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Consumer Finance Update: CFPB Moving Ahead with Arbitration Ban?

We think investors should be prepared for the agency to press ahead in the next 2-3 months with heavy-handed limits on consumer finance companies' use of class-action waivers in consumer contract arbitration agreements. While such a rule could open the door to widespread class-action litigation risk for almost all consumer finance companies that currently utilize mandatory arbitration language in contracts with customers, we believe the Republican-controlled Congress would likely override the rule with a simple majority vote under authorities granted by the Congressional Review Act (CRA). However, as with most items requiring congressional action, an override might not occur until well into 2018.

What does this rule do and what products and services are captured?

The proposed rule would bar consumer finance companies from utilizing pre-dispute arbitration agreements that prevent or limit consumers from filing or joining class actions in court. The proposal captures wide swaths of the consumer finance space, including:

- Most types of consumer lending (extending consumer credit under Regulation B, such as **making loans**, issuing **credit cards**, certain types of **retail installment sales**, and providing credit in certain other contexts);
- Providers of credit in the form of deferred third-party billing services;
- Participating in activities related to the extension or decision to extend consumer credit, such as **providing referrals, servicing, credit monitoring** and repair, **debt relief, debt collection** services, and **purchasing consumer loans**;
- Extending or **brokering of automobile leases**; and
- Other business related to storing, transmitting, or exchanging funds (including **savings and deposit accounts, remittance transfer providers**, providers of **domestic money transfer services** or currency exchange, general-purpose reloadable **prepaid card issuers**, and check cashing providers, among others).

When to expect a new rule and potential CRA override?

We think the CFPB will finalize a rule in the next 2-3 months. The most recent regulatory agenda update out of the CFPB was from late 2016 and suggested that the agency planned to finalize its rule in February 2017, though delays in meeting the non-binding, self-imposed deadlines are very common. We have long been of the opinion that the agency would avoid formally promulgating new rules, instead relying more heavily on its enforcement authorities, due to the risk of the Republican Congress overriding rules under the CRA.

However, in a move that suggests to us that Republicans are concerned that the agency *will* produce a new rule in the near-term, House Financial Services Committee Chairman Jeb Hensarling (R-TX) recently suggested that

he might hold CFPB Director Richard Cordray in contempt of his committee if he finalizes the arbitration rule before responding to unrelated document requests made by the committee. Furthermore, consumer finance industry representatives appear to be increasingly concerned that the agency will go ahead with a rule, with several making recent public comments voicing such concerns.

Because the proposed rule has proven to be extremely controversial in Congress, with nearly universal Republican and some Democratic opposition, in addition to widespread industry opposition, we believe there is more than adequate opposition to the rule in Congress for a successful CRA override. However, any congressional override could easily slip well into 2018, as Congress has up to 60 days (calculated as those days when Congress is officially in session) to review any new rules under the CRA.

What is the timeline for Cordray leaving the agency?

It isn't clear, but we have long-anticipated that Director Cordray would remain in office for the bulk of 2017, if not through the end of his term in June 2018. However, there continues to be widely reported speculation that Cordray will resign from his post late this year in order to pursue a gubernatorial run in his home state of Ohio.

That said, we expect to see a decision regarding the constitutionality of the CFPB from the en banc panel of the U.S. Court of Appeals for the D.C. Circuit in *PHH v. CFPB* in early-Q4. We think that the court is likely to agree with **PHH** (PHH) on the case-specific facts regarding compliance with the Real Estate Settlement Procedures Act (RESPA), but stop short of deeming the CFPB to be unconstitutionally structured (thus maintaining status quo at the agency). If we are correct, we suspect replacing Cordray before the end of his term or before he leaves on his own will require Hensarling to hold him in contempt of his committee, thus providing the President with "cause" to remove him.

Additional information is available upon request.

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