BETTER
MARKETS

August 22, 2016

Monica Jackson
Office of the Executive Secretary
Consumer Financial Protection Bureau
1700 G Street NW
Washington, D.C. 20552

Re: Arbitration Agreements (RIN 3170-AA51; Docket No. CFPB-2016-0020)

Dear Ms. Jackson:

Better Markets[1] appreciates the opportunity to comment on the rule proposal cited above ("Proposed Rule") governing the use of pre-dispute arbitration agreements in consumer finance contracts.

INTRODUCTION AND SUMMARY OF COMMENTS

The Proposed Rule establishes two important reforms: It precludes the use of class action waivers in pre-dispute arbitration clauses, and it requires financial services firms to collect and report data on the consumer arbitration proceedings that will continue even after the Proposed Rule goes into effect.

Better Markets strongly supports these measures. By preserving the right of consumers to participate in class actions, the Proposed Rule will enhance their ability to obtain meaningful relief when they have been the victims of unfair, deceptive, or abusive conduct by firms that provide financial products or services. Protecting the class action option for consumers will also serve as a powerful deterrent against misconduct by financial companies. And the Proposed Rule, through its new reporting obligations, will lay the

[1] Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements, and more.

foundation for possible future rulemaking and enforcement activity to address any continuing abuses in the arbitration process.

Although the Proposed Rule is a strong measure that will significantly enhance consumer protection, the Consumer Financial Protection Bureau ("CFPB") can and should strengthen it in several key respects.

- First, the CFPB should exercise the full extent of its authority under Section 1028 of the Dodd-Frank Act and broadly prohibit the use of all pre-dispute arbitration clauses that effectively mandate, or force, binding arbitration upon consumers. Preserving the right of injured consumers to initiate or participate in *class action* lawsuits (as the Proposed Rule does) is an important step, but it does not go far enough. There is already a robust body of evidence showing that arbitration proceedings tend to disadvantage consumers, and financial firms should no longer be permitted to force that process on their customers and clients for the resolution of individual *or* class action claims.

- Second, the CFPB should strengthen the Proposed Rule by eliminating or limiting the grandfather clause. All agreements, past and future, should become subject to the Proposed Rule upon the compliance date. At a minimum, whenever a financial firm chooses to amend a pre-existing agreement with a consumer by changing the terms—including the rates, fees, penalties, or other conditions—the agreement should be subject to the ban on class action waivers set forth in the Proposed Rule. Furthermore, the CFPB must resist the expected wave of arguments calling for additional carve-outs or exemptions from the Proposed Rule, from which a number of financial industry sectors are already exempt.

- Third, the CFPB should expand the reporting requirement so that covered firms must submit their arbitration agreements and all related documents (and any changes to them) to the CFPB, not just documents pertaining to specific arbitration proceedings that are actually instituted, often long after arbitration clauses have been in effect. Absent this additional disclosure, the CFPB will not have access to important information about financial firms' arbitration agreements and related documents in real time.

- Fourth, the CFPB should maximize transparency by publicly sharing as much information as possible regarding filed arbitration cases, consistent with any legitimate confidentiality concerns. And, the agency should review the data it receives not only for evidence of abuses in the arbitration process, but also for evidence of fraud or other misconduct that should be the subject of enforcement action.

- Finally, the CFPB should coordinate with other agencies that share regulatory and enforcement jurisdiction over aspects of the Proposed Rule, including state attorneys general, and it should also engage in a strong public education campaign

> so that consumers better understand the rights and remedies they have for resolving disputes with financial firms.

BACKGROUND

The Release appropriately begins with an overview detailing the expansion of consumer protection laws beginning in the 1960s and the increasingly important role that private rights of action have played in effectuating those protections.[2] As the Supreme Court has noted in the securities field, "meritorious private actions to enforce federal antifraud securities laws are an essential supplement to criminal prosecutions and civil enforcement actions brought by the Department of Justice and the Securities and Exchange Commission."[3] The same principle applies generally, not just in the securities markets: Private remedies are a critically important adjunct to regulatory enforcement. They not only facilitate recovery for those harmed by illegal conduct, they also deter violations of the law by financial institutions.

The Release also traces the history of class action lawsuits, a uniquely powerful form of private action that provides a remedy for large groups of consumers who have been the victims of widespread patterns of fraud and abuse. Even with the significant limitations on class actions that have evolved since the mid-1990s under federal statutory and decisional law,[4] this form of redress still enables large numbers of claimants to seek recovery in an efficient way (from the standpoint of consumers as well as courts). This mechanism is especially important where the average individual claim is relatively modest in amount. Indeed, as the CFPB's own study shows, class actions are the single most effective private means of facilitating recovery and deterring misconduct. One early court decision aptly described the importance of the class action mechanism:

> It is hardly necessary in this age to argue the worth of the class action in our ever-expanding system of jurisprudence. Over the years it has promoted the convenience of courts and parties infinitely, reduced the expense of lawsuits incalculably, and contributed immeasurably to efficient judicial administration. It has, too, made its mark on the development of the law. The reports are dotted with landmark cases which without benefit of representative litigation would never have seen the light of day.
>
> Even more profoundly, the class action has provided access to the judicial process for those who need it most. It has been the refuge of the poor, the hope

[2] Release at 32832.

[3] *Tellabs, Inc. v. Makor Issues and Rights, Ltd.*, 551 U.S. 28, 31 (2007).

[4] *See, e.g.*, 15 U.S.C.A. § 78u-4(b)(1)- (2) (imposing heightened pleading requirements for fraud claims in class actions); *see also Bell Atlantic v. Twombly*, 550 U.S. 544, 548-49 (2007) (dismissing an antitrust class action for failing to provide factual context suggesting that defendants engaged in parallel conduct).

> of the downtrodden, and the salvation of the many whom our social institutions all too frequently victimize, unwittingly or otherwise. Truly it is said that '(t)he class action is one of the few legal remedies the small claimant has against those who command the status quo.'[5]

The Release further canvasses the growth of arbitration clauses and the mounting concerns surrounding their use in agreements between firms and consumers. Until modern times, arbitration was used principally to resolve commercial disputes between companies with roughly equal bargaining power.[6] Beginning in the 1980s, however, companies began to incorporate arbitration agreements in contracts with consumers, investors, and employees, typically through the use of barely readable clauses buried in standard form agreements. Increasingly, those agreements have prohibited consumers from pursuing or participating in any court actions, including class actions.

As discussed in more detail below, arbitration proceedings have become the subject of strong, persistent, and persuasive criticism to the effect that the proceedings are forced upon consumers without their knowledge or meaningful consent; that they follow deeply unfair procedures; that they create a classic un-level playing field tilted dramatically against individual consumers and in favor of corporations; and that they are ineffective at procuring meaningful relief for those who have suffered fraud and abuse at the hands of firms selling financial products and services to consumers. When coupled with clauses that preclude consumers from participating in class actions to recover damages for widespread or systemic abuses, arbitration clauses can be doubly harmful.

This history served as the backdrop and the impetus for Section 1028 in the Dodd-Frank Act. It provides in relevant part that—

> (a) STUDY AND REPORT.—The Bureau shall conduct a study of, and shall provide a report to Congress concerning, the use of agreements providing for arbitration of any future dispute between covered persons and consumers in connection with the offering or providing of consumer financial products or services.
>
> (b) FURTHER AUTHORITY.—The Bureau, by regulation, may prohibit or impose conditions or limitations on the use of an agreement between a covered person and a consumer for a consumer financial product or service providing for arbitration of any future dispute between the parties, if the Bureau finds that such a prohibition or imposition of conditions or limitations is in the public interest and for the protection of consumers. The findings in such rule shall be consistent with the study conducted under subsection (a).

[5] *Williams v. Mumford*, 511 F.2d 363, 371 (D.C. Cir. 1975).

[6] Release at 32835.

The CFPB conducted the study required under Section 1028, and the Release reviews its findings. Based largely on those results, the CFPB has reached a number of preliminary conclusions that form the basis for the Proposed Rule:

> The Bureau preliminarily concludes, consistent with the Study and based on its experience and expertise, that: (1) The evidence is inconclusive on whether individual arbitration conducted during the Study period is superior or inferior to individual litigation in terms of remediating consumer harm; (2) individual dispute resolution is insufficient as the sole mechanism available to consumers to enforce contracts and the laws applicable to consumer financial products and services; (3) class actions provide a more effective means of securing relief for large numbers of consumers affected by common legally questionable practices and for changing companies' potentially harmful behaviors; (4) arbitration agreements block many class action claims that are filed and discourage the filing of others; and (5) public enforcement does not obviate the need for a private class action mechanism.[7]

As discussed below, the Proposed Rule creates an important bulwark against efforts by financial service providers to extinguish the rights of consumers to seek redress through class actions. However, the proposal should be made even broader and stronger.

COMMENTS

I. Banning arbitration clauses that prevent consumers from participating in class action lawsuits was unquestionably an appropriate step, and the CFPB must remain steadfast in this approach in the final rule.

The CFPB has an ample legal and factual basis for the Proposed Rule. Section 1028 of the Dodd-Frank Act gave the CFPB broad discretion to propose a rule limiting and even prohibiting the use of pre-dispute arbitration clauses in consumer finance contracts. That section sets up two conditions for such a rulemaking, both of which are met here.

First, the rule must be based on a finding that it is "in the public interest and for the protection of consumers." As discussed in the Release, those two elements encompass a wide variety of factors applicable here. For example, the public interest and consumer protection standards seek to ensure that markets for consumer financial products are fair and transparent, and the Proposed Rule directly serves those ends.[8] In addition, the Proposed Rule will help promote even broader values embodied in the public interest and the consumer protection prongs, including adherence to the rule of law and a broad-based accountability among commercial enterprises.[9]

[7] Release at 32855.

[8] Release at 32854.

[9] *Id.*

Second, any findings supporting the rule must be "consistent with the study." That requirement also is satisfied here. The conclusions set forth in the Release and quoted above clearly show that, among other realities, (1) individual dispute resolution is insufficient as the sole mechanism available to consumers for enforcing contracts and laws applicable to consumer financial products and services, and (2) class actions provide a more effective means of securing relief for large numbers of consumers affected by common legally questionable practices and for changing companies' potentially harmful behaviors.

More specifically, the CFPB study mandated by Section 1028 provides many important findings regarding the nature of arbitration and its stifling impact. For example, the Study shows that arbitration clauses are prevalent in contracts between consumers and financial firms and that "nearly all the arbitration agreements studied" expressly prohibit *class arbitrations* in addition to barring class action lawsuits.[10] The case law confirms that these provisions are difficult for consumers to overcome. For example, the Supreme Court's 2011 decision in *AT&T Mobility v. Concepcion* significantly impaired consumers' ability to pursue legal theories that class action waivers are invalid under contract law.[11] And in 2013, the Supreme Court's ruling in *American Express Co. v. Italian Colors* greatly diminished consumers' ability to argue that class action waivers are unenforceable even when they prevent claimants from pursuing federal statutory rights.[12] Thus, without regulatory intervention, consumers face insuperable barriers to meaningful relief through class actions.

Among the most significant revelations in the Study is the data confirming that arbitration is an extremely poor substitute for class action litigation as a means of redress for consumers. One data point shows that over a two-year period, arbitration proceedings involving consumer finance disputes that were actually resolved by an arbitrator produced only $172,422 in awarded relief, along with $189,107 in debt forbearance.[13] In stark contrast, a review of just class action *settlements* over a four-year period resulted in $2.7 billion in relief, representing $2.05 billion in cash and $644 million in in-kind remedies.[14] Thus, even accounting for the differential in the time periods studied, the relief obtained through arbitration pales in comparison to that obtained through the class action process.[15]

The Proposed Rule is also fully consistent with the determination made in other areas of financial regulation that the use of arbitration agreements can and should be limited. For example, FINRA has for decades prohibited its broker-dealer members from enforcing arbitration agreements against investors who wish to participate in class action lawsuits.

[10] Release at 32842.

[11] *See* 563 U.S. 333 (2011).

[12] *See* 133 S. Ct. 2304 (2013).

[13] Release at 32845.

[14] Release at 32849.

[15] The CFPB was unable to compare arbitration settlement amounts with class action settlement amounts principally because the terms of arbitration settlements are generally not public—further evidencing the secrecy surrounding arbitrations referenced in the discussion above. Release at 32845.

Recent reports also confirm that the use of arbitration clauses is on the rise among banks.[16] Thus, implementation of a strong rule implementing Section 1028 is more important than ever.

In reality, financial services companies that include class action waivers in form contracts are effectively inoculating themselves from private enforcement of the law.[17] This not only directly harms individual consumers, it also eliminates a powerful incentive for firms to obey the law and treat their customers fairly. The CFPB has an ample legal and factual basis to address these problems through the ban on class action waivers set forth in the Proposed Rule and the proposal should not be weakened.

II. The CFPB should fully exercise its authority under Section 1028 and ban all pre-dispute forced arbitration clauses in consumer finance contracts.

The Proposed Rule actually does not go far enough. The CFPB has, for the time being at least, decided not to prohibit financial services firms from forcing their customers to submit to binding arbitration for any *individual* claims they have arising from the sale of financial products and services. This is a mistake.

The CFPB clearly has the legal authority to entirely ban the use of pre-dispute arbitration clauses, given the broad scope of Section 1028. There is a strong empirical foundation as well. For years, consumer advocates have identified a long list of problems associated with the use of such clauses and the arbitration proceedings that they impose on consumers. Unfortunately, arbitration typically provides an opaque, biased, and ineffective dispute resolution mechanism, often marked by these specific impediments to fair adjudication:

- consumers have no idea that they have contractually waived their right to seek redress in court, and in any event they have no power to negotiate over arbitration clauses with the powerful companies that insist on them;

- arbitration panels are biased toward industry;

- consumers have little choice but to shoulder the expense of hiring an attorney to achieve some level of parity with the experienced counsel typically hired by financial services firms;

[16] Ann Carrns, *More Big Banks Using Arbitration to Bar Customer Lawsuits*, N.Y. TIMES, Aug. 17, 2016.

[17] Jessica Silver-Greenberg and Micheal Corkery, *In Arbitration, a 'Privatization of the Justice System'*, N.Y. TIMES, Nov. 1, 2015, http://www.nytimes.com/2015/11/02/business/dealbook/in-arbitration-a-privatization-of-the-justice-system.html.

- the process affords very limited discovery rights, which tend to favor the financial firms who enjoy exclusive access to some of the most important evidence relating to consumer claims;

- consumers cannot recover punitive damages or even attorneys' fees;

- so-called victories for consumers mean little since the damages awarded fall short of the actual harm sustained;

- the process is private, not public, and decisions come with little or no explanation, frustrating a consumer's desire to understand whether justice has been done and preventing the creation of a jurisprudence that could guide other consumers confronting arbitration;

- rights of appeal are virtually nonexistent; and

- while the process may be faster than a court proceeding, it may not be, and in any case, this arguable advantage (if it is one at all) is far outweighed by the other disadvantages of the arbitration process.

The Study itself specifically confirms a number of these shortcomings, including the lack of discovery, the limited grounds for appeal, and the widespread failure to make consumers aware of arbitration clauses and what they signify.[18] In short, as explained in the Release—

> The use of arbitration agreements in such contracts has become a contentious legal and policy issue due to concerns about whether the effects of arbitration agreements are salient to consumers, whether arbitration has proved to be a fair and efficient dispute resolution mechanism, and whether arbitration agreements effectively discourage the filing or resolution of certain claims in court or in arbitration.[19]

In fact, this language from the Release understates the case: In the minds of Congress and numerous other regulators, these "concerns" have already ripened into the steadfast conclusion that a wholesale ban on the use of pre-dispute arbitration clauses is appropriate and necessary. For example, CFTC regulations require that arbitration agreements in commodity contracts be voluntary; Fannie Mae and Freddie Mac ceased purchasing mortgages with arbitration agreements over a decade ago; and FTC regulations bar the use of binding arbitration in consumer warranty agreements.[20]

[18] Release at 32843-44.

[19] Release at 32831.

[20] Release at 32837.

The trend toward banning arbitration agreements outright was also amply reflected in the Dodd-Frank Act. For example, Section 1414(a) prohibited the use of arbitration agreements in mortgage contracts:

> (1) IN GENERAL.— No residential mortgage loan and no extension of credit under an open end consumer credit plan secured by the principal dwelling of the consumer may include terms which require arbitration or any other nonjudicial procedure as the method for resolving any controversy or settling any claims arising out of the transaction.

And Section 921 of the Dodd-Frank Act authorized the SEC—without the necessity of any study—to limit or "prohibit" the use of arbitration agreements between investors and broker-dealers or investment advisers. Thus, there is already abundant precedent for regulatory measures that entirely prohibit the use of pre-dispute arbitration clauses.

The CFPB evidently believes that a more incremental approach is appropriate based upon one of its core findings: It notes in the Release that the evidence is "inconclusive" as to whether individual arbitration is superior or inferior to individual litigation in terms of remediating consumer harm. However, this observation is—first of all—inconsistent with the mountain of evidence showing that arbitration is an unfair and inferior method of redress for consumers.

But even if it were accepted as true, it does not justify the CFPB's decision not to ban the use of all pre-dispute forced arbitration clauses. Even if court litigation and arbitration were equally effective methods of dispute resolution, there is no justification for allowing financial firms to *require* consumers to arbitrate. A ban on pre-dispute forced arbitration clauses would still allow institutions and consumers to resort to arbitration if they so agree at the time a dispute arises. And, if arbitration proceedings were actually structured to offer genuine benefits to consumers, then consumers would begin to opt for them. But the critical point is that consumers should have a meaningful choice in the matter, and without a rule banning the practice of forcing consumers into arbitration, that choice will never exist.

For all of these reasons, the CFPB should expand the scope of the Proposed Rule to flatly ban the use of pre-dispute binding arbitration clauses in financial service contracts.

III. The CFPB should resist any call for additional exemptions from the Proposed Rule, and it should strengthen the rule by eliminating or limiting the grandfather clause.

Under Title X of the Dodd-Frank Act, the Proposed Rule will not apply to a number of financial sectors. The statute outlines the CFPB's authority over "consumer financial products and services" in detail. Among those excluded from the Proposed Rule will be auto dealers, real estate brokers, certain legal service providers, and insurance providers and businesses—all of which fall outside the CFPB's authority under Title X. The same is true for broker-dealers subject to regulation by the Securities and Exchange Commission. And of course, even those financial services companies falling under the Proposed Rule will still be able to require the arbitration of *individual* disputes—not to mention employ sundry non-arbitration liability mitigation tactics, such as exclusive-forum provisions, jury trial waiver provisions, and damage caps.

Thus, the familiar problems with forced arbitration and class action waivers will persist with respect to many individuals and entities that are outside the CFPB's jurisdiction. Accordingly, the CFPB should steadfastly resist any calls during the comment period to create additional carve-outs or safe harbors that favor other financial industry sectors.

In addition, the CFPB should strengthen the Proposed Rule by eliminating or at least narrowing the grandfather clause. As proposed, the rule will not apply to agreements between firms and consumers entered prior to the compliance date, even if the institution later elects to amend the agreement in a number of ways. This is unacceptable. Under this approach, institutions will be free to amend a prior agreement by adding new and onerous terms, including, for example, higher rates, penalties, or fees, without becoming subject to the ban on class action waivers. The optimal remedy is to subject all agreements, pre-existing and future, to the Proposed Rule as of the compliance date. Short of that, the Proposed Rule should be amended to provide that any change to any pre-existing agreement automatically triggers application of the ban on class action waivers.

IV. Requiring the submission of arbitration documents to the CFPB is appropriate, but the CFPB should expand the universe of required information and strengthen the provision to ensure greater transparency.

The CFPB has also proposed requiring consumer financial service providers that still use arbitration agreements to regularly submit to the CFPB information regarding arbitrations that do proceed. The reporting requirements cover a wide array of information, including the arbitration agreement filed with the arbitrator, judgments or awards (if any) issued by the arbitrator, information on claims and counterclaims, and certain correspondence regarding a provider's non-payment of arbitral fees.

This is an appropriate exercise of the CFPB's authority, and it is especially important given that the Proposed Rule will allow the continued use of forced individual arbitration clauses. Perhaps with the benefit of the additional data gathered under the Proposed Rule, the CFPB will take the appropriate step to ban completely the use of all mandatory arbitration clauses.

In any case, the CFPB should strengthen the Proposed Rule in several respects. First, it should require all covered institutions to file their arbitration agreements and any other documents reflecting the specific conditions under which consumers are required to arbitrate their claims, not just documents pertaining to specific, filed arbitrations. This requirement must include any updates and amendments to arbitration clauses, and it must require prompt submission of such documents and amendments, to help ensure that the CFPB has a real-time understanding of the approach to arbitration that financial firms are following. Those agreements may well reflect onerous terms and conditions that further limit the consumer's rights in arbitration, ranging from inconvenient arbitration venues, the appointment of arbitration organizations that favor industry, additional limits on discovery, and the unfair allocation of fees. Such conditions may actually discourage consumers from bringing any claims in arbitration at all, depriving the CFPB of any data in such instances, since no proceedings will be filed.

With respect to transparency, the CFPB appears to be considering publishing this information on its website in an appropriately redacted and possibly aggregated form. Better Markets strongly encourages the CFPB to distribute this information for public consumption with as much particularity and transparency as is practicable. Arbitration has historically been a secretive process without public access to filings, awards, and other relevant data. But there is a strong public interest in shining a light on this important dispute resolution arena. Potential claimants would undoubtedly value more information with which to make informed judgments about their prospects for success in arbitration. They stand to benefit from knowing the rate at which arbitral claimants tend to prevail, the types of claims and defenses that are typically raised, and the types of awards that may be possible. Greater transparency will also create benefits not just for potential claimants, but for attorneys, academics, regulators, and the public at large as well.

To further strengthen the Proposed Rule, Better Markets urges the CFPB to take the following affirmative steps with respect to the arbitral data:

- Consider and regularly report on whether specific practices common to arbitration that come to light in the data constitute unfair, deceptive, or abusive practices that are appropriate for enforcement action.

- Take appropriate enforcement action if the data show that particular firms are injuring consumers by not paying arbitration fees or awards.

- Determine whether there are developments in arbitral proceedings that raise additional concerns that justify further rulemaking, reporting requirements, or enforcement action.

V. Given the CFPB's non-overlapping regulatory and enforcement authority, the CFPB must begin planning a coordinated effort now to ensure maximal enforcement of the final rule.

Though not discussed in the proposal, it is crucial to bear in mind that the CFPB's regulatory authority under Title X of the Dodd-Frank Act is not co-terminus with its enforcement authority. For example, the CFPB has authority over a variety of nonbank financial services companies as well as banks with more than $10 billion in assets. But the Federal Trade Commission will have to enforce the final arbitration rule with respect to other non-banks, and the federal banking agencies will have enforcement authority over the remaining smaller banks.

State attorneys general will also have a role in a robust enforcement regime. Section 1042 of the Dodd-Frank Act permits such state enforcement actions even against national banks and federal thrifts, provided there is consultation with the CFPB in advance.

The CFPB should reach out to all of these agencies, including state attorneys general, to develop alliances and to encourage others to devote time and resources to enforcement of the final rule. In short, the CFPB must implement a coordinated enforcement effort.

Finally, the CFPB should undertake a public education campaign to educate consumers about their rights under the final rule. Anything that the CFPB can do to promote greater awareness of consumers' rights will also serve the underlying goals of the Proposed Rule.

CONCLUSION

We hope these comments are helpful as the CFPB finalizes the Proposed Rule.

Sincerely,

Dennis M. Kelleher
President & CEO

Stephen W. Hall
Legal Director & Securities Specialist

Better Markets, Inc.
1825 K Street, NW
Suite 1080
Washington, DC 20006
(202) 618-6464

dkelleher@bettermarkets.com
shall@bettermarkets.com
www.bettermarkets.com