



Member FINRA/SIPC

## Washington Policy

## Flash Note

# CFPB's Arbitration Rule Released, Public Perception to Determine CRA Fate

July 10, 2017

Isaac Boltansky

202.534.1396

iboltansky@compasspointllc.com

Lukas Davaz

202.548.8342

ldavaz@compasspointllc.com

On July 10, the CFPB issued its long awaited [final rule](#) curtailing the current usage of mandatory arbitration agreements in contracts for certain consumer financial products and services. The final rule is 775 pages and it will take time to digest, but the [executive summary](#) is a useful resource. The rule generally applies to central consumer financial products and services including bank accounts, credit cards, payday loans, auto loans, student loans, prepaid cards, remittances, credit reporting/monitoring, and debt collection. There are a number of notable exemptions, including firms regulated by the CFTC and SEC, but at first blush these exemptions appear in line with expectations. At its core, the rule still allows the use of mandatory arbitration clauses, but it prohibits covered entities from including mandatory arbitration agreements that block class-action litigation in contracts. Furthermore, the Bureau's rule imposes data collection requirements for the continued use of mandatory arbitration clauses. Effectively, the use of mandatory arbitration agreements as a means of preventing class-action litigation would end and the value of using arbitration as a litigation hurdle would be lessened by new public data reporting requirements. The rule is set to become effective 60 days after it is published in the Federal Register, but it will only apply to covered agreements entered into 241 days after publication in the Federal Register. In terms of impact, the final rule will likely lead to higher operational and litigation expenses for impacted industries including banks, credit cards, student lenders, and auto lenders. Following the finalization of the CFPB's mandatory arbitration rule, there are three key questions:

**Will the mandatory arbitration rule be reversed via the Congressional Review Act (CRA)?** As a reminder, the CRA gives Congress the ability to nullify agency regulations with a simple majority, thereby avoiding the Senate filibuster. When assessing the likelihood of the mandatory arbitration rule being reversed, it is best to do so in the context of the recently failed effort to reverse the CFPB's prepaid card rule via CRA. The effort to reverse the prepaid rule via the CRA failed for four reasons: (1) disharmony within the financial services community over the CRA strategy; (2) the realization that using the CRA for reversing the rule would prevent substantively similar rulemaking in the future unless new legislation was passed; (3) the CFPB's delay of the effective date lessened Congressional urgency on the matter; and (4) there was a degree of "CRA fatigue" as lawmakers had already reversed over a dozen rules. The coming effort to reverse the mandatory arbitration rule is far better positioned politically than the prepaid rule CRA, but the fate of the arbitration rule will be determined by public perception in the coming weeks. If the rule is tagged as an eleventh-hour policy aimed at padding the pockets of trial attorneys and setting the stage for an end to arbitration all together, then the odds will be modestly in favor of reversal. If the rule is successfully framed as a valiant defense of consumer rights against Wall Street greed, then the odds will be against reversal. At this moment, we believe the odds of the CFPB's arbitration rule being reversed via CRA are slightly less than 50% given the Congressional calendar and initial channel checks.

**Will this lead to President Trump attempting to dismiss Director Cordray?** The CFPB's finalization of its arbitration rule will surely drive headlines in the days ahead, but our sense is that the White House remains disinterested in the public and legal battles that would come from dismissing Director Cordray. Our base case remains that Director Cordray will retain his seat into 2018. The February 2018 filing deadline in the Ohio gubernatorial race could conceivably catalyze an earlier departure, but the associated chatter has lessened in recent weeks.

**What does this mean for the CFPB's small dollar rulemaking effort?** We believe the CFPB's finalization of its mandatory arbitration rule serves as a clear signal that it will push to finalize its payday/small dollar loan rule before the end of Director Cordray's term. Even if the mandatory arbitration rule is reversed via CRA, we firmly believe there are not the necessary votes in the Senate for a CRA reversal of a final payday lending rule. Please see [here](#) and [here](#) for our most recent updates on the CFPB's small dollar lending effort.

Incidence of Arbitration Clauses in Consumer Financial Services Contracts 2013-2014				
Type of Contract	Arbitration Clause		No Arbitration Clause	
	# of Contracts	% of Market	# of Contracts	% of Market
<b>Credit Cards*</b>	67 (15.8%)	53.0%	356 (84.2%)	47.0%
<b>Checking Accounts**</b>	7.7%	44.4%	92.3%	55.6%
<b>Prepaid Cards</b>	48 (92.3%)	>82.9%	4 (7.7%)	<17.1%
<b>Storefront Payday Loans</b>	83.7%	98.5%	16.3%	1.5%
<b>Private Student Loans</b>	6 (85.7%)	NA	1 (14.3%)	NA
<b>Mobile Wireless</b>	7 (87.5%)	99.9%	1 (12.5%)	0.1%

\*Four defendants in the Ross antitrust litigation settled claims by agreeing not to use arbitration clauses in their credit card contracts for three and one-half years. 05-Civ. 7116 (Southern District of New York). The credit card loans outstanding of the Ross settlers constituted 86.4% of the outstandings not subject to arbitration clauses. If the settling defendants in Ross had continued to use arbitration clauses, 93.6% of credit card loans outstanding would be subject to arbitration clauses. None of the Ross settlers has resumed using arbitration clauses as of February 2015.

\*\*The incidence of arbitration clauses in checking account agreements shown in this table is an extrapolation to the entire market of banks and does not include credit unions. See 2013 Preliminary Results at 24–26. Data on the incidence of arbitration clauses in the banks and credit unions in our sample are described in Section 2.3.2. Similarly, the incidence of arbitration clauses in storefront payday loan agreements shown in the table is an extrapolation, as explained in Section 2.3.4.

Source: CFPB, Compass Point

## Important Disclosures

### Analyst Certification

We, Isaac Boltansky and Lukas Davaz, hereby certify that the views expressed in this research report accurately reflect our personal views about the subject securities or issues. We further certify that we have not received direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

Isaac Boltansky is Compass Point's Washington Policy Strategist. His contributions to this document relate solely to Washington Policy and should not be attributed to any company specific research, ratings, or conclusions.

Coverage Universe		Investment Banking Relationships			
Rating	Number	Percent	Rating	Number	Percent
Buy	70	45	Buy	16	23
Neutral	69	45	Neutral	8	12
Sell	16	10	Sell	1	6
Total	155	100%	Total	25	100%

\*Percentage of Investment Banking Clients in Coverage Universe by Rating

### Ownership and Material Conflicts of Interest

#### **Ratings, Coverage Groups, and Views and Related Definitions**

The information and rating included in this report represent the long-term view as described more fully below. The analyst may have different views regarding short-term trading strategies with respect to the stocks covered by the rating, options on such stocks, and/or other securities or financial instruments issued by the subject company(ies). Our brokers and analysts may make recommendations to their clients that are contrary to the recommendations contained in this research report. Such recommendations or investment decisions are based on the particular investment strategies, risk tolerances, and other investment factors of that particular client or affiliate. From time to time, Compass Point and its respective directors, officers, employees, or members of their immediate families may have a long or short position in the securities or other financial instruments mentioned in this report.

Current Stock Ratings System (NOTE: As of **January 11, 2016**, Compass Point has changed the definitions of Buy (B), Neutral (N) and Sell (S) in its Stock Ratings System to the definitions contained herein):

Buy (B): We expect the stock to outperform its peers on a risk adjusted basis over the next 12 months.

Neutral (N): We expect the stock to perform in line with its peers on a risk adjusted basis over the next 12 months.

Sell (S): We expect the stock to underperform its peers on a risk adjusted basis over the next 12 months.

Not Rated (NR): No rating at this time. Rating Suspended (RS): Compass Point Research has suspended the investment rating and price target for this stock, because there is not a sufficient fundamental basis for determining an investment rating or target. The previous investment rating and price Compass Point has suspended coverage of this company. Not Covered (NC): Compass Point does not cover this company. Not Available or Not Applicable (NA): The information is not available for display or is not applicable. Not Meaningful (NM): The information is not meaningful and is therefore excluded.

[Prior Stock Ratings System for all Research Reports Published BEFORE January 11, 2016:

A Buy (B) represents a total rate of return potential of 15% or more on a 12-month horizon.

A Neutral (N) represents a total rate of return of -15% to +15% on a 12-month horizon. As of July 31, 2015, an analyst may assign a Neutral (N) rating even if the total rate of return is not between -15% and +15% if the analyst does not feel conviction that the stock is a Buy (B) or a Sell (S) and particular circumstances exist, such as, for example, if the stock has an extraordinarily high dividend yield or is low-priced. If an analyst assigns a Neutral (N) rating utilizing the foregoing exception, they will provide an explanation as to their reasoning.

A Sell (S) represents a total rate of return -15% or below on a 12-month horizon.

Return potential represents potential and projected dividends and the price differential between the current share price and the price target expected on a 12-month time horizon associated with the price target. Price targets are required for all covered stocks.]

### **Global Disclaimer**

Compass Point Research & Trading, LLC expects to receive or intends to seek compensation for investment banking services from the subject company(ies) in the next 3 months.

The research analyst(s) named in the certification above receives compensation based upon various factors, including, but not limited to, the quality and accuracy of research, client feedback, competitive factors, and overall firm revenues, which include revenues generated by Compass Point Research & Trading, LLC's investment banking activities.

This report is based upon public information that Compass Point Research & Trading, LLC and the research analyst named in the attestation above assume to be correct.

Assumptions, opinions, forecasts, and estimates constitute the research analyst's judgment as of the date of this material and are subject to change without notice. The research analyst's judgments may be wrong.

Neither Compass Point Research & Trading, LLC nor its affiliates, nor the research analyst, are responsible for any errors, omissions, or results obtained from the use of this information.

---

Past performance is not necessarily indicative of future results.

The securities and/or financial instruments mentioned in this research report, and the trading strategies related thereto, may not be suitable for all investors. You must consider your specific investment goals and objectives prior to transacting in any security or financial instrument. Consult with your financial advisor before making any transactions or investments.

© Compass Point Research & Trading, LLC 2017. All rights reserved. Reproduction or quotation in whole or part without permission is forbidden.