House Financial Services Subcommittee Examines the CFPB's Arbitration Proposal

On Wednesday, May 18, 2016, CBA Vice President and Regulatory Counsel Dong Hong testified before the House Financial Services Subcommittee on Financial Institutions and Consumer Credit for a hearing entitled "Examining the CFPB's Proposed Rulemaking on Arbitration: Is it in the Public Interest and for the Protection of Consumers?" Mr. Hong was joined by Professor Jason Johnston, from the University of Virginia School of Law, Mr. Andrew Pincus, a partner at Mayer Brown LLP who was representing the U.S. Chamber of Commerce, and Mr. Paul Bland, Jr., the Executive Director of Public Justice.

The hearing followed the recent release of the CFPB's proposed rule on arbitration on May 5, 2016. The proposal, which is undergoing a 90-day comment period, would restrict the use of pre-dispute arbitration by banning the use of class action waivers. This action followed the release of the CFPB's study on arbitration on March 15, 2015. The study, which was required by the Dodd-Frank Act, was highly critical of arbitration and unabashed in its preference for class actions lawsuits.

Key Takeaways

- The hearing featured strong attendance from both Democrats and Republicans; however, it was interrupted by votes which affected attendance during the question and answer session.

- Republicans generally agreed consumers benefit from being able to participate in arbitration. Also, they were highly critical of the class action bar and the limited benefits of class action lawsuits realized by consumers. The CFPB's study came under scrutiny for being inadequate at assessing the merits of arbitration and the unintended consequences that would follow from a restriction, including the elimination of certain products and services and decreased credit access.

- Some Democrats were supportive of the CFPB's proposal. Others, however, suggested the possibility of a more balanced approach, such as class-wide arbitration for consumers.

- Republicans also noted the CFPB's broad enforcement and supervisory authority. Given this authority, several Republicans argued the Bureau should be well-equipped to address marketplace abuses. The members wondered why there also is a need for private right of action.

Opening Statements

In his opening statement, Financial Institutions and Consumer Credit Subcommittee Chairman Randy Neugebauer (R-TX) highlighted arbitration as an efficient dispute resolution process. "Arbitration has long been recognized as an important form of alternative dispute resolution for a consumer that encourages efficiency, expediency, and lower barriers to bring disputes," he said. He continued, "After my own review of the material, I have serious doubts that the Bureau has met the statutory requirements set-forth in Section 1028. Further, I fear a single, unelected

bureaucrat has directed agency action that is arbitrary and capricious. The Bureau has failed to articulate a rational connection between the facts found in its May 2015 study and the agency action before us today. In my view, the proposed rule is a clear error in judgement by the Bureau."

Subcommittee Ranking Member Lacy Clay (D-MO) countered Chairman Neugebauer's view of arbitration. "Fair, enabling, cost-effective. Those are the words the corporations use to promote the arbitration fine print buried at the end of contracts that consumers sign. We should be using words like 'unfair,' 'biased,' 'expensive,' 'opaque' and 'discouraging.'" he said.

Testimony

In his oral and written testimony, Mr. Hong identified the incomplete nature of the CFPB's study on arbitration and the insufficient basis for restricting the use of arbitration in the Bureau's proposed rule. In particular, he pointed to the failure of the study to prove that restricting arbitration is "in the public interest and for the protection of consumers" as required by the Dodd-Frank Act for any rulemaking on the issue to occur.

Absent in the CFPB's study was critical information about arbitration settlements, consumers' experiences with arbitration, and the full impact of public supervision and enforcement on consumer welfare and protection, among other key elements. Despite its incomplete nature, Mr. Hong pointed out that according to the CFPB's own study consumers are better served taking their disputes to an arbitrator rather than participating in a class action lawsuit. In fact, consumer recover approximately $5,400 in arbitration compared to $32 in a class action. Mr. Hong concluded that a more thorough analysis needs to be completed before the CFPB finalizes a rule which could seriously harm consumers.

Professor Johnston used his testimony to outline the different incentives inherent in arbitration and class actions. He also highlighted the benefits of arbitration, citing that according to the CFPB 63% of consumers studied got an average arbitration award of $5400 over a period of 5 months. He also identified that the CFPB's data on class action settlements was highly dependent on one class action settlement relate to overdraft. Professor Johnston also concluded that more study is needed and that any proposal should evidence such analysis.

In his testimony, Mr. Pincus described the CFPB study as flawed and demonstrating pre-ordained results. He also highlighted that the Bureau never addressed the following critical policy issue: will consumers be better off if arbitration is eliminated? He concluded that the CFPB did not address this question because the answer would be "no" as demonstrated by the benefits of arbitration.

Mr. Bland used his testimony to claim that banks and payday lenders cheat their customers when the only dispute resolution process available is arbitration. He described arbitration as a secretive and arduous process, which ultimately prevents consumers from filing claims. Alternatively, he expressed support for class action litigation as a way for more consumers to get relief.

Question & Answer Session

There were numerous questions asked during the question and answer session of the hearing. Republican members generally focused on the consumer benefits of arbitration, how consumers would be harmed if the proposal went into effect, the legal precedent for arbitration, and the effects on small businesses. Only a few Democrats remained to ask questions of the witnesses. Questions from the Democratic side of the aisle, which was largely empty, ranged supportive of the CFPB's proposal and the availability of class wide arbitration to cautious about the proposal and understanding of the need to find a balanced approach to consumer protection.

Specially, Chairman Neugebauer questioned Professor Johnston about the CFPB's role in policing bad actors and protecting consumers through its enforcement actions. Mr. Johnston agreed that the CFPB is well suited to monitor the marketplace and their oversight would be preferable to opening up businesses to class actions, which may include members without any actual harm.

Rep. Leutkemeyer (R-MO) inquired about how businesses would pass along increased costs from the expected uptick in litigation. Mr. Hong cited the availability of and innovation in consumer financial products and services resulting from the increased capital requirements that may be required by prudential regulators to compensate for the increased litigation risks.

Ranking Member Clay used his time to demonstrate that class actions can shift company behavior. However, he also showed an openness on changes to the CFPB's rule when he asked the witnesses how they would develop a balanced rule that would ensure consumers are protected. Similarly, Rep. David Scott (D-GA) gave witnesses the opportunity to explain what the rule got right and wrong. Mr. Hong identified several of the shortcomings of the study and the rule but acknowledged the need for additional consumer education of arbitration.

CBA can provide a full outline of the question and answer session, should you desire additional details.