The Trouble With Disclosure: It Doesn't Work

by Jesse Eisinger *ProPublica, Feb. 11, 2015*

Louis Brandeis was wrong.

The lawyer and Supreme Court justice famously declared that sunlight is the best disinfectant, and we have unquestioningly embraced that advice ever since.

About The Trade

In this column, co-published with New York Times' DealBook, I monitor the financial markets to hold companies, executives and government officials accountable for their actions. Tips? Praise? Contact me at jesse@propublica.org

Over the last century, disclosure and transparency have become our regulatory crutch, the answer to every vexing problem. We require corporations and government to release reams of information on food, medicine, household products, consumer financial tools, campaign finance and crime statistics. We have a booming "report card" industry for a range of services, including hospitals, public schools and restaurants.

All this sunlight is blinding. As new scholarship is demonstrating, the value of all this information is unproved. Paradoxically, disclosure can be useless — and sometimes actually harmful or counterproductive.

"We are doing disclosure as a regulatory move all over the board," says Adam J. Levitin, a law professor at Georgetown, "The funny thing is, we are doing this despite very little evidence of its efficacy."
Let's start with something everyone knows about — the "terms of service" agreements for the likes of iTunes. Like everybody else, I click the "I agree" box, feeling a flash of resentment. I'm certain that in Paragraph 184 is a clause signing away my firstborn to a life of indentured servitude to Timothy D. Cook as his chief caviar spoon keeper.

Our legal theoreticians have determined these opaque monstrosities work because someone, somewhere reads the fine print in these contracts and keeps corporations honest. It turns out what we laymen intuit is true: No one reads them, according to research by a New York University law professor, Florencia Marotta-Wurgler.

In real life, there is no critical mass of readers policing the agreements. And if there were an eagle-eyed crew of legal experts combing through these agreements, what recourse would they have? Most people don't even know that the Supreme Court has gutted their rights to sue in court, and they instead have to go into arbitration, which usually favors corporations.
The disclosure bonanza is easy to explain. Nobody is against it. It's politically expedient. Companies prefer such rules, especially in lieu of actual regulations that would curtail bad products or behavior. The opacity lobby — the remora fish class of lawyers, lobbyists and consultants in New York and Washington — knows that disclosure requirements are no bar to dodgy practices. You just have to explain what you're doing in sufficiently incomprehensible language, a task that earns those lawyers a hefty fee.
Of course, some disclosure works. Professor Levitin cites two examples. The first is an olfactory disclosure. Methane doesn't have any scent, but a foul smell is added to alert people to a gas leak. The second is ATM. fees. A study in Australia showed that once fees were disclosed, people avoided the high-fee machines and took out more when they had to go to them.

But to Omri Ben-Shahar, co-author of a recent book, " More Than You Wanted To Know: The Failure of Mandated Disclosure," these are cherry-picked examples in a world awash in useless disclosures. Of course, information is valuable. But disclosure as a regulatory mechanism doesn't work nearly well enough, he argues.

First, it really works only when things are simple. As soon as transactions become complex, disclosure starts to stumble. Buying a car, for instance, turns out to be several transactions: the purchase itself, the financing, maybe the trade-in of old car and various insurance and warranty decisions. These are all subject to various disclosure rules, but making the choices clear and useful has proved nigh impossible.

In complex transactions, we then must rely on intermediaries to give us advice. Because they are often conflicted, they, too, become subject to disclosure obligations. Ah, even more boilerplate to puzzle over!

And then there's the harm. Over the years, banks that sold complex securities often stuck impossible-to-understand clauses deep in prospectuses that "disclosed" what was really going on. When the securities blew up, as they often did, banks then fended off lawsuits by arguing they had done everything the law required and were therefore not liable.

"That's the harm of disclosure," Professor Ben-Shahar said. "It provides a safe harbor for practices that smell bad. It sanitizes every bad practice."

The anti-disclosure movement is taking on the " Nudge" school, embraced by the Obama administration and promoted most prominently by Cass R. Sunstein, a scholar at Harvard, and Richard H. Thaler, an economist at the University of Chicago. These nudgers believe that small policies will prod people to do what's in their best interests.

The real-world evidence in favor of nudging is thin. Take the 2009 Credit Card Accountability Responsibility and Disclosure Act, which broadly did two things. It banned some exploitative credit card company practices and fees and then also made disclosures simpler and clearer. The first part of the law has been a remarkable success. Economists studied the tangible bans and restrictions and found that they had saved consumers just under $12 billion a year. By contrast, the nudges that disclosed more clearly how much consumers would save by paying off more quickly saved, at most, $71 million a year. Disclosure may also mislead. Although it is in the customer's interest to pay off the balance more quickly, it's in the card issuer's interest for the balance to be paid off more slowly. The card issuer could make a minimum payment more prominent on the form, leading the customer to focus on it. Professor Levitin says that sometimes customers double or triple the minimum payment, thinking they are making more progress in paying down their debt than they actually are.

Professor Ben-Shahar argues that disclosure devolves into a tool that gives advantages to the well educated and affluent over the poor and disadvantaged. The wealthy know which hospitals have good ratings; the poor don't. The wealthy access those finite services, at the expense of the uneducated.

Of course, sometimes disclosure works — just not the way we had intended. In forcing companies to disclose top executive pay, many held the naïve hope that this would embarrass corporations into keeping pay down. Quite the opposite has occurred. Now, companies simply benchmark against their peers and pay their guy (and it is mostly guys, of course) more. Economists have called this the Lake Wobegon effect, named for Garrison Keillor's mythical town in which everyone is above average. And although many political donations are opaque, some contributors, like the casino magnate Sheldon Adelson, proudly trumpet their astronomical spending.

The ever-alluring notion is that we are just one or two changes away from having meaningful disclosure. If we could only have annual Securities and Exchange Commission filings in plain English, we could finally understand what's going on at corporations. A University of San Diego Law School professor, Frank Partnoy, and Icalled for better bank disclosure in an article in The Atlantic a few years ago. Professor Ben-Shahar mocks it. " 'Plain English!' 'Make it simple.' That is the deus ex machina, the god that will solve everything," he said. Complex things are, sadly, complex. A mortgage is not an easy transaction to understand. People are not good at predicting their future behavior and so don't know what options are best for them. "The project of simplification is facing a very poor empirical track record and very powerful theoretical problem," he said.

What to do instead? Hard and fast rules. If lawmakers want to end a bad practice, ban it. Having them admit it is not enough.