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RESEARCH SUMMARY

THE CONSUMER FINANCIAL PROTECTION BUREAU'S ARBITRATION STUDY
A Summary and Critique

The Dodd-Frank Act requires the Consumer Financial Protection Bureau (CFPB) to provide Congress with a report on the use of arbitration agreements in disputes between consumers and providers of consumer financial products. After issuing its report, the CFPB is empowered to promulgate regulations designed to protect consumers from agreements the CFPB deems harmful. In March 2015, the CFPB released its final report to Congress, and the tone and conclusions of the report suggest that the CFPB intends to aggressively regulate arbitration agreements in consumer credit contracts. The CFPB could also implement an outright ban on mandatory arbitration clauses.

In a new study for the Mercatus Center at George Mason University, law professors Jason Scott Johnston and Todd Zywicki provide an overview and critique of the CFPB's report. The study criticizes the report using primarily evidence supplied by the report itself. The CFPB's findings show that arbitration is relatively fair and successful at resolving a range of disputes between consumers and providers of consumer financial products, and that regulatory efforts to limit the use of arbitration will likely leave consumers worse off. Moreover, owing to flaws in the report's design and a lack of information, the report should not be used as the basis for any legislative or regulatory proposal to limit the use of consumer arbitration.

To read the study in its entirety and learn more about its authors, see "The Consumer Financial Protection Bureau's Arbitration Study: A Summary and Critique."

BACKGROUND: ARBITRATION VS. LITIGATION

Most people handle a dispute with the provider of a financial service—such as an erroneous credit card charge—by complaining to the provider, and by switching providers if the original provider does not respond to their satisfaction. For the few who want to take further action when their financial services provider refuses to provide relief, AAA (American Arbitration

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Association) consumer arbitration can offer a low-cost, speedy avenue of dispute resolution. Arbitration has become cheaper and easier over the years, and more and more companies—such as cellphone providers—offer to pay amounts as large as $10,000 to consumers who win in arbitration, regardless of the size of the charge or fee that the consumer contests.

In contrast, most people who get a notice in the mail explaining that they are part of a class action lawsuit and might receive compensation if they fill out a claim form never take the time and trouble to fill out the form. The reason is that they are unlikely to get more than a couple of hundred dollars (often much less)—and if they do get anything, it will be many years later. Arbitration is often a superior and more efficient type of dispute resolution, yet the CFPB's study condemns it based on faulty information and analysis.

KEY ISSUES WITH THE CFPB REPORT

- *Comparing class action settlements with arbitration awards is methodologically flawed.* The CFPB was not given access to information about the terms of consumer arbitration settlements. Most consumer arbitrations settle, just as most consumer class actions do. Because of this, the CFPB's study does not allow a meaningful comparison of how consumers fare in arbitration versus how they fare as members of class actions.

- *The CFPB paints a misleading picture of class action outcomes.* Even if the CFPB had data on arbitration settlements, its data on class action settlements—which show attorneys' fees that are an unexpectedly low percentage of total class recovery and class compensation rates that are unexpectedly high—cannot be used to compare arbitration and class actions. These data reflect primarily settlements in fewer than a dozen huge class actions, and mask much lower class payout rates and higher attorneys' fees in typical consumer class action settlements. Moreover, most of the class action settlements studied by the CFPB involved debt collection cases, but these rarely involve defendants even covered by an arbitration clause, so they should have been excluded as irrelevant to the issues the CFPB was examining.

- *The market's solution to inaccurate charges works better than either arbitration or litigation.* The CFPB's survey found that most consumers prefer the market response of canceling a credit card when they feel an issuer has failed to respond fairly to a complaint about charges, and that these consumers do not know much about either arbitration or class actions. This is exactly what should be expected given data showing that banks usually respond to consumer complaints by canceling or reversing charges. For consumers, the market response is far superior to ex post disputing via either arbitration or litigation.

- *Consumers perform better in arbitration than in litigation.* The majority of AAA consumer claimants represented by counsel, as well as the majority of AAA consumer claimants in general, realize higher rates of overall success (likely settlements or awards on the merits) compared to individual consumer litigants in federal court.

CONCLUSION

The CFPB's arbitration report contains substantial methodological flaws and does not support a ban on arbitration clauses in consumer credit contracts. To the contrary, the data presented in the report show that consumers on balance are better off if they have the arbitration process available to them for dispute resolution. Rather than relying on flawed methodology and inaccurate data, the CFPB should focus on the actual benefits arbitration provides to consumers.