

The Bureau of Consumer Financial Protection: Broad Authority to Regulate Arbitration Agreements

Comprehensive financial reform legislation known as the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Act”) will significantly alter regulation of the financial industry. In particular, Title X of the Act will create a new agency called the Bureau of Consumer Financial Protection (“Bureau”), which has broad authority over providers of financial products and services for the protection of consumers.

Of particular importance is the Bureau’s authority to regulate mandatory pre-dispute arbitration agreements between consumers and financial product or service providers. The Bureau’s authority has several components under Section 1028. In order to define the scope of its regulations, the Bureau must first conduct a formal study of the use of binding arbitration agreements in the consumer financial services industry. The legislation does not state whether the Bureau must use a disinterested third party to conduct the study or whether the Bureau itself may perform the necessary review. The legislation is also silent as to the breadth of the study, the manner in which the study is performed or whether any members of the industry will be asked to contribute to the study. Once the study has been completed, the Bureau must report to Congress on the results.

Also, once the study and report are complete, the Bureau may use its regulatory powers to limit or completely prohibit arbitration agreements in financial services contracts. However, there are three restrictions on this authority. First, the Bureau must find that its regulations are “in the public interest and for the protection of consumers.” The Act does not explain what the Bureau must consider to make this finding. Second, the regulations must be consistent with the Bureau’s study. Lastly, the Bureau may not prohibit or restrict a consumer’s ability to enter into voluntary arbitration agreements after a dispute has arisen.

The results of the Bureau’s study and subsequent regulations will affect many financial services providers that have incorporated such provisions into their contracts with consumers. The Bureau’s primary purpose is to protect consumers and it may make a determination that a complete prohibition on arbitration clauses is “in the public interest” and consistent with its study. Industry participants have long held the view that mandatory consumer arbitration clauses are in the best interests of consumers because arbitration provides an efficient, low-cost forum for consumers to seek redress for their disputes against creditors. Indeed, while businesses generally fare less well in arbitration forums where findings tend to favor individual complainants, the cost of the forum is less than for a court adjudication and the process is much quicker.

On the other hand, consumer advocates and some legal scholars argue that mandatory arbitration obviates consumers’ constitutional rights, forces consumer agreement to provisions they may not understand or cannot negotiate,¹ and may be as cost-prohibitive as litigation for low-income individuals.² These groups are particularly concerned about provisions in arbitration agreements that

¹ Linda J. Demaine & Deborah R. Hensler, “Volunteering” to Arbitrate through Predispute Arbitration Clauses: *The Average Consumer’s Experience*, 67 Law & Contemp. Probs. 55, 56 (2004).

² Mark E. Budnitz, *The High Cost of Mandatory Consumer Arbitration*, 67 Law & Contemp. Probs. 133, 133-34 (2004).

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require consumers to waive their right to bring a class action.³ Consumer advocates argue that these waivers prevent individuals from bringing smaller claims and further threaten constitutional rights, while they dismiss company assertions that reduced dispute resolution costs can lead to lower prices for consumers.⁴ The Bureau's consumer protection mandate may suggest that mandatory pre-dispute arbitration clauses may end up on the cutting room floor. However, in order to avoid the appearance of preconceived bias, the Bureau may want to commission an independent party to conduct the study, with instructions for substantial industry input into the data gathering.

Regardless, the study and new rules must comply with existing law governing arbitration agreements, including the Federal Arbitration Act ("FAA"). The FAA states 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," which reflects a strong presumption in favor of

arbitration.⁵ Section 1028 and the Bureau's later regulations may contrast sharply with both the FAA and the national trend towards this method of dispute resolution to reduce litigation costs and clogged court dockets. Ultimately, both Section 1028 and Section 921 (which authorizes the SEC to conduct similar rulemaking on agreements between customers and securities broker-dealers) threaten to change the current status of the use of mandatory pre-dispute arbitration agreements in contracts throughout the financial services industry.

However, this provision and any of the Bureau's regulations are unlikely to go into effect in the near future. The Bureau is a new agency and must initially rely on resources from other agencies and hiring new staff before it becomes fully operational, or at least operationally sufficient to conduct studies. Even after the Board adopts final rules, those rules will only apply to contracts entered into after 180 days after the stated effective date of the rules.⁶

³ Jean R. Sternlight & Elizabeth J. Jensen, *Using Arbitration to Eliminate Consumer Class Actions: Efficient Business Practice or Unconscionable Abuse?*, 67 Law & Contemp. Probs. 75, 75-76 (2004).

⁴ *Id.* at 85-91, 92-99.

⁵ 9 U.S.C. § 2.

⁶ Chris Edwards and Jerry Loeser would like to thank summer associate Caroline Wenzke for her work on this client briefing.

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