Consumer Federation of America

SIFMA's Latest Attack on DOL Fiduciary Rulemaking Misses the Mark

Another industry-funded "study" attempting to derail the Department of Labor's fiduciary rulemaking was published this week. The study, conducted by NERA Economic Consulting and commissioned by the Securities Industry and Financial Markets Association (SIFMA), tries unsuccessfully to discredit the White House Council of Economic Advisers' Report, "The Effects of Conflicted Investment Advice on Retirement Savings."

The White House Report was based on a careful review of the relevant academic literature relating to the costs that conflicted advice has on retirement savers. The White House's essential finding was that conflicts of interest have large and meaningful costs for Americans' retirement savings. The White House estimated that, based on the value of assets invested according to conflicted advice ($1.7 trillion), and the estimated effect of conflict on investment returns (1 percent loss in annual returns), the total dollar cost of conflicted investment advice is at least $17 billion per year.

It is hardly surprising that SIFMA, the Wall Street brokerage lobby, which spent over $8 million lobbying last year and vociferously opposes DOL fiduciary rulemaking, is doing everything it can to subvert DOL's moving forward. SIFMA represents the brokerage firms who under the current regulatory regime are allowed to profit at their clients' expense to the tune of $17 billion a year. Their motive to preserve the status quo is clear.

What is surprising about this "Review of the White House Report" is just how weak it is. The review does not dispute the White House Report's essential findings, including:

- The cited academic papers find evidence of conflicts of interest between brokers and investors;
- The cited academic papers find evidence that funds marketed and sold through the broker distribution channel underperform funds marketed and sold directly to the public; and
- That retirement savers suffer financial harm as a result.

Presumably, if SIFMA/NERA had evidence to disprove the White House's essential findings or show why the White House's estimates are misguided, they would provide it. After all, the firms are the gatekeepers of the data that would allow for a more exhaustive analysis. The fact that they don't put forward that data suggests that their evidence does not say what they want it to. So instead SIFMA/NERA resort to a handful of strawman arguments about the White House Report, including:

- Claim: The Report does not put forward a clear proposal and therefore it cannot perform a proper cost-benefit analysis.
    - Reality: The Report was not offered for the purpose of putting forward a proposal, it was only offered for showing evidence of harm as a result of conflicted advice. The industry has relentlessly claimed "there is no proof of harm…show us proof of harm." This is what they asked for.
    - It is particularly disingenuous for the industry to complain about not having seen a proposal when they are doing everything in their power, including releasing this report, to ensure that a proposal and the economic analysis underlying it are not made public.
- Claim: While broker-sold funds may suffer from underperformance, investors who "choose" broker-sold funds may be receiving intangible benefits that may provide them "as-yet-unmeasured reasons" to invest in broker-sold funds.

- Reality: SIFMA/NERA are relying on an intellectually lazy argument – that, while they can't prove that broker-sold funds provide something of value, since investors are buying those funds, that value must exist.
- The reality is broker-sold funds compete to be sold, not bought. It is by and large financially unsophisticated investors who seek advice from brokers and implement their broker's recommendations by buying broker-sold funds. Because of this information asymmetry, brokers do not have to compete for business by offering their clients the lowest-cost, highest performing funds.
- Other benefits they cite – for example that brokers encourage their customers to save more – would remain if brokers were required to act in their customers' best interests. There is therefore no trade-off that needs to be weighed against the benefits of requiring brokers to put their customers' interests first.

- Claim: Much of the academic findings on which the Report focuses refer to the average performance of funds rather than the performance of investors in funds.
    - Reality: Individual investors experience far worse performance than the funds that they're invested in. That is because investors mis-time the market, buying funds when they're doing well and selling funds when they're doing poorly. They also trade too often, and as a result pay high transaction costs. The evidence holds true for all investors, regardless of what type of fund they're invested in.
    - Presumably, if SIFMA/NERA had concrete evidence to show that broker clients time the market better than direct sold clients and engage in less frequent trading than direct sold clients, SIFMA/NERA would provide it. Instead, they speculate that "brokers and financial advisors might in fact be able to ameliorate the problem of investor mis-timing by explaining to individual investors that they should trade less frequently." They cite no academic research to support their speculation and ignore the incentive brokers have to encourage more frequent trading.
- Claim: The Report mentions that "the authors estimate underperformance for the first year in which the funds are purchased rather than underperformance for every year that the saver holds the fund."
    - Reality: SIFMA/NERA conveniently omit the White House report's following sentences, which explain that, "While the literature provides little formal guidance on this specific question, the authors control for cyclical fluctuations that might lead their underperformance estimate to differ depending on business cycle conditions. In addition, studies that estimate underperformance in portfolios, where a fund's performance can be tracked beyond the first year of ownership, find annual estimates of underperformance over time that are consistent with the first-year effect (Hackenthal et al. 2012b, Chalmers and Reuter 2014, Foerster et al. 2014). Both of these explanations provide suggestive evidence that the one-year estimate of underperformance in Christoffersen et al. (2013) is a reasonable approximation for the persistent effect."
- Claim: While discussing the United Kingdom's reform, the Report omits the discussion of disadvantages suffered by low-wealth consumers.
    - Reality: The White House presented a table of seven countries' various approaches to mitigating conflicts of interest; it did not endorse the United Kingdom's approach to ban commission-based compensation. In fact, the Department of Labor and the White House have repeatedly made clear that they will not ban commissions, so an in-depth discussion of the U.K. experience is irrelevant in this context.

As hard as SIFMA/NERA try to poke holes in the White House Council of Economic Advisers' Report, SIFMA/NERA unwittingly show how flimsy their complaints about the Report are and, by contrast, how thoughtful and meticulous the Council of Economic Advisers was with its review and analysis of the academic literature relating to conflicted retirement advice.