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Consumer Financial Protection Bureau
1700 G Street, NW
Washington DC 20552

Docket No.: CFPB-2016-0020, RIN: 3170-AA51

August 22, 2016

Dear Consumer Financial Protection Bureau:

I write, in my individual capacity,[1] to oppose the CFPB's proposed rule prohibiting class-action-preclusive arbitration clauses in consumer-finance products, CFPB-2016-0020, RIN: 3170-AA51. The Bureau's March 2015 study,[2] provided to Congress pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010,[3] is certainly extensive—running to some 410 pages plus appendices; as is the proposed rulemaking itself, which runs to 377 pages.[4] But the CFPB's analysis is not exhaustive, and to a significant extent it is long on data but short on the appropriate analysis.

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[1] Since 2003, I have directed legal policy research for the Manhattan Institute for Policy Research, a privately funded 501(c)(3) non-profit think tank. Previously, I was a management consultant at McKinsey & Company, focusing largely on the financial sector. I was awarded J.D. and MBA degrees from Yale, the latter with a concentration in finance; at Yale, I was an Olin Fellow in Law and Economics and a Teaching Fellow in Macroeconomics and Game Theory. I also hold an M.Sc. in Politics of the World Economy from the London School of Economics and Political Science; and a B.A. in Economics, with Highest Distinction and Highest Honors, from the University of North Carolina at Chapel Hill, where I was awarded the Honors Prize in Economics.

The Manhattan Institute does not take institutional positions on legislation, rules, or regulations. Thus, although my comments draw upon the Manhattan Institute's published studies and reports, and are informed by our long-running research on class actions and civil justice, my comments are solely my own, and not my employer's.

[2] *Arbitration Study: Report to Congress, pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act § 1028(a)*, Consumer Financial Protection Bureau (March, 2015), *available at* http://files.consumerfinance.gov/f/201503_cfpb_arbitration-study-report-to-congress-2015.pdf [hereinafter "CFPB Study"].

[3] Pub. L. No. 111-203, 124 Stat. 1376, § 1028(a) (2010) [hereinafter "Dodd-Frank"].

[4] *See* CFPB-2016-0020, RIN: 3170-AA51 [hereinafter "Proposed Rule"].

To be justified under the CFPB's enabling legislation, the proposed rule must be judged "in the public interest and for the protection of consumers,"[5] and the agency must consider "the potential benefits and costs to consumers and covered persons, including the potential reduction of access by consumers to consumer financial products or services resulting from such rule."[6] For all the voluminous work that went into the CFPB's study and proposed rule, the agency does not adequately analyze the costs of the proposed rule and the likely reduction in consumer access to credit that would result from its final adoption. In particular, the CFPB has not adequately considered:

1. **Class Action Costs: the consumer-harming effects of private class litigation.** The CFPB assumes that class-action litigation generates consumer "benefit[s] from an enterprise-wide change" that often results from such lawsuits.[7] The agency fails to consider that such changes often generate costs for consumers, which may exceed the benefits. In practice, class-action lawsuits generate substantial economic incentives to settle regardless of the merits of underlying asserted claims. Thus, such lawsuits tend to allow class attorneys to extract rents from defendant companies, and they often encourage enterprise changes in companies that do not necessarily flow from legal rules and in many cases harm rather than help consumers.

2. **Inverse Federalism: the risks in delegating federal consumer markets to states.** Assuming that at least some class action lawsuits adequately reflect state consumer laws, such laws may be nevertheless suboptimal, anticompetitive, or inimical to the public interest; and state-law-based legal actions may prompt nationwide enterprise-wide changes that not only harm consumers but also interfere with other states' policy interests. The risks of such "inverse federalism" were among the principal reasons Congress enacted the Class Action Fairness Act of 2005,[8] and there is substantial reason to believe that many state courts and legislatures may be effectively captured by the plaintiffs' bar.[9]

3. **Banking and Credit Access: the reduction in banking and credit access for vulnerable households.** According to the FDIC's 2013 survey of the unbanked and

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[5] Dodd-Frank, *supra* note 3, at § 1028(b).
[6] *Id.* at § 1022(b)(2)(A)(i).
[7] Proposed Rule, *supra* note 4, at 104–05.
[8] *See generally* Pub. L. 109–2, 119 Stat. 4–14 (2005).
[9] *See, e.g.*, MANHATTAN INSTITUTE, TRIAL LAWYERS, INC.: CLASS ACTIONS AND MASS TORTS, 2016, 9–14, *available at* https://www.manhattan-institute.org/sites/default/files/TLI-0116.pdf (showing political influence of plaintiffs' firms over state officials); MANHATTAN INSTITUTE, TRIAL LAWYERS, INC—K STREET.: A REPORT ON THE LITIGATION LOBBY, 2010, 12–15, *available at* http://www.manhattan-institute.org/pdf/TLI-KStreet.pdf (same); MANHATTAN INSTITUTE, TRIAL LAWYERS, INC.: A REPORT ON THE LAWSUIT INDUSTRY IN AMERICA, 2003, 6–9, 20–21, *available at* http://www.triallawyersinc.com/html/part01.html (same).

underbanked, almost 30 percent of U.S. households were unbanked or underbanked.[10] Mandating consumer class actions is likely to increase this percentage, *ceteris paribus*, as it will drive up the cost of serving households with impaired credit ratings, lower income, and lower financial assets.

Were such costs fairly considered, the CFPB's proposed rule would fail its required cost-benefit analysis.

**Statement of Interest and Prior Research**

Although I am submitting this comment letter in my individual capacity, my thoughts draw heavily from prior research published or sponsored by my employer, the Manhattan Institute for Policy Research, at which I have directed legal policy research since 2003.[11] For most of its existence, the Manhattan Institute has considered the policy implications of legal rules.[12] Since the mid-1980s, the Institute has extensively studied the impact of civil litigation on the American economy.[13] In the realm of class-action litigation, the Institute has produced studies that consider the issue theoretically,[14] anecdotally,[15] and empirically.[16] Then-Senator Herb Kohl (D-Wisc.) introduced the Class Action Fairness Act of 2005 by reference to the Manhattan Institute's empirical work.[17]

In recent years, under my direction, the Manhattan Institute has taken particular interest in the issue underlying the CFPB's proposed rule: the merits of consumer arbitration provisions

[10] *See* 2013 FDIC National Survey of Unbanked and Underbanked Households, Oct. 2014, at 4, *available at* https://www.fdic.gov/householdsurvey/2013report.pdf [hereinafter "FDIC Survey"].
[11] *See* Manhattan Institute, https://www.manhattan-institute.org/.
[12] *See* MI: Legal Reform, https://www.manhattan-institute.org/legal-reform. The Manhattan Institute was founded in 1978; one of the first books sponsored by the. Institute was Roberta Karmel's *Regulation by Prosecution: The Securities and Exchange Commission vs Corporate America* (1981).
[13] For an early Manhattan Institute book on the subject, see my colleague Peter Huber's *Liability: The Legal Revolution and its Consequences* (1988).
[14] *See, e.g.*, Richard A. Epstein, *Class Actions: The Need for a Hard Second Look* (Manhattan Institute 2002), *available at* https://www.manhattan-institute.org/html/class-actions-need-hard-second-look-5885.html.
[15] *See, e.g.*, Lester Brickman, *Anatomy of a Madison County (Illinois) Class Action: A Study of Pathology* (Manhattan Institute 2002), *available at* http://www.manhattan-institute.org/pdf/cjr_06.pdf.
[16] *See, e.g.*, John H. Beisner & Jessica Davidson Miller, *They're Making a Federal Case Out of It . . . In State Court* (Manhattan Institute 2001), *available at* http://www.manhattan-institute.org/pdf/cjr_03.pdf.
[17] *See* Statement of Herb Kohl, Introduction of Class Action Fairness Act of 2005, Jan. 24, 2005, *available at* http://votesmart.org/public-statement/80874/introduction-of-class-action-fairness-act-of-2005 (citing Beisner and Miller study) ("Comprehensive studies support the anecdotes we have discussed. For example, a study on the class action problem by the Manhattan Institute demonstrates that class action cases are being brought disproportionately in a few counties where plaintiffs expect to be able to take advantage of lax certification rules…. Another trend evident in the research was the use of 'cut-and-paste' complaints in which plaintiffs' attorneys file a number of suits against different defendants in the same industry challenging standard industry practices…. The system is not working as intended and needs to be fixed.").

precluding class-action litigation.[18] Following the 2011 *Concepcion* decision[19] by the U.S. Supreme Court—holding that arbitration clauses that foreclosed class-action relief for consumers were enforceable under the Federal Arbitration Act[20]—the Manhattan Institute commissioned a study by Ted Frank, an Institute adjunct fellow and the founder and director of the Center for Class Action Fairness,[21] to examine the merits of the decision from an economic and consumer perspective.[22] Following the CFPB's promulgation of its proposed rule in May 2016, the Institute commissioned a study by Jason Johnston, Henry L. and Grace Doherty Charitable Foundation Professor of Law at the University of Virginia,[23] to assess the rule's probable impact on consumers.[24] Both Mr. Frank's report and Professor Johnston's preliminary report are attached as appendices to this comment letter and incorporated by reference.[25]

**Legal Standard**

As the CFPB observed in its proposed rule,[26] it is statutorily authorized to promulgate rulemaking relating to arbitration clauses under two sections of Dodd-Frank, 1022 and 1028. Section 1022(b) of Dodd-Frank is a general grant of agency rulemaking authority to the CFPB for prescribing rules under federal consumer financial laws, and Section 1028(b) specifically empowers the agency to "prohibit or impose conditions or limitations on the use of an agreement . . . providing for arbitration of any future dispute . . . 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." I agree with the CFPB's decision to consider "the public interest" and "the protection of consumers" as separate tests for the CFPB to consider in evaluating a proposed

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[18] Prior to submitting this comment letter, I have previously criticized the CFPB's proposed rule in various public forums. *See, e.g.*, James R. Copland, *Why the Trial Bar and Its Friends Detest Arbitration*, WALL ST. J., Dec. 25, 2015, *available at* https://www.manhattan-institute.org/html/why-trial-bar-and-its-friends-detest-arbitration-8302.html; Copland, *The Obama Administration's New Sop to Trial Lawyers*, NAT'L REV. ONLINE, May 6, 2016, *available at* https://www.manhattan-institute.org/html/obama-administrations-new-sop-trial-lawyers-8853.html.

[19] AT&T Mobility v. Concepcion, 563 U.S. 333 (2011).

[20] Pub. L. 68–401, 43 Stat. 883 (1925).

[21] The Center for Class Action Fairness, a public-interest law firm dedicated to challenging abusive class-action settlements, is unaffiliated with the Manhattan Institute. Mr. Frank founded the Center in 2009 as a stand-alone entity; the Center is currently affiliated with the Competitive Enterprise Institute, where Mr. Frank is a Senior Attorney. *See* Competitive Enterprise Institute, Class Action Fairness, https://cei.org/issues/class-action-fairness.

[22] *See* Ted Frank, *Class Actions, Arbitration, and Consumer Rights: Why Concepcion is a Pro-Consumer Decision* (Manhattan Institute 2013), *available at* http://www.manhattan-institute.org/pdf/lpr_16.pdf.

[23] *See* Jason S. Johnston, University of Virginia School of Law, http://www.law.virginia.edu/lawweb/faculty.nsf/FHPbI/1177536.

[24] *See* Jason S. Johnston, *Class Actions and the Economics of Internal Dispute Resolution and Financial Fee Forgiveness* (Preliminary Report, August 2016), *available at* http://www.manhattan-institute.org/html/class-actions-and-economics-internal-dispute-resolution-and-financial-fee. Although this report is preliminary, further editorial changes are expected to be solely in style and syntax, and perhaps detail, not in the paper's underlying conclusions.

[25] Both studies were supported out of Manhattan Institute general funds and not commissioned for any outside funder; nor, upon information and belief, did either author receive any additional payments for this research, aside from Manhattan Institute funding.

[26] *See* Proposed Rule, *supra* note 4, at 82–92.

arbitration rule under Section 1028. I also would argue that in promulgating any proposed rule, the CFPB should carefully consider the standards for rulemaking contemplated under Section 1022(b)(2)(A)(i), namely "the potential benefits and costs to consumers and covered persons, including the potential reduction of access by consumers to consumer financial products or services resulting from such rule" (as the CFPB acknowledges in its proposed rule[27]).

### 1. Class Action Costs

The CFPB is not wrong to conclude that class-action litigation can prompt "enterprise-wide change" in defendant companies—or even prospective defendant companies; but it is wrong to assume that such changes necessarily comport with consumer interest. Class-action attorneys are incented to select and settle cases based on expected net returns to class-action attorneys, not based on some ideal standard of public interest. And defendant companies settle cases not based on benefits to consumers but rather to minimize expected costs to the company.

Indeed, class-action lawsuits are paradigmatic examples of the types of litigation that can become "abusive": suits that "have little legal merit, regardless of the magnitude of the recovery sought," but are nevertheless profitable to pursue.[28] (As explained by my former colleague Marie Gryphon (Newhouse) in a 2008 Manhattan Institute report, "'Lottery suits' are defined by a combination of low legal merit and very high stakes."[29]) As a general rule, defendant corporations will settle low-merit cases whenever the expected cost of going to trial exceeds the proposed settlement cost.[30] Precisely because the costs of defending a class action lawsuit at trial are so large—both in terms of legal and discovery costs and because of the large expected payout even for low-probability claims—low-merit cases will regularly settle. And a defendant company

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[27] *See* Proposed Rule, *supra* note 4, at 87–88. Although the CFPB finds independent statutory authority to promulgate its proposed rule under Section 1022, that section does not articulate specific Congressional intent to grant the agency the authority to promulgate rules in conflict with the Federal Arbitration Act; thus, I disagree that Section 1022 standing alone would afford the agency sufficient statutory authority to promulgate the proposed rule. That said, nothing in Section 1028 suggests any Congressional design not to interpret that section's "public interest" test consistently with the agency's broader rulemaking standard under Section 1022—namely that it consider "the potential benefits and costs to consumers and covered persons, including the potential reduction of access by consumers to consumer financial products or services resulting from such rule."

[28] Marie Gryphon, *Greater Justice, Lower Cost: How a "Loser Pays" Rule Would Improve the American Legal System* 4 (Manhattan Institute 2008), *available at* http://www.manhattan-institute.org/pdf/cjr_11.pdf.

[29] *Id.* at 4 & fig. 1.

[30] For the category of abusive lawsuits Gryphon characterizes as "nuisance suits," defendant companies who expect to face similar suits in the future—repeat players in a game-theoretic construct—may choose to fight such lawsuits even when settling would be the rational strategy for a "single-shot" game. *See* Gryphon, *supra* note 28, at 6–7. This strategy would rarely apply, however, in class-action litigation, where the sheer size of potential recoveries generates a "lottery" scenario that drives settlement. In such cases, the size and uncertainty of pending litigation can impair company credit and stock prices until litigation is resolved. Moreover, even when litigating rather than settling may be in the interest of the average diversified corporate shareholder, agency costs would tend to make corporate managements and boards more likely to settle than to litigate in many instances, as managers and boards would bear more concentrated costs in the event of an unexpected negative verdict.

will be willing to agree to costly injunctive relief with the same calculus: the lost profits generated by the change in practice are added to the settlement value and weighed against expected legal expenses and the probability-adjusted payments expected from a trial. Substantive liability rules are only germane to the extent they affect the probability of a pro-plaintiff verdict, and consumer cost or benefit does not enter into the defendant company's calculation except through that window.[31]

Moreover, perverse incentives divide class counsel's interests from consumers': plaintiffs' lawyers face incentives to trade off both class monetary relief and consumer-aiding injunctive relief for counsel fees. As Ted Frank observes in his 2013 Manhattan Institute paper, class-action suits "suffer from several structural deficiencies that can prevent class members from having their rights vindicated."[32] Frank observes that "in some cases, the problem of under-compensation [for the class] and self-dealing [by the class counsel] is so severe that class settlements unambiguously harm class members by putting them in a worse position than they were in before the litigation began."[33] For example, in the settlement in *Kamilewicz v. Bank of Boston*, cited in the Senate report for the Class Action Fairness Act,[34] an Alabama state court subtracted attorney fees from escrow accounts for members of the plaintiff class, leaving some members of the class with less money than before the litigation.

As Frank explains:

> The problems arising from the class attorneys' conflict of interest are inevitable, but courts do not have any effective means to police all abusive class settlements. Although courts are tasked with ensuring that class attorneys act as fiduciaries for the class as a whole, they often do not have the information necessary to measure whether the class attorney and defendant have arrived at a fair settlement; accordingly, courts cannot easily act to prevent attorney self-dealing. Moreover, courts' incentives are poorly structured: approving an unfair settlement will rarely result in reversal, both because appellate review tends to be deferential and because objectors rarely have the financial incentive to follow through on an appeal. The incentive to follow through with an appeal is perversely muted when an appeal would have a high likelihood of success: class counsel will always have more at stake than an objector will, and a for-profit objector whose appeal might be successful can maximize his financial return by a *quid pro quo* with the class counsel—being paid to walk away—at the expense of the class. Indeed, for-profit objectors are usually better off if they lose objections at the district-court level and proceed with an appeal because that maximizes their chances that they will be

[31] Even given that settlement decisions are driven in part by substantive liability rules, this fact does not necessarily imply that such rules always, generally, or even usually comport with the public interest; see *infra* Section 2.
[32] *See* Frank, *supra* note 22, Executive Summary.
[33] *Id.* at 10.
[34] S. Rep. No. 109-14, at 14 (citing Kamilewicz v. Bank of Boston Corp., 92 F.3d 506 (7th Cir. 1996)).

> paid to go away; such payments are substantially more lucrative than the possibility of fees for a successful objection. This all adds up to courts having little incentive to assess settlement proposals and little information with which to do so.[35]

Not only is there little reason to believe that class-action injunctive relief is likely to accrue to consumers' benefit, the very case the CFPB singles out as an example of "enterprise-wide change" helping consumers—the overdraft litigation, exemplified by the *Gutierrez v. Wells Fargo* decision[36]—tends to show quite the opposite. As Jason Johnston suggests in his 2016 preliminary report for the Manhattan Institute, the overdraft fees involved in *Gutierrez* were "clearly authorized under their contract with consumers."[37] But *Gutierrez* and other class-action lawsuits targeting bank overdraft fees have reduced "the return to a bank from investing in costly but informative *ex post* dispute-resolution systems and create[d] further *ex ante* risk from dealing with low-balance, high-transaction-volume customers."[38] As a result, "[f]ree checking accounts have now become a thing of the past" as banks charge monthly fees to customers who fail to maintain substantial bank balances.[39] Essentially, then, the shift in overdraft policy has priced out of the banking market households of limited means that cannot afford to maintain high balances (or would prefer not to do so) but were able to avoid regularly overdrafting their accounts.

### 2. Inverse Federalism

To be sure, at least some class-action lawsuits seek to vindicate claims that have some legitimate basis under state or federal law. In *Gutierrez*, although Wells Fargo used contractual language that clearly justified its application of overdraft fees, it may be the case that it ran afoul of California's state consumer-protection law. But it is not at all self-evidently clear that federal law under the auspices of the CFPB should preclude language in private contracts that would foreclose class-action enforcement of otherwise-valid state-law remedies—a premise that the CFPB's proposed rule seems to assume without justification. Indeed, where the litigation involved may have cross-state spillover effects—such that a successful suit under California law may prompt a nationwide change in corporate contracting—the class remedy runs the risk of precisely the sort of "inverse federalism" that the Class Action Fairness Act of 2005 was designed to avoid.[40]

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[35] *Id.* at 11.
[36] *Gutierrez* v. *Wells Fargo Bank*, N.A., 730 F. Supp. 2d 1080, 1082 (N.D. Cal. 2010), *rev'd in part*, 704 F.3d 712, 730 (9th Cir. 2012).
[37] Johnston, *supra* note 24, at 15–16.
[38] *Id.* at 32.
[39] *Id.*
[40] In a seminal Manhattan Institute study of class-action lawsuit abuse that helped frame the case for the Class Action Fairness Act, *see supra* note 17, John Beisner and Jessica Miller describe "a case brought against State Farm in . . . Illinois, regarding the use of original equipment manufacturer parts in insurance claims," in which "an Illinois

In its report and proposed rulemaking, the CFPB does not give adequate consideration to the risks in applying a federal rule to empower state class-action lawsuits. States like California have consumer-protection laws that are notoriously prone to abuse.[41] This is hardly surprising; particularly with regard to civil litigation, there is substantial evidence to buttress James Madison's argument that there is an advantage "enjoyed by the Union over the States"—by the large republic over the small—in controlling the abuse of factions.[42] The organized plaintiffs' bar has shown a capacity to influence state legislative, attorney general, and judicial races to a significant degree.[43] Indeed, one well-publicized example of the potential for such influence involves the CFPB's very own director, Richard Cordray, who regularly hired plaintiffs' law firms to file securities class-action lawsuits on behalf of state pension funds as attorney general of Ohio.[44] "In 2007 and 2008, out-of-state plaintiffs' firms donated $830,000 to the Ohio Democratic Party, led by the New York firms Kaplan Fox & Kilsheimer and Bernstein Litowitz Berger & Grossmann—both shareholder-class-action specialists— which contributed $270,000 and $175,000, respectively"; the state party in turn heavily funded Cordray's election campaign.[45]

Thus, the CFPB should not assume, as it does, that it is necessarily in the public interest to prevent private contracts that foreclose class-action remedies enforcing state consumer protection laws. Such laws *may*, upon occasion, be predicated upon the public interest; but they also may reflect state officials' capture by interest-group factions. And they may, as applied through the class-action litigation and settlement process previously described, interfere with other states' policy choices—effectively generating a "race to the bottom" (plaintiffs' bar capture) versus a "race to the top."[46] Given that the CFPB's analysis ignores these possibilities, it cannot be said to have adequately or fully considered the potential costs of its proposed rule.

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county court upheld a verdict on behalf of a nationwide class, even though several insurance commissioners testified that their state laws allowed or even required insurance companies to engage in the challenged practice." John H. Beisner & Jessica Davidson Miller, *Class Action Magnet Courts: The Allure Intensifies* 11 n.13 (Manhattan Institute 2002), *available at* http://www.manhattan-institute.org/pdf/cjr_05.pdf. Although such a nationwide class would now generally be foreclosed by the Class Action Fairness Act, a state-court application of state law—as in *Gutierrez*—may nevertheless encourage companies to adopt nationwide responses, contrary to other states' public-policy choices and the public interest.

[41] *See* Walter Olson, *The Shakedown State*, 2003, *available at* https://www.manhattan-institute.org/html/shakedown-state-0602.html. *See generally* Joanna M. Shepherd-Bailey, *Consumer Protection Acts or Consumer Litigation Acts? A Historical and Empirical Examination of State CPAs,* ATR Foundation (2014), *available at* http://atra.org/sites/default/files/documents/Shepherd-Bailey%20White%20Paper%20-%20FINAL_0.pdf.

[42] FEDERALIST NO. 10 (Madison).

[43] *See* sources gathered at note 9, *supra*; *see also* Robert Young, *Reflections of a Survivor of State Judicial Election Warfare* (Manhattan Institute 2001), *available at* http://www.manhattan-institute.org/html/reflections-survivor-state-judicial-election-warfare-5883.html.

[44] *See* Mark Maremont et al., *Trial Lawyers Contribute, Shareholder Suits Follow*, WALL ST. J., Feb 3, 2010, *available at* http://online.wsj.com/article/SB10001424052748703837004575013633550087098.html.

[45] MANHATTAN INSTITUTE, TRIAL LAWYERS, INC.: STATE AGS—A REPORT ON THE ALLIANCE BETWEEN STATE AGS AND THE PLAINTIFFS' BAR, 2011 11, *available at* http://www.manhattan-institute.org/pdf/TLI-ag.pdf.

[46] *Cf.* Ralph K. Winter*, State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251 (1977); Winter, *The "Race for the Top" Revisited: A Comment on Eisenberg*, 89 COLUM. L. REV. 1526 (1989);

### 3. Banking and Credit Access

In articulating the standards for CFPB rulemaking, the Dodd-Frank Act specifically singles out as critical to the agency's required cost-benefit analysis "the potential reduction of access by consumers to consumer financial products or services resulting from" proposed rules.[47] This is hardly surprising. As the Federal Deposit Insurance Corporation found in a 2014 report:

> [M]any households—referred to in this report as "unbanked"—do not have an account at an insured institution. Additional households have an account, but have also obtained financial services and products from non-bank, alternative financial services (AFS) providers in the prior 12 months. These households are referred to here as "underbanked."[48]

The CFPB, in its 2015 study and 2016 proposed rule, does not adequately explore the degree to which its proposed arbitration requirement may reduce access to credit and exacerbate the already-pervasive American problem of "unbanked" and "underbanked" households.

In section 10 of its 2015 study, the CFPB does analyze whether arbitration clauses that foreclose class-action litigation might increase the price of consumer borrowing or reduce credit limits, each of which would have an impact on consumer access to credit. The agency conducts a difference-in-differences regression analysis comparing (a) banks subject to a class-action settlement in *Ross v. Bank of America*, which eliminated such clauses for credit card disputes, and (b) those banks that did not fall under the settlement.[49] Although this settlement did require the banks under it to drop previously existing pre-dispute arbitration clauses that precluded class-action litigation, that class of banks as compared to all others may not be an adequate proxy for the value of an arbitration clause—especially crossing a period that involved a federal bill reforming credit-card fees and disclosures, the 2009 CARD Act;[50] the Dodd-Frank Act of 2010; pending Supreme Court litigation involving the applicability of the Federal Arbitration Act to

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Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225 (1985) (finding the "race to the top" hypothesis more supported than the "race to the bottom" hypothesis in empirical testing of state corporate-governance law); *but see* William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663, 663, 705 (1974) (calling Delaware "both the sponsor and the victim of a system contributing to the deterioration of corporation standards" and decrying corporate law's "race for the bottom, with Delaware in the lead").

[47] Dodd-Frank, *supra* note 3, at § 1022(b)(2)(A)(i).

[48] FDIC Survey, *supra* note 10, at 4.

[49] *See* CFPB Study, *supra* note 2, at § 10, 6. *See also* Stipulation and Agreement of Settlement with Bank of America, N.A. (USA) (N/K/A/FIA Card Services, N.A.) and Bank of America, N.A., ¶ 3(b), Ross v. Bank of America, N.A., (USA), No. 05-cv-7116 (S.D.N.Y. Feb. 23, 2010), *available at* http://www.arbitration.ccfsettlement.com/documents/files/2010-02-23-stip-and-agreement-with-bank-of-america.pdf.

[50] Credit Card Accountability Responsibility and Disclosure Act of 2009, Pub. L. 111-24, 123 Stat. 1734 (2009).

such clauses;[51] and other ongoing class action lawsuits involving parallel issues. Also, the CFPB admits that the credit-limit analysis is problematic at best as a proxy for reduced access to credit.[52]

Notwithstanding the foregoing, the CFPB essentially buries its finding that the *Ross* settlement *did* prompt differential pricing responses from the banks involved. As the study observes in footnote 34 of the section:

> Statistically significant positive results for price sub-components are as follows. APR 24 months after account opening increase of 1.87 (p-value = 0.043) for consumers with credit scores <660. Average net annual fee 24 months after account opening increase of 6.38 (p-value = 0.017) for all consumers. Average net annual fee 24 months after account opening increase of 4.31 (p-value = 0.031) for consumers with credit scores ≥660.[53]

The study tries to explain this finding away as statistical noise—and observes no statistically significant effect once costs are collapsed into a single total cost of credit (TCC) variable—but the variegated pricing reaction of banks to losing the arbitration clause comports with economic expectations.[54]

As Professor Johnston observes in his 2016 preliminary report for the Manhattan Institute, credit institutions foreclosed from opting out of class-action lawsuits "will screen out" lower-value customers when "there is some probability that [fees] will be refunded through class-action liability."[55] By raising annualized percentage rates for higher-risk customers—those with credit ratings below 660—credit institutions are raising prices on precisely those customers, to price in the additional risk. By raising annual fees more broadly,[56] the credit institutions are

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[51] *See* Concepcion, 563 U.S. 333.
[52] *See* CFPB Study, *supra* note 2, at § 10, 17–19.
[53] *See* CFPB Study, *supra* note 2, at § 10, 15, n.34.
[54] The CFPB's interpretation of its results is odd. In essence, the study's regression finds that a class-action settlement *eliminating* arbitration clauses for credit cards—thus opening the door to class-action litigation that the CFPB's own analysis suggests would lead to *elimination of certain fees*—had *no* statistically significant effect on overall pricing that the settling banks charged consumers. That result implies that the banks *increased other costs* charged to consumers—precisely the effect seen in the CFPB's additional regression analyses, with respect to APR and annual fees.

Because not all consumers are situated similarly, some consumers necessarily suffered—notably those consumers who did not engage in conduct that would trigger the fees likely targeted in class-action lawsuits; and particularly those consumers for whom high annual fees or interest rates constituted a higher share of their overall expected bank balances. Such consumers are certainly concentrated among those historically unbanked and underbanked communities, particularly low-income households, unmarried households, and racial and ethnic minorities. *See* FDIC Survey, *supra* note 10, at 21–22 App. Tbl. A-6b (showing that 81.8 percent of long-term unbanked households earned $30,000 or less; 78.6 percent were not married couples; and 63.5 percent were Black or Hispanic).
[55] *See* Johnston, *supra* note 24, at 30.
[56] The CFPB finds that annual fees increased significantly for all customers of the banks in the *Ross* settlement group.

pricing in the additional risk for consumers who may generate default or non-default risks not captured by credit scores, particularly for lower-income and lower-volume borrowers for whom such fees are a higher share of their annual costs. Banks are well aware that customers respond differently to different types of rates and fees and that not all classes of customers react the same to changes in fee structures.[57] The actual evidence adduced by the CFPB tends to comport with the variegated response one would expect from creditors in light of expected class-action liability. With less flexibility to use fees as *ex post* pricing mechanisms to remedy costs and potential defaults from higher-risk customer groups, banks in the *Ross* settlement group raised certain other broadly applicable *ex ante* prices—interest rates and annual fees—thus pricing out at least some classes of customers who may well have been able to afford credit absent the settlement.

Aside from the CFPB's regression methodology detailed in section 10 of the CFPB study—which applies only to credit cards—there is ample evidence that class-action litigation does in fact lead to reduced access to banking and credit. As detailed by Professor Johnston in his preliminary report, the overdraft settlements—which the CFPB touts as the paradigm case for the consumer benefits flowing from class-action litigation—have in fact made free checking accounts "a thing of the past"[58] and led to monthly fees and balance requirements that will price out many American households, increasing the ranks of the un- and under-banked.

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[57] Academic analysts have long understood that consumers vary in how they respond to pricing changes, including interest rates. *See, e.g.*, James J. White & Frank W. Munger, Jr., *Consumer Sensitivity to Interest Rates: An Empirical Study of New-Car Buyers and Auto Loans*, 69 MICH. L. REV. 1207, 1239 (1971) ("We found that many who live in the county failed to seek the lowest-cost loan for which they could have qualified. We conclude that the lack of knowledge of the lower interest rate was not the principal deterrent to procuring such a loan . . . ."). Consumer psychology and behavioral economics suggest that customers do not in fact aggregate all costs and comparison shop so as to minimize pricing but rather respond differently to different fee and pricing structures. *See, e.g.*, John T. Gourville & Dilip Soman, *Pricing and the Psychology of Consumption*, HARVARD BUS. REV., Sept. 2002, *available at* https://hbr.org/2002/09/pricing-and-the-psychology-of-consumption ("Because pricing has such a powerful effect on consumption, managers must make careful decisions about when and how to charge for goods and services."). In banking, customers react to rate, fee, and balance requirements differently, and not all classes of customer respond similarly. *See, e.g.*, Vishy Cvsa, *Bank Deposits Get Interesting*, 2 MCKINSEY QUARTERLY 10, 11 & exh. 2 (2002), *available at* http://www.stern.nyu.edu/om/faculty/pinedo/ofs/download/bank_deposits.pdf ("Some customers are very sensitive to changes in the minimum monthly balance, for example, but far less so to changes in the monthly fee. . . . When customers were presented with two comparable checking-account price changes—one emphasizing a higher fee, the other a higher minimum-balance requirement—for example, their switching behavior was so different that one package would have generated six times more revenue than the other . . . .").

[58] Johnston, *supra* note 24, at 32. In addition to Johnston's evidence, the author of this letter has observed a significant change in his own account with his primary bank, JPMorgan Chase, effective August 20, 2016. The bank communicated the following:

> We're simplifying our Overdraft Protection service, which may help you avoid fees and interest. Starting August 20, here is what's changing:
>
> - New and existing Chase credit cards or existing Overdraft Lines of Credit can no longer be used as a backup funding account; a Chase savings account will be the only option

In other words, America's largest bank by assets has essentially *eliminated overdraft protection lines* for many customers. Although the author of this letter will have little difficulty maintaining adequate savings-account balances to serve as a buffer against unintended overdrafts, many less fortunate consumers will doubtless "incur the

**Conclusion**

The CFPB has shown that a large percentage of American consumers are not aware of consumer-finance contractual clauses that would require arbitration in lieu of class-action litigation,[59] but American law has long understood that consumer unawareness of form clauses in contracts is not *ipso facto* evidence of unfairness.[60] Nor are such clauses *ipso facto* unfair merely due to differences in bargaining power between parties.[61]

The CFPB has not adequately analyzed (1) the consumer-harming effects of class-action litigation; (2) the extent to which state consumer-protection laws that enable large class-action lawsuits in the consumer-finance space may subvert the public interest through inverted federalism; and (3) the mechanisms through which its proposed arbitration rule may reduce consumer access to banking and credit. I am confident that were the CFPB to engage in such analysis, it would find that "the potential benefits and costs to consumers . . . including the potential reduction of access by consumers to consumer financial products or services resulting from such rule"[62] militate against the proposed rule's adoption.

Respectfully,

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Appendix A: Frank Report and Appendix B: Johnston Preliminary Report are attached.

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cascading fees and loss of reputation triggered when the bank refuses payment" on a returned check. Johnston, *supra* note 24, at 17.

[59] *See* CFPB Study, *supra* note 2, at § 3.

[60] *See* Carnival Cruise Lines, Inc. v. Shute, 499 U.S. 585 (1991) (forum-selection clause in tiny type on back of cruise ship ticket is enforceable).

[61] *See* Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 32 (1991) (form-contract arbitration clause is not unenforceable due to unequal bargaining power between parties). Indeed, as Judge Easterbrook has observed, in many cases, "[m]aking the institution of contract unreliable by trying to adjust matters *ex post* in favor of the weaker party will just make weaker parties worse off in the long run." IFC Credit Corp. v. United Business & Indus. Federal Credit Union, 512 F.3d 989 (7th Cir. 2008).

[62] Dodd-Frank, *supra* note 3, at § 1022(b)(2)(A)(i).