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## STATEMENT FOR THE RECORD

COMMITTEE ON FINANCIAL SERVICES  
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT  
UNITED STATES HOUSE OF REPRESENTATIVES

May 18, 2016

*Examining the CFPB's Proposed Rulemaking on Arbitration:  
Is it in the Public Interest and for the Protection of Consumers?*

CHAIRMAN RANDY NEUGEBAUER  
RANKING MEMBER LACY CLAY

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Thank you Chairman Neugebauer, Ranking Member Clay, and Members of the Committee for the opportunity to submit this statement for the record. My name is Eric R. Bolinder, and I am Counsel at Cause of Action Institute (“CoA Institute”), a nonprofit, nonpartisan, strategic oversight group committed to ensuring that government decision-making is open, honest, and fair. In carrying out this mission, CoA Institute uses strategic litigation and investigative tools to hold government accountable and educate the general public about the importance of government transparency and accountability.

CoA Institute submits this testimony to highlight an important and, so far, undiscussed issue regarding the Consumer Financial Protection Bureau’s (“CFPB”) recently proposed arbitration rules.<sup>1</sup> During the Committee’s May 18, 2016 hearing, members of the Committee and witnesses detailed the serious shortcomings in the data and scientific methodology

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<sup>1</sup> Arbitration Agreements, 81 Fed. Reg. 32,829 (May 24, 2016) (to be codified at 12 C.F.R. pt. 1040) [hereinafter “proposed rules”].

underlying the CFPB Arbitration Study,<sup>2</sup> upon which the agency relies for its proposed rules.<sup>3</sup> Because the Dodd-Frank Act requires that any arbitration rules proposed by CFPB be “in the public interest and for the protection of consumers,” as well as consistent with the Arbitration Study,<sup>4</sup> rules that ultimately rely on faulty data and scientific methodology cannot be sustained. That result follows not only from the terms of the Dodd-Frank Act but also from the standards imposed on CFPB by the Information Quality Act (“IQA”).

## I. Background

### a. The Information Quality Act and OMB Guidelines

The Information Quality Act is a short piece of legislation enacted in December 2000 as Section 515 of the Treasury and General Appropriations Act for Fiscal Year 2001.<sup>5</sup> The Act directs the Office of Management and Budget (“OMB”) to issue guidance to agencies to ensure the “quality, objectivity, utility, and integrity” of information disseminated to the public.<sup>6</sup> OMB issued guidelines in 2002, which provided “policy and procedural guidance” on the IQA and further defined statutory terms.<sup>7</sup> In those guidelines, OMB set “quality” as the general term applicable to information disseminated to the public and established “objectivity, utility, and integrity” as defining terms.<sup>8</sup> “Objectivity” asks whether information is presented in a “clear, complete, and unbiased manner” and is “accurate, reliable, and unbiased[.]”<sup>9</sup> OMB adds, “[i]f data and analytic results have been subjected to formal, independent, external peer review, the information may generally be presumed to be of acceptable objectivity.”<sup>10</sup> “Utility” demands that information be useful for intended users.<sup>11</sup> “Integrity” ensures that data is free from corruption and falsification.<sup>12</sup>

Both the IQA and OMB Guidelines require agencies to issue their own guidelines that allow “affected persons to seek and obtain correction of information.”<sup>13</sup> The purpose of this

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<sup>2</sup> CONSUMER FIN. PROT. BUREAU, ARBITRATION STUDY (2015), *available at*

[http://files.consumerfinance.gov/f/201503\\_cfpb\\_arbitration-study-report-to-congress-2015.pdf](http://files.consumerfinance.gov/f/201503_cfpb_arbitration-study-report-to-congress-2015.pdf).

<sup>3</sup> Section 1028 of the Dodd-Frank Act required the CFPB to conduct a study concerning pre-dispute arbitration agreements used “in connection with the offering or providing of consumer financial products or services” and to justify any new arbitration rules consistent with that study. 12 U.S.C. § 5518(a)-(b).

<sup>4</sup> *Id.* § 5518(b).

<sup>5</sup> Pub. L. 106-554 (codified at 44 U.S.C. § 3516); *see also* CONG. RESEARCH SERV., THE INFORMATION QUALITY ACT: OMB’S GUIDANCE AND INITIAL IMPLEMENTATION, Order Code RL32532 (2004), *available at* <https://www.fas.org/sgp/crs/RL32532.pdf>.

<sup>6</sup> *Id.*

<sup>7</sup> Office of Mgmt. & Budget, Guidelines for Ensuring and Maximizing the Quality, Objectivity, Utility, and Integrity of Information Disseminated by Federal Agencies, 67 Fed. Reg. 8452 (Feb. 22, 2002) [hereinafter “OMB Guidelines”].

<sup>8</sup> *Id.* at 8453.

<sup>9</sup> *Id.* at 8459.

<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

<sup>12</sup> *Id.* at 8460.

<sup>13</sup> *Id.* at 8459–60; *see, e.g., Information quality guidelines*, CONSUMER FIN. PROT. BUREAU, <http://www.consumerfinance.gov/informationquality/> (last accessed May 19, 2016) [hereinafter “CFPB Guidelines”].

petition process is to challenge the objectivity, utility, or integrity of information and thereby force agencies to issue corrections. In the event of any denial of a petition, the petitioner may lodge an administrative appeal with an agency.<sup>14</sup>

### **b. OMB Peer Review Bulletin**

In 2004, OMB issued a memorandum for heads of departments and agencies containing the “Final Information Quality Bulletin for Peer Review.”<sup>15</sup> This bulletin “includes guidance to federal agencies on what information is subject to peer review, the selection of appropriate peer reviewers, opportunities for public participation and related issues.”<sup>16</sup> The bulletin “establishes that important scientific information *shall be* peer reviewed by qualified specialists before it is disseminated by the federal government.”<sup>17</sup>

The IQA peer review requirements apply to any influential scientific information disseminated by an agency.<sup>18</sup> OMB defines “dissemination [as] agency initiated or sponsored distribution of information to the public”<sup>19</sup> and “scientific information [as] factual inputs, data, models, analyses, technical information, or scientific assessments based on the behavioral and social sciences, public health and medical sciences, life and earth sciences, engineering, or physical sciences.”<sup>20</sup> “Influential scientific information” is “scientific information the agency reasonably can determine will have or does have a clear and substantial impact on important public policies or private sector decisions[.]”<sup>21</sup>

## **II. The CFPB Failure To Follow IQA Procedures**

### **a. Violation of IQA Quality, Utility, and Integrity Standards**

The Arbitration Study does not meet the IQA standards for quality. As Committee witness Professor Jason Scott Johnston explained in a Mercatus Working Paper, “the CFPB’s data do not allow for meaningful comparison between arbitration and class actions[.]” later adding that “[t]hese data suffer from a number of shortcomings.”<sup>22</sup>

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<sup>14</sup> To date, CFPB claims to have received only one IQA petition, which it granted in part and denied in part. It denied the subsequent appeal. See CFPB Guidelines, *supra* note 13 (“At this time, we’ve received one information quality correction request.”).

<sup>15</sup> Memorandum from Joshua B. Bolten, Dir., OMB, to Heads of Departments and Agencies concerning “Issuance of OMB’s ‘Final Information Quality Bulletin for Peer Review’” M-05-03 (Dec. 16, 2004) [hereinafter “OMB Bulletin”], *available at*

<https://www.whitehouse.gov/sites/default/files/omb/memoranda/fy2005/m05-03.pdf>.

<sup>16</sup> *Id.* at 1.

<sup>17</sup> *Id.* at 2 (emphasis added).

<sup>18</sup> *Id.* at 37.

<sup>19</sup> *Id.* at 35.

<sup>20</sup> *Id.* at 36.

<sup>21</sup> *Id.*

<sup>22</sup> Jason Scott Johnston & Todd Zywicki, *The Consumer Financial Protection Bureau’s Arbitration Study – A Summary and Critique* at 6 (Mercatus Center, Working Paper, 2015) [hereinafter “Working Paper”], *available at* <http://mercatus.org/sites/default/files/Johnston-CFPB-Arbitration.pdf>.

For example, CFPB presents “data on what consumers recover when arbitrations make a judgment in their favor but no data on what consumers recover when arbitrations settle . . . [inviting] a false apples-to-oranges comparison between class action *settlements* and arbitral *awards*.”<sup>23</sup> Furthermore, CFPB uses “aggregate averages” to evaluate the effectiveness of class action cases. Rather than differentiating the different types of class actions, CFPB lumps them all together.<sup>24</sup> This “tends to overweight data from only half a dozen huge class action settlements[]”<sup>25</sup> and suggests that individual consumer relief from arbitration, as an average, brings larger benefits to more consumers than class actions.

Elsewhere, Professor Johnston points out that “the CFPB found that arbitration is such a simple and cheap process (now requiring only a \$200 filing fee) that consumers achieve good outcomes even when they are not represented by counsel.”<sup>26</sup> CFPB considers one important issue, concerning how arbitration procedures differ from federal court procedures, in the shortest section of the study, making “no attempt in the section to estimate the actual transaction costs that a consumer would face in pursuing an individual claim in federal court rather than in arbitration.”<sup>27</sup> Professor Johnston also points out that “the Report fails to indicate whether the CFPB checked to ensure the validity of the econometric technique it used[]” in evaluating price changes between companies with arbitration clauses and ones without.<sup>28</sup> The technique CFPB used “is valid only if prices in the two groups of companies had been changing at the same rate before the imposition of the moratorium.”<sup>29</sup> CFPB also struggles to properly consider all reasonable interpretations of its results. For example, “CFPB implies that the absence of [] small-dollar claims from the dataset suggests that arbitration is not a feasible dispute resolution procedure for many consumers.”<sup>30</sup> In reality, though, it is possible that the absence of small-dollar claims is a result of consumers resolving these low dollar amount disputes “without arbitration or litigation,” instead relying on the bank’s desire “to preserve customer goodwill and relationships.”<sup>31</sup> In his harshest criticism, Professor Johnston writes,

In perhaps its most glaring omission, however, the CFPB Report makes no attempt to assess the merit of consumer class actions that end in the class action settlements it reports. It does not present any data that even illuminate which firms tend to settle and which do not and how key measures of class action performance (claims rates and attorneys’ fees relative to the class payout) vary with the statutory basis of the claim settled. After reading the voluminous Report, one knows no more about whether the settlement of frivolous consumer class actions is a real social problem than one did before reading it. Likewise, one knows no more about whether arbitration realizes its

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<sup>23</sup> *Id.*

<sup>24</sup> *Id.* at 7.

<sup>25</sup> *Id.*

<sup>26</sup> *Id.*

<sup>27</sup> *Id.* at 24.

<sup>28</sup> *Id.* at 34. Checking the validity of statistical techniques is one of the features of peer review. *See infra* p. 6.

<sup>29</sup> Working Paper, *supra* note 22, at 34.

<sup>30</sup> *Id.* at 37.

<sup>31</sup> *Id.*

promise of achieving more accurate determination of consumer disputes on the legal merits.<sup>32</sup>

These are only a sample of the methodological faults in CFPB's study.

As Professor Johnston concludes, the CFPB study's "findings fail to support any conclusion that arbitration clauses in consumer credit contracts reduce consumer welfare or that encouraging more class action litigation would be beneficial to consumers and the economy."<sup>33</sup> The agency's own guidelines state that CFPB "will produce information products that are presented in an unbiased, clear, complete, and well-documented manner."<sup>34</sup> And recall OMB's Guidelines, which demand that the information be "accurate, reliable, and unbiased[.]"<sup>35</sup> CFPB's report fails to meet these standards.

As explained in a prior report from this Committee, manipulating data follows a pattern of behavior for this agency.<sup>36</sup> For example, in an analysis of the indirect auto lending industry, CFPB used a proxy methodology known as "Bayesian Improved Surname Geocoding" to determine the race of individuals, as that information is not available in loan applications.<sup>37</sup> That method combines surname and geographical information into a single proxy probability for race and ethnicity.<sup>38</sup> In other words, the model establishes the probability of a person's race and ethnicity based on the person's last name and where he or she is from. According to the House Report, the CFPB initially went to great lengths to hide the formulas, computer code, and other internals of the methodology, making it impossible for any critic to test the accuracy of the results.<sup>39</sup> Only under pressure from Congress did the CFPB release some details of its methodology, which faced instant scrutiny and was criticized as an inferior proxy method when compared to other available formulas.<sup>40</sup> Internal communications from the CFPB also showed that the agency knew its proxy was "less accurate . . . than some proprietary proxy methods that use nonpublic data."<sup>41</sup> The CFPB elsewhere acknowledged that its statistical methods were under attack as "racial profiling and junk science."<sup>42</sup> In a report on the CFPB analysis, Charles River Associates ("CRA"), hired by a consumer credit trade association, the American Financial Services Association, stated that the CFPB methodology was "conceptually flawed in [its] application and subject to significant bias and estimation error."<sup>43</sup>

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<sup>32</sup> *Id.* at 55–56.

<sup>33</sup> Working Paper, *supra* note 22, at 6.

<sup>34</sup> CFPB Guidelines, *supra* note 13.

<sup>35</sup> OMB Guidelines, *supra* note 7, at 8459.

<sup>36</sup> U.S. H.R., COMM. ON FIN. SERVS., STAFF REPORT: UNSAFE AT ANY BUREAUCRACY: CFPB JUNK SCIENCE AND INDIRECT AUTO LENDING (2015), *available at* [http://financialservices.house.gov/uploadedfiles/11-24-15\\_cfpb\\_indirect\\_auto\\_staff\\_report.pdf](http://financialservices.house.gov/uploadedfiles/11-24-15_cfpb_indirect_auto_staff_report.pdf).

<sup>37</sup> *Id.* at 24.

<sup>38</sup> *Id.* at 26.

<sup>39</sup> *Id.* at 24–25.

<sup>40</sup> *Id.* at 26–27.

<sup>41</sup> *Id.* at 27.

<sup>42</sup> *Id.* at 28.

<sup>43</sup> Arthur P. Baines & Dr. Marsha J. Courchane, *Fair Lending: Implications for the Indirect Auto Finance Market* at 33 (Nov. 19, 2014) (Charles River Associates (CRA) Report for Prepared for American Financial

### **b. Lack of Peer Review**

CFPB's Arbitration Study qualifies as "influential scientific information." It was disseminated to the public, includes scientific and data analysis, and will have a clear and substantial impact on important public policies and the private sector. The Study was mandated by statute and is the foundation of a new rulemaking that seeks to alter a long-standing and judicially-recognized dispute resolution process.<sup>44</sup> If CFPB had followed IQA and the OMB bulletin, the Arbitration Study would have undergone a rigorous, transparent peer review process to ensure the quality of the disseminated information.<sup>45</sup>

Unfortunately, CFPB failed its duty of peer review. CFPB has made no public indication, either in the Arbitration Study itself or accompanying press, that peer review played any part in the Study's preparation.<sup>46</sup> The lack of peer review, as required under the IQA, together with the flawed methodology and incomplete data highlighted at the May 18, 2016 hearing, raise serious questions about the integrity of CFPB's rules.

### **III. Conclusion**

The track record of CFPB shows that the agency is prone to use incomplete data and poor methodology. Congress enacted the Information Quality Act to prevent such agency abuse and to hold bureaucrats accountable for manipulating data and relying on junk science. CFPB should retract its proposed arbitration rules until it completes a proper peer review of the Arbitration Study and remedies the Study's methodological faults and improper use of data.

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Services Association (AFSA)), available at <http://www.crai.com/sites/default/files/publications/Fair-Lending-Implications-for-the-Indirect-Auto-FinanceMarket.pdf>.

<sup>44</sup> See *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 345 (2011) ("our cases place it beyond dispute that the [Federal Arbitration Act] was designed to promote arbitration").

<sup>45</sup> See OMB Bulletin, *supra* note 15, at 12 ("The National Academy of Public Administration suggests that the intensity of peer review should be commensurate with the significance of the information being disseminated and the likely implications for policy decisions.") (internal citation omitted).

<sup>46</sup> CFPB's IQA Guidelines contain a blanket disclaimer stating none of the materials the agency produces are subject to IQA and OMB's peer review provisions. CFPB Guidelines *supra* note 13. CFPB may be claiming this under the authority of Section IX of the OMB Peer Review Bulletin, which finds that "accounting, budget, actuarial, and financial information, including that which is generated or used by agencies that focus on interest rates, banking, currency, securities, commodities, futures, or taxes[]" are exempt from peer review. However, neither the Arbitration Study nor the proposed regulations fall under any of these categories. Indeed, it is a social and behavioral study—concentrating not only on award numbers, but also consumer preference and awareness—on how consumers fare in and react to two different circumstances: individual arbitration and class actions.

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Please feel free to contact me by telephone at (202) 470-2396, or by e-mail at [eric.bolinder@causeofaction.org](mailto:eric.bolinder@causeofaction.org), if there is anything further that CoA Institute can provide to the Committee.

Respectfully,



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