

Consumer Finance Monitor Podcast (Season 9, Episode 45): What Are Class Action Waivers Worth? A New Study Looks to the Stock Market for Answers

Speakers: Alan Kaplinsky and James Tierney

Alan Kaplinsky:

Welcome to the award-winning Consumer Finance Monitor podcast. Where we explore important new developments in the world of consumer financial services and what they mean for your business, your customers, and the industry. This is a weekly podcast show brought to you by the Consumer Financial Services Group at the Ballard Spahr Law Firm.

I'm your host, Alan Kaplinsky, the founder and former practice group leader for 25 years, and now senior counsel of the Consumer Financial Services Group at Ballard Spahr. And I'll be moderating and hosting today's program.

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Well, let me tell you about today's show, and I'm very excited about it. Because on a personal level, it concerns a subject that has occupied a significant portion of my professional career, namely arbitration agreements, including class action waivers in a variety of contracts, but mostly in consumer finance contracts. Beginning in the late 1990s, I became one of the principal advocates for the adoption of arbitration provisions containing class action waivers in consumer contracts, working with banks, credit card issuers, finance companies, and other providers of consumer financial services. I urged the use of these provisions as a means of reducing the enormous costs and the very high risks associated with class action litigation. While also providing the same time, providing consumers with an alternative form for resolving their disputes. Which I believe that it's more efficacious than being a member of a putative class in a class action lawsuit.

Many of the largest financial institutions in the country ultimately adopted arbitration provisions, including class action waivers. As many of our listeners know, the enforceability of class action waivers became the subject of extensive litigation, ultimately leading to landmark Supreme Court decisions such as *AT&T Mobility v. Concepcion*, *American Express v. Italian Colors Restaurant*, and *Epic Systems Corp v. Lewis*. The debate later moved to the regulatory arena when the CFPB issued in 2017 the arbitration rule, which would've prohibited the use of class action waivers in many consumer finance contracts.

And then ultimately to the ... I don't know if I'll say the surprise, but certainly to the satisfaction of the industry. The Congress ultimately repealed the CFPB anti-arbitration rule, or I should say anti-class action waiver rule under the Congressional Review Act. And that happened with no votes to spare. It required Vice President Pence to break the tie in the Senate, and he did. And that was the end of the CFPB arbitration rule.

The policy debate surrounding arbitration is typically focused on questions such as consumer access to justice, litigation costs, the value to consumers of class actions, deterrence of bad behavior by companies, and fairness. The Dodd-Frank Act required the CFB to conduct the study of consumer arbitration to determine whether there was a need for a regulation curbing the use of arbitration or class action waivers in consumer finance contracts. And ultimately after conducting the research, the CFPB issued a voluminous report that among other things focused on the value of class actions to consumers and the tremendous cost to the industry of defending class actions.

The following statistics regarding class action waivers were derived from the CFPB's own report, their own study, which was led by Richard Cordray, who is certainly ... He was a very first official director of the CFPB and a very consumer oriented director, I might say. They looked at 563 class actions in the study and they found that only 12.3% of those class actions produced any settlement benefits to the putative class members. Since none of the class actions actually went to trial, that means about 87% of the putative class members received no benefits at all from the class action CFPB study. 60% of the class actions either settled individually with the named plaintiff or were dropped by the named plaintiffs and the litigation didn't proceed, leaving the putative class members to fend for themselves. The benefits received by putative class members in the 12.3% of the class actions that settled were minuscule, an average of \$32 per class member. And for that paltry sum, the settlement class members had to wait two or more years.

In class actions that required the members to submit a claim form, the weighted average claims rate was only 4%, meaning that 96% of the potentially eligible putative class members failed to obtain any benefits at all because they didn't submit claims. Director Cordray argued at the time that the lawyers for the class ... He stated that the lawyers for the class collect a small portion compared with consumers. But the CFPB study determined that the plaintiff's lawyers received a staggering \$424,495,451 in attorney's fees in the class actions that were studied, hardly what anybody would call a small portion.

The CFPB's own study revealed the following data regarding the cost to the industry of defending class action. And this is going to tie in directly with my guest who I'm about to introduce, who's conducted I think just a fabulous study about the class actions and the impact that it has on stock market value of the company adopting an arbitration program.

The CFPB estimated that the proposed rule to ban class action waivers would cause 53,000 consumer finance providers who currently utilize arbitration agreements to incur between 2.62 billion and 5.23 billion over a five-year period to deal with 6,042 additional federal and state court class actions that would be filed due to the proposed rules elimination of class waivers.

So our guest today, that's what was in the CFPB study. Obviously the CFPB study did not look at what impact nor did they really care what impact adopting an arbitration provision would have on how Wall Street or how the stock market evaluated the adoption of a class action waiver. Was there any value to it? What does the stock market think of arbitration clauses and class action waivers? What does it think they're worth?

The question is the subject of this new working paper entitled, The Value of Class Action Waivers Evidence from Invalidation of the CFPB Arbitration Rule. It's available on the Social Science Research Network, that's SSRN. And as someone who has spent years encouraging financial institutions to adopt these provisions, I found this article intriguing. Because it attempts to quantify something which many of us believe for years that protection against class action litigation had substantial economic value.

And let me introduce our speaker today. Our speaker and my guest is Professor James Fallows Tierney. Professor Tierney is Associate Dean for Academic Affairs and Associate Professor of law at Chicago Kent College of Law. His scholarship focuses on the intersection of law, financial markets and consumer finance. Before entering academia, he served in the office of the general counsel of the SEC. He practiced law at Mayer Brown, which is another law firm that very heavily involved in litigating the enforceability of consumer arbitration provisions, including class action waivers and is the law firm that represented AT&T in the Concepcion case. He then clerked for Judge Mary Schroeder of the US Court of Appeals for the Ninth Circuit. His scholarship has appeared in numerous leading law journals and focuses on how legal rules affect the financial markets and economic behavior.

So I know you've been waiting a long time, James, so we get to the many questions that I have for you. But I wanted to set this up to make sure our audience fully understood the background of leading to the study, which you ended up doing. So a very warm welcome to our podcast show.

James Tierney:

Thanks very much, Alan, for having me. I'm really happy to chat with you today.

Alan Kaplinsky:

Great. So let's start out with just some background and the motivation behind what you did. What prompted you to undertake this study? And what drew you to examine arbitration through the lens of the financial markets?

James Tierney:

Yeah, so this article is about I'd say almost eight years in the making. Your intro talked about the regulatory debate leading up to the Consumer Financial Protection Bureau's arbitration rule. And during this time, the early mid 2010s, I was working at Mayer Brown doing appellate litigation, regulatory policy work, and one of the teams that I worked on involved litigating and trying to shape policy around arbitration.

So in that context, there was this starting point in the policy debate about ... And it had not yet been settled empirically. And lots of folks in the debate accepted that a class waiver is going to reduce firm's expected litigation costs by keeping claims out of court. And so one of the fights in the policy debate is about who ends up with those savings. And I think the defenders would say competition in the kind of primary market forces firms to pass on those savings to consumers, employees through lower prices, better terms. Critics had a different story about firms suppressing claims.

But what struck me about this debate was how little direct evidence there was on this question of who pays or who gets the savings. And there was this important claim sitting at the center of the debate with very little kind of direct investigation. And I had kind of had this idea floating in my mind for a few years after I left Mayer Brown, I worked at the SEC, and then I eventually was transitioning into academia. And it occurred to me that financial markets offered this way in to examine what was, by this point, a several year old policy debate. If you think markets are reasonably efficient, stock prices are kind of compact summaries of investors' expectations around future cash flows, which it could include a company's legal exposure.

And so when the law changes the enforceability of those clauses, if investors kind of pick up this news, we can watch how they might revalue firms that are going to get affected by this rule. And so it doesn't answer the whole question of is this good or bad or what's the value? Who gets the value? But it does directly test one thing, whether the market thinks arbitration protection is worth something to the firm and so it's the stockholders. And I think that's one pressure point in the debate.

Alan Kaplinsky:

Yeah. So before you conducted the study, James, did you have a hypothesis about what you expected to find? Or were you actually surprised by the results that turned out?

James Tierney:

No. I mean, I did have a hypothesis and I wasn't all that surprised. The hypothesis is pretty specific and pretty directional. If you have an event in the world that makes it more likely that the CFPB is going to restrict class waivers in arbitration. So the fact that the CFPB is doing this in the first place, the release of its study, the proposed rule, the final rule. Each of these events should make investors think, "Oh, the chances of this passing and then affecting the firm is going to go up."

And by the same token, events that might roll the restriction back, maybe the Congressional Review Act repeal should push the value of treated firms up because investors should think this is good news. And so in advance, I coded each of the 11 events, we can talk about the specifics with a predicted sign. And the result didn't surprise insofar as the headline result is that firms that were exposed to the CFPB's arbitration rule moved in the predicted direction more than other financial services firms that wouldn't be affected. And so I think we can talk about how to interpret that. But I wouldn't say it's all that surprising.

Alan Kaplinsky:

Yeah. So you refer to this as an event study. And for listeners who are not economists or securities lawyers, what exactly is an event study and why is it a useful tool here?

James Tierney:

Sure. So I'll try and keep the technical stuff about the paper to a minimum in today's conversation. But an event study is a technique from financial economics that tries to isolate how some event, some piece of news, some fact in the world that people are learning affects a company's stock price. And there's a simple intuition behind it. On any given day, a stock moves for all sorts of reasons. The whole market is up or down, the sector is moving, and what you want is the piece of the

movement that can't be explained by those broad factors. We call that the abnormal return. And so that leftover abnormal return is your best estimate of how investors might react to the news.

So to do that, you first build kind of a statistical model of what the stock's return should have been if we had the kind of historical relationship of market-wide factors and so on. And we use a stretch of days before the event to build that model. And then we look for each piece of information, each event that gets revealed. We do a really tight window around the day at issue and then figure out how far the actual return departs from what we predicted. You can add up all those daily departures over a couple day window, and then you can see this is how much the stock changed compared to what we think it should have done on other days.

So that's useful here for two reasons. One is it lets markets speak to a question that's otherwise really hard to measure directly. What is the private value of this contract term to a firm and its investors? Second, by comparing the treated firms, firms that are going to get exposed to the CFPB's rule because they have a product line that is subject to the rule. If we compare those firms against other comparable financial firms that aren't going to get affected because they don't have those product lines, then we get to difference out news that hit the whole sector on the same day. So we're really trying to hone in on that arbitration specific piece of information and how it's changing. Rather than like, oh, financial stocks moved that week.

Alan Kaplinsky:

Right, right, right, right. So how did you identify, you mentioned a little bit earlier some of the critical events that occurred, and I think you said there were 11 different events that you identified as so-called market moving events related to arbitration. But how did you go about, maybe talk a little bit more about that. And how did you identify the firms that you were going to look at, those that adopted arbitration, those that didn't adopt arbitration?

James Tierney:

Sure, absolutely. So let me start with events. I followed the approach that is often used in this kind of study around legislative or regulatory events, right? Event studies are most often used in securities fraud class actions where people are fighting about whether some piece of information from the company changed the market on that day.

But when we're trying to apply this method to study policy changes, we're thinking about public facing events that people can react to. And so there are actually only so many public facing events in the course of an ordinary regulatory notice and rulemaking process. So we have the CFPB's initial public inquiry. They released a preliminary study, a final study, then they released a proposed rule. There was a House hearing, they released a final rule. And then finally, once the Congressional Review Act repeal process got started, each of those different steps, the House has to approve the Senate, the president, and so on, those are each going to be potential high profile events that other people might know about.

Stuff that happens inside the agency, if it doesn't get publicized, then it probably isn't going to be the kind of information that moves markets. So I focused on public events that were kind of highly visible. As for firms-

Alan Kaplinsky:

Well, before you get to the firms, did you consider the enactment of the Dodd-Frank Act, which I think was on, if I got it correctly, July 21, 2010. Was that a public event? Or did you wait until the CFPB actually ... It took them quite a while before they launched the study?

James Tierney:

Yeah, I didn't look at the Dodd-Frank event specifically. There are a couple reasons for that. The main one is that it was just a really monumental change to the industry. And so trying to parse out what's the arbitration specific effect of Dodd-Frank as compared to everything else is kind of hard.

Alan Kaplinsky:

That makes complete sense.

James Tierney:

If it had been a slightly smaller change in Dodd-Frank to the industry, I might have been able to do that.

Alan Kaplinsky:

I mean, it created the CFPB and that would be considered, I would think, by investors to be a big negative event on financial institution stocks.

James Tierney:

Yes. And some financial economists have looked at that question. And to my recollection, the evidence is that financial stocks did not do particularly well around the enactment of Dodd-Frank. But we were also right outside the tail end of the financial crisis, and so there's a lot of other stuff happening too.

Alan Kaplinsky:

Right. So let's talk now about the identification of the firms that you looked at.

James Tierney:

Sure. So I kind of looked at this topically insofar as the CFPB's final rule covered certain kinds of consumer financial services, like credit card issuers, certain lenders, debt management firms. And so what I tried to do is identify firms based on their, what's called a SIC code. It's basically a standard industry classification, I think is what it stands for. And you can get pretty specific into what kinds of industries different firms are in.

From there, there's other kind of public data sources about the lines of business that different firms are in. And so I categorized these firms as either ... Well, first of all, they had to be publicly traded. Because in order to do this, you need to be able to look at stock price changes. If they're private, can't do that. So we're already just looking at public companies, and I made two groups.

One was treated firms. So these are the firms whose product lines fell into the categories I was just talking about. But then there were other publicly traded financial firms that would not be affected by this rule. So for instance, a broker dealer, certain kinds of asset managers, certain insurers, those would be financial firms, and so they'd be affected by other kind of financial market news that day. They offered a plausible counterfactual. That's kind of hard insofar as we're trying to choose a clean control group, firms that are similar enough to absorb the same sector news, but genuinely outside the rule's reach.

The other thing I'll just say about the event dates, picking those, this is the one perhaps I want to be most candid about as a limitation. There's other stuff that happens on these days, confounding news. And so any given event might include other stuff that happened unrelated to arbitration. I haven't yet done that kind of further extension of the project, but trying to go into nexus and figure out if there were any adverse company ... Or positive company announcements that day I think is important. And so that's a caveat.

Alan Kaplinsky:

What about size of the public companies that you looked at? Was that a factor?

James Tierney:

Size is I think included insofar as one of the models I used has what's called the Fama-French four-factor model. And I don't want to get too technical, but what we're trying to do is figure out how much a stock should move on any given day. And one of those factors is how big your company is. A really big company or small cap companies often have more volatile, higher returns. If we're looking at size, that also is a proxy for potential firms that are going to get targeted for class action litigation because of a deep pockets effect.

So I like the Fama-French four-factor model when I do this kind of statistical analysis a couple times different ways, but this version does account for size in this respect. And so I think it gives us a little bit more granular view.

Alan Kaplinsky:

Got it, got it. So let's talk about the findings that were developed out of your study. What is the single most important takeaway from your paper?

James Tierney:

Yeah, I think the highlight ... And without just reading a bunch of numbers to you. The highlight is that stock market investors generally during the course of this regulatory debate treated the enforceability or the likely future enforceability of consumer class action waivers as a real attribute that is relevant to firm value. It's not just kind of legal boilerplate. There are some headline numbers, which is to say treated firms kind of moved in the theory predicted direction about 0.71% per event more than comparable firms. And that's statistically significant. This result also kind of survives a bunch of different changing the camera to see if we look at it a different way, is it going to change?

And so the interpretive punchline I think is that this is evidence both that stock investors think enforceable class action waivers are good, they result in higher returns to firms in the future. I also think it complicates the debate about who gets all of the benefits of arbitration. Insofar as the strongest version of the claim is that all of the cost savings of arbitration are competed away and passed through to consumers. And I think that strongest version probably is not consistent with investors thinking like, "And we're going to get a piece of the pie too." If the market generally expected full pass through, then news about enforceability wouldn't move firms all that much. And they did. And so I think that's consistent with firms retaining a really meaningful share of whatever cost savings get generated from arbitration.

Alan Kaplinsky:

Right, right. So in the events, and you enumerated a bunch of the events that a lot of people were familiar with, is there one particular event that generated the strongest market reaction? And if so, why do you think that the market reacted so strongly to the one event?

James Tierney:

Yeah, it's a great question. So you mentioned this in the kind of introduction. The Senate approved the Congressional Review Act resolution to repeal the CFPB's arbitration rule. And it did so at night after the markets closed in a tie vote broken by the vice president. And so the difference between how much stocks of companies exposed to the rule, the treated companies, changed relative to untreated companies. It was about 2%, and that's the biggest in the study.

And I think investors reacted strongly to that event because for all the reasons you mentioned, it carried the most genuinely new information. Every other step in the repeal process, or I should say in the whole process. If you were participating in the arbitration debate in the early to mid 2010s, the view would've been, "Oh, the CFPB is going to pursue a fairly aggressive maximalist arbitration restrictions here." And every piece of evidence from Director Cordray seemed to further that kind of expectation.

In that sense, market expectations were probably baked in already with respect to what the CFPB would do. And so investors probably didn't really know what would happen with the repeal because it was a lot more uncertain. It was the first event in certainly the CRA sequence where the outcome was actually in doubt. And investors had, I think, assigned some real probability to the rule surviving. And the repeal, at least to some folks, might have delivered a kind of genuine welcome surprise.

I also mentioned that it happened on market close. So what that means is that the reaction concentrated in the next trading day rather than being smeared out over the afternoon or partly pre-priced in. And so all of that kind of genuine uncertainty plus pretty clean timing makes it the cleanest single test in the paper.

Alan Kaplinsky:

Right. So is there a way to figure out how economically significant the stock price movements were that you observed when translated into market capitalization?

James Tierney:

Yeah. I mean, I have thoughts about this, although I kind of want to be careful and precise rather than to overstate it. One of the reasons I started down this path was to try and figure out an answer to this question specifically.

So what the paper talks about is these abnormal returns in percentage terms. Maybe across each event, 0.7% up each time under the model I prefer. And 2% over a couple days for the Senate vote. And the paper talks about this in terms of how much the stock is changing over a period of time. And it's kind of tough to change that into an aggregate dollar figure because it's an average of a bunch of different observations.

But the qualitative point I think is an important one. Which is that a differential of this size that is statistically significant that accumulates each time across an 11 event sequence. It's up 0.7%, it's up 0.7% and so on. That accumulates and is not the signature of a market that regards these clauses as competitively neutral. For public equities where you have lots and lots of analysts taking an intense look at the company's business, persistent directional arbitration specific movement of this magnitude suggests that folks in the market see it as economically meaningful, meaningful enough to be noticed and priced. Which I think to me is exactly the kind of threshold that matters for this question of who keeps some of the benefits of these arbitration cost savings.

Alan Kaplinsky:

Yeah. I'm wondering if you talked to any institutional investors about whether or not they believe that adopting an arbitration provision with a class action waiver would be a market moving event. Because I recognize that would just simply be anecdotal and it wouldn't really be empirical evidence of anything other than an opinion of an institutional investor. But I'm wondering if by doing that you could sort of say, "Yeah, well now I understand why my study came out the way it did because I spoke to some of the big institutional investors and they all said this was really important."

James Tierney:

Yeah. So to be transparent, I did not do that and it might be a good follow-up extension. I think one of the challenges with talking with an institutional investor, an asset manager at a pension fund or something like that, as compared to maybe a sell side, a brokerage analyst who covers the financial services industry. Is the investment manager may have positions in a thousand different securities and may not have the independent deep knowledge of the industry to think about what might be market moving. By contrast, I do think ... And I did look at this, there were analyst reports that talked about, tried to repackage, for instance, commentary from law firms and say, "Hey, this is the kind of regulatory event that might change the market." And so we, as investors, need to be aware of it."

Alan Kaplinsky:

Yeah, interesting. So probably some ... I don't know if your firm had a blog, but we had a blog. We followed the whole thing blow-by-blow. And I know there were a lot of ... Because I saw ... Sometimes I'd be contacted by an institutional investor who want to know if they had permission to circulate a blog I wrote.

Yeah, because that raises another question. How educated would buyers and sellers of financial institution stocks, how much would they really know about which entities have adopted arbitration with class action waivers? Have they really suffered from a cost standpoint on defending class actions until they adopted arbitration? I'm wondering how important that is, the educational factor, or maybe that's not really relevant.

James Tierney:

So I think it's hard to generalize about what investors are going to know and how sophisticated they are. They're certainly going to have been less sophisticated about this stuff than say the Alan Kaplinskys of the world who know about the details from clients, from industry, from being an expert in this space to know which firms are moving and so on.

I'd say probably the retail investors would be least likely to know unless they themselves have experienced terms of service that include a new arbitration clause or so on. Those sorts of people knowing probably don't affect the market all that much, retail

investors at this time. And so we're looking more at the kind of informationally sophisticated investors maybe who are following financial services more closely.

Public facing firms have to make all sorts of disclosures and including material litigation, litigation risks and so on. And so if a firm has talked about its class action exposure in the past or if it's talked about we've adopted arbitration in its public filings, then that's one way that investors would know about whether a company is exposed or not. Otherwise, if you're a financial services stock analyst and your job is to kind of follow the industry, then that's probably going to include reading industry news, reading blogs from law firms and so on. And it probably will be in the air or it will be noticeable to folks in that position is my guess.

Alan Kaplinsky:

Right. I got it. So was there anything in the findings that you made that surprised you or didn't fit your expectations? I mean, you said earlier you thought before you began the study, this would be the end result. But was there anything that surprised you?

James Tierney:

Yeah, there was one event that I struggled to make meaning of, which is that the presidential signing of the CRA bill on November 1st, 2017, in legal terms, this is unambiguously good news for treated firms. It finalizes the repeal. And so I predicted that this would be kind of a positive change. But instead the statistics found a small negative change.

And I think the most plausible explanation for this surprise finding is anticipation. Which is to say by the time the president signed, the Senate vote a week earlier had already revealed the outcome with pretty high probability. And there was not a whole lot of uncertainty about whether President Trump was going to veto the CRA resolution and little new information. So any small offsetting bit of contemporaneous news could easily dominate.

I think that's actually a nice illustration of the event study principle. Which is that markets price information and a legally momentous act, the final thing you need to do to make it effective, could be a financial non-event if everyone saw it coming. And I think the kind of central result doesn't depend on that event.

Alan Kaplinsky:

Right. So let's probe a little bit more on your methodology. One potential criticism is that your study measures investor expectations rather than actual litigation costs of the financial institutions that either have adopted arbitration with class action waivers or haven't done it. How would you respond to that criticism?

James Tierney:

I'd say it's correct as a description, but I don't think it undermines the project. Because what I'm trying to do is to measure those expectations in the first place. There are lots of other angles we could look at to shed light on this problem. We could, if we had information, usually this is private from firms. But if we had information over time about realized litigation costs, about the number of lawsuits, demands they face, you might be able to track it like that.

You might also be able to track the other side of the equation, which is to say, do prices charged to consumers change around the adoption of arbitration clauses or do wages change and so on? So in that sense, I'm measuring only a slice of the problem, what sophisticated investors with money at stake expect those future litigation costs to be. Because every settlement, every lawsuit you have to defend is going to be less money available for shareholders as dividends, whatever.

And so they are going to revise those expectations when the law changes. I think that's the right instrument for this kind of question. The debate about whether arbitration protection has value that isn't completely competed away. When we have investor expectations capitalized into prices, that's a pretty good read on whether the market thinks this is good or bad for firms. And if markets expected, if we were trying to figure out something ... Or I should say if markets expected that firms would not be able to keep some of these cost savings, then they wouldn't revalue these firms based on changing news about enforceability. And they did. And so then it's only expectations point is kind of what makes the design informative, even

though it can't by itself tell us how much of this value is going to shareholders versus consumers or otherwise complete the whole welfare ledger.

Alan Kaplinsky:

Yeah. Well, I mean, actually the truth of the matter is that maybe it did affect costs to some extent, but not everything got passed along to consumers. And shareholders were able to benefit from the adoption of arbitration with class action waivers.

The other thing I would mention, and I said this during my introductory remarks, that the CFPB actually, as part of the study, projected what the impact of the study was going to be on the industry. I think they had to do that as they had to do a cost benefit analysis. And I don't recall now the methodology they used for doing that, but the numbers were quite staggering over what was in the billions of dollars that the industry would ... If the rule got adopted, what the cost would be to the industry.

So another possible criticism is that investors may have been reacting to broader regulatory developments involving the CFPB rather than arbitration specifically. How would you respond to that concern?

James Tierney:

Yeah, it's a good question. To answer it more directly, I think we would need to look at other events. We'd have to figure out whether we still see this change between firms that are exposed to this rule and firms that aren't around other non-arbitration specific CFPB events. And if that's the case, then you'd see that news kind of hitting both categories of firms differently. And I'll be candid that I didn't do that in this project and instead was trying to look at the differential treated minus control and difference out whatever would be common to the sector.

I think the CFPB's reputation among financial industry investors was already pretty low at this time period. And my suspicion is that investors in lots of these kinds of firms were looking at trying to figure out what the worst case scenario of some of these regulatory developments would be for their businesses or for the firms that they're investing in.

And I do think that there are ways to address statistically in the regressions using fixed effects to identify what some variation might be between these different categories of firms that makes it kind of hard to attribute the finding to broad market or sector-wide movements as you might expect from ... If the story here were that investors were reacting to broader regulatory developments involving the CFPB rather than arbitration specifically.

Alan Kaplinsky:

Right, right, right. So wondering what response, if any, you've received yet to publishing your article on SSRN. All of our listeners may not be familiar with SSRN, but it's generally a way for academics that are either writing a law review article or doing a study like what you've done to expose the study to all of academia. And to allow other academics or other people to comment on what has been published. Have you received anything yet?

James Tierney:

I have some folks in my space who work on arbitration issues. And those folks have kind of taken a look at the project and have given me some comments on how to improve it moving forward. But for the most part, I'd say it actually hasn't gotten a whole lot of attention. And I'll be honest, I'm not that surprised. I mean, we're looking at ... Your audience may be particularly interested in this topic. But we are talking about a regulatory debate that happened now at this point like 10 years ago under very different political circumstances. And I think if this study had come out under Biden administration where the CFPB was trying to do something similar that they couldn't really because of the CRA, you could imagine circumstances where this would really make a splash for a live policy debate.

But I'd say the CRA resolution, which basically tells the CFPB to the extent it still exists or still is kind of functional, you can't pursue this kind of policy anymore. That means that it doesn't really tell us a whole lot about what the CFPB could do to regulate in this space. That said, politics change and there's always a possibility that either some other statute, some other regulatory agency might try and come in and regulate arbitration. To that extent, I do think it would make this topic more live again in the modern regulatory debate.

In the meantime though, it's both one further step down a particular path in legal scholarship of trying to figure out what is the effect of a legal rule in the real world? And to the extent that this gives us some new information about how the enforceability of arbitration with class action waivers affects the real world, then I think it still contributes to that broader debate.

Alan Kaplinsky:

Right, right, right. So yeah, I'd like to conclude our program today by talking about the thing you just touched upon. Do you think there are other areas of consumer finance regulation where an event study analysis could provide useful insights? And the other thing is, do you have future research in mind that is related or connected to what you did here?

James Tierney:

Sure. So I would say that the event study model, although we usually see it in terms of financial markets, it actually can be applied very broadly. And so you could use it on other kinds of metrics. You could do an event study on wages or on prices. And the method itself, trying to figure out the isolated effect of some intervention on an underlying metric, travels well to any setting that has a discreet, reasonably well-defined shocks, like a new regulation, a new legislation, a court decision.

Plus when you have an identifiable set of affected firms, and that's going to be true for much of consumer financial regulation. So rulemakings around fee practices, disclosure regimes, debt collection, other statutory or regulatory interventions, or even prudential actions by the prudential regulators, they have all the ingredients. Clear event dates, a treated population defined by the rule comparison group. And so you could apply the same design for arbitration and figure out how markets price those changes in other contexts as well.

You also asked about what I'd prioritize next. With respect to ... I'll say actually, I kind of jump around a lot between projects. This project took about seven or eight years for me to finish. I started it in 2018. And so with respect to this project, the extension is I want to complete that audit of each event, each 11 events in the series against the news database to figure out that there isn't kind of interfering firm specific news. And so that's the caveat that I think I most want to close.

Beyond that, I think the natural future research direction is trying to figure out how these sorts of reactions change based on product line or claim type or maybe the specifics of contractual design. And push a little harder on the question that you raised earlier, the disclosure channel. If you have a firm that's already flagged arbitration risk or their class action costs in the past, we start to probe that here, but it's not fully ready for primetime yet. But looking forward to doing future projects in this space.

Alan Kaplinsky:

Yeah. Well, James, I really want to thank you for joining us today on the program and for discussing what I consider to be a fascinating area that you looked at and something that's never been done before. And for decades, debates about arbitration clauses and class action waivers have been fought in the courtrooms before regulatory agencies in Congress and in academic journals. And most participants in the debates have focused on issues like fairness, access to justice, consumer protection, deterrence, and litigation costs.

What makes your article particularly interesting is that it approaches the issue from this entirely different perspective rather than asking whether arbitration is good or bad policy, and you don't address that, of course. You ask what investors believed was at stake economically when the enforceability of class action waivers was under threat. Whether one supports or opposes arbitration as a matter of public policy, your study provides evidence that investors view class action waivers as having substantial economic value for consumer financial services companies.

At the same time, your article reminds us that there's an important distinction between investor expectations and actual outcomes. The study doesn't purport to resolve the broader policy debate over arbitration, but it contributes, in my view, important empirical perspective that has been missing from this debate. So I thank you not only for joining us, but thank you for contributing to this discussion.

I'll give you one more opportunity to make some closing remarks if you'd like. Something I may not have covered during our discussion.

James Tierney:

Well, first let me just say thank you for your kind words and for having me here. Certainly you have been a major player in this space for some time and it's nice to meet you in person such as this. I think one thing that I'll just add about ... to wrap this up, is who knows what the future holds for arbitration policy? And I think maybe what this paper is trying to contribute is take a look at one specific empirical data point for that debate. And I would encourage folks who are interested in this question to pick up not just the shareholder side finding, but to think about how else we could creatively look at other aspects of this question.

The right use of this study certainly would I think not be that markets proved arbitration is bad for consumers. I don't think that's what you can imply from investors thinking that it's good for investors. But I think moving the debate forward that way and trying to figure out other ways of getting at the question. Or other ways like a market-based perspective, like you mentioned, is going to move this debate forward, whatever the future regulatory possibilities look like.

Alan Kaplinsky:

Yeah. Well, thanks again, James. And I also want to, of course, thank all of our listeners for tuning in to the podcast show today. And if you enjoyed today's episode, please subscribe wherever you get your podcasts and be sure to visit our blog. We're also going by the name of Consumer Finance Monitor for our latest blog posts, webinars, podcast episodes. And the subject of arbitration, some people would say we have wrote about it ad nauseam. I mean, we have covered it. Every little event that was occurring during this battle that was going on for more than a decade, we've tried to cover. So I hope with that, you enjoy the rest of your day.