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RESEARCH SUMMARY

COMMENT ON PROPOSED RULE ON ARBITRATION AGREEMENTS, 12 CFR PART 1040

BACKGROUND

The Bureau of Consumer Financial Protection (the Bureau) proposes a rule to prohibit mandatory arbitration agreements in consumer financial-product or service contracts. The Bureau bases its proposed rulemaking on findings from its 2015 study, which was mandated by Congress under Section 1028(a) of the Dodd-Frank Act.

In a new public interest comment for the Mercatus Center at George Mason University, University of Virginia law professor Jason S. Johnston, George Mason University law professor Todd J. Zywicki, and Mercatus Center senior policy writer Michael P. Wilt examine the Bureau's proposed rule and findings, and they demonstrate that the Bureau's data and analysis are often inconsistent, inadequate, and flawed.

To read the public interest comment in its entirety, see "Comment on Proposed Rule on Arbitration Agreements, 12 CFR Part 1040."

Because of flaws in the methodology and data, the Bureau's 2015 study should not be used as the basis for any regulatory proposal to limit the use of consumer arbitration. Furthermore, regulatory efforts to limit the use of arbitration will likely leave consumers worse off. A deeper analysis of the Bureau's data shows that arbitration is, in reality, relatively fair and successful at resolving a range of disputes between consumers and providers of consumer financial products.

KEY FINDINGS

The Bureau's proposed rulemaking makes several flawed assumptions and comparisons between arbitration and class-action litigation. Arbitration is an efficient and beneficial means of dispute resolution. Its procedural setup is more informal, quicker, and easier for consumers to use, and hiring counsel to represent a claim in arbitration is usually unnecessary. Litigation, on the other

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hand, can be expensive, time consuming, and complex, and it usually requires hiring an attorney. The comment letter finds several flaws in the proposed rulemaking's analysis:

- *The Bureau's proposed rulemaking incorrectly compares class-action settlements with arbitral awards.* This is a methodologically flawed means of comparison because most arbitrations settle, just as most consumer class actions settle.

- *The Bureau paints a misleading picture of class-action litigation outcomes.* Typical settlements result in very small payouts ($32 per class member), while class-action attorneys are often the big winners; attorneys collected $424 million during the Bureau's study period of 2010–2012.

- *The Bureau should have excluded class actions that did not involve financial products or services subject to mandatory arbitration.* The inclusion of debt-collection cases and the simultaneous exclusion of ATM notice-failure cases biases the Bureau's sample.

- *The market's solution for inaccurate charges works better than arbitration or litigation.* The Bureau's survey of consumers shows that consumers prefer to simply change credit cards if the provider does not satisfactorily resolve a dispute, rather than litigate or arbitrate.

- *Consumers perform better in arbitration than in litigation.* The Bureau's data indicate that consumers have higher rates of overall success in arbitration and that arbitrations are resolved within a matter of months.

- *The Bureau did not adequately consider the costs of its proposal.* Economic theory predicts that over time, financial-services providers will pass on the costs of the arbitration ban to their consumers.

- *The Bureau did not consider less restrictive alternatives to banning mandatory arbitration.* The Bureau should reassess its proposal in light of successful consumer arbitration clauses such as AT&T's, which provides thousands of dollars in liquidated damages and no filing fees.

RECOMMENDATION

The proposed arbitration rules are not in the public interest and will not protect consumers as intended and required under the Dodd-Frank Act. The Bureau should go back to the drawing board, conduct a proper study with accepted econometric methodology, consider less restrictive alternatives, and reconsider its decision to impose new regulations that will inhibit an efficient and effective means of dispute resolution.