cfpb Consumer Financial Protection Bureau

1700 G Street, N.W., Washington, DC 20552

January 30, 2017

The Honorable Jeff Flake
United States Senate
413 Russell Senate Office Building
Washington, DC 20510

Dear Senator Flake:

Thank you for your letters regarding the Consumer Financial Protection Bureau's proposal to regulate pre-dispute arbitration agreements in contracts for consumer financial products and services.[1] The Bureau welcomes your feedback as we continue to engage with you and other stakeholders on our rulemaking.

As you know, in May 2016, the Bureau published a proposed rule that would prohibit pre-dispute arbitration clauses that deny groups of consumers the ability to get relief through the courts. The proposal would prohibit covered providers of certain consumer financial products and services from using an arbitration agreement to bar the consumer from filing or participating in a class action. Under the proposal, companies would still be able to include pre-dispute arbitration clauses in their contracts. However, for contracts subject to the proposal, the clauses would have to state explicitly that they cannot be used to stop consumers from being part of a class action in court. The proposal would also require a covered provider that is involved in arbitration pursuant to a pre-dispute arbitration agreement to submit specified arbitral records to the Bureau.

This proposal is based on a number of preliminary findings outlined in the proposed rule. These findings include the Bureau's preliminary determination, noted in your letter, that companies widely use pre-dispute arbitration agreements to prevent consumers from seeking relief for potential violations of the law on a class basis and consumers rarely file individual lawsuits or arbitration cases to obtain such relief. The Bureau's proposal is designed to protect consumers' rights to pursue justice and relief and to deter companies from violating the law. The proposal, if finalized, would allow consumers who remain subject to pre-dispute arbitration agreements to file a class action or join a class action when someone else files it. The Bureau is currently reviewing the comments on the proposed rule and will consider any comments received in accordance with its obligations for notice-and-comment rulemaking.

The Arbitration Study and the Proposed Rule address many of the questions posed in your letter. As the rulemaking process continues, the Bureau will act in accordance with its obligations under

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[1] Arbitration Agreements Notice of Proposed Rulemaking (NPRM), 81 FR 32829 (May 24, 2016), *available at* https://federalregister.gov/a/2016-10961.

the Administrative Procedures Act and appropriately consider issues raised by commenters.

1. *The study compares total awards from class action settlements over a five-year period with arbitral awards over only a two-year period.*
    a. *Please explain why, given the inherent differences between class action settlements and damage awards, the Bureau believe this to be an apple-to-apple comparison?*

*Response*

The Bureau did not draw comparisons between class action settlements and damage awards in either the Study or the NPRM. As the Study's frequency analysis shows, in significant respects, the disputes that are filed in arbitration differ from the disputes that are filed in litigation. To a greater or lesser degree of certainty, these differences result from decisions that the parties make about arbitration and litigation, such as the company's decision to have an arbitration clause, the consumer's willingness to initiate either arbitration or litigation, the company's or consumer's decision to invoke the arbitration clause in a given litigation, and the parties' decision to settle or litigate. Disputes, in short, are not randomly assigned to the two different fora. They exist in one forum or the other because of purposeful decisions by one or both parties. And the known outcomes — principally the cases resolved through an arbitrator's or court's decision — likewise reach that form of outcome, at least in part because of purposeful decisions by one or both parties.

As also noted in the Study, while the Bureau was able to locate federal class settlements dating back to 2008 in the Courtlink database maintained by LexisNexis, electronic records for arbitral awards only became available in 2010. As the Study also noted, more than half of the arbitrations filed in 2012 were still outstanding as of the time the Bureau began its analysis in 2013, such that it was not feasible to analyze a sufficient number of outcomes in those cases.

    b. *Please explain why, given the inherent differences between settlements and damage awards, the Bureau did not compare class action settlements to pre-arbitral alternatives like mediation and "customer service" settlements?*

*Response*

As stated in its proposal, the Bureau preliminarily found that informal dispute resolution mechanisms are insufficient to fully resolve potential violations of the law that broadly apply to many or all customers of a particular company for a given product or service. The Bureau stated that it understands that when an individual consumer complains about a particular charge or other practice, it is often in the financial institution's interest to provide the individual with a response explaining that charge and, in some cases, a full or partial refund or reversal of the practice, in order to preserve the customer relationship. But, many consumers may not be aware that a company is behaving in a particular way, let alone that the company's conduct is unlawful. Thus, an informal dispute resolution system may be unlikely to provide relief to all consumers who are adversely affected by a particular practice. Indeed, the Bureau has observed that its enforcement

actions deliver relief to consumers who have not received it already through informal dispute resolution.

Moreover, even where consumers do make complaints informally, the outcome of these disputes may be unrelated to the underlying merits of the claim. Nothing requires a company to resolve a dispute in a particular consumer's favor, to award complete relief to that consumer, to discontinue the complained of practice in the future, to decide the same dispute in the same way for all consumers, or to reimburse consumers who had not raised their dispute to a company. Regardless of the merits of or similarities between the complaints, the company retains discretion to decide how to resolve them. For example, if two consumers bring the same dispute to a company, the company might resolve the dispute in favor of a consumer who is a source of significant profit while it might reach a different resolution for a less profitable consumer. Indeed, the Bureau understands that it is quite common for financial institutions (especially the larger ones that interact with the greatest number of consumers) to maintain profitability scores on each customer and to cabin the discretion of customer service representatives to make adjustments on behalf of complaining consumers based on such scores.

The Bureau noted in its proposal that it has considered arguments that arbitration agreements provide a sufficiently strong incentive to providers to address consumers' concerns and obviate the need to strengthen private enforcement mechanisms. One such argument is that many agreements contain filing fee-shifting provisions that require providers to pay consumers' up front filing fees. Some stakeholders have posited that the ease and low up front cost of arbitration may change many negative-value individual legal claims into positive-value arbitrations that, in turn, create an additional incentive for providers to resolve matters internally. In principle, if arbitration agreements had the effect of transforming many negative-value claims into positive ones, that would affect not just providers' incentives to resolve individual cases (as some stakeholders have posited) but also their incentives to comply with the law ex ante.

As noted in the Bureau's proposal, however, there has been little if any empirical support for such an argument. The Bureau has only been able to document several hundred consumers per year actually filing arbitration claims and the Bureau is unaware that providers have routinely concluded that considerably more consumers were likely to file. The Bureau has received comments on the proposal, including on the issue of this type of "informal" dispute resolution and its relationship to arbitration, and is considering the comments that it has received.

2. *On what basis did the Bureau exclude data on arbitral settlements? On what basis did it exclude data on mediation and "customer service" settlements?*

*Response*

For the most part, the arbitral settlements are data that has not been available to researchers, including the Bureau. Arbitrators do not resolve the vast majority of consumer financial disputes filed with the American Arbitration Association (which is the largest administrator of consumer

arbitrations), as disputes are frequently settled or reach other procedural outcomes, and the content of those settlements are not set forth in the case file. The Bureau's ability to review substantive outcomes in arbitration therefore is generally limited to arbitration decisions on the merits, and the substantive outcomes of most consumer financial arbitration disputes are unknown and largely unknowable to reviewers.[2]

The Study also focused on formal dispute resolution, of which arbitration is one type, and litigation is another. As discussed above, customer service accommodations may preclude a need for formal dispute resolution of a given consumer's issue. However, formal dispute resolution exists, is used, and generates the relief described in the Study, and the Bureau preliminarily found in the proposal that these data substantiate its view, as described in the previous question, that informal dispute resolution does not adequately resolve all claims of legal violations. The Bureau has received comments on the nature and extent of informal dispute resolution and will consider those comments in accordance with its obligations for notice-and-comment rulemaking.

3. *Please describe any and all of the alternatives to the proposed new regulatory regime that the Bureau considered.*

*Response*

The proposed rule describes several potential alternatives, including consumer disclosures, consumer education, opt-in or opt-out requirements, a total ban on pre-dispute arbitration agreements, as well as specific exemptions such as for small entities or matters that entities have reported to regulators.[3] As noted in the proposal, the goals of the proposal are to ensure adequate deterrence of and remedies for violations of law in consumer financial markets. In the proposal, the Bureau stated its belief that none of the alternatives described would be significant alternatives insofar as they would not accomplish the goal of the proposed rulemaking with substantially less regulatory burden. However, the Bureau requested comment on these potential alternative policy options, including any evidence that would indicate that the option could achieve such goals. The Bureau is currently reviewing the comments received on the proposed rule and potential alternatives thereto and will consider any comments received in accordance with its obligations for notice-and-comment rulemaking.

4. *Is it possible for arbitration agreement between consumers and financial institutions to be fair and non-deceptive? If yes, would such an agreement meet the Bureau's approval?*

*Response*

Yes, it is possible for arbitration agreements between consumers and financial institutions to be fair and non-deceptive. As is stated in the proposal, arbitration clauses, apart from blocking class

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[2] See also, answer to 1b.

[3] *See* Arbitration Agreements Notice of Proposed Rulemaking, 81 FR 32920-32922.

actions, have historically included provisions that have been used to harm consumers. Nevertheless, the Bureau has not proposed to prohibit arbitration agreements generally because of its preliminary finding that the relative fairness of individual arbitration, as compared to individual litigation, was inconclusive. The Bureau has received comments on this preliminary finding and will consider those comments in accordance with its obligations for notice-and-comment rulemaking.

5. *The Bureau has only operated since July 2011. In that time, it has supposedly recovered $11.2 billion for consumers through enforcement actions and $300 million through supervisory actions.*

   a. *Given the Bureau's enforcement record since 2011, why did the Bureau deem it appropriate to only study data from 2008 to 2012?*

*Response*

The Study identified public and private enforcement actions that occurred between 2008-2012 and then searched for the respective matching private and public enforcement actions without a date limitation of 2012.[4] The Study showed private class actions often complement public enforcement rather than duplicate it. In 88 percent of the public enforcement actions the Bureau identified, the Bureau did not find an overlapping private class action. Similarly, in 68 percent of the private class actions the Bureau identified, the Bureau did not find an overlapping public enforcement action. Moreover, in a sample of class action settlements of less than $10 million, the Bureau did not find overlapping public enforcement action 82 percent of the time. Even where there was overlap, private class actions tended to precede public enforcement actions, roughly two-thirds of the time. The Bureau has received comments on the methods used for its analysis of public and private enforcement actions, including on whether it selected the appropriate time period for its analysis, and will consider those comments in accordance with its obligations for notice-and-comment rulemaking.

   b. *What effect does the existence of the Bureau's enforcement power since July 2011 have on the net benefit of class actions?*

*Response*

As is noted in the proposed rule, the Bureau preliminarily concluded, based upon the results of the Study and its own experience and expertise, that public enforcement is not itself a sufficient means to enforce consumer protection laws and consumer finance contracts. As the Bureau noted, the market for consumer finance products and services is vast, encompassing trillions of dollars of assets and revenue and the proposal alone would cover about 50,000 firms. In contrast, the resources of public enforcement agencies, including the Bureau, are limited. For example, the Bureau enforces over 20 separate Federal consumer financial protection laws with respect to every

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[4] *Arbitration Study: Report to Congress, pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act §1028*, Appendix U.

depository institution with assets of more than $10 billion and all non-depository institutions. Yet the Bureau has about 1,500 employees, only some of whom work in its Division of Supervision, Enforcement, and Fair Lending, which supervises for compliance and enforces these laws. The Bureau has received comments on the proposal, including on the issue of the impact of its recent enforcement activity, and will consider the comments it has received in accordance with its obligations for notice-and-comment rulemaking.

6. *The Arbitration Rule is based on the premise that banning the use of agreements that prohibit class-action lawsuits is "in the best interest of the public." However, in many instances, attorney fees comprise large portions of the aggregate payments made to classes in settlements. As Judge Richard Posner has observed:*

> *[C]lass counsel...have an opportunity to maximize their attorneys' fees...at the expense of the class. The defendant cares only about the size of the settlement, not how it is divided between attorneys' fees and compensation for the class. From the selfish standpoint of class counsel and the defendant, therefore, the optimal settlement is one modest in overall amount but heavily tilted toward attorneys' fees. Eubank, et al. v. Pella Corp. & Pella Windows & Doors, Inc., 753 F.3d 718, 720 (2014).*

*Indeed the Bureau's study confirmed this, finding that in settlements of $100,000 or less attorney fees comprised 57 percent of total payouts.*

   a. *Did the Bureau consider placing a limit on the percentage of fees an attorney can demand in a lawsuit?*

*Response*

As discussed above in the response to Question 3, the goals of the proposal are to ensure adequate deterrence of and remedies for violations of law in consumer financial markets. The Bureau has requested comment on alternative policy options, including any evidence that would indicate that the option could achieve such goals. Further, as the proposal noted, Congress, state legislatures, and the courts have adopted mechanisms for managing class procedures over time. As part of these procedures, courts must approve all class actions settlements, including the reasonableness of the award of attorneys' fees to the class plaintiffs' lawyers. The Bureau has received comments on the proposal, including on the issue of attorney's fees, and is considering those comments in accordance with its obligations for notice-and-comment rulemakings.

   b. *What would you consider to be a reasonable range of attorney fees by percentage of payments made in a settlement? Why?*

*Response*

In the Arbitration Study, the data presented showed that there were differences in the amount of attorneys' fees in settlements in relation to the amount awarded.[5] However, the Bureau did not use this data to determine whether a certain percentage of a settlement would be a reasonable amount to award to plaintiffs' attorneys.[6] As stated above, Congress, state legislatures, and the courts have the ability to determine the proper rules and procedures for the approval of class action settlements, including attorneys' fees. Courts may also consider the prospect for success on the merits when determining what fees are reasonable in a class settlement. In addition, Congress has passed legislation, such as the Class Action Fairness Act, that limits frivolous suits and allows courts to reduce the amount of attorneys' fees that are deemed to be excessive.[7] Again, as noted above, the Bureau has received comments on the issue of attorney's fees and will consider them in accordance with its obligations for notice-and-comment rulemakings.

7. *You stated on February 16, 2016, "the Bureau's rule requires companies to provide the Bureau with arbitral claims and awards, which might be made public, the proposals we are considering would bring the arbitration of individual disputes into the sunlight of public scrutiny." You have argued that this information is vital in evaluating arbitration. If the information is vital to evaluate the effectiveness of arbitration, why didn't the Bureau require it in the study?*

*Response*

The Bureau did study this information on a retrospective basis, as detailed in Section 5 of the Study. Insofar as the proposal would allow consumer arbitration to continue into the future, the Bureau wants to be able to continue to study the role arbitration plays in the resolution of consumer disputes on a going forward basis, as the use of arbitration continues to evolve, in a manner that also informs the public.

8. *Did the Bureau consider whether the restriction of mandatory arbitration agreements would affect the availability of arbitration as a means to settle disputes between consumers and financial institutions? If so, why did the Bureau disregard this concern?*

*Response*

Yes, the proposal did preliminarily consider the potential for continued use of arbitration agreements for individual disputes. The proposal explained that, to the extent some providers find that the arbitration agreement provides insufficient benefits to themselves or their consumers in individual disputes then it is possible the agreement would not be maintained if the Bureau adopted the class part of its proposal. For any such providers, however, as explained in the proposal, the

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[5] *Arbitration Study: Report to Congress, pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act §1028*, pp. 236-40; 353-57

[6] *Id.*

[7] 28 U.S.C. § 1712

Bureau believes the arbitration agreement has thus effectively been serving no significant function other than as a class action lawsuit waiver. Further, the Bureau has received comments on the proposal, including on the potential effect on the use of arbitration agreements going forward, and is considering the comments it has received in accordance with its obligations for notice-and-comment rulemakings.

Thank you once again for your interest in the Bureau and for providing feedback on our proposal. The Bureau will give due consideration to the issues raised in your letter. Please feel free to contact me should you have any additional questions, or have your staff contact Matthew Pippin in the Bureau's Office of Legislative Affairs. Mr. Pippin can be reached at (202) 435-7552. I look forward to working with you on this and other consumer financial protection matters of importance to you and your constituents.

Sincerely,

Let me know if you need anything further.
Rich

Richard Cordray
Director