CFPB's Arbitration Rule No Favor for Consumers

When it comes to identifying the worst government agency, it's hard to pick just one. It's equally hard not to immediately think of the Consumer Financial Protection Bureau. There's just something particularly off-putting about an agency that is so self-righteous in trumpeting its virtuous defense of consumers but nevertheless keeps finding ways to make them worse off.

Established in 2010 as part of Dodd-Frank, the CFPB didn't take long to become notorious. One of its first acts was to completely and lavishly renovate its own headquarters — which, in typical Washington fashion, succumbed to ever-rising cost estimates. It then began participating in Operation Choke Point, an Obama-era attempt to strong-arm banks into closing the accounts of legal businesses that happen to operate in markets — such as firearms and tobacco — disfavored by politicians.

The CFPB also has waged a relentless war against small-dollar lenders who service a poorer clientele than traditional lenders, all while saddling conventional banks with costly new regulations. It's little wonder then that since the CFPB was created, free checking accounts have been on the decline and credit for the poor has been harder to find.

The latest example of CFPB overreach comes in the form of a rule prohibiting financial services companies from including binding arbitration clauses in their contracts. This is a misguided decision for several reasons.

For starters, an internal study used by the CFPB to justify its rule was methodically flawed. My colleague Todd Zywicki and the University of Pennsylvania Law School's Jason Scott Johnston have shown that the CFPB report was aimed toward reaching a predetermined conclusion and contained no data on arbitration settlements, the most common outcome. If anything, the report proved that arbitration works for consumers because it offers, in Zywicki and Johnston's words, such "an inexpensive, fast, and efficient process."

What's more, the CFPB further waved away all the academic literature that establishes the effectiveness of arbitration and discounted its own data showing that arbitration more often compensates consumers faster — and with larger awards — than class action suits.

Despite the fact that arbitration has a long, established history, the CFPB study insists that class action is preferable to arbitration. The evidence rests on the average $220 million awarded to 6.8 million consumers annually. However, the reality is that class action only produces token rewards for class members (an average of $32.38 per person, according to CFPB data), which stands in contrast to the huge fees collected by lawyers. As Zywicki and Johnston noted, “during the 2010-12 period examined in the study, class action attorneys raked in $424,495,451.”

Let me repeat that: Millions of consumers get the same paltry amount as a few hundred lawyers. In other words, bureaucrats have decided that what matters most is for consumers to have “their day in court,” even if it means waiting three times as long for a resolution and getting a smaller payout.

Such condescension is typical, as the CFPB is essentially premised on the idea that what is better for people is what bureaucrats say is better, as opposed to people’s own revealed preferences. And as the Cause of Action Institute’s Alfred J. Lechner Jr. (also a former U.S. District Court judge) adds, to promote its preferences, the CFPB is content to use junk science rather than sound research. How else can it justify banning a mechanism that many consumers willingly agree to even when other alternatives are readily available?

The CFPB is unique in American history in that its structure means that it lacks any semblance of political accountability. It features a single director — who can’t be removed except for cause — has access to unlimited funds from the Federal Reserve and has free rein to make law as it sees fit. This problem must be addressed, but in the meantime, Congress could stand in the way of the CFPB’s jabs at the American economy.

The House on Tuesday passed a resolution disapproving of the CFPB’s invasive arbitration rule under the Congressional Review Act, which affords Congress the opportunity to overturn federal regulations within 60 legislative days. Let’s hope the Senate doesn’t now live up to its moniker as the place where good ideas go to die.

Veronique de Rugy is a senior research fellow at the Mercatus Center at George Mason University. To find out more about Veronique de Rugy and read features by other Creators Syndicate writers and cartoonists, visit the Creators Syndicate webpage at www.creators.com.