CFPB Signals Potentially Expanding Class Actions

By Jesse Moore, Cox Smith Senior Counsel

Future CFPB regulations limiting the use of arbitration clauses in consumer financial reports seem likely in light of last week's press release discussing the CFPB's 782-page study finding that "arbitration clauses restrict consumer relief in disputes with financial companies by limiting class actions." Based on this finding, CFPB Director Richard Cordray stated that the CFPB is considering "what next steps are appropriate." Between these statements and the overall tenor of the report and press release, it appears that limiting arbitration in consumer finance may be a question of how and when instead of if.

Such steps would seem premature. The CFPB has not collected any meaningful data on the costs of such regulation, and the data that the CFPB has collected on the benefits of such regulation is incomplete. However, given the bias shown by the CFPB's heavily spun press release on the report and the report itself, such regulation may be a fait accompli.

CFPB Spins Report in Favor of Limiting Arbitration

The Dodd-Frank Act gave the CFPB broad authority to limit or even prohibit mandatory arbitration clauses in consumer finance if the CFPB finds that such regulation is "in the public interest and for the protection of consumers." While the report keeps mum on key findings as to the "public interest" and "protection of consumers," the unmistakable spin put on the report by the CFPB's press release seems to indicate that this is the inevitable next step.

The press release argues that class actions are valuable, noting that "settlements totaled $2.7 billion in cash, in-kind relief, and attorney's fees and expenses" with "roughly 18 percent of that going to expenses and attorneys' fees." The report, in contrast, states that cash relief was only $2 billion dollars and that attorneys' fees consumed 21% of that amount. Indeed, the report finds that attorneys' fees constitute 24% of total cash payments, significantly more than the 18% touted by the press release. The CFPB's desire to downplay the politically unpopular fact that a handful of lawyers get rich off of class actions is obvious (and understandable.)

To the credit of the CFPB, its press release does not argue that class actions actually increase the prevalence of legal compliance in consumer finance. Along with undermining the importance of the CFPB as a regulator, such a statement would not be supportable. The report notes that class actions are not quickly resolve—the average time to settlement is 690 days, and delays skyrocket in larger cases, where the average time to resolution is more three years. In contrast, a CFPB enforcement action typically results in relief within a matter of weeks. This unusual missed opportunity for self-promotion suggests a different agenda at the CFPB.

Most Americans' experience with class action comes in the form of apparent junk mail informing recipients that, unless they show up in some distant court, their class lawyers and representatives will get millions while class members may get rebates, coupons, or small checks, if they jump through a number of annoying hoops. The report confirms this—the weighted average rate of consumers who bother to respond to class settlements by filing claims is only four percent. The CFPB's press release does not mention this deafening lack of consumer

interest in class actions. The CFPB emphasizes that consumers are not aware of arbitration provisions, but ignores the fact that consumers appear to be equally indifferent to class actions.

The CFPB press release emphasizes that arbitration provisions are a barrier to class actions by noting that "in cases where credit card issuers with an arbitration clause were sued in a class action, companies invoked the arbitration clause to block class actions 65 percent of the time." If anything, this is remarkably low, given the risk of class actions—in most cases, companies will only avoid arbitration if the case is likely to be dismissed. This statistic may suggest that the other 35% of class actions are completely frivolous. No such neutral counter-spin is provided to the public.

CFPB's Inadequate Research into Costs & Benefits of Arbitration

The CFPB report ignores the following crucial research needed to truly weigh and balance the competing interests here:

- the effectiveness and cost of other alternatives for policing compliance, such as regulatory action
- the effect of recent judicial decisions expanding arbitration upon legal compliance
- the increased costs to defendants from class actions
- the increased costs to courts, the justice system, and taxpayers from class actions

Instead, the report's final section on the effect of arbitration provisions upon consumer prices is a statistical hatchet job. The press release emphasizes the report's conclusion that there is no correlation between consumer prices and arbitration provisions. However, this conclusion is based on an all-but-meaningless comparison: costs to consumers for a one-year period between November 2008 and October 2009 are used as the "base" and compared to costs for a two-year period between January 2010 and November 2011 when arbitration provisions were waived.

Anyone familiar with financial institution operations could guess that this comparison is unlikely to produce any significant differences. First, expecting legal costs to immediately be reduced in this scenario is unrealistic—reducing legal department budgets takes years. Passing these cost reductions along to consumers takes even longer.

Anyone familiar with recent history could also see the problems with this contrived comparison. Expecting any reduction in consumer costs during the historic financial crisis and its historic aftermath would be absurd. Increased defaults increased costs for banks. Increased regulatory burdens and risks also increased costs. Although the report states that attempts were made to control for these variables, it does not provide a meaningful explanation of these attempts. Moreover, such controls may not be effective—looking for a significant impact on consumer prices in a short period during the middle of the financial crisis and its immediate aftermath is like listening for waterfall in a thunder storm.

What's Next

It is hard to see how the CFPB can adequately judge whether further regulation is in the public interest, and what regulations are suitable, when the CFPB has not done a balanced cost/benefit analysis. Yet expanding consumer class actions may be the CFPB's destiny. In an era of tort reform, Congress did not want to incur political backlash by directly amending federal law to roll-back arbitration. So instead Congress and the President avoided the inconvenience of responsibility by delegating this power to the CFPB. And it appears that the CFPB will hold up its end of this implicit bargain based on everything that has happened so far.

The question then becomes how the CFPB will limit arbitration clauses in consumer agreements. The CFPB could take many paths. Options range from limited rules requiring small-claims arbitration opt-outs to broad rules prohibiting agreements from prohibiting class actions or from requiring arbitration. Indeed, the report itself identifies no less than thirteen specific aspects of arbitration clauses that could be regulated, such as arbitrator selection, arbitrator review of arbitration provisions, punitive damage availability, limitations periods, confidentiality, in-person hearings, arbitration venue, arbitration costs, minimum recoveries, venue, arbitration clause disclosures, and arbitration appeals. The permutations of potential rules are infinite.

While the rules are supposed to be reasonably tailored to address genuine consumer protection concerns, the CFPB will have considerable discretion nonetheless. Challenging its rules in court after they are enacted will be difficult. Industry involvement in the rulemaking process itself will be crucial. Further, despite the CFPB's relative autonomy, it is nevertheless a political entity ultimately subject to the will of elected officials and their constituents. Influencing the public and their representatives can also help. Early preparation and effective coordination of efforts will be crucial.