

October 24, 2017

The Honorable Steven T. Mnuchin
Secretary of the Treasury
United States Department of the Treasury
1500 Pennsylvania Avenue NW
Washington, DC 20220

Dear Secretary Mnuchin,

Yesterday, we saw for the first time a Treasury Department report on the Consumer Financial Protection Bureau's arbitration rule. The rule itself was issued in July, based on an arbitration study that Congress directed the Bureau to complete, which was published in March 2015. Throughout the two years of the rulemaking process, the Bureau consulted repeatedly with staff representatives from the prudential regulators and Treasury Department. Over that period, the Treasury Department raised no issues or concerns with the Bureau.

I asked Bureau staff to review the Treasury report and expedite the attached memorandum on the issues raised. As the memorandum explains, Treasury underestimates the benefits from class action settlements, underestimates the deterrence effect of class actions, overstates the cost of class actions, and misstates the impact of the Arbitration Rule on individual arbitration. In short, Treasury's report ignores large parts of the rule – which address the very issues Treasury raises – and misunderstands much of the underlying data. In fact, the arbitration rule strongly supports the Bureau's conclusion that it is in the public interest and for the protection of consumers.

Please do not hesitate to call me at any time to discuss this matter further.

Sincerely,



Richard Cordray
Director

October 24, 2017

Memorandum for the Director

FROM	Arbitration Rulemaking Team
THROUGH	David Silberman, Associate Director, Research, Markets and Regulations
SUBJECT	Analysis by Department of the Treasury of the Arbitration Rule

Introduction

This memorandum provides you with our initial observations concerning the analysis in the 18-page Treasury Department publication released yesterday, October 23, 2017, concerning the Bureau’s Arbitration Agreements Rule (the “Arbitration Rule” or “Final Rule”). This is the first time the Treasury Department has offered any observations to us regarding the Arbitration Rule despite our having consulted with them on three separate occasions. Treasury did not provide any comments when we consulted with them prior to releasing the Arbitration Rule in July 2017, prior to issuing the proposed rule in May 2016, or prior to conducting the small business review panel in October 2015.

The Treasury Analysis claims (at p. 1) that “the Bureau failed to meaningfully evaluate whether prohibiting mandatory arbitration clauses in consumer financial contracts would serve either consumer protections or the public interest” and that “closer inspection” of the Bureau’s Arbitration Study and the Rule demonstrate the opposite. In truth, the Rule does not “prohibit” mandatory arbitration clauses. Moreover, Treasury’s “closer inspection” ignores large parts of the Final Rule – which address the very issues Treasury raises – and misunderstands much of the underlying data. This memorandum addresses some of the issues raised in the Treasury Analysis, observing that Treasury underestimates the benefits from class action settlements, underestimates the deterrence effect of class actions, overstates the cost of class actions, and misstates the impact of the Arbitration Rule on individual arbitration.

1. Treasury underestimates the benefits that consumers derive from class actions

Treasury claims (at pp. 1, 5) that “[o]n average, only 4% of plaintiffs entitled to claim class settlement funds actually do so” and that “[i]n a typical case ... only a small percentage of plaintiffs recover anything.” The Treasury Analysis ignores, however, that a significant number of class action settlements provide for *automatic* payments to consumers – meaning that in these cases virtually all class members obtain relief. Indeed, the Study found, and the Final Rule notes, that 24 million consumers received \$709 million in payments automatically over a five year period, without making claims. See 82 FR at 33236 n.349. Treasury makes no mention of

this. Treasury likewise fails to note that overall at least 34 million consumers received cash payments from class actions over five years, and that \$1.1 billion was actually paid out to consumers. *Id.* at 33234, 33263. And, the Treasury Analysis also neglects to mention the 106 million class members who benefited from settling companies' agreements to change their practices (known as behavioral relief). *Id.*

It is true, as Treasury notes (at p. 4), that the average payment to class members is in the range of \$32. But this point was made repeatedly in comments on the proposed rule and is therefore carefully addressed in the Final Rule. As the Final Rule explains, "the class action procedure is designed to aggregate claims for small damages precisely because rational consumers do not spend the time or the money to litigate them on their own." *See* 82 FR at 33266. Thus, "in assessing the relevance of the small size of the average relief obtained, it is important to compare that to the alternative in which these consumers obtain no relief at all – because ... virtually none of them will pursue their individual claims." *Id.* Indeed, Treasury makes no note of the fact that the Study found only about 25 disputes a year involving affirmative claims in arbitration by consumers for \$1,000 or less. *Id.*¹

2. Treasury underestimates the deterrent effect of class action exposure in inducing compliance with consumer financial laws and contracts

Treasury claims (at p. 2) that "the Bureau offered no foundation for its assumption that the Rule will improve compliance with federal consumer financial law" and (at p. 7) that the Arbitration Rule is unclear as to "how effectively the Rule would increase provider incentives to invest in more compliance – because even full compliance does not guarantee immunity from class actions." Indeed, Treasury goes so far as to assert (at p. 2) that "the Bureau cannot credibly claim that the Rule would yield more effective levels of compliance."

In truth, the Final Rule sets forth in detail why historical evidence and economic theory support the conclusion that exposure to class action litigation deters companies from violating the law. *See* 82 FR at 33280-84 and 33290-94. Indeed, the Final Rule stated that "[w]hile compliance with the law may not fully insulate a company from the threat of a class action lawsuit, failing to comply with the law would almost certainly increase the likelihood that company will be sued and the value of the claims asserted." 82 FR at 33290. In these sections of the Final Rule, the Bureau discussed a number of examples of class action litigation prompting industry-wide changes in practices even among companies not sued in the litigation and further provided empirical evidence for the deterrent effect of class actions by identifying a large number of examples of companies monitoring class litigation so that they can mitigate their liability by changing their conduct before being sued themselves. For example, as the Final Rule noted,

¹ Treasury also claims that (at p. 1) that "only 13% of consumer class action lawsuits filed result in class-wide recovery." In fact, in lawsuits in which individual plaintiffs allege their own claims and seek relief for a class (a "putative" class action), the individual claims appear to be settled in approximately 60% of the cases and class recovery is achieved in 18.1% of the cases. *See* 82 FR at 33270. Responding to comments on this issue, the Final Rule explained that "[p]arties may choose to settle a putative class case on an individual basis for any number of reasons, such as because the defendant ... offered the named plaintiff full relief on his or her individual claim." *Id.* at 33271. Such a settlement "does not prevent other consumers from resolving similar claims in court or arbitration, including by filing their own class action." *Id.* The Bureau concluded that "the best measure of the effectiveness of class actions for all consumers is the absolute relief they provide in light of the number of consumers who receive this relief, and not the proportion of putative class cases that result in other outcomes." *Id.* Treasury ignores these points.

“upon issuance of the Bureau’s proposal several law firms advised their clients to review their compliance given the possibility of the Bureau finalizing the proposal and the clients’ subsequent increased risk of class actions.” *Id.* at 33291.

3. Treasury overstates the costs of class action litigation

Treasury states (at p. 2) that the Rule “will effect a large wealth transfer to plaintiffs’ attorneys,” asserting that “[i]n an average case, plaintiffs’ attorneys collect more than \$1 million; actual plaintiffs receive \$32 each.” But it is obviously incorrect to compare the average recovery of one class member to the average fees paid for representing every class member. The Bureau found that, on average, fees paid to plaintiffs’ attorneys were 24% of the total amounts paid by defendants, 82 FR at 33234, which Treasury recasts as 31% of the total amount paid to class members. Regardless of whether the denominator is the total amount paid out or just the amount paid out to class members, simple division establishes that, for every \$32 paid to consumers on average, only about \$10 is paid to their lawyers.

The Final Rule addresses and rejects the claim that “these data suggest that plaintiff’s attorneys are being unjustly enriched,” noting that “it is time-intensive and expensive to litigate large-scale consumer class actions”; that “most plaintiff’s attorneys would not take on such cases if they did not expect to be paid for successful cases”; and that even in individual cases, “an attorney will request a 33 percent or higher contingency from any funds that their client might receive.” 82 FR at 33304.

It is true that the Bureau’s projections of the future costs of the Final Rule suggest an even lower ratio (16%) of fees to total payouts than the 24% observed in the historical data. The Treasury Analysis claims (at p.4) that the Bureau’s projection is “inexplicable.” However, the Final Rule carefully explains the methodology used by the Bureau to project from the relevant cases in the Study, on a market-by-market basis, the expected number of incremental class actions, the projected settlement costs for those class actions, and the projected fees to be paid to plaintiffs’ attorneys and for litigation defense. *See* 82 FR at 33399-33406. There is nothing mysterious about this methodology – it was set forth in the Bureau’s proposal and no commenter faulted the approach.

The Treasury Analysis also claims (at p. 1) that “[r]emarkably, the Bureau’s estimates do not account for expected increases in state court litigation.” In truth, the Final Rule explains that while it was not feasible to do a systematic historical study of State court class-action litigation due to data limitations in State court records, “the Bureau assumes that providers who become subject to class actions as a result of the rule will enter into a similar number of class settlements in State court.” 82 FR at 33233, 33403. The Bureau went on to observe that although “it does not have reliable data to estimate the cost of additional State class actions ... [m]ost State court class actions will seek smaller amounts of monetary relief than Federal court class actions, sometimes considerably so, due to the fact that class actions seeking more than \$5 million in relief generally can be removed to Federal court” and thus “payments to consumers will be markedly lower than in cases settled in Federal court.” *Id.* at 33406. Despite its criticisms, Treasury does not suggest that the Bureau’s hypothesis is wrong or point in the direction of other available data.

4. Treasury misstates the impact of the Rule on individual arbitration

The Treasury Analysis asserts (at p. 17) that “The Bureau’s Rule would upend a century of federal policy favoring freedom of contract to provide for low-cost dispute resolution” and (at p.10) that “the Bureau may underestimate consumer benefits from the systemic availability of fast, efficient dispute resolution.” But the Rule expressly rejected proposals to prohibit the use of pre-dispute arbitration clauses in consumer finance contracts. Rather, all that the Rule does is to prohibit such clauses from being invoked to bar class action litigation, leaving companies free to invoke arbitration with respect to individual disputes. As the Final Rule explains, “the relevant question is whether, in a world where class actions are available, maintaining arbitration agreements would no longer be in the companies’ interest, resulting in the loss of arbitration as a dispute resolution option for those consumers that would have elected to pursue it.” 82 FR at 33294. The Final Rule carefully canvasses the many reasons for doubting that this would be the case. *See id.* at 33295-96. Indeed, in the implementation period, the Bureau has been receiving guidance inquiries from industry on how to comply with the Rule, suggesting at least some providers plan to keep arbitration agreements.

Moreover, as the Final Rule notes, “even if providers do remove their arbitration agreements, harm to consumers would be negligible because so few consumers pursue arbitration today.” 82 FR at 33295. Specifically, the Study found that, across six consumer finance markets, just over 400 arbitration cases were filed per year by consumers in the predominant arbitration forum whereas nearly 7 million consumers per year actually obtained cash payments through class actions. *Id.* “Thus, the number of consumers who sought relief in arbitration pales in comparison to the number who actually obtained relief through class actions” and “also pales in comparison” to the number who benefitted “from the deterrent effect of class actions.” *Id.* In addition, the Bureau noted that the data was “inconclusive” on whether individual arbitration was superior to individual litigation and that, “even if consumers do not have access to arbitration for individual claims those still can be filed in court, including small claims court.” *Id.* at 33295-96.