

**REMINDER: JUNE 1, 2013 STARTS BAN ON ARBITRATION CLAUSES
IN MORTGAGE LOAN CONTRACTS**

Effective June 1, 2013, Regulation Z will prohibit the inclusion of clauses requiring a consumer to submit disputes concerning certain mortgage transactions to binding arbitration or other non-judicial procedures. As part of a final rule issued on February 15, 2013 which generally dealt with loan originators, the Consumer Financial Protection Bureau (CFPB) added new Section 1026.36(h)(1) to Regulation Z. The new rule prohibits a contract for a closed-end consumer loan secured by a dwelling and an open-end home equity line of credit (HELOC) secured by the consumer's principal dwelling (Covered Loan) from including terms that require arbitration or any other non-judicial procedure to resolve any controversy or settle any claims arising out of the transaction. Note that closed-end mortgage loans are covered when secured by the consumer's dwelling, whether it is the consumer's principal dwelling or a second or vacation home. On the other hand HELOCs are covered only when secured by the consumer's principal dwelling.

The new rule also provides that an agreement relating to a Covered Loan cannot bar a consumer from bringing a claim in court for relief for any alleged violation of federal law. This will preclude, among other things, contract provisions that waive the consumer's right to bring a class action against the creditor, at least for violations of federal law.

The CFPB does not interpret the new rule as prohibiting waivers of the right to a jury trial because a bench trial is still a judicial proceeding (78 FR at 11387). Institutions are reminded, however, that pre-dispute jury waivers are problematic in California because they have been held to be unenforceable under the California constitution.

As an aside, some institutions include judicial reference provisions in their consumer loan contracts, which provisions are based upon California Code of Civil Procedure Sections 638 and 639. Judicial reference is initiated by the filing of a lawsuit and thereafter the court appoints a referee (usually a retired judge) to hear and decide the matter. In that the entire reference process grows out of the filing of a lawsuit and requires the court's participation at certain points in the process, judicial reference is clearly not a "non-judicial procedure." However, since Covered Loans typically are secured by real property, judicial reference is not necessary because creditors have the benefit of foreclosing under their private power of sale in the case of a default. In addition, judicial reference could potentially be disruptive to the foreclosure process. As such

provisions requiring judicial reference generally are not recommended in the case of mortgage loans secured by real property.

Institutions should review their loan documents on Covered Loans before June 1, 2013 and remove any mandatory arbitration provisions, class action waivers, jury waivers or other prohibited provisions. For individualized advice, including document reviews, please contact Robert K. Olsen, who heads the law firm's Consumer Practice Group.