

Do Facts Matter? The Role of Independent Research in the Policy-Making Process

Barbara Roper, Consumer Federation of America¹

I am honored to have been invited to speak to you, and particularly honored to have been invited to speak as part of a forum named for Esther Peterson. Esther Peterson was near the end of a career that spanned more than 60 years when I joined CFA in the mid-1980s. I still remember her as a regular feature at CFA conferences back then, with her crown of silver braids. There's always been an impressive group of women leaders in the consumer movement – Rhoda Karpatkin, Joan Claybrook, Esther Peterson, Irene Leech – lighting the road for those of us who came after. It's humbling to contemplate their legacy of achievements. But, if I follow in Esther Peterson's footsteps, I just hit the halfway mark of my career. There's still plenty of time for me to make my mark!

When Irene Leech invited me to speak, it was back in the heady days after we had secured the most important investor protection victory of my career – a rule from the Department of Labor requiring all those who give investment advice to retirement investors to act in their clients' best interests and requiring the firms that employ those advisers to eliminate the toxic web of incentives that encourage advice that is not in clients' best interests. In other words, a rule requiring financial professionals to do exactly what most investors naturally assumed their financial advisor was required to do all along.

That victory was a big deal, something I'd personally been working toward since I wrote my first report for CFA back in 1987 on abuses in the financial planning industry. The idea for this speech was that I'd use the DOL victory as a jumping off point from which to talk about the important role that independent research can play in the policymaking process. Because, make no mistake about it, independent, peer-reviewed academic research on the harmful impact of conflicts of interest was the foundation on which this rule was built and defended. So my message was all set to be a positive one, about taking this highly successful model and replicating it on other consumer protection issues.

But that was then, as they say, and this is now. And instead of celebrating official implementation of the rule, which was set to begin earlier this month but has now been delayed for two months, we're fighting with everything we've got to see how much of the rule we can salvage in a new, more hostile political environment. You wouldn't think requiring financial advisers to act in their customers' best interests would be a particularly partisan issue, and it's not with the general public. But the sad fact is that every Republican in Congress, with the notable exception of Walter Jones from North Carolina, voted to kill the DOL fiduciary rule. They were prevented from doing so only by a veto from President Obama. Now we have a new president, and in March President Trump issued a memorandum calling for the Department of Labor to reconsider the rule with an eye toward revising it or revoking it outright.

Last Monday, my colleague Micah Hauptman and I submitted a 145-page comment letter for that reconsideration – 260-some if you count the appendices. It was packed with every form of evidence we could find – proof from the marketplace that fiduciary services can be provided affordably to small accounts, statements from financial industry executives that they are prepared to implement the rule and do so in ways that will benefit investors, data regarding retirement plan costs that shows employees are paying way more than they need to for their retirement plan investments. It also includes information from several independent academic studies on topics that are relevant to the rule – differences in the quality of advice from fiduciary and non-fiduciary advisers, failure of competition to discipline mutual fund fees, excess fees paid by 401(k) plan investors, and the broader economic impact of conflicted advice. In that sense, you could say our letter is an expression of faith that facts still matter in the policymaking process.

I start from a basic premise ... and maybe someone here more steeped in the history of the consumer movement can correct me if I'm wrong ... but I can't think of a single significant piece of pro-consumer legislation or a pro-consumer regulation that was adopted without a strong factual case being made about: the nature of the problem, the extent of the harm consumers suffer as a result, and the practicality of the proposed solution. That is very much the CFA model. We pride ourselves on being a research-driven advocacy organization – making the case across a range of issues for why a particular policy is needed and how a particular regulatory approach would help to resolve the problem.

We can all think of examples where this approach worked, right? Ralph Nader published *Unsafe at Any Speed* and by the end of the following year the agency that would become the National Highway Traffic Safety Administration had been launched. Research was published showing the harmful effect of

second-hand smoke on non-smokers, and new laws limiting smoking in public places were soon adopted. And, although it was many years in the making, the CARD Act was adopted in response to consumer group and academic research documenting abusive credit card practices. But I can also think of plenty of examples of pro-consumer policies that weren't adopted despite compelling research demonstrating the need, and many examples of anti-consumer policies that were adopted despite a total lack of compelling research showing they were justified. In the latter category, one example that comes to mind was the adoption of bankruptcy "reform" legislation despite a total lack of evidence of systemic abuses by borrowers and extensive evidence of abusive credit practices that encouraged consumers to take on unsustainable debt.

Which is how I got to the answer to my question: In the policymaking process, do facts matter? Yes But not always And not as much as they should.

Background on DOL Fiduciary Rule

The DOL fiduciary rule is definitely one case where the facts mattered, but the Department of Labor's journey to adoption of the rule followed a somewhat different trajectory than is typical for these things. And not just because it ended in enactment of a rule opposed by powerful financial interests. There was no history of consumer advocates pounding on the door of DOL demanding action. I'd been working on this issue for many years when DOL took it up in 2010, but my focus and that of other investor advocates had been at the Securities and Exchange Commission and, until they got preempted in the 1990s, at the state level. The DOL wasn't really on our radar.

But DOL had identified a problem with their definition of fiduciary investment advice under ERISA that they thought they should address. That definition was so full of loopholes, they found it almost impossible to bring enforcement actions for violations in certain situations where, in their view, a fiduciary duty clearly should apply.

- The advice had to be ongoing to be considered fiduciary investment advice. A one-time recommendation, including about something as consequential as a rollover out of pension or 401(k) plan, wasn't considered fiduciary advice.
- The advice had to be the primary basis for the investment decision, and the financial professional and client had to agree that this was the case. So a disclaimer in 6-point type on a disclosure document that the advice wasn't intended to be the primary basis for the investment decision was enough for an adviser to escape their fiduciary duty.
- And this was true with regard to advice to plan sponsors about setting up plan investment menus, advice to plan participants about their own investment selections, and advice to Individual Retirement Account or IRA investors.

When the DOL took this issue up, fiduciary duty was in the air. Then SEC Chair Mary Schapiro had said getting a uniform fiduciary duty adopted for brokers and investment advisers under the securities laws was a priority. Congress had included a provision in Dodd-Frank authorizing the SEC to act. And there had even been discussion during the debate over Dodd-Frank of applying a fiduciary duty to certain derivatives transactions with pension funds and municipalities and the like. It seemed only natural for the DOL to get in on the action and address the loopholes in its definition of fiduciary investment advice, just as the SEC at the time appeared likely to do within its separate jurisdiction.

The rule proposal DOL put out in 2010 wasn't, in all honesty, very good. Among other things, it had a huge seller's carve-out that seemed to us to recreate in different form the very loopholes it was attempting to close. That meant that the fiduciary duty wouldn't apply when the conflicts were the greatest. But industry wasn't buying it, and they launched an all-out, ultimately successful campaign to get the rule withdrawn in 2011. It was at this point that industry rule opponents made what turned out to be a fatal mistake. As part of their campaign to kill the rule, they demanded that the Department of Labor conduct a more thorough economic analysis to justify its rule before re-proposing a revised rule. They also essentially boycotted the rulemaking process, presumably out of confidence that they had succeeded in deep-sixing the rule, and that they could always kill it in Congress if the need arose.

The DOL, on the other hand, took this directive to produce a more robust economic defense of the rule quite seriously. And they set about making the factual case for why the rule was needed and why their revised regulatory approach made sense. In preparing a comprehensive analysis of the issue, the Department consulted: statistical analyses of conflicted investment channels; experimental studies, such as mystery shopper surveys; government reports documenting abuse, and economic theory on the dangers posed by conflicts of interest and by the asymmetries of information and expertise that characterize

interactions between ordinary retirement investors and conflicted advisers, to reach their conclusions that conflicts of interest pervade the advice market and have a harmful impact on retirement investors. The resulting 395-page Regulatory Impact Analysis provides a compelling, data-dense portrait of what the Department calls a “substantial failure of the market for retirement advice.” While the Department concluded that much of the resulting harm to retirement investors was not quantifiable, they did rely on the best available peer-reviewed, academic research to form the basis for an estimate of the harm that occurs in one area of the market – recommendations of front-end load mutual funds to IRA investors.

And that factual analysis of the problem contained in the RIA has been critical to the rule’s success ... even though I sometimes think Micah and I are the only ones who have actually read it outside of the career staff at DOL who wrote it and a few industry economists whose job it is to try to poke holes in it. It is not, for example, the source of the most widely known “fact” that is constantly referred to in discussions of the rule – that retirement investors are losing \$17 billion a year as a result of conflicted investment advice. That fact, or perhaps it is better described as a “factoid,” came from a Council of Economic Advisers report that is far less comprehensive, detailed, and authoritative than the DOL’s subsequent calculations. But the CEA report was timely, and quotable, and founded in sound economic analysis, and it too played an important role in enactment of the rule.

So, what exactly do I mean when I say that the DOL fiduciary rulemaking is a case in which the facts clearly mattered?

- First, the economic analysis that the Department conducted, in which it really dug into all the best available research on how conflicts of interest operate in this field and the extent and nature of those conflicts, caused the Department to come up with a better, more defensible regulatory approach.

Gone was the seller’s carve-out, which preserved the harmful impact of the most prevalent conflicts. And in its place was a regulatory approach that truly closed loopholes in the definition and focused less on how advisers are compensated and more on all the hidden conflicts operating behind the scenes. So, instead of worrying about the fact that brokers and insurance agents were paid through commissions, DOL focused on the fact that they could be paid more, and often much more, for selling one product than they would be for selling another. And they focused on the fact that even a broker who technically earns the same commission for selling proprietary funds as they do for selling third party funds might still have a quota they have to meet for selling proprietary funds, and the adviser’s bonus might depend on his success in meeting that quota.

Based on that analysis, the Department came up with an approach that backed up its best interest standard for advice with a requirement that firms eliminate, or at least dramatically scale back, this toxic web of financial incentives that encourage advisers to recommend investments based on their own financial interests rather than the best interests of the client. That, in our view, is the single most important provision in the DOL rule, which means, of course, that it is also a provision very much under attack by industry rule opponents.

So, a thorough exploration of the facts – and in particular the evidence from peer-reviewed academic studies – led the Department to adopt a better regulatory approach.

- Second, that factoid I mentioned earlier – the \$17 billion figure – became part of an easily understandable narrative about why the rule is needed.

As you know, when you are trying to get a regulation (or legislation) adopted in the face of strong, well-funded industry opposition, you need to be able to sell it to the public, the media, and dare I say members of Congress, who aren’t going to read a 395-page economic analysis of the failings of the retirement advice market. Talk about the importance of a fiduciary standard of care in relationships of trust and reliance, and watch their eyes glaze over. Talk about \$17 billion a year that is being syphoned out of the accounts of hard-working retirement savers to line the coffers of powerful Wall Street firms, and now you have a story that makes people sit up and listen.

That \$17 billion figure fits well in speeches and letters to Congress and press reports. And if, as in this case, the figure has a firm enough foundation in independent research that it is largely impervious to industry attacks, all the better. Throw in a victim or two with a compelling story to tell, and you have all the makings of an effective public messaging strategy to defend the rule against inevitable industry attacks.

- Third, and crucially important in this case, the comprehensive economic analysis the Department conducted has been critical to DOL’s success defending the rule in court.

It was clear the moment the Department decided to re-propose the fiduciary rule in 2015 that the end result of this process, if the rule was ultimately adopted, was going to be a court challenge by rule opponents seeking to get it overturned. Industry groups, with strong backing from the Chamber of Commerce, have made a specialty out of these sorts of legal challenges of rules that they don't like. High on their list of arguments when they bring these sorts of cases is the claim that the agency in question failed to conduct an adequate economic analysis to support their chosen regulatory approach. And they've been quite successful overall. I think you can point to pretty compelling evidence that the SEC's court loss, over precisely this issue, in the challenge to its proxy access rules back in 2011 left the agency timid and unwilling to tackle any rule – including the fiduciary rule – that might end up landing it back in court.

The Department of Labor learned a different lesson from that experience. Instead of taking away the message that they should just avoid tackling controversial topics, they learned the importance of doing rigorous analysis that would stand up to legal challenge. And that has happened now in three separate federal district courts, all of which have provided sweeping decisions in favor of the DOL and in support of the rule. In other words, the very tactic industry sought to use to prevent the DOL from acting – demanding a more rigorous economic analysis – has been crucial to the Department's success in defending the rule in court.

When facts DON'T matter, why don't they matter?

That's the good news from the DOL fiduciary rule experience. But not all the news is good. As I mentioned earlier, the only thing that protected the rule from being over-turned in Congress was the power of the presidential veto. Republicans were united against it. And until nearly the end of the process, Democratic support for the rule was far from unanimous. So why didn't the facts matter to them? I think the reasons the facts didn't always matter, or matter more, in this case are pretty universal to the policy-making process in general: the corrupting influence of money, real or feigned ambiguity regarding the facts, and the strange workings of the human brain.

- **The Power of Money**

The DOL rule faced vigorous opposition from the brokerage industry, the insurance industry, the mutual fund companies, and all the other financial interests who were profiting handsomely, thank you very much, from the status quo. As a consumer advocate, when you have to fight the combined forces J.P. Morgan, Voya, and Fidelity, you don't expect to win that fight. Or put another way – because individual firms were quite reluctant to be the public face of opposition to a best interest standard – when you have to fight the Chamber of Commerce, SIFMA, ACLI and ICI, along with a few others – NAIFA, NAFA, and the IRI – the odds are not stacked in your favor.

In the normal course of things, we would have lost this fight. And, frankly, I think the industry lobbyists who fought this rule still can't quite figure out why their usual tactics didn't work in this case. The only reason they didn't is because of a remarkable group of public servants – including former Labor Secretary Tom Perez, Assistant Secretary Phyllis Borzi, the whole rule-writing team at the DOL, and the rule's lesser known champion, Jeff Zeints at National Economic Council – who were persuaded by the importance of the issue and the merits of the argument to persist in the face of relentless, occasionally quite nasty industry attacks.

Of course, we may still lose this fight as the result of this current reconsideration – the odds are certainly against us. After all, industry lobbyists have made it clear that there is no limit to what they are willing to spend – in Congress, in court, and lobbying the Administration – to send this rule to its grave once and for all. And the statements we've heard from the Administration suggest that they've carefully read the industry rule opponents' talking points and have already decided on the outcome of this process, regardless of the facts. So clearly we have our work cut out for us.

- **Ambiguity**

The second difficulty in winning a debate like this based on the facts is that facts can be complicated, easy to misinterpret, even ambiguous. And the DOL's economic analysis and the academic studies it is based on aren't exactly an easy read. Or, and this was very much the case in this rulemaking, the facts can be made to *look* ambiguous, even when they are not.

The groups that lined up in opposition to this rule are masters of this technique. Their favorite tactics – and they are tactics we have seen across a wide array of issues – include:

- Raising questions about the validity of the Department's conclusions, using all the complex jargon only an economist could love.
- Funding studies based on faulty assumptions about the rule and proprietary data sets that aren't open to public analysis to portray a different, and misleading story about the rule's effects.

- And then packaging that story in a way that is likely to play well with friendly members of Congress and get wide coverage in the media.

In this case, industry's story was that the rule, no matter how well intended, would end up harming small savers – those with only small amounts to invest – by making it too costly or risky for firms to serve this market. As a result, they say the rule would deny these small savers who are most in need of assistance affordable access to advice. I won't take the time here to explain all the reasons that story doesn't hold water. The most obvious was that it assumed that the rule would make it impossible for firms to offer commission-based retirement accounts, something that was verifiably untrue.

But that story – that misguided Washington bureaucrats were going to make it harder for Americans to save for retirement – had just enough verisimilitude that industry lobbyists could sell it to Congress and the press. And only rarely did those press accounts draw a clear distinction between the Department's claims based on independent, peer-reviewed academic research by individuals with no particular axe to grind and industry's claims based on studies they had funded that carefully hid the underlying data and were premised on a false characterization of the rule's requirements.

- The Power of Negative Thinking

The final factor I want to talk about – something I've been learning more about as I prepared this speech – is the strange functioning of the human brain, that makes it all too likely that we will dismiss facts, no matter how well documented, if they conflict with our underlying beliefs. I don't want to present myself as an expert on this topic. I've barely skimmed the surface. And many of you in the audience likely know far more about it than I do, but it is a topic that I think helps explain why some members of Congress and others respond as they do to this rule, and it has huge ramifications for the healthy functioning of our policymaking process.

There is a whole body of scientific literature, developed over many decades, that demonstrates that people have a tendency to embrace information that supports their beliefs and reject information that contradicts them. This tendency, known as confirmation bias, only seems to get worse in the presence of strong feelings about the issues. I read in a *Boston Globe* article called "How Facts Backfire," for example, how researchers at the University of Michigan conducted a series of studies in which they found that when misinformed people, *particularly political partisans*, were exposed to corrected facts in news stories, they rarely changed their minds. In fact, they often became *even more strongly* set in their beliefs. Facts, according to the article, were not *curing* misinformation. "Like an underpowered antibiotic," the authors wrote, "facts could actually make misinformation even stronger."

Other research, in this case described in an article in *The New Yorker*, "Why Facts Don't Change Our Minds," describes how we tend to create communities of knowledge in which we rely on each other's expertise. While this sort of collaboration has served a valuable evolutionary purpose, it can become dangerous when applied to policy questions, according to the researchers. "As a rule, strong feelings about issues do not emerge from deep understanding," the authors of the study write, and "our dependence on other minds reinforces the problem. If your position on, say, the Affordable Care Act [or in this case the DOL fiduciary rule] is baseless and I rely on it, then my opinion is also baseless. When I talk to Tom and he decides he agrees with me, his opinion is also baseless, but now that the three of us concur we feel that much more smug about our views." As a result of this process, we are more likely to dismiss as unconvincing any information that contradicts our opinion.

As the author of the *Boston Globe* article states, "This bodes ill for a democracy," because voters are likely to have strong beliefs that make them resistant to contradictory facts. Even more than voters, policymakers are likely to approach issues with a strong set of beliefs and an exaggerated confidence in their own expertise. They operate within tightly knit communities of knowledge – political parties – where they reinforce each other's beliefs and (mis)information and emerge with a smug confidence that they are right.

In the DOL rule debate, for example, industry rule opponents had a message specially crafted to appeal to the more rabidly partisan members of their target audience – think American Action Forum and *Wall Street Journal* editorial board. For this audience, their message didn't bother to go into specifics about the rule. Instead, they talked about how those socialists in the Obama Administration were out to deprive Americans of the freedom to make their own choices about saving for retirement. For the members of Congress and members of the public who are prepared to accept that statement as gospel – and there are more than a few of them – that renders everything that follows, about the supposed harmful impact of the rule, all the more convincing, and any contradictory information I might try to tell them completely irrelevant. Because let's face it, no matter how many facts I cite, those same folks are likely to find

anything I say, no matter how well documented, to be completely unconvincing. Because, as a representative of a progressive consumer organization, I am most emphatically not a member of their community of knowledge.

So how do we cross that barrier? I wish I had a really good answer to that question, but I don't. It's easy to feel hopeless in the face of our dysfunctional democracy. But if there is an answer, if not for reaching the people on the far side of the ideological divide, at least for reaching those who are in the middle or on the fence and keeping an open mind, I remain convinced that part of the answer lies in independent, peer-reviewed research written by people with no particular axe to grind and a commitment to following the data wherever it takes them.

How can we give independent research a more effective role in the policymaking process?

With that in mind, CFA has set about establishing a research center, operating within CFA but independently funded, to support and help disseminate independent research related to important investor protection policy priorities. The goal is to better integrate independent research into the policy-making process.

As we look at it, some of the same things that make independent academic research so valuable to the policymaking process, also pose significant challenges.

- Researchers don't work to a schedule dictated by policymaking deadlines. A study that will have made its way through the rigorous peer-review process a year or more from now doesn't do me much good in a policy debate that's being decided today.
- Researchers don't necessarily choose their topics based on which would be most useful in the policy debate. Other factors, like personal interest or the availability of a previously unexplored dataset, may dictate their choice.
- And, at the risk of being undiplomatic, academics in my experience don't always feel the need to be completely politically realistic when they propose a policy solution to a problem. So, they might propose banning commissions for investment advice, for example, for which a good case can be made, when there's not a snowball's chance in Hell that approach would be politically viable here, regardless of its merits.
- And some, and in my experience I'd say particularly the economists, don't necessarily write in a style that renders their findings comprehensible to a lay audience. That's a problem because most policymakers definitely fall within the lay audience category
- Finally, even where their research is directly relevant to an ongoing policy debate, the research often doesn't get communicated to those who could act on it.

That, of course, is a gross generalization. And I have no doubt that many in this room bring a practical bent to their research. That is, after all, a hallmark of this organization, as evidenced by many of the research topics being discussed here this week. But when we look further afield, we do not always find the same degree of engagement with issues that affect the daily lives of average investors.

Through the creation of this Investment Research Center, we thought we could help with several of these challenges. We can, for example, help to make sure that good, rigorous research gets into the hands of the policymakers who can make best use of it. We can help draw the connection between the research and its policy implications. And we can help to communicate that research more broadly to the media, including in some cases by working with authors to translate its findings into a more comprehensible language suitable for a lay audience. At the same time, we may be able to direct researchers toward topics that would have particular relevance to important policy debates.

For now, this effort is still very much in the fledgling stages. We're just pulling together our advisory board and still seeking funding. But we're making progress, and we recently held our first issue briefing on an academic paper dealing with mutual fund fee dispersion – why nearly identical funds charge dramatically different fees – and what the implications are for mutual fund fee disclosure.

Conclusion

Right now, it's hard to tell whether any of this will make any difference in terms of influencing policy. After all, we've just watched the Republican Congress and President Trump wipe a series of Obama-era rules off the books, using the Congressional Review Act, without a second's pause to consider the merits of those rules or the facts that led to their adoption. My point is not that those rules were perfect. Many dealt with topics about which I claim no particular expertise. My point is that the decision to abolish them wasn't based on a thoughtful review of the facts or their merits.

But I've been at CFA long enough to have been through several political upheavals, and I've learned how quickly the situation can reverse itself, providing an unexpected opportunity to press a pro-consumer, pro-investor agenda. We will only be ready to seize that opportunity, when it comes, if we lay the foundation now in the form of solid, thoughtful research into the problems that consumers and investors face and the causes and solutions to those problems. This is worth doing. Because, in the end, I have to believe that the facts do still matter.

References

- Keohane, J. (2010, July). How Facts Backfire. *The Boston Globe* (July 11, 2010). Retrieved from http://archive.boston.com/bostonglobe/ideas/articles/2010/07/11/how_facts_backfire/
- Kolbert, E. (2017, February). Why Facts Don't Change Our Minds. *The New Yorker*. Retrieved from <http://www.newyorker.com/magazine/2017/02/27/why-facts-dont-change-our-minds>

¹Director of Investor Protection, Consumer Federation of America, 1620 I Street, N.W., Washington, D.C. 20006. Phone: 719-543-9468. Email: bnroper@comcast.net.