Office of the Comptroller of the Currency

Washington, DC 20219

October 17, 2017

The Honorable Mike Crapo
Chairman
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, D.C. 20510

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Chairman Crapo and Ranking Member Brown:

On October 13, 2017, Director Richard Cordray of the Consumer Financial Protection Bureau (CFPB) wrote Senator Brown a letter taking issue with the Office of the Comptroller of the Currency's (OCC) review of his agency's study and data used to develop and support its final rule on arbitration agreements (Arbitration Rule).[1] Director Cordray also publicly stated that the OCC's review is a "gratuitous attempt to undermine the evidence that supports [the CFPB's] rule" and "relied on so-called analysis that is simply embarrassing." As a number of reporters have asked for my comment, I wanted to share my response with you directly.

To begin, OCC economists only replicated the results of the working paper relied on by the CFPB by using the CFPB's own data and methodology. Consequently, there is no real difference between the OCC and CFPB as to the content of the study that underlies the CFPB's Arbitration Rule. Both agencies found an economically significant increase in the cost of credit with the removal of arbitration clauses, with consumers potentially facing an average increase in the cost of credit of as much as 3.43 percentage points. The data relied on by both agencies also suggested that there is an 88 percent chance that the cost of credit would increase. As a matter of statistics, this effect of the CFPB's Arbitration Rule is said to lack statistical significance, because to be statistically significant there would need to be at least a 95 percent confidence level that the cost of credit would increase.

Thus, when the CFPB states that the likely increase in cost to consumers resulting from the Arbitration Rule is not statistically significant, it is simply stating there is not a 95 percent or greater chance of cost rising. The CFPB relied on the absence of statistical significance to

[1] 82 Fed. Reg. 33210 (July 19, 2017).

support not providing quantitative estimates of the increased costs to consumers observed in the data supporting the Arbitration Rule. Contrary to Director Cordray's assertions, the OCC is not trying to undermine the CFPB's study, it is only presenting quantitative information about the range of increased costs to consumers observed in the data that both agencies reviewed. To date, the CFPB has not denied, because it cannot, that its own data show that there is an 88 percent chance of the cost of credit increasing in the absence of arbitration clauses, with consumers potentially facing an average increase in the cost of credit of as much as 3.43 percentage points. Thus, to the extent the CFPB's Arbitration Rule is being undermined, it is undermined by the CFPB's own data and the working paper on which the CFPB relied.

As a prudential regulator tasked with ensuring the safety and soundness of the banking system and the fair treatment of consumers, the OCC must concern itself with not only statistical significance but also with the practical and economic results that rules, such as the Arbitration Rule, have on the banking system and consumers. The real question is: Do we want to risk increasing the cost of credit to working Americans by as much as 3.43 percentage points (or approximately 25 percent over current market rates) simply because there is an 88 percent chance, rather than a 95 percent or greater chance, that such increase will in fact result from the Arbitration Rule? This is all the more important given that there is no evidence to suggest that banks will change their behavior as result of the rule. Nothing in the CFPB's data demonstrates that the 47 percent of banks that do not to use arbitration clauses have fewer compliance issues, behave better, or treat their customers better in meaningful ways than the 53 percent that do.

The importance of practical, significant economic consequences is made plain when we think about other contexts. For example, would anyone dispute the disastrous outcome that would have resulted if the National Weather Service and the Federal Emergency Management Agency had not told the public to prepare for particular hurricanes because these agencies had internal data that they would not disclose to the public showing only an 88 percent chance that these storms would produce rain and a 56 percent chance they would devastate a particular area? Moreover, would the CFPB not examine and look into cases of consumers being harmed if the CFPB's review of data showed that there was an 88 percent chance that consumers were in fact harmed by a particular practice by a financial institution? I would hope that no agency or government official would abdicate their responsibility in such a manner.

More fundamentally, any difference between the OCC and the CFPB on this matter can be resolved with transparency. If Director Cordray does not object, the OCC will make public the data and other information it received from the CFPB that the CFPB relied on to support its Arbitration Rule. Members of the public from all sides could then analyze the data and reach their own conclusions. Ensuring that rules and regulations are not based on secret data available only to the government will ensure that agencies do not behave in arbitrary and capricious ways.

Finally, Director Cordray has stated that "over 90 percent of the community banks and credit unions [the CFPB] studied do not even have these clauses in their checking account contracts. . . . [and that the CFPB's] analysis showed that community banks and other small businesses had a less than one in 1,500 chance of a new class action due to the rule." Again, no one outside the CFPB knows how many community banks and credit unions the CFPB studied or any other information it relied on to draw these conclusions and so the statistics become meaningless. In fact, I hear time and again from community banks that the Arbitration Rule could threaten their very existence. Director Cordray may feel confident of the CFPB's secret analysis, but, as discussed above, practical results are what matter most to working Americans who are counting on their government officials to look out for their interests and not the special interests benefitted by this rule. Because regulations have real consequences, it is essential that regulators listen to, and carefully consider, those being affected by their regulations.

Sincerely yours,

Keith A. Noreika
Acting Comptroller of the Currency

Enclosure

cc: Senate Banking Committee Members

MEMORANDUM

To: Keith Noreika, Acting Comptroller of the Currency

From: Michael Sullivan, Senior Deputy Comptroller, Economics Department, Office of the Comptroller of the Currency

Re: Review of data supporting the CFPB's Arbitration Rule

Date: October 17, 2017

Thank you for giving me the opportunity to respond to critical analysis by CFPB economists of the OCC's review of credit card data analysis that was part of the CFPB's arbitration rule.

Some forget that "cannot reject the null hypothesis" does not mean "accept the null hypothesis." More subtly, some economists overemphasize statistical test results and ignore other information relevant to a particular study and its conclusions. Some prominent economists, for example Professor Campbell Harvey of Duke University, argue that this overemphasis is so pervasive that it may undermine the credibility of economic analysis. The American Statistical Association was so concerned about the misuse and misinterpretation of statistical significance, more broadly than economics, that they formed a panel of eminent statisticians, solicited the views of professional statisticians, and published a paper to clarify the role of statistical tests in research studies. Two points of emphasis of that panel were that statistical significance is not equivalent to economic significance and using "bright-line rules" such as p-value < 0.05 can lead to erroneous beliefs and poor decisions.

Before addressing the credit card analysis, I note for consideration the following from an amicus brief filed with the Supreme Court: "failing to reject the null hypothesis does not mean that one should then accept it. In particular, if one estimates the size of an effect by calculating a statistical parameter but is unable to reject the null hypothesis that this parameter is equal to zero, one does not then accept the null hypothesis and apply a value of zero to this parameter. Instead the best estimate of the size of the effect is the value of the parameter that one has calculated."[1] Moreover, "failing to reject the null hypothesis [sic] does not mean that the effect in question is meaningless or unimportant."[2]

With respect to the OCC's review of the credit card analysis, the purpose of the review was to analyze and verify the results found by Alexei Alexandrov. Alexandrov conducted a careful study and employed valid statistical methods to the credit card data. We agree with his methods, interpretation, and conclusions. In particular, we agree with the following from Alexandrov:

[1] Brief of Amici Curiae statistics experts Professors Deirdre N. Mccloskey and Stephen T. Ziliak in support of respondents in the Supreme Court case of Matrixx Initiatives, Inc., et al., v. James Siracusano and Neca-ibew Pension Fund.

[2] "Bank Regulator Report: 'Arbitration Rule' on Credit Cards Will Raise Costs on Consumers," Iain Murray, September 29, 2017.

> The available data only allows me to attempt to estimate causally the magnitude of effect (2), increased prices or decreased quality in these two markets. The estimates are not statistically significant: I cannot rule out that the introduction of such liability had no adverse impact on prices or quantity. However, in the credit card application, the magnitude of the standard errors is, arguably, economically significant, and thus I cannot rule out an economically significant response.[3]

After replicating his analysis, we went on to elaborate on potential economic significance using the distribution of the estimated coefficient as indicated by the data. We did not calculate p-values to construct our table of probabilities of various increases in the cost of credit. We simply represented the probability distribution in table form. It might be easier for some to think of it this way: according to the credit card data, there is at least a 50 percent chance that the cost of credit will increase by at least 3.43 percentage points. Posed to most, that would be considered economically significant.

Based on the credit card data used for analysis, a best estimate of the economic impact of the arbitration rule for the relevant credit market is a 3.43 percentage point increase. The standard errors caution us that it is not a great estimate; it is just one piece of evidence. We agree that the estimate is surprisingly large, however, it is what the data and statistical analysis show. No individual data set or statistical study is the final word. That is why we suggested additional analysis could be done to better inform the discussion of the potential impact of the arbitration rule.

To his credit, Alexandrov did not overemphasize statistical significance but instead suggested that the standard errors arguably indicate potential economically significant effects. It is open for discussion whether, based on statistical significance alone, making a decision not to provide estimates of the cost to consumers, or indeed any details of the results of the statistical analysis, as part of the Arbitration Study is appropriate.

[3] Id.