October 7, 2015

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Field Hearing on Arbitration

Denver, Colo.
October 7, 2015

Thank you all for joining us in Denver today. We are here to talk about something important that is often buried deeply in the fine print of many contracts for consumer financial products and services, such as credit cards and bank accounts. It is called an arbitration clause, or more precisely, a mandatory pre-dispute arbitration clause. If you do not know what an arbitration clause is, you are just like the vast majority of American consumers.

Companies use this clause, in particular, to block class action lawsuits. They thus provide themselves with a free pass from being held accountable by their customers. That free pass is secured by making sure their customers cannot group together to seek relief for wrongdoing. Many violations of consumer financial law involve relatively small amounts of money for the individual victim. Group claims often are the only effective way consumers can pursue meaningful relief for harms that can add up to large amounts of money for financial providers. At the Consumer Financial Protection Bureau, we estimate that this free pass affects tens of millions of consumers.

To understand this issue more plainly, we can look at a hypothetical example based on real-world consumer experiences. Maria and Kate (their names are fictitious) are customers at two different banks, and both are beginning to rack up unexpected overdraft fees on their checking accounts. It turns out that their banks are processing transactions in unexpected ways that increase the number of overdraft fees and without ever clearly explaining what they are doing. These practices cost Maria and Kate at most a few hundred dollars each. But they have earned the banks hundreds of millions of dollars across many customers.

After consulting lawyers, Maria and Kate are told that similar practices have been found to be illegal at another bank, but it would not make economic sense to sue just to recover the small amount each of them has been overcharged. Maria and Kate could call their banks and demand a refund, but there is no guarantee they would get their money back. Even if they managed to do so, the same practices would continue to affect others. So Maria and Kate each agree to sue their banks, not just on behalf of themselves, but on behalf of all the other consumers who were victimized in the same way.

Maria succeeds in bringing a group claim and obtaining a settlement with her bank on behalf of two million customers. As a group, the customers are eligible to receive upwards of a $100 million refund for the fees they were wrongfully charged, and their bank agrees to change its practices so these harms cannot continue. By contrast, Kate's lawsuit is dismissed. So far as we know, Kate gets nothing for herself and the other customers of the bank are left without relief, despite the fact that her bank engaged in similar practices and used similar disclosures. The difference is that Kate's bank had an arbitration clause that gave it a free pass from her efforts to pursue relief by blocking her group claims.

By simply invoking the magic words of the arbitration clause, Kate's bank could avoid being held to account for its actions. The only option for customers at Kate's bank was to bring their own individual arbitration cases for such relatively small amounts that it would be impractical to pursue them. In addition, the results of any such arbitration cases would never be revealed to the general public.

The dramatically different experiences of these two consumers illustrate how companies have been able to use this little-known clause to rig the game against their customers. Group lawsuits can result in substantial relief for many consumers and create the leverage to bring about much-needed changes in business practices. But by inserting the free pass into their consumer financial contracts, companies can sidestep the legal system, avoid big refunds, and continue to pursue profitable practices that may violate the law and harm consumers on a large scale.

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Let me take a step back and give you a little background on how we got here. At its most basic level, arbitration is a way to resolve disagreements outside of the federal and state court systems. Originally, arbitration was primarily used for disputes between businesses; it was rarely used in disagreements between businesses and consumers. But in the last 20 years or so, companies started including arbitration clauses in their consumer contracts requiring any disputes or disagreements be resolved through private arbitration. And to make doubly sure that they could escape accountability, many companies specifically blocked group claims even in arbitration, thus forcing consumers to go through the process by themselves in isolation, or forgo it altogether.

Some companies offer their customers the chance to opt out of an arbitration clause. But very few customers, if any, ever exercise that option, which is unsurprising given that the majority of consumers do not even know that the arbitration clause exists. Group lawsuits depend on a group. The few consumers who opt out of arbitration find that very few others are still available to join their lawsuits. It is simply impossible to have an effective group claim where the vast majority of consumers have all lost their right to have their day in court.

Even before the Consumer Bureau was created, Congress had started to take a more active role in dealing specifically with the problems of forced arbitration. In the last decade, Congress had begun to distinguish between mandatory pre-dispute arbitration, which is typically imposed on consumers in the contractual boilerplate, and arbitration that both parties can freely decide to undertake after a dispute has already arisen between them. In 2007, Congress passed the Military Lending Act, which prohibited mandatory pre-dispute arbitration clauses in connection with certain loans made to servicemembers. Three years later, in the Dodd-Frank Wall Street Reform and Consumer Protection Act, Congress went further and banned such clauses from most residential mortgage contracts.

In the Dodd-Frank Act, Congress also put in place a further measure that brings us to where we are today. In a two-step process, the law empowers the Bureau to address the same concerns that Congress had already highlighted around mandatory pre-dispute arbitration clauses. First, Congress required the Bureau to conduct a study and issue a report on the use of arbitration clauses in connection with consumer financial products or services. Once that initial work was completed, Congress gave the Bureau the broad authority to consider whether to issue regulations that it deemed to be in the public interest, for the protection of consumers, and consistent with the results of its study.

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We published that study and issued our report to Congress earlier this year. In the months since, even our critics have acknowledged that the multi-year study, which runs to 728 pages and analyzes extensive data, was the most rigorous and comprehensive study of consumer finance arbitration ever undertaken. In the study, we found that arbitration clauses are pervasive, but the vast majority of consumers do not even know they exist. We also found that tens of millions of consumers are covered by arbitration clauses in several consumer finance markets. Large banks, in particular, commonly include these clauses in their standard agreements for credit cards and checking accounts. We also found that many payday lenders put such clauses in their contracts. And our study shows that more than three-quarters of the consumers we surveyed in the credit card market did not know whether they were subject to an arbitration clause in their contract.

The Bureau's study specifically concluded that group lawsuits can be an effective way to provide relief to consumers when they are allowed to proceed. Indeed, by examining five years of data, we found that group lawsuits delivered, on average, about $220 million in payments to 6.8 million consumers per year in consumer financial services cases. But we also saw that in many instances, as in Kate's situation, group claims are thwarted by companies that invoke their arbitration clauses to cut off such relief. For example, in cases where credit card companies with an arbitration clause in their contracts were sued in a class action, the companies invoked the clause to block the lawsuit almost two-thirds of the time.

One point of special interest to us was the claim, frequently made by companies that tout the benefits of arbitration, that these clauses enable them to lower the cost of consumer financial services for consumers. Our study was able to examine this claim closely by comparing large credit card companies that did and did not have arbitration clauses in their contracts, including some companies that previously had such clauses but had stopped using them in the wake of adverse litigation. Our analysis did not find evidence that credit card companies either increased prices or reduced access to credit when they eliminated their arbitration clauses.

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After carefully considering the findings of our landmark study, the Bureau has decided to launch a rulemaking process to protect consumers. The proposal under consideration would prohibit companies from blocking group lawsuits through the use of arbitration clauses in their contracts. This would apply generally to the consumer financial products and services that the Bureau oversees, including credit cards, checking and deposit accounts, certain auto loans, small-dollar or payday loans, private student loans, and some other products and services as well.

One approach we might have taken would be a complete ban on all pre-dispute arbitration agreements for consumer financial products and services. Our proposal would not do that. Companies could still have an arbitration clause, but they would have to say explicitly that it does not apply to cases brought on behalf of a class unless and until the class certification is denied by the court or the class claims are dismissed in court. This means we are not proposing at this time to limit the use of arbitration clauses as they apply to individual cases.

This approach is consistent with the conclusions reached in our study. It is also consistent with rules that the Financial Industry Regulatory Authority has applied to broker-dealers for years, with the approval of the Securities and Exchange Commission. While at one time certain individual arbitration systems were problematic for consumers in terms of procedures and results, we found that companies today generally cannot bring cases against consumers in arbitration. We also found that companies rarely use their arbitration clauses to block consumers from suing them in individual cases. In addition, we found that only a small number of consumers bring individual arbitrations.

Although we are not proposing to prohibit the use of pre-dispute arbitration clauses, we will continue to monitor the effects of such clauses on the resolution of individual disputes. To enable us to do so, our proposals would require companies to send to the Bureau all filings made by or against them in consumer financial arbitration disputes and any decisions that stem from those filings. By developing comprehensive data on these matters, over time we will be able to refine our evaluation of how such proceedings may affect consumer protection, if at all.

In order to create more transparency and spur broader thinking by researchers and other interested parties, we are considering publishing this information for all to see, so the public can analyze it as they see fit. Depending on what the data reveals, down the road these issues could be subject to further consideration by the Bureau and by other policymakers.

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So the essence of the proposals we have under consideration is that they would get rid of this free pass that prevents consumers from holding their financial providers directly accountable for the harm they cause when they violate the law. Doing so would produce three general benefits.

First, consumers would have the opportunity to get their day in court. This is a core American principle. Under the U.S. Constitution, each one of us is entitled to seek justice through due process of law. This right is reinforced in many state constitutions, which recognize the right to an effective remedy to redress injuries we may sustain to our person or our property. This is an important element of personal liberty, that people should have the ability to protect themselves by acting to vindicate their rights. Nobody should have to rely on the government first deciding to pursue an enforcement action in order to get their money back and hold others accountable. But as we have already noted, it is simply not worth it for consumers to undertake the burden and cost of bringing an individual case just to challenge small fees and charges.

As noted U.S. Court of Appeals Judge Richard Posner has convincingly observed, “The realistic alternative to a class action is not 17 million individual suits, but zero individual suits, as only a lunatic or a fanatic sues for $30.” That is, in fact, a primary reason why procedures allowing for group lawsuits have been widely adopted in virtually all of our federal and state courts in the last century. By joining together to pursue their claims as a group, all of the affected consumers would be able to seek and, when appropriate, obtain meaningful relief that as a practical matter they could not get on their own.

Second, another important benefit of the proposals we are considering is that they would deter wrongdoing on a broader scale. One way this is often expressed is by describing group lawsuits as being brought by "private attorneys general" as a means of vindicating public rights and as an aid to other methods of law enforcement. Although many consumer financial violations impose only small costs on each individual consumer, taken as a whole these unlawful practices can yield millions or even billions of dollars in revenue for financial providers.

Arbitration clauses that bar group lawsuits protect these ill-gotten gains by enabling companies to avoid being held accountable for their misdeeds. Thus, companies are likely to take less care to ensure that their conduct complies with the law than they would have taken if they did not have a free pass from group lawsuits. Indeed, some companies may even feel emboldened that they can safely engage in conduct that could violate consumer protection laws or even their own contracts with customers. The potential to be held accountable in a group lawsuit changes this dynamic.

When a group lawsuit leads to a court order conferring relief on tens of thousands of consumers who were victimized by suspect practices, the likely result is to create a safer market for current and future customers of that company, as well as the other companies in the same market. That is true because a substantial monetary award can lead a company to rethink its practices by reassessing its bottom line. It is also true because such actions may result in specific measures that force companies to change the way they do business. And the public spotlight on these cases can influence business practices at other companies that become aware of the need to make similar changes to avoid facing the ire of their customers and the risks of similar lawsuits.

Third, by requiring companies to provide the Bureau with arbitration filings and written awards, which might be made public, the proposals we are considering would bring the arbitration of individual disputes into the sunlight of public scrutiny. This would provide a safeguard against arbitration proceedings that are unfair or otherwise harmful to consumers. Furthermore, both the Bureau and the public would be able to monitor and assess the pros and cons of how arbitration clauses affect resolutions for individuals who do not pursue group claims. This will improve our understanding and enable policymaking that is better informed and more precise. In the end, that will be better for consumers, for responsible businesses, and for the economy as a whole.

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One way to think about the effect of enforced pre-dispute arbitration clauses is to recall what Sherlock Holmes described as "the curious incident of the dog in the night-time." In the famous detective story, everyone except Holmes misses the fact that the dog did nothing during the night, including not barking at all, which yields the important clue that the intruder likely was recognized. What the story illustrates is that it is often hard to grasp the significance of something that does *not* happen and thus can easily go unnoticed.

The same point can also be applied to arbitration. What we learned in the course of our study is that very few consumers of financial products and services are seeking relief individually, either through the arbitration process or in court. Moreover, there are also an unknown number of cases that are never filed because of the mere presence of an arbitration clause. And millions of other consumers who may not even realize that their rights are being violated might have obtained relief if group lawsuits were permissible. Like the dog that did not bark in the night, the silent fact of all this missing relief for consumers can be hard to notice, but it is nevertheless a vital piece of the story.

The central idea of the proposals we are considering is to restore to consumers the rights that most do not even know had been taken away from them. Companies should not be able to place themselves above the law and evade public accountability by inserting the magic word "arbitration" in a document and dictating the favorable consequences. Consumers should be able to join together to assert and vindicate their established legal rights. Under the approach we are considering, companies would not be able to tip the scales in their favor by writing their own free pass to the detriment of consumers. Everyone benefits from a market where companies are held accountable for their actions. Thank you.

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