Information Disclosure, Cognitive Biases, And Payday Borrowing

by Marianne Bertrand and Adair Morse

Comments by Jeremy Tobacman

Federal Reserve Bank of Philadelphia
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Summary of Paper

- Randomized field experiment; three treatments:
  - "APR Treatment": Disclose payday loan interest rates in explicit comparison to other interest rates (cf, "Coherent Arbitrariness," Ariely, Loewenstein, and Prelec 2003)
  - "Dollar Treatment": Disclose how fees accumulate for up to three months. Overcoming the "peanuts effect." Also, procrastination (O'Donoghue and Rabin 1999, 2001ab) is more severe when decision periods are short
  - "Refinancing Information Treatment": Direct de-biasing attempt about (average) future use: how long does it take to repay?
- (Crossed with a "savings planner" treatment)
- Randomization at the store-day level, across 77 stores and 12 days. Carefully balanced.

Summary, cont: Results

- Dollar Treatment: statistically significant reduction in subsequent borrowing frequencies, 54.2% vs. 48.7% per pay cycle over the next four months
- APR Treatment, Refinancing Information Treatment: smaller and insignificant on average
- Without the Savings Planner, effects in the expected direction: APR and Refinancing Info reduce subsequent borrowing by 4.2% and 3.2%, respectively
- Similar effects on loan amounts
- Savings Planner: Perverse effect of increasing subsequent borrowing under the APR Treatment
- Assessment: wisely designed, carefully implemented; informative about the effect of disclosures

Thought Experiment

- Generally TILA disclosures are provided *before* a borrower receives loan disbursement, so that the disclosures can inform the choice about the current loan offering
- Here the disclosures arrive *simultaneously* with the loan disbursement, inducing possible biases relative to the thought experiment
  - Time delay – underestimation in absolute value
  - Take the information home – overestimation
  - Cognitive dissonance – underestimation
    - Festinger and Carlsmith (1959) found that paying a small amount for telling a lie led to more subsequent belief in the lie than paying a larger amount. When actions and beliefs are in conflict, beliefs may be revised to decrease the cognitive dissonance
    - (Hundreds of papers since; Aronson: "We come to like things for which we suffer.")
    - CD effects may correlate with education, and with use for gratification

Size of the effect

- We can all agree that the point estimates here are statistically large
- Economically, how should we think about a reduction in subsequent borrowing from 54.2% to 48.7%?
- It's huge!
  - Can be implemented for zero marginal cost
  - A form of benign/limited/libertarian paternalism
- It's tiny!
  - After being confronted– quite baldly– with unattractive features of payday loans, almost half still borrow subsequently, in *each pay cycle*
  - Effect of the Dollar Treatment is biggest– and that does little more than perform multiplication
  - No effect for big borrowers

TILA and Payday Lending

- "The annual percentage rate shall be the nominal annual percentage rate determined by multiplying the unit-period rate by the number of unit-periods in a year." (12 C.F.R. Part 226, Appendix J)
- The key word is "multiplying"
- Payday lenders generally do not allow interest to compound, but borrowers have extended spans of indebtedness (~12 loans per year)
- Annualized cost of liquidity would use compounding
- Payday loans are often framed as "a finance charge of $15 per $100 cash," which sounds like a fee for a service

Wish List

- This is an excellent, highly informative paper.
  - Additional analysis is very interesting, on
    - The dynamic path of the effects
    - Heterogeneity across education groups, past payday loan usage, loan purpose, and self-control
- With arbitrary additional time, money, and cooperation with a lender, we might be interested in….
  - Longer period of follow-up
  - Measures of subsequent well-being
  - Information on borrowers' ex ante subjective expectations
  - Comparison of on-the-spot disclosures to explicit financial education