William Blair

Congress Overturns CFPB Ban on Forced Arbitration

If the CFPB's ban on forced arbitration clauses had been enacted, it could have had a chilling effect on specialty finance M&A activity.

Industry Commentary

J.P. Young
+1 312 364 8160
jyoung@williamblair.com

In July, the Consumer Financial Protection Bureau (CFPB) finalized a rule that would have prevented credit card providers, banks, and other consumer finance companies from including clauses in their contracts that force consumers to use arbitration, rather than joining class-action lawsuits, to settle disputes with the companies. The Republican-controlled Congress, however, voted to overturn the CFPB's rule, which was scheduled to take effect in March 2018.

Under the Congressional Review Act, Congress has the authority to overturn certain rules issued by federal agencies within 60 days of the rules being announced. In July, the House introduced and passed a resolution to overturn the CFPB's proposed ban on forced arbitration. The Senate narrowly approved the resolution in late October, with Vice President Mike Pence casting the tie-breaking vote, and President Donald Trump signed the resolution into law on November 1.

A White House press release, issued October 24, described the president's opposition to the CFPB rule: "According to a recent report by the Department of the Treasury, the evidence is clear that the CFPB's rule would neither protect consumers nor serve the public interest. Rather, under the rule, consumers would have fewer options for quickly and efficiently resolving financial disputes. Further, the rule would harm our community banks and credit unions by opening the door to frivolous lawsuits by special interest trial lawyers."

In a July 2017 statement announcing the rule, CFPB Director Richard Cordray explained the agency's rationale for banning forced arbitration clauses: "Arbitration clauses in contracts for products like bank accounts and credit cards make it nearly impossible for people to take companies to court when things go wrong. These clauses allow companies to avoid accountability by blocking group lawsuits and forcing people to go it alone or give up. Our new rule will stop companies from sidestepping the courts and ensure that people who are harmed together can take action together."

Impact on M&A Activity

By overturning the forced-arbitration ban, we believe that Congress has eliminated what could have been a significant headwind to M&A activity in the specialty finance industry, in terms of both valuations and volume. While the rule applied to most companies under the CFPB's purview, the impact likely would have been the greatest for providers of credit cards, prepaid debit cards, payday loans, and other fee-based products. Smaller companies with limited budgets for litigation defense likely would have been hit especially hard.

If the rule had gone into effect, buyers would have needed to account for heightened litigation risks when analyzing a target company, and this likely would have led to lower valuations and fewer transactions. Many buyers may have looked to limit their litigation risk by completing asset purchases that exclude higher-risk portions of the target's loan portfolio. These types of transactions are much more cumbersome and difficult to execute than traditional equity acquisitions.

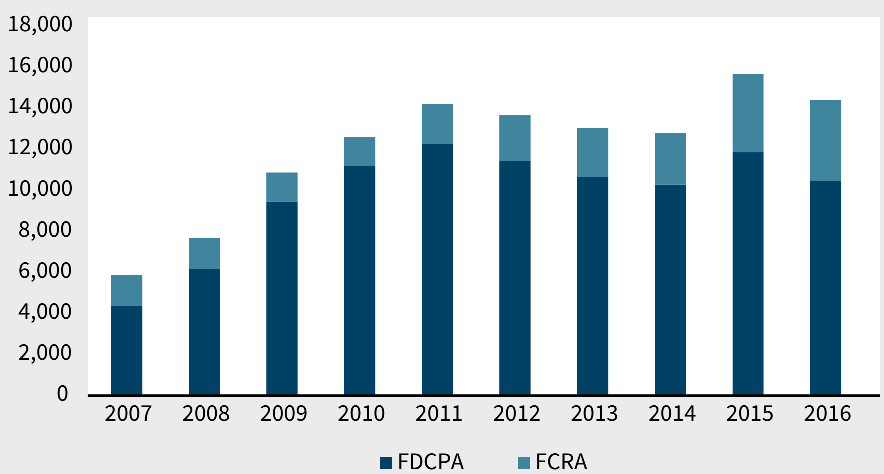
At William Blair, we recently completed a sale of a specialty lender whose customer contracts did not include a forced-arbitration clause. The buyer viewed this as creating a high-severity albeit low-probability risk, and wanted to take steps to absolve itself from assuming this risk. As a result, the buyer structured the acquisition as an asset purchase that did not include the portion of the loan portfolio that was not covered by an arbitration clause. The transaction ultimately got completed, but it was much more complex than most specialty finance acquisitions.

We will continue to monitor and update you on regulatory changes in Washington that could affect valuations and transaction activity for specialty finance companies. In the meantime, please do not hesitate to contact us about these or other trends that are the shaping the dealmaking landscape in specialty finance.

While the rule applied to most companies under the CFPB's purview, the impact likely would have been the greatest for providers of credit cards, prepaid debit cards, payday loans, and other fee-based products. Smaller companies with limited budgets for litigation defense likely would have been hit especially hard.

Consumer Lawsuits Against Finance Companies

The number of consumer lawsuits against finance companies under the Fair Debt Collection Practices Act (FDCPA) and the Fair Credit Reporting Act (FCRA) have increased significantly since the financial crisis. If the CFPB's new rule banning "forced arbitration" had gone into effect in March 2018, the number of lawsuits against consumer finance companies was expected to surge, creating increased litigation risk for providers of credit cards, checking and savings accounts, and a host of other products. The CFPB's rule, however, was overturned by a House resolution that was approved by the Senate in late October and signed into law by President Trump on November 1.



Source: WebRecon LLC