumer file, as defined by 15 U.S.C. 1681a(g), in each case except for a consumer report provided solely in connection with an adverse action as defined in 15 U.S.C. 1681a(k) with respect to a product or service that is not covered by 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 12 U.S.C. 5481(29) except when necessary to another product or service if that product or service:

(i) Is offered or provided by the person transmitting or exchanging funds; and

(ii) Is not covered by this section;

(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 12 U.S.C. 5481(18) or initiating a credit card or charge card transaction for the consumer, except by a person selling or marketing a good or service that is not covered by this section, for which the payment or credit card or charge card transaction is being made;

(9) Providing 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 (a)(1) through (9) of this section when performed 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 in the following circumstances:

(1)(i) A person regulated by the Securities and Exchange Commission as defined by 12 U.S.C. 5481(21); or

(ii) A person to the extent regulated by a State securities commission as described in 12 U.S.C. 5517(h) as either:

(A) A broker dealer; or

(B) An investment adviser; or

(iii) A person regulated by the Commodity Futures Trading Commission as defined by 12 U.S.C. 5481(20) or a person with respect to any account, contract, agreement, or transaction to the extent subject to the jurisdiction of the Commodity Futures Trading Commission under the Commodity Exchange Act, 7 U.S.C. 1 *et seq.*

(2)(i) A Federal agency as defined in 28 U.S.C. 2671;

(ii) Any State, Tribe, or other person to the extent such person qualifies as an "arm" of a State or Tribe under Federal sovereign immunity law and the person's immunities have not been abrogated by the U.S. Congress;

(3) Any person with respect to 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) A merchant, retailer, or other seller of nonfinancial goods or services to the extent such person:

(i) Offers or provides 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

(A) Is not subject to the Bureau's rulemaking authority under 12 U.S.C. 5517(a)(2)(B); or

(B) Is subject to the Bureau's rulemaking 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) Purchases or acquires an extension of consumer credit excluded by paragraph (b)(4)(i) of this section.

(5) Any "employer" as defined in the Fair Labor Standards Act, 29 U.S.C. 203(d), to the extent it is offering or providing a product or service described in paragraph (a) of this section to its employee as an employee benefit; or

(6) A person to the extent providing a product or service in circumstances where they are excluded from the Bureau's rulemaking authority including pursuant to 12 U.S.C. 5517 or 5519.

**§ 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 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 concerns 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 such review has been resolved such that the case cannot proceed as a class action.

(2) *Provision required in covered pre-dispute arbitration agreements.* Upon entering into a pre-dispute arbitration agreement for a consumer financial product or service covered by § 1040.3 after the date set forth in § 1040.5(a):

(i) Except as provided elsewhere in this paragraph (a)(2) or in § 1040.5(b), a provider shall ensure that any such pre-dispute arbitration agreement contains the following provision: "We agree that neither we nor anyone else will rely on 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 filed by someone else."

(ii) When the pre-dispute arbitration agreement applies to 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 required by paragraph (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. The following provision applies only to class action claims concerning the products or services covered by that Rule: We agree that neither we nor anyone else will rely on 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 filed by someone else."

(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:

(A) The provider shall either ensure the pre-dispute arbitration agreement is amended to contain the provision specified in paragraph (a)(2)(i) or (a)(2)(ii) of this section or provide any consumer to whom the agreement applies with the following written notice: "We agree not to rely on 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 filed by someone else." When the pre-dispute arbitration agreement applies to multiple products or services, only some of which are covered by § 1040.3, the provider may, in this written notice, include the following optional additional language: "This notice applies only to class action claims concerning the products or services covered by the Arbitration Agreements Rule issued by the Consumer Financial Protection Bureau."

(B) The provider shall ensure the pre-dispute arbitration agreement is amended or provide the notice to consumers within 60 days of entering into the pre-dispute arbitration agreement.

(iv) A provider may add any one or more of the following sentences at the end of the disclosures required by paragraphs (a)(2)(i) and (ii) of this section:

(A)(*1*) "This provision does not apply to parties that entered into this agreement before March 19, 2018."

(*2*) "This provision does not apply to products or services first provided to you before March 19, 2018 that are subject to an arbitration agreement entered into before that date."

(B) "This provision does not apply to persons that are excluded from the Consumer Financial Protection Bureau's Arbitration Agreements Rule."

(C) "This provision also applies to the delegation provision." A provider using this sentence as part of the disclosure required by paragraph (a)(2)(i) or (ii) of this section in a pre-dispute arbitration agreement is not required to separately insert the disclosure required by

paragraph (a)(2)(i) or (ii) of this section into a delegation provision that relates to such a pre-dispute arbitration agreement.

(v) In any provision or notice required by this paragraph (a)(2), if the provider uses a standard term in the rest of the agreement to describe the provider or the consumer, the provider may use that term instead of the term "we" or "you."

(vi) In any provision or notice required by this paragraph (a)(2), if a person has a genuine belief that sovereign immunity from suit under applicable law may apply to any person that may seek to assert the pre-dispute arbitration agreement, then the provision or notice may include, after the sentence reading "You may file a class action in court or you may be a member of a class action filed by someone else," the following language: "However, the defendants in the class action may claim they cannot be sued due to their sovereign immunity. This provision does not create or waive any such immunity." In the preceding sentence, the word "notice" may be substituted for the word "provision" when the included language is in a notice.

(vii) A provider may provide any provision or notice required by this paragraph (a)(2) in a language other than English if the pre-dispute arbitration agreement also is written in that other language.

(b) *Submission of arbitral and court records*. For any pre-dispute arbitration agreement for a consumer financial product or service covered by § 1040.3 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 answer to any initial claim and/or counterclaim, if any;

(C) The pre-dispute arbitration agreement filed with the arbitrator or arbitration administrator;

(D) The judgment or award, if any, issued by the arbitrator or arbitration administrator; and

(E) 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;

(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; and

(iii) In connection with any case in court by or against the provider concerning any of the consumer financial products or services covered by § 1040.3:

(A) Any submission to a court that relies on a pre-dispute arbitration agreement in support of the provider's attempt to seek dismissal, deferral, or stay of any aspect of a case; and

(B) The pre-dispute arbitration agreement relied upon in the motion or filing.

(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, arbitration administrator, or court, 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, the court, 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.

(4) *Internet posting of arbitral and court records.* The Bureau shall establish and maintain on its publicly available internet site a central repository of the records that providers submit to it pursuant to paragraph (b)(1) of this section, and such records shall be easily accessible and retrievable by the public on its internet site.

(5) *Further redaction prior to internet posting.* Prior to making records identified in paragraph (b)(1) of this section easily accessible and retrievable by the public as required by paragraph (b)(4) of this section, the Bureau shall make such further redactions as are needed to comply with applicable privacy laws.

(6) *Deadline for internet posting of arbitral and court records.* The Bureau shall initially make records submitted to the Bureau by providers under paragraph (b)(1) of this section easily accessible and retrievable by the public on its internet site no later than July 1, 2019. The Bureau

will annually make records submitted under paragraph (b)(1) available each year thereafter for documents received by the end of the prior calendar year.

**§ 1040.5 Compliance date and temporary exception.**

(a) *Compliance date.* Compliance with this part is required for any pre-dispute arbitration agreement entered into on or after March 19, 2018.

(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 requirements set forth in paragraphs (b)(1)(i) through (iii) of this section are satisfied; 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) Pre-dispute arbitration agreement.*

1. *Scope of the term includes agreements with covered persons that are not providers.*

i. While § 1040.2(c) defines "pre-dispute arbitration agreement" as an agreement between a covered person and a consumer, the rule's substantive requirements, which are contained in § 1040.4, apply only to "providers." "Covered persons" as that term is defined in 12 U.S.C. 5481(6) include persons excluded from the Bureau's rulemaking authority under 12 U.S.C. 5517 and 5519. Therefore, the requirements contained in § 1040.4 would not apply to any such excluded persons entering into a pre-dispute arbitration agreement because they are not "providers," by virtue of the definition in § 1040.2(d) which excludes persons described in § 1040.3(b) including its paragraph (b)(6) (under which any person is excluded under § 1040.3(b) to the extent it is not subject to the Bureau's rulemaking authority including under sections 1027 or 1029). The requirements in § 1040.4 could apply, however, to the use of any such pre-dispute arbitration agreement by a different person that meets the definition of provider in § 1040.2(d), when the pre-dispute arbitration agreement was entered into after the compliance date.

ii. For example, an automobile dealer that extends consumer credit is a covered person under 12 U.S.C. 5481(6). Its pre-dispute arbitration agreement would therefore fall within the scope of the definition in § 1040.2(c). However, an automobile dealer excluded from the Bureau's rulemaking authority in circumstances described by Dodd-Frank section 1029 would not be required to comply with the requirements in § 1040.4, because those requirements apply only to providers, and such dealers are excluded by § 1040.3(b)(6) and therefore are not

providers under § 1040.2(d). The requirements in § 1040.4 would apply, however, to the use of the automobile dealer's pre-dispute arbitration agreement by a different person that meets the definition of provider, such as a servicer or purchaser or acquirer of the automobile loan, when the agreement was entered into after the compliance date.

2. *Delegation provisions*. The term pre-dispute arbitration agreement as defined in § 1040.2(c) includes delegation provisions. Delegation provisions are agreements to arbitrate threshold issues concerning a pre-dispute arbitration agreement, and may sometimes appear elsewhere in a contract containing or relating to the arbitration agreement.

3. *Form of pre-dispute arbitration agreements*. A pre-dispute arbitration agreement for a consumer financial product or service includes any agreement between a covered person and a consumer providing for arbitration of any future disputes between the parties concerning a consumer financial product or service described in § 1040.3(a), regardless of the form or structure of the agreement. 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.

*2(d) Provider.*

1. *Providers of multiple products or services.* A provider as defined in § 1040.2(d) 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 as a general service, when that funds transmittal activity is not necessary to its offering or provision of products or services that are not covered by this part, would be covered pursuant to § 1040.3(a)(7) 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, however, except when extending consumer credit in certain circumstances as provided in 12 U.S.C. 5517(a)(2)(B)(ii) or (iii).

2. *Affiliated service providers.* Section 1040.2(d)(2) defines the term "provider" to include an affiliate of another provider as defined in § 1040.2(d)(1) when the affiliate is acting as a service provider to the other provider consistent with 12 U.S.C. 5481(6)(B). The rule applies to such an affiliated service provider in connection with the offering or provision of a covered consumer financial product or service by the other provider, even when the affiliated service provider is not itself directly engaged in offering or providing a consumer financial product or service covered by § 1040.3(a). However, even if an affiliated service provider does not meet the definition of provider in § 1040.2(d)(2) because it provides services to a person who is excluded from the rule under § 1040.3(b) and thus is not a provider, the affiliated service provider still could be a provider as defined in § 1040.2(d)(1). For example, if an affiliate of a merchant excluded by § 1040.3(b)(6) services consumer credit extended by the merchant, the affiliate may, in its own right, be "servicing an extension of consumer credit covered by paragraph (a)(1)(i) of this section" as discussed in § 1040.3(a)(1)(v). As a result, the affiliate servicer may meet the definition of provider in § 1040.2(d)(1) even though the merchant is not a provider.

*Section 1040.3—Coverage and exclusions from coverage*

*3(a) Covered products and 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 therein 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 the first type of consumer financial products or services. An example of the second type of consumer financial product or service is debt collection, when the underlying loan that is the subject of collection is a consumer financial product or service.

2. *Mobile phone applications and online access tools.* If a provider of a consumer financial product or service covered by this part offers or provides a consumer a technological means for accessing information about that product or service, such as a mobile phone application or an internet website, this part shall apply to the application or internet website as it concerns that product or service.

*Paragraph (a)(1)(iii).*

1. *Offering or providing creditor referral or selection services.* Section 1040.3(a)(1)(iii) includes in the coverage of part 1040 providing referrals or selecting or offering to select creditors for consumer credit consistent with the meaning in 12 CFR 1002.2(l) by a creditor as defined in 12 CFR 1002.2(l). Section 1040.3(a)(1)(iii) does not apply when such a creditor's referral or selection activity is incidental to its business activity not covered by this section. *See* § 1040.3(a)(1)(iii)(C). For example, a merchant may regularly and in the ordinary course of its business provide creditor referrals or selection services to help a consumer pay for nonfinancial goods or services sold by that merchant. By virtue of such activities, such a merchant may be a creditor as defined in 12 CFR 1002.2(l). Nonetheless, such a merchant would not be covered by § 1040.3(a)(1)(iii) because its creditor referral or selection services are incidental to its sale of goods or services not covered by this section.

*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 covered by § 1040.3(a)(1)(i). 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)(i).*

1. *Debt relief products and services.* Section 1040.3(a)(3)(i) 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 § 1040.3(a)(3)(i) 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 § 1040.3(a)(1)(i) or from a consumer financial product or service more generally.

*Paragraph (a)(3)(ii).*

1. *Credit repair products or services.* Section 1040.3(a)(3)(ii) includes in the coverage of part 1040 products or services represented to remove derogatory information from, or improve, a person's credit history, credit record, or credit rating. The description of these products and services in § 1040.3(a)(3)(ii) is generally based upon the coverage of credit repair goods or services in regulations implementing 15 U.S.C. 6101 *et seq.*, codified at 16 CFR 310.4(a)(2). However, part 1040 also would apply even if such credit repair goods or services would not be covered under the regulations implementing 15 U.S.C. 6101 *et seq.*, codified at 16 CFR 310.4(a)(2), solely because they were not the subject of telemarketing as defined in 16 CFR 310.2(gg).

*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 § 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 noncovered 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 (a)(1) through (9) of § 1040.3, including, for example, an extension of consumer credit described in § 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 (a)(1) through (9) of § 1040.3, the collection of that other debt is not included in the coverage of § 1040.3(a)(10)(i). For example, if a creditor extended consumer credit to consumers and business credit to other persons, § 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, § 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.* Paragraphs (a)(10)(i) and (ii) of § 1040.3 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)(2)(ii).*

1. *Exclusion for States under Federal sovereign immunity law.* Section 1043.3(b)(2)(ii) excludes States and other persons to the extent they would be an arm of the State under Federal sovereign immunity law and their immunity has not been abrogated by the U.S. Congress. For purposes of this rule, the term State includes any State, territory, or possession of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, Guam, American Samoa, and the U.S. Virgin Islands.

2. *Exclusion for Tribes under Federal sovereign immunity law.* Section 1040.3(b)(2)(ii) excludes Tribes and other persons to the extent that they would be an arm of a Tribe under Federal sovereign immunity law and their immunity has not been abrogated by the U.S. Congress. For purposes of this exclusion, the term "Tribe" refers to any federally recognized Indian Tribe, as defined by the Secretary of the Interior under section 104(a) of the Federally Recognized Indian Tribe List Act of 1994, 25 U.S.C. 479a-1(a).

*Paragraph (b)(3).*

1. *Including consumers to whom affiliates provide a product or service toward the numerical threshold for exemption of a person under § 1040.3(b)(3).* Section 1040.3(b)(3) provides an exclusion to persons providing a product or service covered by § 1040.3(a) if no more than 25 consumers are provided the product or service in the current and prior calendar years by the person and its affiliates. The exclusion applies based on the frequency with which the product is provided, regardless of the number of times a product is offered. Note, however, that participating in a credit decision with regard to consumer credit in circumstances described in § 1040.3(a)(1)(ii), for example, constitutes providing a product or service covered by

§ 1040.3(a), even if an application for consumer credit is denied. In addition, for purposes of this test, the number of consumers to whom affiliates of a person provide a product or service is combined with the number of consumers to whom the person itself 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.

2. *Effect of exceeding the numerical threshold for the exemption.* If, during a calendar year, a person to that point excluded by § 1040.3(b)(3) for a given product or service described in § 1040.3(a) provides that product or service to a 26th consumer, then that person ceases to be eligible for this exclusion at that time with respect to that product or service. The provider must begin complying with this part with respect to the covered product or service provided to that 26th consumer. In addition, the provider will not be eligible for the exclusion in § 1040.3(b)(3) whenever it offers or provides that product or service for the remainder of that calendar year and the following calendar year.

*Paragraph (b)(4).*

1. *Exemption for merchants who purchase or acquire consumer credit from other merchants who are exempt.* Section 1040.3(b)(4)(ii) provides an exemption for a merchant who purchases or acquires consumer credit from another merchant when the merchant from whom the credit is being purchased or acquired is exempt under § 1040.3(b)(4)(i). This exemption in § 1040.3(b)(4)(ii) applies not only to the purchase or acquisition itself, but also to any servicing or collection activities by the merchant purchaser or acquirer.

*Paragraph (b)(5).*

1. *Exemption for employers providing employee benefits.* Section 1040.3(b)(5) provides an exemption for an employer to the extent it is offering or providing a consumer financial

product or service to an employee as an employee benefit. If an employer offers or provides a consumer financial product or service covered by § 1040.3(a) to an employee on terms and conditions that the employer makes available to the general public, such product or service is not an employee benefit for purposes of § 1040.3(b)(5).

*Section 1040.4—Limitations on the Use of Pre-Dispute Arbitration Agreements*

1. *Enters into a pre-dispute arbitration agreement.*

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, after the date set forth in § 1040.5(a), a new product or service covered by § 1040.3(a) that is subject to a pre-existing agreement to arbitrate future disputes between the parties, and the provider is a party to that agreement, regardless of whether that agreement predates the date set forth in § 1040.5(a). When that agreement predates the date set forth in § 1040.5(a), § 1040.4 applies only with respect to any such new product or service;

B. Acquires or purchases after the date set forth in § 1040.5(a) a product or service 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 seller is excluded from coverage under § 1040.3(b) or the pre-dispute arbitration agreement was entered into before the date set forth in § 1040.5(a); or

C. Adds a pre-dispute arbitration agreement after the date set forth in § 1040.5(a) 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 without engaging in the conduct described in comment 4-1.i after the date set forth in § 1040.5(a). However, a provider does enter into a pre-dispute arbitration agreement for purposes of § 1040.4 when the modification, amendment, or implementation constitutes the provision of a new product or service. See comment 4-1.i(A).

B. Acquires or purchases a product or service that is subject to a pre-dispute arbitration agreement but does not become a party to the pre-dispute arbitration agreement that applies to the product or service.

2. *Application of section 1040.4 to providers that do not enter into pre-dispute arbitration agreements.*

i. Pursuant to § 1040.4(a)(1), a provider that has not entered into a pre-dispute arbitration agreement cannot rely on any pre-dispute arbitration agreement entered into by another person after the compliance date specified in § 1040.5(a) with respect to any aspect of a class action concerning a consumer financial product or service covered by § 1040.3. In addition, pursuant to § 1040.4(b), the provider is required to submit certain specified records concerning claims filed in arbitration pursuant to such pre-dispute arbitration agreements. However, as discussed in comment 4(a)(2)-1, § 1040.4(a)(2) does not apply to providers that do not enter into pre-dispute arbitration agreements.

ii. 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 after the compliance date specified in § 1040.5(a) 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. The debt collector in this example is subject to § 1040.4(a)(1) even if the creditor was a merchant, government, or other person who was excluded from coverage by § 1040.3(b)(5).

*4(a) Use of pre-dispute arbitration agreements in class actions.*

*Paragraph 4(a)(1) General rule.*

1. *Reliance on a pre-dispute arbitration agreement.*

i. *Examples of conduct that constitutes reliance.* Sections 1040.4(a)(1) and (2) both use the term "rely on." For purposes of these provisions, reliance on a pre-dispute arbitration agreement includes, but is not limited to, doing any of the following on the basis of a pre-dispute arbitration agreement:

A. Seeking dismissal, deferral, or stay of any aspect of a class action;

B. Seeking to exclude a person or persons from a class in a class action;

C. Objecting to or seeking a protective order intended to avoid responding to discovery in a class action;

D. Filing a claim in arbitration against a consumer who has filed a claim on the same issue in a class action;

E. 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

F. 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.

ii. *Example of conduct that does not constitute reliance.* Reliance on a pre-dispute arbitration agreement for purposes of § 1040.4(a)(1) and (2) does not include, among other things, a class action defendant seeking or taking steps to preserve the defendant's ability to seek arbitration after the trial court has denied a motion to certify the class and either an appellate court has affirmed that decision on an interlocutory appeal of that motion, or the time to seek such an appeal has elapsed.

2. *Protected petitioning conduct.* A class action defendant does not violate § 1040.4(a)(1) by relying on a pre-dispute arbitration agreement where it has a genuine belief that it is not subject to this part. For example, a class action defendant does not violate § 1040.4(a)(1) by relying on a pre-dispute arbitration agreement where it has a genuine belief either that it is not covered by the rule because it is not a provider pursuant to § 1040.2(d), or that none of the claims asserted in the class action concern any of the consumer financial products or services covered pursuant to § 1040.3.

3. *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.

*Paragraph 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 after the

compliance date set forth in § 1040.5(a). 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) to ensure the agreement is amended to contain either of those provisions, as applicable, 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) or the alternative permitted by § 1040.4(a)(2)(ii), or to provide the notice specified in § 1040.4(a)(2)(iii)(B). 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. 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. *Contract provision for a delegation provision.* If a provider has included in its pre-dispute arbitration agreement the language required by § 1040.4(a)(2), and the provider's pre-dispute arbitration agreement contains a delegation provision, the provider must also separately insert the language required by § 1040.4(a)(2) into the delegation provision, except under § 1040.4(a)(2)(iv)(C). Under § 1040.4(a)(2)(iv)(C), the provider need not also include the language required by § 1040.4(a)(2) within a separate delegation provision—the language can be included once and applies to both the pre-dispute arbitration agreement and the delegation provision.

*4(b) Submission of arbitral records.*

1. *Submission by entities other than providers.* Section 1040.4(b) requires providers to submit specified arbitral and court 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).

2. *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).

*Paragraph 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. However, when the determination occurs with respect to a pre-dispute arbitration agreement that the provider has not entered into with any consumers, 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.

*Paragraph 4(b)(1)(iii).*

1. *Reliance on a pre-dispute arbitration agreement.* Section 1040.4(b)(1)(iii) requires that a provider shall submit to the Bureau certain submissions in court that rely on a pre-dispute arbitration agreement entered into after the compliance date set forth in § 1040.5(a) with respect to certain aspects of a case concerning any of the consumer financial products or services covered by § 1040.3.

2. A submission does not rely on a pre-dispute arbitration agreement, for purposes of § 1040(b)(1)(iii), if it:

i. Objects to or seeks a protective order intended to avoid responding to discovery;

ii. Is only referred to in an answer to a complaint or a counterclaim; or

iii. Is only incidentally part of an attachment to a submission. For instance, if a motion attaches the entire consumer financial contract, including the pre-dispute arbitration agreement, but the motion does not cite or rely on the pre-dispute arbitration agreement, the provider is not required to submit the motion to the Bureau.

*Section 1040.5—Compliance Date and Temporary Exception*

*5(b) Exception for pre-packaged general-purpose reloadable prepaid card agreements.*

1. *Application of § 1040.4(a)(1) to providers of general-purpose reloadable prepaid card agreements.* Where § 1040.4(a)(2) does not apply to a provider that enters into a pre-dispute arbitration agreement on or after the compliance date by virtue of the temporary exception in § 1040.5(b)(2), the provider must still comply with § 1040.4(a)(1).

*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 consumer registers the card and gives the provider the consumer's mailing address or email address.

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**Richard Cordray,**

*Director, Bureau of Consumer Financial Protection.*

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