August 22, 2016

The Honorable Richard Cordray
Director
Consumer Financial Protection Bureau
1700 G Street, NW
Washington, D.C. 20552

Re: Arbitration Agreements, Proposed Rule; CFPB-2016-0020, RIN 3170-AA51

Dear Director Cordray,

The Conference of State Bank Supervisors (CSBS) appreciates the opportunity to comment on the Consumer Financial Protection Bureau’s (Bureau) notice of proposed rulemaking, entitled Arbitration Agreements, establishing rules to govern the use of pre-dispute arbitration agreements by providers of certain consumer financial products and services.

Since the establishment of the Bureau, CSBS has actively provided feedback on proposed rules implementing federal consumer financial law. As with these prior rulemakings, State banking regulators support efforts to encourage compliance with State and Federal consumer protection laws. Nevertheless, CSBS has written this letter to highlight specific supervisory concerns regarding the heightened compliance risks and legal uncertainty resulting from the proposed rule and to make several recommendations as to how these supervisory concerns may be mitigated.

SUPERVISORY CONCERNS

The proposed regulation would govern two aspects of alternative dispute resolution between consumer finance providers and their customers. First, the proposed rule would prohibit covered providers from including class action waivers in pre-dispute arbitration agreements. Second, the proposed rule would require covered providers to submit specified arbitral records to the Bureau.

As the Bureau acknowledges, the proposed rule will create significant additional litigation exposures for covered providers. These additional exposures will serve as a novel source of heightened compliance and reputation risks for covered providers. While the Bureau attempted to gauge the size and scope of these additional litigation exposures, the Bureau’s estimates project only the cost of additional Federal class litigation.1 CSBS is concerned that the Bureau’s limited analysis of state class litigation has led to an underestimation of the additional litigation costs stemming from the proposed rule.

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1 Because of data limitations, the Bureau does not attempt to quantify the costs of additional State class litigation. While it is assumed that the amount of class litigation in state courts is roughly equal to that brought in federal courts, this assumption is not reflected in the reported cost estimates presumably because the Bureau assumes that the amounts at stake in state courts are not nearly as large as the amounts at stake in federal court. See 81 Fed. Reg. 32907.
Certain challenges unique to state class litigation may render it more costly to covered providers than federal class litigation. These same challenges will also impose potentially insurmountable barriers to consumers pursuing remediation in state court and thereby undercut the benefits provided to consumers by class actions relative to individual arbitration. State regulators encourage the Bureau, prior to finalizing the proposed rule, to study further the greater litigation costs and barriers to consumer remediation potentially posed in state class litigation and to revise its estimates and findings accordingly.

In the case of depository institutions, the additional compliance and reputation risks stemming from increased class litigation exposures may ultimately pose significant safety and soundness concerns. The Bureau believes that the additional litigation costs imposed on small depository institutions would have “practically no effect that could be monetized” because class litigation involving smaller entities is reportedly infrequent and for much smaller amounts. State regulators remind the Bureau that even a relatively limited litigation exposure can nevertheless materialize, through heightened compliance and reputation risks, into a significant safety and soundness concern. Thus, in addition to posing significant risk management burdens on covered banks, CSBS is concerned that the proposal will also create significant difficulties for examiners in the assessment of a bank’s exposure to litigation and its impact on the bank’s risk profile.

With respect to compliance costs, CSBS is troubled by the Bureau’s inability to quantify the additional compliance costs stemming from the proposed rule or, more generally, the current levels of investment in compliance activities under consumer protection laws. State supervisors believe that a thorough quantitative analysis of levels of investment in compliance among covered providers would serve as a stronger foundation for the Bureau’s finding that the proposed rule is in the public interest and for the protection of consumers.

Finally, State supervisors are concerned that the litigation exposures and additional compliance costs resulting from the proposed rule may preclude the introduction of new products and services by covered providers. Given the many complexities inherent in consumer protection laws and regulations, the adequacy of compliance with the applicable law is not always susceptible to a clear categorical determination. CSBS believes that, where covered providers remain uncertain as to their compliance status, the heightened compliance risks resulting from the proposed rule will compel covered providers to refrain from introducing new and innovative products and services.

**LEGAL UNCERTAINTY**

State regulators are concerned that the legal uncertainty created by the proposed rule will only exacerbate the supervisory concerns discussed above. The proposed rule will introduce significant legal

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2 For instance, the predominance inquiry, perhaps the most stringent prerequisite to class certification, requires a fact-driven qualitative assessment of both the generalized proof needed to prove the class-wide claim and the individualized proof needed for any distinct individual claim. This time-intensive inquiry is a costly process, particularly when class members’ claims are not governed by the same law as is often the case in state class litigation. See, e.g., *Compaq Computer Corp. v. Lapray*, 135 S.W.3d 657, 53 U.C.C. Rep. Serv. 2d 483 (Tex. 2004).

3 See, e.g., *Citizens Ins. Co. of America v. Daccach*, 217 S.W.3d 430 (Tex. 2007) (holding that common questions of law may not predominate if class members’ claims are not governed by the same law); *Schnall v. AT & T Wireless Services, Inc.*, 171 Wash. 2d 260, 259 P.3d 129 (2011) (holding that variations in state law may swamp any common issues and defeat predominance).
uncertainty due to the lack of clarity as to the proposal’s impact on the Federal Arbitration Act (FAA), and relatedly, on state laws governing class action waivers in arbitration agreements.

While the Bureau provides a background discussion of the preemptive effect of AT&T Mobility v. Concepcion, the Bureau does not discuss the extent to which the proposed rule will impact or alter the preemptive effect of that decision. For this reason, it is unclear whether or not previous interpretations of the FAA continue to preempt conflicting state law and whether or not the proposed rule would preempt state laws more favorable to arbitration. Additionally, concerns have been raised as to whether Section 1028 of the Dodd-Frank Act—the legal authority for the proposed rule—itself constitutes an improper delegation of legislative power to the Bureau with respect to the FAA.

Moreover, it is unclear whether the provision required by proposed § 1040.4(a)(2) to be inserted into arbitration agreements would apply solely to class actions brought under Federal and State consumer protection laws or would apply to class actions brought under other State and Federal laws as well. Finally, the preemptive effect of the requirement to submit arbitral records to the Bureau is similarly unclear given the prevalence of State laws deeming arbitral records to be private and confidential.

This general state of legal uncertainty amplifies the potential litigation exposures stemming from the proposed rule and creates further difficulties for examiners in factoring these exposures into the evaluation of compliance and reputational risks. For this reason, in the spirit of cooperative federalism, State regulators request that the Bureau thoroughly clarify the preemptive effect of the proposed rule relative to the FAA and conflicting or inconsistent State law.

**Recommendations**

In addition to the requests for further analysis and clarification, discussed above, State regulators believe that certain minor modifications or supplementary action would not only mitigate the significance of the litigation exposures and resultant safety and soundness issues for covered providers, discussed above, but also would reduce the difficulties created in the evaluation of litigation exposures in the examination process.

First, CSBS requests that, prior to finalizing the proposed rule, the Bureau issue small entity compliance guides for each of the Federal consumer financial laws for which a private right of action is statutorily provided. Such guidance is an indispensable tool for small entities that may lack the resources to determine the adequacy of their risk management systems and compliance programs.

Second, in addition to clarifying the preemptive effect of the proposed rule, State supervisors encourage the Bureau to clarify the scope of the provision required to be inserted in arbitration agreements in order to minimize the legal uncertainty introduced by the proposed rule. Specifically, we request that the Bureau provide greater clarity as to the type of State and Federal laws under which class litigation may be initiated.

Third, State regulators request that the Bureau refrain from making the arbitral records of covered providers publicly available. State supervisors believe that publicizing the arbitral records submitted under the rule would potentially provide a road-map for future class litigation and thereby exacerbate

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4 When involved in an arbitration pursuant to a pre-dispute arbitration agreement, the proposed rule will require providers to submit specified arbitral records to the Bureau. However, the Bureau does not specify in the proposed rule whether it would make such records publicly available.
the difficulties already facing examiners in the evaluation of class litigation exposures. Additionally, refraining from publicizing these arbitral records would minimize the preemptive effect of the proposed rule with respect to State law governing the confidentiality of arbitral records.

**CONCLUSION**

CSBS appreciates the opportunity to comment on the Bureau’s proposed rule restricting the use of pre-dispute arbitration agreements. State banking regulators support efforts to encourage thorough compliance with State and Federal consumer protection laws. We look forward to continued engagement with the Bureau as it finalizes the proposed rule and continues to calibrate regulations so as to encourage compliance with consumer protection laws.

Sincerely,

John W. Ryan
President & CEO