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The CFPB's Flawed Case For Banning Class Action Waivers

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In the Dodd-Frank Act, Congress asked the Consumer Financial Protection Bureau to study the use of consumer arbitration clauses, and authorized the CFPB to prohibit or impose conditions or limitations on the use of such clauses if doing so was "in the public interest and for the protection of consumers."[1] That broad charter gave the CFPB the opportunity to think afresh about dispute resolution, and to imagine and foster a system through which consumers' rights would be upheld efficiently and effectively. Unfortunately, the CFPB instead decided to revert to a class action regime that its own study indicates poorly serves consumers' interests. The CFPB should look more deeply at the facts it assembled — and investigate critical questions it failed to analyze — before taking such a drastic step.

Remarkably, one of the critical failings with the CFPB's analysis is its failure to systematically assess the many ways in which its own performance and potential diminish the need for this proposed rule. The CFPB has a robust and efficient enforcement program, the ability to ensure that arbitration is fair and accessible, and innovative public outreach programs that could be used to educate consumers about the availability and use of their arbitration rights. Instead of factoring these considerations into its analysis, the CFPB argues for class actions as if it did not exist.

In brief, the CFPB has proposed a rule that would prohibit the waiver of class action rights as part of an arbitration clause.[2] Banning such waivers will cause financial institutions to abandon arbitration.[3] This is a bad trade for consumers. First, class actions are expensive and apply only to limited fact patterns. So a large number of consumers would be losing arbitration and gaining nothing. Second, the CFPB already performs the same functions as class actions and obtains better results at a fraction of the cost. Third, the same regulatory authority that the CFPB is using to end arbitration could be used instead to ensure its transparency and accessibility. In light of these issues, the proposed rule fails the very consumers in whose name it is offered.

Consumer Class Actions Are an Inadequate Way to Protect Consumers

The CFPB's proposed rule will reinvigorate a class action regime that the CFPB's own study shows to be of dubious value. The CFPB's cost data and estimates demonstrate that class actions are enormously expensive and provide no benefits to most consumers — including most consumers in putative class actions. At the same time, the rare class actions that provide class benefits do so by settling for pennies on the dollar.

Class Actions are Expensive

The Dodd-Frank Act requires the CFPB to consider the potential benefits and costs to consumers and financial institutions of proposed regulations.[4] The CFPB's study understates the costs of a class action regime — and still demonstrates that such private law enforcement is expensive.

The CFPB study focuses on 422 consumer financial services class actions settled in federal district courts from 2008 through 2012. In estimating "cash relief of $2.0 billion" from those settlements, the CFPB includes plaintiffs' attorneys' fees and costs of more than $489 million.[5] In light of these costs, the maximum cash relief available to class members was about $1.5 billion. Furthermore, of the $1.5 billion available for cash consumer redress, the CFPB estimated that only about $1.1 billion in payments actually made its way to class members.[6] Thus, plaintiffs' counsel got about 31 cents for every dollar available to class members — and about 44 cents for every dollar actually paid to class members.

Moreover, "the study does not contain data on the defense costs incurred by the providers."[7] Instead, the CFPB's proposed rule makes some fairly heroic assumptions to generate the estimate that defense counsel cost only about 75 percent of the amounts awarded to plaintiffs counsel in settled class actions.[8] Likewise, the CFPB decides that putative class actions cases that are not settled on a class basis cost only 40 percent as much for defendants to litigate.[9]

Applying the cost estimates in the CFPB's proposed rule to the class action data in the CFPB study generates a more complete picture of the costs of class actions. For example, the CFPB's estimate that defense costs equal 75 percent of plaintiffs' fee awards means that the settlements that cost $489 million in plaintiffs attorneys' fees cost another $367 million for defense attorneys.

However, there are defense costs to nonsettled cases as well. Accepting the CFPB's estimate "that putative class actions that are not settled on a class basis ... cost 40 percent ... less to litigate" but are five times as numerous,[10] the nonsettled actions in the CFPB study cost another $733 million more to defend without producing any additional class benefits. All told, and using only the numbers and estimates supplied by the CFPB, the class actions in the CFPB study provided for a maximum of about $1.5 billion in cash to class members and cash payments of about $1.6 billion to the lawyers.

Of course, these are only rough estimates of both costs and benefits. Class settlements may include noncash benefits, and class action litigation includes noncash costs. What is indisputable is that a full accounting of the costs of a class action regime must include at least the costs of all counsel, and the costs of all class actions — and that the resulting total costs are high relative to the benefits to consumers.

Class Actions Benefit Relatively Few Consumers

The CFPB's study also demonstrates that class actions benefit relatively few consumers. The most frequent results in the cases studied were that the individual plaintiff withdrew (36.7 percent of the cases) or settled (24.4 percent) his or her claims.[11] Another 10 percent of the cases involved the dismissal of one or more defendants.[12] No more than 17 percent were settled on a class basis.[13] In short, most consumers in a putative class action get nothing.

These numbers hint at a larger truth, which is that the vast majority of consumer claims are not susceptible to class treatment. Case law, federal statutes and Federal Rule of Civil Procedure 23 all contain obstacles to a consumer who claims to represent a class, and many consumer financial disputes

(e.g., claims involving alleged misrepresentations or other conduct unique to an individual consumer) do not qualify for class treatment. Consumers with disputes that cannot surmount these obstacles gain nothing — and lose arbitration — under the proposed rule.

Class Actions Offer Only Partial Benefits

The only class relief found by the CFPB study was the product of settlements between financial institutions and their customers. In such settlements, class members routinely receive no more than a fraction of what they might have obtained if they had prevailed at trial. In return for this fractional recovery, consumers must settle their entire claim. Further, their fractional recovery is then further reduced by the attorneys' fees award to class counsel. In other words, even the most successful class members only get half a loaf.

To cite a typical example, Capital One recently settled a lawsuit over allegedly deceptive practices relating to overdraft fees settled for approximately $31.8 million — which was about 35 percent of what the plaintiffs' counsel estimated that they might recover at trial.[14] Moreover, the court allowed class counsel to receive 31 percent of the settlement amount, or about $9.8 million.[15] Thus, the class surrendered claims of about $90.8 million in return for about $22 million in cash relief. The court found that this was "an outstanding result for the settlement class,"[16] and that is correct: in most class actions, consumers receive nothing at all.

The CFPB Recognizes the Flaws in Class Actions

The CFPB clearly recognizes the flaws in a class action regime, as it has decided to allow government agencies that provide consumer financial goods and services to include class action waivers in their arbitration clauses with consumers.[17] The CFPB justifies this exception on the grounds that the government is "uniquely accountable through the democratic process to consumers."[18] However, the CFPB insists elsewhere in the proposed rule that "consumers are often unaware that they may have suffered legal harm," and are unlikely to take action when their losses are small.[19]

Moreover, the CFPB fails to explain why there would be any harm to government agencies from being held accountable through class actions as well as the ballot box. This is likely because describing the high costs and limited value of class actions would undermine the CFPB's endorsement of class actions against other entities. But the government exception makes sense only if those costs and inefficiencies are substantial. It is also revealing that the CFPB can conceive of a government agency, compelled by the democratic process "to treat consumers fairly with respect to dispute resolution," nonetheless employing class action waivers.[20] This concession — that class action waivers are compatible with fairness to consumers — suggests that the CFPB could have stopped short of banning them altogether.

The CFPB Has Reduced the Need for Class Actions

Given the expense, difficulty and fractional recoveries of a class action regime, it would be surprising if there was not a better way to protect consumers. What's particularly startling here is that the CFPB study ignores the solution right under its nose: the success of the CFPB itself. As is demonstrated below, the CFPB's enforcement program has provided recoveries for large groups of consumers that are far beyond the capabilities of private class actions. In particular:

- **The CFPB has superior information:** The CFPB receives hundreds of thousands of complaints annually, which it can investigate and then use to identify issues

to pursue. The CFPB also has an entire fleet of examination and supervisory staff with untrammeled, prelitigation access to all of a financial institution's records.

- **The CFPB has superior discovery tools:** The CFPB's Enforcement Division has powerful tools to investigate potential wrongdoing, including the power to require financial institutions to produce documents, information, and testimony — all without having to file a complaint or provide reciprocal discovery.

- **The CFPB has a superior ability to bring cases:** The CFPB also has the enormous advantage of being able to bring enforcement actions in an administrative proceeding. These proceedings last no more than a year, offer defendants limited discovery, and may not be governed by statutes of limitations.[21]

- **The CFPB has superior ability to fashion and monitor injunctive relief:** The CFPB has enormous advantages in designing and enforcing injunctive relief. The CFPB does not need to confine injunctive relief to the issues found in the case,[22] and has the in-house expertise to devise and enforce meaningful, effective injunctive relief.

In sum, the tools available to the CFPB to identify, pursue and resolve consumer issues are far stronger than those available to class counsel.

With all of these institutional advantages, it is no surprise that the CFPB is far more effective than class action plaintiffs' lawyers at securing relief for large groups of consumers. As detailed in a recent law review article by a special advisor to the CFPB director, "Consumer Financial Protection Bureau Law Enforcement: An Empirical Review," the CFPB has an extraordinary record of protecting consumers.[23] For example, the empirical review reports that the CFPB filed 55 enforcement actions in 2015 that awarded $6.4 billion in relief to consumers.[24]

The CFPB achieves these results efficiently. The total cost of the CFPB's Supervision, Enforcement and Fair Lending Division in 2015 was $140 million.[25] Thus, CFPB enforcement produced $6.4 billion in relief to consumers for less than $140 million in attorneys' fees in 2015. In contrast, class actions produced $1.5 billion in cash relief to consumers for $489 million in attorneys' fees from 2008-2012.[26] Put another way, a dollar of relief to consumers cost about 31 cents in plaintiffs attorney fees when private class counsel handles a matter, and less than three cents when the CFPB handles the action.[27]

The CFPB's study misses these facts in part because it focuses on public enforcement prior to the CFPB's existence. The CFPB study uses data from Jan. 1, 2008, through Dec. 31, 2012.[28] The CFPB opened its doors in July 2011, and did not bring an enforcement action until July 18, 2012.[29] Since that time, its activity has grown exponentially: from eight public enforcement cases in 2012 to 55 in 2015.[30] The amounts recovered have increased even more rapidly, from $425 million in 2012 to $6.4 billion in 2015. One reason for these enormous amounts is that CFPB settlements often provide full redress to consumers — unlike the fractional recovery in class actions.[31]

The proposed rule acknowledges that "[p]ublic enforcement could theoretically bring some of the same cases that are not going to be brought by private enforcement absent the proposed rule."[32] However,

the CFPB then dismisses that possibility by asserting that "public enforcement resources are limited."[33] In fact, public resources in this area are now plentiful. The CFPB has spent less than the funds made available to it by Congress in every year of its operations, and the unused $134 million in 2015 alone could have almost doubled the CFPB's budget for supervision, enforcement and fair lending.[34]

The CFPB study also describes the possibility that "public prosecutors could be more cautious [than class counsel] or have other, nonconsumer priorities."[35] However, the CFPB controls its own enforcement agenda, and "consumer protection is the CFPB's singular focus."[36] Neither the CFPB study, nor the proposed rule, nor any other public statement by the CFPB suggests that the CFPB is failing in its mission. And if the CFPB did identify ways in which it had fallen short, it could address them directly, by altering its own enforcement agenda, increasing its own budget, and reallocating resources.

Other justifications for the proposed rule likewise ignore the CFPB's impact. For example, the proposed rule argues that one of the main effects of the proposed rule would be "a deterrence incentive ... to comply with the law."[37] However, the CFPB later "recognizes that the CFPB's own creation in 2010 may have increased incentives for some providers to increase compliance investments."[38] This is clearly true — CFPB Director Richard Cordray testified to Congress in 2014 that the CFPB has "strengthened compliance management at the large banks and caused many large nonbank firms to implement compliance management systems for the first time."[39] The CFPB concedes that such an impact would mean it has overestimated the benefits to consumers from the proposed rule,[40] but fails to measure the extent of this error.

The CFPB also justifies the proposed rule by citing the portion of the CFPB study that found little overlap between public and private enforcement.[41] However, the CFPB study covers 2008 through 2012,[42] and does not tell us how the CFPB's recovery of over $10 billion in 2014 through 2015 might alter its findings. Furthermore, the fact that a private action was sometimes the first or only enforcement action does not prove that a public enforcement action would not have addressed the same issue in due time. Indeed, given the superiority of the CFPB's tools, costs and results, a private action that crowds out a public enforcement action may well be a net negative for the relevant consumers.

In these and other ways, the CFPB's ignores its own success. "[T]he CFPB has fulfilled Congress' vision of a federal agency with 'the authority and accountability to ensure that existing consumer protection laws and regulations are comprehensive, fair and rigorously enforced.'"[43] Unfortunately, the CFPB study and proposed rule fail to analyze the extent to which this transformation of consumer protection undermines the case for class actions.

Arbitration Provides an Effective Way to Resolve Consumer Disputes

The foregoing demonstrates how efficiently and effectively the CFPB can handle, through enforcement, the type of disputes that are susceptible to class treatment. Accordingly, what consumers most need is not to duplicate the CFPB's efforts through class actions, but to supplement the CFPB's efforts with a system that allows them to resolve disputes that are too small and idiosyncratic to become the subject of a CFPB (or class) action. Arbitration provides just that sort of alternative dispute system. As Congress has explained, "[t]he advantages of arbitration are many: it is usually cheaper and faster than litigation, it can have simple procedural and evidentiary rules; it normally minimizes hostility and is less disruptive … [and] is often more flexible."[44]

The CFPB's criticism of arbitration — like its support for class actions — largely ignores the role the CFPB

itself can play in addressing consumer protection issues. To begin with, the CFPB can obtain the data needed to fairly evaluate arbitration. As the CFPB study acknowledges, it is "quite challenging to answer even the simple question of how well do consumers (or companies) fare in arbitration."[45] Accordingly, the proposed rule requires that financial service providers share with the CFPB (1) all initial claims filed in arbitration; (2) the underlying arbitration agreement; (3) the judgment and award, if any; and (4) any dismissal of claims by the arbitrator due to a failure to pay required filing or administrative fees.[46] The CFPB explains that such information "would aid the CFPB in its ongoing review of arbitration."[47] But the CFPB does not explain why it will regulate arbitration before fully understanding it.

To the extent the CFPB is concerned that consumers do not know about, or use, their arbitration rights, it has the power to educate them. The CFPB has an impressive infrastructure to foster consumer's knowledge about their rights, and has recently reaffirmed that "[a]n essential part of the CFPB mission is to empower consumers to take more control over their financial lives and improve their financial well-being."[48] This commitment to consumer education has led the CFPB to become "engaged around the country with libraries, social service providers, community groups, state and local policymakers, and various other partners."[49] Unfortunately, just as the CFPB ignores its own impact on consumer law enforcement, it ignores its power and potential to change consumer awareness.

A creative, constructive approach to arbitration by the CFPB would mean adding arbitration to the dozens of subjects on which it already provides detailed resources to consumers. [50] For example, the CFPB website already includes searchable online tools on a wide range of consumer issues, from auto loans to debt collection to prepaid cards. When it comes to mortgages, the CFPB offers a toolkit to help consumers find their way through the process. When a consumer is sued by a debt collector, the CFPB provides them with advice and links to legal aid offices. There is no reason why the CFPB could not engage in similar efforts to help consumers understand and exercise their arbitration rights.

Such increased awareness would empower consumers. As the CFPB study demonstrates, consumers have choices: arbitration provisions appear in the credit card agreements of only 15.8 percent of credit card issuers (which cover 53 percent of credit card loans outstanding), and in the checking account agreements of 7.7 percent of financial institutions (which have 44.4 percent of insured deposits).[51] Moreover, many of those arbitration agreements allow consumers to accept the product but reject the arbitration agreement.[52] Accordingly, a CFPB education effort would not only educate consumers about their arbitration rights, but help individual consumers choose whether they want to opt out of arbitration altogether.

To the extent the CFPB is concerned that current arbitration agreements are unfair to consumers, it could take far less drastic steps than those in the proposed rule. Every concern raised in the past about arbitration — ranging from the initial filing fees to the final appeal rights — could be addressed by the CFPB. In this regard, the CFPB would be following in the footsteps of financial institutions and other businesses that have been pioneers in making arbitration accessible and affordable.[53] Moreover, the future of arbitration is significantly enhanced by the prospects for online dispute resolution, which offers speed and convenience that are polar opposite from class action litigation.

In short, the CFPB has a remarkable opportunity to help fashion alternative dispute resolution for the 21st century. Instead, it has chosen to return to a model that poorly serves some consumers, and leaves others with no effective means of resolving their disputes. The justification for that proposed rule relies upon old data and old arguments, both of which ignore the transformative effect of the CFPB on consumer protection. As is demonstrated above, the performance and potential of the CFPB raises important new questions about whether consumers would truly benefit from losing arbitration.

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[1] 12 U.S.C. § 5518 (2010).

[2] Arbitration Agreements, 12 C.F.R. § 1040 (2016) (proposed rule).

[3] The American Bankers Association, Consumer Bankers Association and Financial Services Roundtable have all gone on the record that prohibiting class action waivers means that "many companies are likely to discontinue offering arbitration to consumers." See Joint ABA, CBA and FSR Comments on the Bureau's Arbitration Study (July 13, 2015), available online at https://www.aba.com/Advocacy/commentletters/Documents/cl-jointArbitration2015.pdf.

[4] 12 U.S.C. § 5512(b)(2)(A); see also 81 Fed. Reg. at 32898.

[5] Arbitration Study, Report to Congress pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act § 1028(a) (March 2015) (CFPB study) at Section 8, page 24, table 7, available online at http://files.consumerfinance.gov/f/201503_cfpb_arbitration-study-report-to-congress-2015.pdf.

[6] Id. at page 28.

[7] 81 Fed. Reg. at 32907.

[8] See id.

[9] 81 Fed. Reg. at 32908.

[10] 81 Fed. Reg. at 32908.

[11] CFPB study at Section 6, page 7.

[12] Id.

[13] Id. (12.2 percent settled on a class basis); see also 81 Fed. Reg 32908 (17 percent).

[14] In re: Checking Account Overdraft Litigation, Case No. 1:09-MD-02036-JLK, MDL No. 2036, Order Granting Final Approval of Settlement, Authorizing Service Awards, and Granting Application for Attorney's Fees (May 22, 2015) at 16, available online at http://www.capitaloneoverdraftsettlement.com/Content/Documents/Final%20Approval%20Order.pdf.

[15] Id. at 26.

[16] Id.

[17] Proposed rule § 1040.3(b)(2).

[18] 81 Fed. Reg. at 32881.

[19] 81 Fed. Reg. at 32900. See also Prepared Remarks of CFPB Director Richard Cordray at the Field Hearing on Arbitration Clauses, May 5, 2016 ("consumers often do not recognize when their rights have been violated"), available online at http://www.consumerfinance.gov/about-us/newsroom/prepared-remarks-cfpb-director-richard-cordray-field-hearing-arbitration-clauses/.

[20] 81 Fed. Reg. at 32881.

[21] See generally, Eric Mogilnicki, The CFPB's Two Faces on Avoiding the Courts, Law 360, May 3, 2016 (describing CFPB administrative proceedings).

[22] Compare CFPB orders, which routinely contain general prohibitions against any future violations of law with e.g. Walker v. Wells Fargo Bank, 589 Fed. Appx. 824 (9th Cir. 2014) cert. denied 136 S. Ct. 1512 (2016) (rejecting injunctive relief unrelated to legal violation).

[23] Forthcoming 90 Tulane Law Review __ (2016), available online at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2780791 ("Empirical Review").

[24] Empirical Review at 22. This measurement appears to "include consumer redress, refunds and canceled debts." Id.

[25] The CFPB Strategic Plan, Budget and Performance Plan and Report (February 2016) at 18, available online at http://files.consumerfinance.gov/f/201602_cfpb_report_strategic_plan-budget-and-performance-plan_FY2016.pdf.

[26] CFPB study Section 8, page 24, Table 7.

[27] As with estimates supra, these estimates are rough, and the data used in the CFPB study and empirical review may differ. What is indisputable is that CFPB enforcement is a much more efficient way to deliver redress to consumers than class actions.

[28] CFPB study Section 9, page 9.

[29] 81 Fed. Reg. 32906; see also empirical review at 20-21.

[30] See id. at 21.

[31] See, e.g., CFPB Orders Chase and JPMorgan Chase to Pay $309 Million Refund for Illegal Credit Card Practices (September 19, 2013) ("*Chase must pay a full refund*, approximately $309 million, to more than two million consumers ... *In addition to the amount paid for the product, Chase must refund interest and any over-the-limit fees* resulting from the charge for the product.") (emphasis supplied) available at http://www.consumerfinance.gov/about-us/newsroom/cfpb-orders-chase-and-jpmorgan-chase-to-pay-309-million-refund-for-illegal-credit-card-practices/.

[32] 81 Fed. Reg. at 32901.

[33] Id.

[34] See empirical review at 47, citing CFPB Financial Reports.

[35] 81 Fed. Reg. at 32901.

[36] Consumer Financial Protection Bureau Strategic Plan FY2013-FY2017, available online at http://www.consumerfinance.gov/strategic-plan.

[37] 81 Fed. Reg. at 32902.

[38] 81 Fed Reg. at 32906.

[39] Written Testimony of CFPB Director Richard Cordray Before the Senate Committee on Banking, Housing and Urban Affairs, Sept. 9, 2014, available at http://www.consumerfinance.gov/about-us/newsroom/written-testimony-director-richard-cordray-before-the-senate-committee-on-banking-housing-and-urban-affairs/

[40] See 81 Fed. Reg. at 32906.

[41] 81 Fed. Reg 32901.

[42] CFPB study at Section 9, page 9.

[43] Statement of Americans for Financial Reform to the Senate Committee on Banking, Housing, and Urban Affairs (April 5, 2016), quoting Joint Explanatory Statement of the [Dodd-Frank] Committee of Conference, at 874 (June 29, 2011), available online at http://www.brown.senate.gov/download/afr-statement-for-the-record-re-cfpb-4-5-2016.

[44] H.R. Rep. No 97-542, at 13 (1982); see also Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 280 (1995).

[45] CFPB study, Section 5, page 7; see also id. at page 6 (*"the substantive outcomes of most consumer financial arbitration disputes are unknown."*)(emphasis in original)

[46] Proposed rule § 1040.4(b)(1)(i)(A).

[47] Arbitration Agreements, 81 Fed. Reg. 32830-01, 32894 (May 24, 2016).

[48] CFPB Fact Sheet: Policy Priorities Over the Next Two Years, at 6 (Feb. 25, 2026), available online at http://files.consumerfinance.gov/f/201602_cfpb_policy-priorities-over-the-next-two-years.pdf

[49] Prepared Remarks of CFPB Director Richard Cordray at the Financial Literacy and Education Commission Meeting (June 29, 2016), available online at http://www.consumerfinance.gov/about-us/newsroom/prepared-remarks-richard-corday-director-consumer-financial-protection-bureau-doe/.

[50] See generally the Ask CFPB portal, found online at http://www.consumerfinance.gov/askcfpb/.

[51] CFPB study at Section 2, page 9.

[52] Id. at Section 2, pages 31-32.

[53] Such innovations have included providing consumers with low fee or no fee arbitrations; arbitration locations near their homes; the ability to shift attorney fees to defendants; minimum recoveries to incent meritorious but small cases; and due process protocols that address additional issues.

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