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ALERT

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CFPB RELEASES CONSUMER ARBITRATION STUDY

The Consumer Financial Protection Bureau recently released its study of "pre-dispute arbitration clauses" in consumer financial services ("Study"). Section 1028(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 required the CFPB to conduct a study of and 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.

As the Study notes, the advantages and disadvantages of arbitration clauses in consumer financial services have been fiercely debated. The CFPB concludes that arbitration agreements restrict consumers' relief for disputes with financial service providers by limiting class actions. The Study found that while millions obtain relief each year through class action settlements, very few consumers individually seek relief through arbitration and the courts.

The 728-page Study is described as empirical, not evaluative, and includes 10 sections and several appendices. The CFPB says it believes the Study to be the most comprehensive empirical study of consumer financial arbitration carried out to date. In addition to the introduction and executive summary, the sections cover the following topics:

- The prevalence and main features of pre-dispute arbitration clauses.
- Consumer's understandings about dispute resolution systems.
- How arbitrations differ from court proceedings.
- The types of claims brought in arbitration and their resolution.
- The types of claims brought in litigation and their resolution.
- Whether consumers sue in small claims courts.
- The value of class action settlements.
- The relationship between public enforcement and consumer financial class actions.
- Whether arbitration clauses lead to lower prices for consumers.

The appendices include additional background, data and further descriptions of methodologies used in the Study.

Early steps in the CFPB's process to study arbitration began in 2012 with a request for information that sought comments on the scope, methods and data sources for the Study. The CFPB received 60 comments and published preliminary results in December 2013, which are set forth as Appendix A of the Study. The CFPB surveyed 1,007 credit card holders with respect to their pre-dispute arbitration agreements between September and December of 2014. The Study is replete with data and statistics and discusses the scope and limitations of the Study. Some of the key findings of the Study are noted below.

Clause Incidence and Features

The Study finds the number of consumers using consumer financial products or services subject to pre-dispute arbitration clauses to be in the tens of millions. Arbitration use in the six markets reviewed breaks down as follows:

- Credit Card – Only 16% of issuers use arbitration clauses, but because they mostly are used by large issuers, 53% of credit card loans are subject to them (this is a reduction from 94%, which is how many would be covered, but for a settlement in which certain issuers agreed to remove the clauses).
- Prepaid Cards – 92% of the agreements obtained by the CFPB.
- Payday Loans – In CA and TX, 99% of the storefront locations' agreements.
- Private Student Loans – 86% of the largest lenders' contracts.
- Checking Accounts – About 8% of banks, covering 44% of insured deposits.
- Mobile Wireless – 88% of the largest carriers, covering 99% of the market.

In addition to incidence, the Study focused on the length and complexity of clauses, finding in the case of credit card agreements, that clauses averaged 1,108 words, which was about 14% of the total words in an agreement. The credit card clauses almost always were more complex and written at a higher grade level than the rest of the agreement, based on the Flesch-Kincaid scale.

The Study also looked at numerous clause features, including whether the clauses included the following [findings in terms of approximate percentages of the credit card market covered by clauses with these features are noted in brackets]: (i) no-class arbitration provisions [99%], (ii) small claim carve-outs [99%], (iii) specific administrators [98% AAA, sole or otherwise], (iv) in-person hearing locations [81%], (v) use of appeals panels [58% appeal by any party], (vi) arbitration cost allocations [46%, initial fee payment, company will pay some or all; 21%, reallocation

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of fees, permits shifting company fees to consumers; 46% award of attorneys' fees/parties bear own attorneys' fees], (vii) delegation of enforceability decisions to the arbitrator [46%], (viii) disclosure of the core characteristics of arbitration [40%, describe no jury, no class action and limited discovery and appeal rights], (ix) consumer opt-outs [26%], (x) contingent minimum recovery [18%], (xi) punitive or other damage exclusions [8%], (xii) non-disclosure provisions [7%] and (xiii) time-periods for bringing the arbitration [1%].

The findings with respect to other markets studied often were similar to the credit card market, particularly with respect to no-class provisions and small claims carve-outs. The American Arbitration Association ("AAA") is the predominant arbitration administrator for all the products studied. The Study noted that the AAA caps the consumers' upfront arbitration costs at or below the AAA's maximum consumer fee thresholds. The AAA also has rules regarding hearing locations, which, like the arbitration clauses themselves, require hearings to take place close to the consumer's residence.

Consumer Understanding and Awareness

The CFPB surveyed 1,007 credit card holders with respect to their pre-dispute arbitration agreements between September and December of 2014. The Study found that dispute resolution mechanisms play a limited role in consumers' decisions to obtain a particular credit card. When asked an open-ended question regarding all features considered in obtaining a credit card, no consumers mentioned dispute resolution procedures. When presented with a list of nine features of credit cards, consumers identified dispute resolution procedures as least relevant to their choice of cards. The features identified from most to least relevant [and for some features, the approximate percentage of consumers who identified the feature as relevant] are as follows: card acceptance [79%], issuer reputation [73%], fees [72%], application convenience, interest rate, rewards, customer service, credit limit and dispute resolution [31%].

In terms of making claims against issuers, the Study found that consumers are very unlikely to bring formal claims. Presented with a hypothetical situation in which they were wrongly charged fees by issuers and had exhausted efforts to obtain relief from the issuers, only about 1% of consumers indicated that they would seek legal advice — 9% would refer the issue to a governmental agency and 57% would cancel their card.

In terms of knowledge of their dispute resolution options, of respondents whose agreements included pre-dispute arbitration provisions, a little more than half did not know if they could sue their issuers in court and about one-third believed they could sue in court (and more than two-thirds of the latter group were mistaken). Most of those surveyed indicated that they had heard of class action lawsuits. A little more than half of respondents whose agreements included pre-dispute arbitration clauses thought that they had the right to participate in a class action proceeding. Given that most of the clauses disallow participation in class action lawsuits, the Study concluded that these consumers largely were mistaken.

Claims Brought in Arbitration Versus Litigation

The Study identified 1,847 AAA arbitration disputes filed during the time-period studied with respect to the following six financial products: credit cards, checking accounts and/or debit cards, payday and similar loans, prepaid cards, private student loans and auto purchase loans. A majority involved credit cards and most involved disputed debt filings. Representation by counsel occurred about 60% of the time across all products for consumers and 90% of the time for companies [46% and 94%, respectively, with respect to credit cards]. The Study identified 3,462 individual federal court litigation cases with respect to five of the financial products listed above. Federal Fair Debt Collection Practices Act claims predominated in those actions.

The Study found that of the arbitration disputes that were resolved at the time data was collected, about one-third were resolved by arbitrators on the merits. The CFPB indicates that (i) the total amount of relief and debt forebearance consumers obtained in all of these cases was under $400,000 and (ii) companies obtained decisions requiring consumers to pay $2.8M in cases filed during this same time period, mostly for disputed debts. The CFPB also noted that few of the litigation cases went to trial and that consumers received just under $1M in damages in the few individual cases decided by judges.

In terms of procedural speed, of the claims resolved by arbitrators, the Study found the median days for the following various resolutions: desk arbitration (119 days), telephone hearing (151 days), in-person hearing (210 days) and award on dispositive motion (232 days). The median time to closure for federal individual court cases not transferred to multidistrict litigation ("MDL") was 127 days; the median time to closure for similar federal class cases was roughly 218 days. The median time for a small number of closed individual cases transferred to an MDL was 396 days. The median time to closure for the federal MDL class cases was 758 days for cases filed in 2010 and 538 days for cases filed in 2011.

Value of Class Action Settlements

The CFPB states that at least 160 million class members were eligible for relief in federal consumer class actions over the 5-year period studied. The settlements totaled $2.7B, with approximately 18% going to attorneys' fees and expenses. The CFPB also says that it is not common for companies to attempt to force an individual lawsuit into arbitration (about 1%), but that it is common for arbitration to be used to avoid a class lawsuit (about 16% for actions in all six consumer financial products markets, or 65% for credit card actions).

In his remarks coinciding with the release of the Study, CFPB Director Cordray noted that Congress provided that the CFPB may prohibit or impose conditions or limitations on the use of pre-dispute arbitration clauses in consumer financial contracts if it finds that such measure "is in the public interest and for the protection of consumers," and findings are "consistent with the study" performed by the CFPB. He indicated that the CFPB will be meeting further with stakeholders after they have had a chance to read the Report.

The Study suggests areas for review with regard to arbitration agreement provisions to make them more consumer-friendly, including the use of plainer language. More also can be done to ensure consumer awareness, which the CFPB and consumer advocates criticize. We can help. ❑

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