Engagement with the Private Sector in Testing

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“Information Disclosure, Cognitive Biases and Payday Borrowers” Bertrand & Morse 2011 *Journal of Finance*

Topic: Even if payday loans are priced fairly and non-predatory, one has to wonder whether cognitive limitations or biases by some borrowers explain the use of payday loans

<u>Idea (not just for this setting) : Mandate disclosure that is</u>

- Better informed as to what mistakes are being made
- Better targeted to de-bias potential cognitive biases causing these mistakes

<u>Field experiment</u> at national chain of payday stores

- Can we impact future borrowing with debiasing disclosure.

Information Treatment 1

Potential problem : People may not internalize APR because focus in store is the dollar fee structure on the wall.

Treatment: Reinforce understanding of APR by presenting it next to other (smaller) APRs.

Annual interest rates on different types of loans

	Median Annual Interest % (from government surveys)
Payday Loan	443%
Installment Car Loans	18%
Credit Card	16%
Subprime Mortgages	10%

Information Treatment 2

Potential Problem: People fail to add up cost of single decision over time

Treatment 2: Present additive dollar costs of payday loan fees into future

How much it will cost in fees or interest if you borrow $300

PAYDAY LENDER (assuming fee is $15 per $100 loan)		CREDIT CARD (assuming a 20% APR)	
If you repay in:		If you repay in:	
2 weeks	$45	2 weeks	$2.50
1 month	$90	1 month	$5
2 months	$180	2 months	$10
3 months	$270	3 months	$15

Results

- De-biasing failure to add up DOLLARS over time reduces future borrowing by 10%. Not APR treatment
  - How: People saved more in the interim
    - Why I like that result: Economists forget that people are very constrained and can't make decisions in rates, but rather live month-to-month in dollar terms
    - But people do not go through exercise of thinking about the adding-up
- Paper advocates for
  - Understanding the specific cognitive biases that may lead to suboptimal decision-making
  - And subsequently designing some correcting or "de-biasing" information disclosure

Challenges of implementation (a sample of headaches)

- Implementation challenges:
  - Training store clerks to be uniform!
- Randomization details matter:
  - Stores not comparable, cannot randomize implementation by store.
  - Cannot randomize by customer, impossible for clerk to keep track
  - Randomize by day of the week, but need distribution across days of the week, because borrowers on different days of the week not random
- Estimation details matter:
  - Observations by store may not be independent (same shocks faced by location)

Why did the Lender agree to do this study?
Why do any companies want to do testing in partnership with unbiased academics or government researchers?

(1) Discussions with private sector about objectives must be done upfront

- Objectives are not to show that their product is great. They understand this.
- But they have a pre-determined view of what an unbiased approach will show. If you tell them that it may not show that. Then they want a veto right.
- Researchers must plan ahead.
  - I say: "The reason you are talking to me is because I have credibility for producing unbiased research. If you go to a research organization with an agenda, the credibility of the study will be questioned. You decide which you want."

Why did the Lender agree to do this study?
Why do any companies want to do testing in partnership with unbiased academics or government researchers?

(2) Essential to understand incentives

- The payday lender understood that I might find that disclosure reduces demand for their product because people acted differently in the interim to save for paying back the loan.
  - But maybe people would default less
  - And, besides, they were facing only negative media from researchers with a bias to show them to look bad
  - They needed to take a risk on unbiased research

Why did the Lender agree to do this study?
Why do any companies want to do testing in partnership with unbiased academics or government researchers?

(2) Essential to understand incentives

- Other incentives I encounter
  - Companies want to have research to genuinely evolve products to make people satisfied
    - Fine line: Some companies want to have research to evolve to cater to behavioral biases or lapses to make as much profits
  - Companies simply trying to learn from the engagement with a research team on how to think about testing and what skill sets they need to acquire

Final thought

- In consumer finance (and other fields), we are starting to learn about heterogeneities in people's use of products or information
  - Next slide (not covered in this presentations) has some examples
- Need to take next step:
  - Implement methods to test designs for "pareto" policy or product improvements across heterogeneity of people
  - I.e.: Make disclosure changes or regulator-governed product changes help some people with certain characteristics without hurting others
  - **** Requires understanding the heterogeneities (in use of a product and in understanding disclosure) and **then** designing remedies

Next generation: Use the literature on people's use of borrowing to improve product design

- Studies of why people get into trouble
  - Smoothing issues/making ends meet: Stephens(`03), Parsons van Wesep(`13), Leary Wang(`16)
  - Preferences: Laibson (1997), Meier Sprenger (2010), Kuchler (2012)
  - Neglect: Berman, Tran, Lynch, Zauberman (2015)
  - Aging: Agrawal, Driscoll, Gabaix, Laibson (2009)
  - Cognition/Focus: Morse Bertrand (2011), Stango Zinman (2011), etc.
- Studies of marginal use of income (helicopter drop studies)
  - Johnson, Parker Souleles (2006;2013 w McClelland); Agrawal, Liu, Souleles (`07); Bertrand Morse (`09)
- Studies of consumer loan contract form
  - 1980s literature Stiglitz Weiss, Hertzberg, Lieberman, Paravisini(`15); Carter, Skiba, Sydnor (`13)