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Invested in America

July 1, 2016

Via E-Mail to: FederalRegisterComments@cfpb.gov

U.S. Bureau of Consumer Financial Protection
1700 G Street, NW
Washington DC 20552
Attn: Monica Jackson, Office of the Executive Secretary

Re: Docket No. CFPB-2016-0020; RIN 3170-AA51
CFPB proposed rule re: class action waivers and arbitral records

Dear Ms. Jackson:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to comment on the Consumer Financial Protection Bureau ("CFPB") proposal (the "Proposal") to establish regulations under 12 CFR Part 1040 that would prohibit covered providers from including class action waiver provisions in consumer contracts, and require covered providers to submit certain arbitral records to the CFPB (the "Proposed Rule").[2]

SIFMA's comment focuses on significant industry concerns over the application and applicability of the Proposed Rule to broker-dealers, investment advisers, and other SEC-regulated entities. We question the necessity and appropriateness of the CFPB extending the Proposed Rule to SEC-regulated entities, based upon clear congressional intent, the explicit statutory language of the Dodd-Frank Act, and sound policy and practical considerations.

In short, we believe that the CFPB should defer regulation of arbitration generally, and arbitration clauses specifically, for SEC-regulated entities to the SEC. Thus, the proposed exemption for broker-dealers in the Proposal, and any prospective exemption for investment advisers, are unnecessary.

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[1] SIFMA is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over $2.5 trillion for businesses and municipalities in the U.S., serving clients with over $20 trillion in assets and managing more than $67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

[2] *Arbitration Agreements*, 12 CFR Part 1040, Docket No. CFPB-2016-0020, RIN 3170-AA51, 81 Fed. Reg. 32830 (May 24, 2016).

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The Proposed Rule purports to apply to broker-dealers because, as the Proposal explains, *"[b]roker-dealers may provide products that are described in [the Proposed Rules]"* by, for example, *"extend[ing] credit to allow customers to purchase securities"* (i.e., engaging in margin lending).[3] The Proposed Rule, however, provides an exclusion for broker-dealers *"to the extent they are providing any products and services covered by proposed § 1040.3(a) that are also subject to specified rules promulgated or authorized by the SEC prohibiting the use of pre-dispute arbitration agreements in class litigation and providing for making arbitral awards public."*[4]

The Proposal notes that since 1992, FINRA rules (which are authorized by the SEC) ban broker-dealers from including class action waivers in PDAAs with their clients,[5] and also require that arbitral awards be made public,[6] and thus, broker-dealers would satisfy the conditions of the exclusion. The Proposal invites comment on whether the broker-dealer exclusion is appropriate and whether it should be expanded or narrowed, and if so, how.

The Proposal also invites comment on whether other SEC-regulated persons, such as investment advisers, may provide a *"consumer financial product or service"* that would be subject to the proposed rules, and if so, whether the proposed rules should also include an exclusion for such persons. Unlike broker-dealers, investment advisers are not currently prohibited by law from including class action waivers in PDAAs with their clients. The Proposal seeks comment on whether the Proposed Rule should include an exclusion for investment advisers *"to the extent they are subject to any SEC rule (which does not currently exist, but which the SEC could adopt in the future, for example, under Dodd-Frank section 921) that is functionally equivalent to the proposed rule."*[7]

Congress gave the SEC and CFPB respective and differing authority to regulate arbitration clauses in investment versus consumer financial contracts

The Dodd-Frank Act provides regulatory authority over pre-dispute arbitration agreements ("PDAAs") in two separate areas: (1) disputes between clients and broker-dealers or investments advisors arising under the federal securities laws, or FINRA rules, as regulated by the SEC; and (2) disputes relating to the provision of a consumer financial product or service, as regulated by the CFPB.

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[3] Proposal at 32880.

[4] Proposed Rule § 1040.3(b)(1).

[5] FINRA Rules 2268(f) and 12204(d).

[6] FINRA Rule 12904(h).

[7] Proposal at 32880.

Specifically, Section 921 of the Dodd-Frank Act amends the Securities Exchange Act of 1934 and the Investment Advisers Act of 1940 to provide the SEC with authority to: "prohibit, or impose conditions or limitations on the use of, agreements that require consumers or clients of any [broker-dealer or investment adviser] to arbitrate any future dispute between them arising under the Federal securities laws, the rules and regulations thereunder, or the rules of a self-regulatory organization if it finds [it to be] in the public interest and for the protection of investors."[8] Congress's intent was for the SEC to regulate PDAAs for entities under their jurisdiction, if the SEC found such regulation necessary.

In contrast, Section 1028 of Dodd-Frank requires the CFPB to study and report to Congress on the use of PDAAs between "covered persons" and consumers in connection with offering or providing "consumer financial products or services," and provides the CFPB with authority to: "prohibit or impose conditions or limitations" on the use of PDAAs for a "consumer financial product or service" if it finds it to be "in the public interest and for the protection of consumers" *and* "the findings in such rule [are] consistent with the [aforementioned] study."[9]

Given the regulatory distinction in Dodd-Frank between PDAAs in investment contracts versus consumer financial contracts, as well as the different congressional approaches to regulatory action on this topic, it was clearly not Congress's intent for the CFPB and SEC to exercise overlapping regulatory authority with respect to PDAAs. The congressional record and legislative history of the Dodd-Frank Act make this point explicit in the following colloquy:

> *Mr. MOORE of Kansas: … "First, do you agree the conferees did not intend to impose the regulatory authority of the bureau over the activities of broker-dealers and investment advisers otherwise subject to regulation by the SEC and CFTC?"*
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> *Mr. FRANK of Massachusetts. "If the gentleman would yield to me, I agree. As the gentleman knows, our bill does give the SEC the power we expect them to use to impose greater fiduciary responsibilities on these people. The consumer protection bureau will be a very powerful one. It will be dealing with financial products in the lending area and elsewhere. It was not intended to duplicate existing regulation. So, in fact, as the gentleman knows, we enhance the regulatory authority of those entities he mentioned, and there is no intention whatsoever, nor is there language, I believe, that would lead to duplicate supervision by the consumer protection bureau."*
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> *Mr. MOORE of Kansas. "I thank the gentleman."*
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> *"Clarification for the Record: Consumer Bureau vs. SEC/CFTC Powers, Provided by Rep. Dennis Moore (KS- 03), June 30, 2010, H.R. 4173, Dodd-Frank Conference Report. It was the conference committee's intent to avoid gaps in*

[8] 15 U.S.C. § 78o(o); 25 U.S.C. 80b-5(f).

[9] 12 U.S.C. § 5518(b).

> *oversight, but also to avoid creating duplicative or competing rulemaking and supervisory authorities, one vested in the Consumer Bureau and the other in the SEC or CFTC. As such, the final report provides exclusive authority to the SEC and the CFTC over persons they regulate to the extent those persons act in a "regulated capacity." If such persons are not acting in a regulated capacity, their activities relating to the offering and provision of consumer financial products or services may be subject to the authority of the Bureau instead of the SEC or CFTC. But to the extent they are acting in a 'regulated capacity', only their functional regulator the SEC or the CFTC-has rulemaking, supervisory, examination or enforcement authority over the regulated person or such activities. To that end, the conference report specifically states that 'the Bureau shall have no authority to exercise any power to enforce this title with respect to any person regulated by the Commission' or the CFTC. It was not the intent of the conference committee to impose the regulatory authority of the Bureau over the activities of broker-dealers and investment advisers otherwise subject to regulation by the SEC and CFTC."*[10]

The CFPB should follow this explicit congressional intent and defer regulation of arbitration generally, and arbitration clauses including PDAAs specifically, for SEC-regulated entities to the SEC.

We would add that FINRA's arbitration forum is available to both investment advisers (under certain conditions) and broker-dealers, and that the SEC has regulated this arbitration system for over four decades. The SEC inspects FINRA's arbitration program, investigates complaints, and approves all changes to FINRA rules after a robust public review and comment process. The current state of the securities regulations and arbitration rules – including the distinction between broker-dealer and investment adviser regulation of class action waivers – reflects the SEC's regulatory judgment in this distinct area of its unquestioned expertise. Thus, principles of sound governance and regulatory restraint would also dictate that the CFPB should not intrude on the province of the SEC, particularly in this area where the SEC has superior expertise and has been continuously and diligently exercising its regulatory judgment for several decades.

CFPB's General Rulemaking Authority is Limited to "Consumer Financial Products or Services"

Even if Congress intended for the CFPB to regulate broker-dealer and investment advisor PDAAs, which we do not believe is the case, the CFPB would not have statutory rulemaking authority over certain services related to securities that it proposes to regulate under the Proposed

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[10] Congressional Record – House, Report on Resolution Providing for Consideration of Conference Report on H.R. 4173, Dodd-Frank Wall Street Reform and Consumer Protection Act, H5212, H5216 – 5217 (June 30, 2010), available at https://www.congress.gov/crec/2010/06/30/CREC-2010-06-30-pt1-PgH5212-3.pdf.

Rule. As noted above, under the Dodd-Frank Act, Congress carefully limited CFPB's statutory authority to regulate PDAAs to *"covered persons"* who offer or provide *"consumer financial products or services."* The statute defines *"covered persons"* as *"any person [or affiliate of a person] that engages in offering or providing a consumer financial product or service."*[11] The statute defines *"consumer financial products or services"* to mean, among other things, extending credit and servicing loans; real estate settlement services; providing financial advisory services (not related to securities); and deposit-taking activities.[12]

The Proposed Rule would apply to PDAAs that cover the following products or services *"when they are consumer financial products or services as defined [in the Dodd-Frank Act]"*:[13]

- ***Consumer credit decisions***: Extending or regularly participating in decisions regarding consumer credit under Regulation B implementing the Equal Credit Opportunity Act ("ECOA"), engaging primarily in the business of providing referrals or selecting creditors for consumers to obtain such credit, and the acquiring, purchasing, selling, or servicing of such credit;
- ***Auto leasing***: Extending or brokering of automobile leases as defined in CFPB regulation;
- ***Debt management or settlement***: Providing services to assist with debt management or debt settlement, modify the terms of any extension of consumer credit, or avoid foreclosure;
- ***Credit reporting***: Providing directly to a consumer a consumer report as defined in the Fair Credit Reporting Act, a credit score, or other information specific to a consumer from a consumer report, except for adverse action notices provided by an employer;
- ***Consumer accounts and remittance transfers***: Providing accounts under the Truth in Savings Act and accounts and remittance transfers subject to the Electronic Fund Transfer Act ("EFTA");
- ***Certain funds transfers and payment processing activity***: Transmitting or exchanging funds (except when integral to another product or service not covered by the proposed rule), certain other payment processing services, and check cashing, check collection, or check guaranty services consistent with the Dodd-Frank Act; and
- ***Debt collection***: Collecting debt arising from any of the above products or services by a provider of any of the above products or services, their affiliates, an acquirer or purchaser of consumer credit, or a person acting on behalf of any of these persons, or by a debt collector as defined by the Fair Debt Collection Practices Act.

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[11] 12 U.S.C. § 5481(6).

[12] 12 U.S.C. § 5481(5), (15).

[13] Proposed Rule § 1040.3(a).

The Businesses of Broker-Dealers and Investment Advisers Are Not Appropriately Covered by the Proposed Rule

As noted above, the Proposed Rule would extend to broker-dealers (and then provide them with an easily applicable exclusion) and investment advisers if they extend credit (i.e., to allow customers to purchase securities/engage in margin lending), as according to the proposal such activity constitutes "extending consumer credit" under Reg. B implementing ECOA. This view, however, ignores the controlling – and jurisdiction limiting – statutory language in the Dodd-Frank Act which provides that the term *"consumer financial products or services"* includes:

> *"providing financial advisory services* ***(other than services related to securities provided by a person regulated by the [SEC] or a person regulated by a State securities Commission, but only to the extent that such person acts in a regulated capacity)*** *to consumers on individual financial matters or relating to proprietary financial products or services ...."* (Emphasis added).[14]

Broker-dealers customarily offer margin to their clients as a valued service. "Margin" means the client borrows money from the broker-dealer to purchase securities and pledges the securities as collateral. Investors generally use margin as a helpful tool to increase their purchasing power. The Federal Reserve Board and FINRA have robust rules that govern margin trading.[15]

When broker-dealers offer or provide margin, they are doing so as: (i) a *"service[] related to securities"* by (ii) an SEC-regulated person, who is (iii) acting in a regulated capacity. Thus, margin lending is inherently a service related to securities because it is the very thing that allows the client to obtain the securities in the first place.

Indeed, broker-dealers provide a range of ancillary services – such as providing remittance transfers subject to Reg. E, and payment processing services, for example – which are not only necessary to the conduct of their securities business, but also closely related to securities as well. Such ancillary services provided by broker-dealers likewise constitute *"services related to securities"* that fall outside the definition of *"consumer financial products or services."* Thus, broker-dealers who offer or provide such services would not thereby subject themselves to the Proposed Rule. For all the same reasons, investment advisers likewise do not provide *"consumer financial products or services"* for purposes of the Proposed Rule.

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[14] 12 U.S.C. § 5481(15)(a)(viii).

[15] *E.g.* FINRA Rule 4210.

CFPB's Rulemaking Authority Over PDAAs is Further Limited to Disputes That "Relate to" a Consumer Financial Product or Service

Even assuming, *arguendo*, that a broker-dealer's or an investment adviser's ancillary services relating to securities were deemed to be *"consumer financial products or services"* (which they are not), the Proposed Rule would only preclude the enforcement of a class action waiver against a customer who sought to join a class action that was *"related to"* any of the consumer financial products or services covered by the Proposed Rule."[16] Thus, for example, if a broker-dealer's margin lending services were deemed to be *"consumer financial products or services,"* then the Proposed Rule would only preclude the broker-dealer from enforcing a class action waiver against a client who wanted to join a class action that *"related to"* the broker-dealer's margin lending services. This narrow, service-by-service approach to regulating PDAAs does not make any practical sense when applied to broker-dealers and investment advisers, who are subject to the SEC's plenary jurisdiction. The rule would impose a new burden on broker-dealers and investment advisers to ensure compliance with the requirements, even thought it would apply only in very limited circumstances that are already regulated under the securities regulatory framework.

CFPB Has No Enforcement Authority Over Broker-Dealers or Investment Advisers

Moreover, CFPB has no enforcement authority over SEC-regulated persons, including broker-dealers and investment advisers, among others. Under Dodd-Frank Act § 1027(i)(1), entitled *"Limitations on authorities of the Bureau,"* Congress expressly provided that *"[t]he [CFPB] shall have no authority to exercise any power to enforce [Title X – Bureau of Consumer Financial Protection] with respect to a person [or entity] regulated by the [SEC]."*[17] So, here we have the CFPB writing rules that could only be enforced by the SEC on a subject matter over which the SEC has been granted complete congressional authority to regulate. This raises the prospect that the Proposed Rule may conflict with the SEC's regulatory judgment, or that it may be superseded by subsequent SEC rulemaking.[18]

* * *

The Proposal assumes jurisdiction over broker-dealers and investment advisers, and then offers exclusions and prospective exclusions to avoid application of the Proposed Rule. In doing

[16] Proposed Rule § 1040.4(a)(1).

[17] 12 U.S.C. § 5517(i)(1).

[18] Section 1022 of Dodd-Frank requires the CFPB to consult with the SEC, among others, prior to proposing a rule, such as the Proposed Rule. In the Proposal, the CFPB states that it "has consulted, or offered to consult, with, … the [SEC]…." Proposal at 32898. Thus, it is unclear whether or not the CFPB actually consulted with the SEC or whether the CFPB otherwise satisfied its statutory obligation to consult.

so, the CFPB is inappropriately usurping the regulatory judgment of the SEC and substituting its own. The SEC has complete rulemaking and enforcement authority over arbitration and arbitration clauses, including PDAAs, between broker-dealers and investment advisers and their clients. The CFPB, on the other hand, has no rulemaking or enforcement authority over broker-dealer or investment adviser arbitration or arbitration clauses. We urge the CFPB to acknowledge that neither broker-dealers nor investment advisers are appropriately subject to the Proposed Rule, and that therefore neither a broker-dealer exclusion, nor an investment adviser exclusion, is necessary.

If you have any questions regarding this letter, please contact the undersigned at 202.962.7382 or kcarroll@sifma.org.

Sincerely,

Kevin M. Carroll
Managing Director and Associate General Counsel

cc: The Hon. Mary Jo White, Chairman
The Hon. Michael S. Piwowar
The Hon. Kara M. Stein
David Grim, Director, Division of Investment Management
Stephen Luparello, Director, Division of Trading and Markets
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