Center for Progressive Reform CPR

## The Consumer Financial Protection Bureau's Forced Arbitration Rule
## Questions and Answers

On May 5, 2016, the Consumer Financial Protection Bureau (CFPB) is slated to release a proposed rule that would limit the ability of banks and other lending institutions to include "forced arbitration clauses" in their contracts with consumers. The formal release will trigger a period of public review and comment. Following the public comment period, the agency will revise its proposal and then publish a final rule. As a final step, the CFPB will have to defend its final rule against the legal challenges that are likely to follow.

To help better explain this proposal and the problem it would address, our policy experts have assembled the following series of questions and answers.

# The Problem: Forced Arbitration

### What is "forced arbitration"?

Buried deep in many contracts with banks, credit card companies, and other financial institutions, consumers are likely to find dense legal jargon that prohibits them from asking the court system to resolve disputes arising out of the contracts. Instead, the contract language shunts the disputes to a private third party called an arbitrator, who acts as a kind of judge but without the checks and balances that ensure fairness in the judicial system. Since the contracts are typically offered on a take it or leave it basis, consumer advocates refer to this scheme of corporate accountability avoidance as "forced arbitration."

### Is it easy for consumers to obtain justice using arbitration?

No. The arbitration process is full of barriers and hurdles that make it difficult, if not impossible, for ordinary people to initiate and succeed in their legitimate claims. Nearly every aspect of the process is heavily stacked in favor of the company and against the consumer.

- The arbitration system is not neutral. In fact, companies that use forced arbitration clauses usually reserve the right to choose the arbitrator who will resolve disputes with the company. Arbitrators thus have a strong incentive to deliver favorable results for the companies in order to drum up repeat business.
- Other barriers to bringing a claim include high up-front fees that consumers must pay to file a claim, requirements that arbitration hearings take place in far-flung locations, shortened deadlines for starting a claim (that is, a short "statute of limitations"), and arbitrary limits on the amount of relief that is available.

- Arbitration proceedings are conducted in secret, and consumers are prohibited from disclosing any details regarding their claims. But the businesses involved in these claims often have access to the details of past arbitration proceedings, which can give them a leg up when fighting other consumer claims.

### When arbitration fails to deliver justice, can't consumers sue anyway?

No. Once subject to a forced arbitration clause, a consumer is bound by its prohibition on defending her rights in court. People have tried to challenge the legality of these clauses, but the Supreme Court has held, in a series of controversial decisions, that even the most anti-consumer of forced arbitration clauses are enforceable.

### How do the results of arbitration compare to the results of traditional court-based dispute resolution?

The CFPB, in a congressionally mandated study of the issue, found that consumers rarely prevailed in arbitration proceedings, and when they did, the award was insufficient to fully compensate for their injuries. For example, in claims calling for affirmative relief, the CFPB study found that ***consumers prevailed only 20 percent of the time, winning an average of 12 cents for every dollar claimed***. In contrast, the CFPB study found that the civil justice system – particularly, the use of class-action litigation – offered consumers a much better path for vindicating their rights. Through litigation, consumers prevailed more often and received substantially greater compensation.

### How common are forced arbitration clauses?

The CFPB study found them in 53 percent of credit card contracts, 86 percent of private student loans, and a whopping 92 percent of prepaid credit cards.

Even though forced arbitration clauses have become so widespread, the CFPB found that consumers rarely knew that a particular contract contained one of these clauses and that few consumers understood them well enough to influence their decision on whether or not to enter a contract that contained one.

## The Solution: Regulation by the Consumer Financial Protection Bureau

### What is the CFPB's proposed forced arbitration rule likely to do?

Assuming the CFPB sticks closely to the outline it announced in October 2015, the proposal will likely ban one type of forced arbitration clause – one that prohibits consumers from joining class action lawsuits. Class action suits allow consumers with similar claims against a common defendant to band together, making it feasible for them to sue even if their individual damages are small.

The CFPB's proposal is unlikely to ban or restrict forced arbitration clauses that prevent lawsuits brought by individuals. Instead, it will likely promote more transparency about this type of forced arbitration by requiring companies to report outcomes of arbitration decisions to a publicly accessible database. CFPB could also use these data to assess whether and what kind of restrictions may be necessary for individual arbitration claims so that the agency can fulfill its statutory mission of protecting consumers and promoting the public interest.

### Why is the CFPB targeting bans on class action lawsuits in particular?

Class action lawsuits are essential to consumer protection in fields where companies engage in broad patterns of wrongdoing that result in relatively small harms to individual consumers. In the absence of class action litigation, the victims of financial abuses involving relatively small amounts of money have no viable means for obtaining justice or for holding corporate wrongdoers accountable because the barriers against doing so through arbitration are so significant.

### Should the CFPB rule do more to protect the rights of customers to go to court as individuals?

Yes. The evidence in the CFPB's study provides ample justification for regulatory action. A ban on forced arbitration of individual claims would greatly benefit consumers. Short of a ban, the CFPB could restrict or prohibit the most anti-consumer features of the arbitration process, including excessive filing fees, prohibitive hearing location restrictions, harsh time limits for initiating claims, improper relief limits, and one-sided restrictions on choice of arbitrators.

## Setting the Record Straight

### I've heard business groups say that the CFPB's rule will limit consumer choice. Is that true?

No. The CFPB's rule would *enhance* consumer choice by preserving the option of using class action litigation, when available, to resolve disputes against banks, credit card companies, and other companies in the financial sector. The rule would enhance consumer choice even further if it provided people with the option of pursuing their individual claims in the courts, as well. Once the rule is in place, consumers will still have the choice to use arbitration to resolve their disputes. It is unlikely that consumers would freely choose arbitration, though, given how tilted the process is against them.

In contrast, maintaining the status quo, as business groups would prefer, would limit consumer choice by continuing to funnel people into an inferior forum for pursuing their legal rights.

### Will the CFPB's rule make it harder or more expensive to get credit cards or bank loans?

No. The CFPB tested this claim empirically and found it to be without merit. The agency looked at data from four large credit card companies that settled a 2009 class action lawsuit in part by agreeing to refrain from incorporating forced arbitration clauses into their consumer contracts for a period of at least three-and-half-years. The CFPB found that the affected credit card companies did not raise their prices relative to their competitors that continued employing forced arbitration clauses. The agency also found no evidence suggesting that the affected credit card companies reduced the amount of credit they made available to potential customers.