

Listening to Consumers: Informing the Regulatory Agenda

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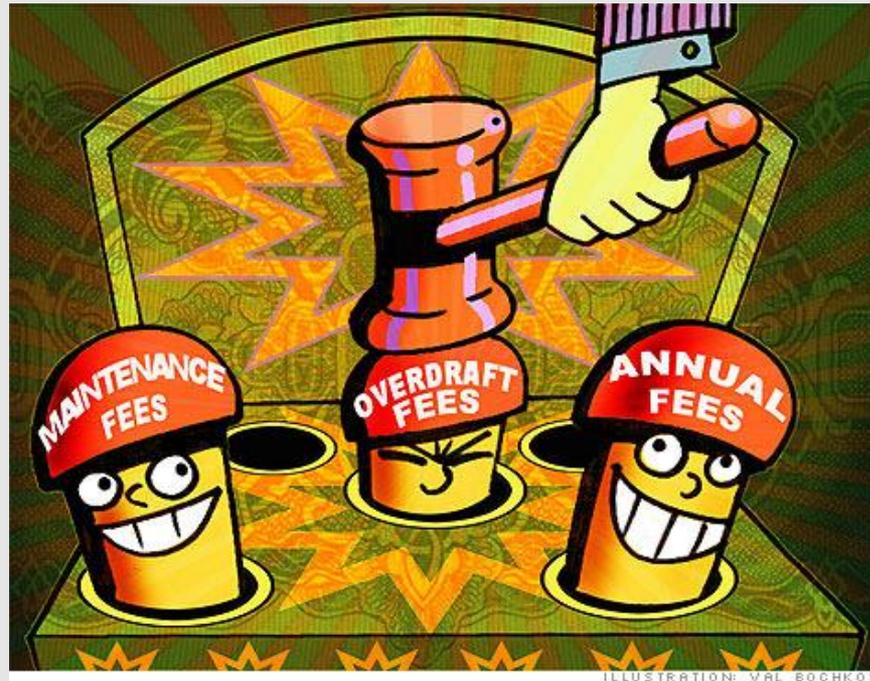
In conjunction with TNS



A critical time for consumer financial regulation and business practice

- **New sense of importance and urgency due to macro-economy**
- **Re-examination of many consumer financial regulations at all levels of government**
- **New Bureau of Consumer Financial Protection**
- **Changes in business models**

Managing without clear priorities....



CNNMoney.com, September 24, 2010

What should drive the agenda and set priorities? A surfeit of “P’s”

- **Power**
 - Profits
 - Promotion (advocacy)
 - Politics
- **Paternalism**
- **Principles**
- **People/Polling**

A. Principles of Consumer Financial Regulation

- **Market failures**
 - Regulate where markets and private transactions either fail or are inefficient
- **Distributional concerns (“fairness”)**
 - Regulate where outcome is inequitable for whatever reason
- **“Consumer Financial Protection” with John Campbell, Howell Jackson, Brigitte Madrian and Peter Tufano**

(1) Private markets need consistent rules

- **Benefits from enforcement of private financial contracts**
- **Without rules, hard to enforce.**
 - Many consumer financial transactions span both time and space
 - Continuous monitoring by customers not feasible
 - Reputation may be insufficient to discipline firms

(2) Externalities give rise to market failures

- **Externalities**
 - **Positive externalities**
 - Human capital
 - Home ownership
 - **Negative externalities**
 - Foreclosure
 - Correlated investment strategies and systemic risk
- **Regulation can directly intervene or force private parties to internalize externalities**

(3) High search costs and market power

- **Search costs can support market power**
- **Regulatory responses**
 - **Information provision**
 - Truth-in-lending-act disclosures
 - **Standardizing information provision**
 - APR
 - Mutual fund fees reporting in prospectuses
 - **Standardizing product provision (“plain vanilla”)**
 - **Direct regulation of prices (e.g. interest rate cap)**

(4) Information as a public good

- **Information as a public good**
- **Regulatory responses**
 - **Mandated information disclosure**
 - **Public information gathering and disclosure**
 - **Anti-fraud rules**

(5) Other informational failures

- **Other information failures (e.g. moral hazard or asymmetric information)**
 - Underprovision of credit
 - Underprovision of insurance
- **Regulatory responses**
 - Mandatory purchase (e.g. car insurance)
 - Public provision
 - Can generate moral hazard!
 - Public subsidies
 - Rules on disclosure/use of information

(6) Consumer cognitive limitations

- **Present-biased preferences**
 - **Internality: decisions of an individual today negatively impact the same individual in the future in a way that is not internally consistent and that implies future regret**
- **Regulatory responses**
 - **Taxes/subsidies**
 - **Placing limits on behavior**
 - **E.g. limit pre-retirement withdrawals from retirement savings accounts**

Cognitive Limitations

- **Cognitive limitations and financial literacy**
- **Regulatory response**
 - Financial literacy programs
 - “Nudges”
 - Portfolio restrictions
 - Personnel licensing requirements and fiduciary responsibilities
 - Product suitability requirements

Cognitive Limitations

- **Lack of self-knowledge**
- **Example: bank fee structure—“free checking” with penalty fees for overdrafts**
 - Naïve consumers purchase “too much” banking because they underestimate total cost
 - Naïve consumers subsidize sophisticated consumers who don’t overdraw their accounts
 - No market incentive to change fee structure or educate naïve consumers

System-wide implication of Cognitive Limitations

- **Trust: lack of trust in financial markets → avoidance**
- **Regulatory responses**
 - Capital requirements
 - Activity restrictions (e.g. limits on insider trading)
 - Product suitability requirements
 - Fiduciary responsibilities

Neo-Classical and Behavioral

Neo-Classical

- Facilitate Contract Enforcement
- Externalities (+/-)
- Search Costs/Market Power
- Information as Public Good
- Other Informational Failures

Behavioral/Cognitive

- Present Bias
- Cognitive Limitations (financial literacy)
- Lack of Trust
- Lack of Self-Knowledge

(7) Distributional Considerations: Fairness

- **Fairness**
 - Universal access
 - Price uniformity
- **Regulatory responses**
 - Limits on price discrimination
 - Mandates to serve market broadly (e.g. CRA)

Summary of Principle-Based Priority Setting

- **Identify long list of potential priorities**
- **List determined by theory**
- **But...no easy way to sort or prioritize**

B. A complementary approach: Listening to People

- **Polling informs political campaigns**
- **Market research informs product design**

- **Why not ask Americans about their regulatory “pain points?”**
- **Collect cross sectional data to see which problems bother which consumers**

Pros and Cons of Listening

- **Pro**

- Consumers have the day to day experiences
- Their information is current
- They can judge severity
- They can judge “fairness”

- **Con**

- They tend to have individual, not system-wide, perspective
- They may have incorrect or incomplete facts
- If they are cognitively challenged, may not be reliable observers

Preliminary results from “first” study

- **National study of Americans**
- **Internet-administered survey**
 - Weighted to be representative, up to a point
 - Need follow up survey to probe deeper and certain groups
 - N = 2276
- **Administered October 2010**

Rich cross sectional data on participants

- **Traditional demographics**
 - Gender, Age, Education, Race, Employment Status, Household Situation, Children, Income, Financial Assets
- **Financial Fragility (Lusardi, Schneider and Tufano with TNS)**
 - Can you come up with \$2000 in 30 days?
- **Overindebttness (Lusardi and Tufano with TNS)**
 - I have no debt; can handle my debt; ...
- **Debt literacy**
 - One question on interest charges on credit cards
- **Financial experiences**
 - Types of financial products currently use

Two sets of questions

- **Overall satisfaction with protection by laws and regulations**
- **Identification of pain points: Elements of the financial system with which they are dissatisfied**

Overall Satisfaction with Financial Regulations

- “To what degree do you think that your household’s financial interests are appropriately protected today by laws and regulations?”

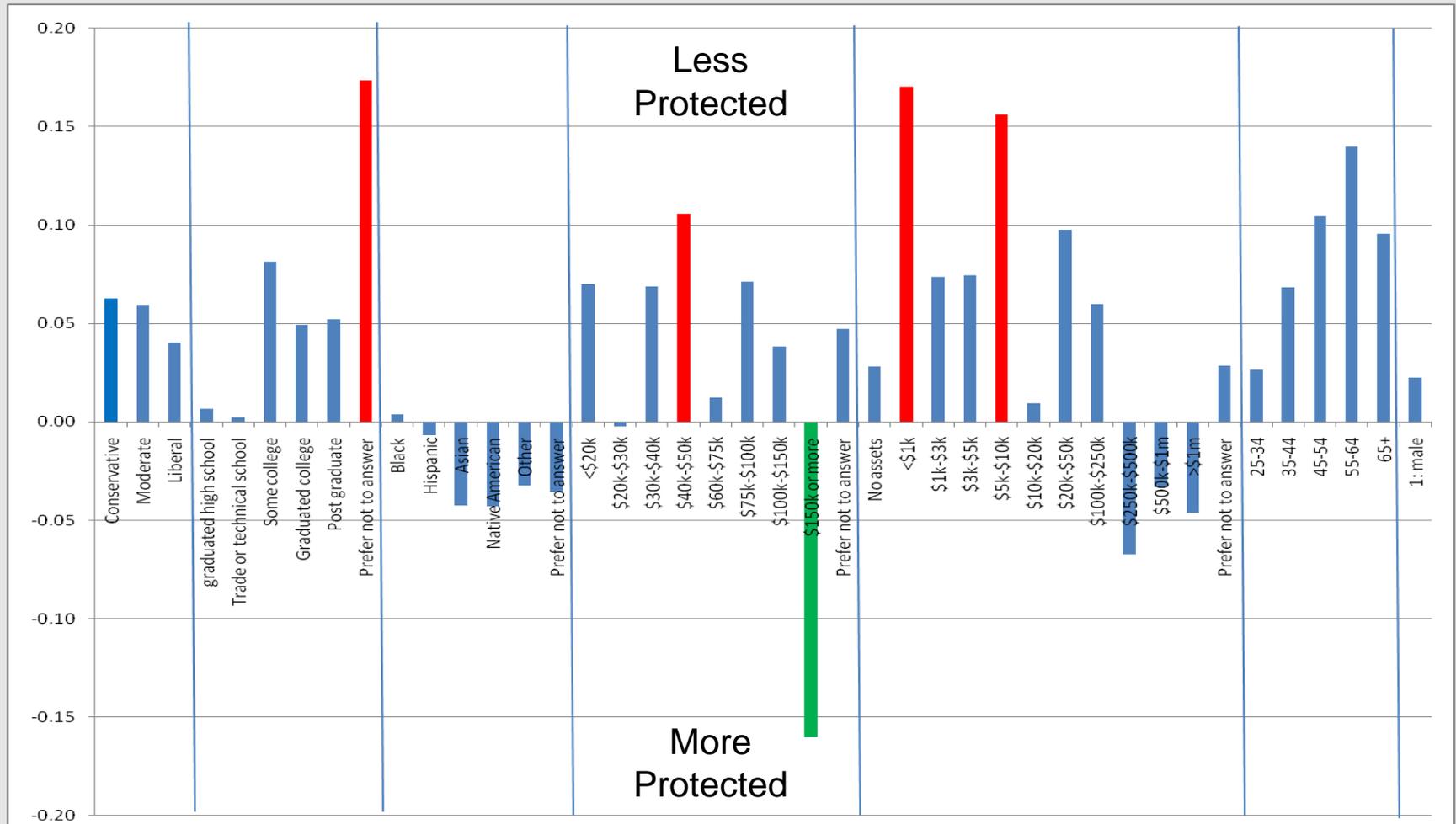
- **Appropriately protected** 46%
- **Neither** 27%
- **Not appropriately protected** 28%

- Internet survey methodology bias ?
- Is this level acceptable ?

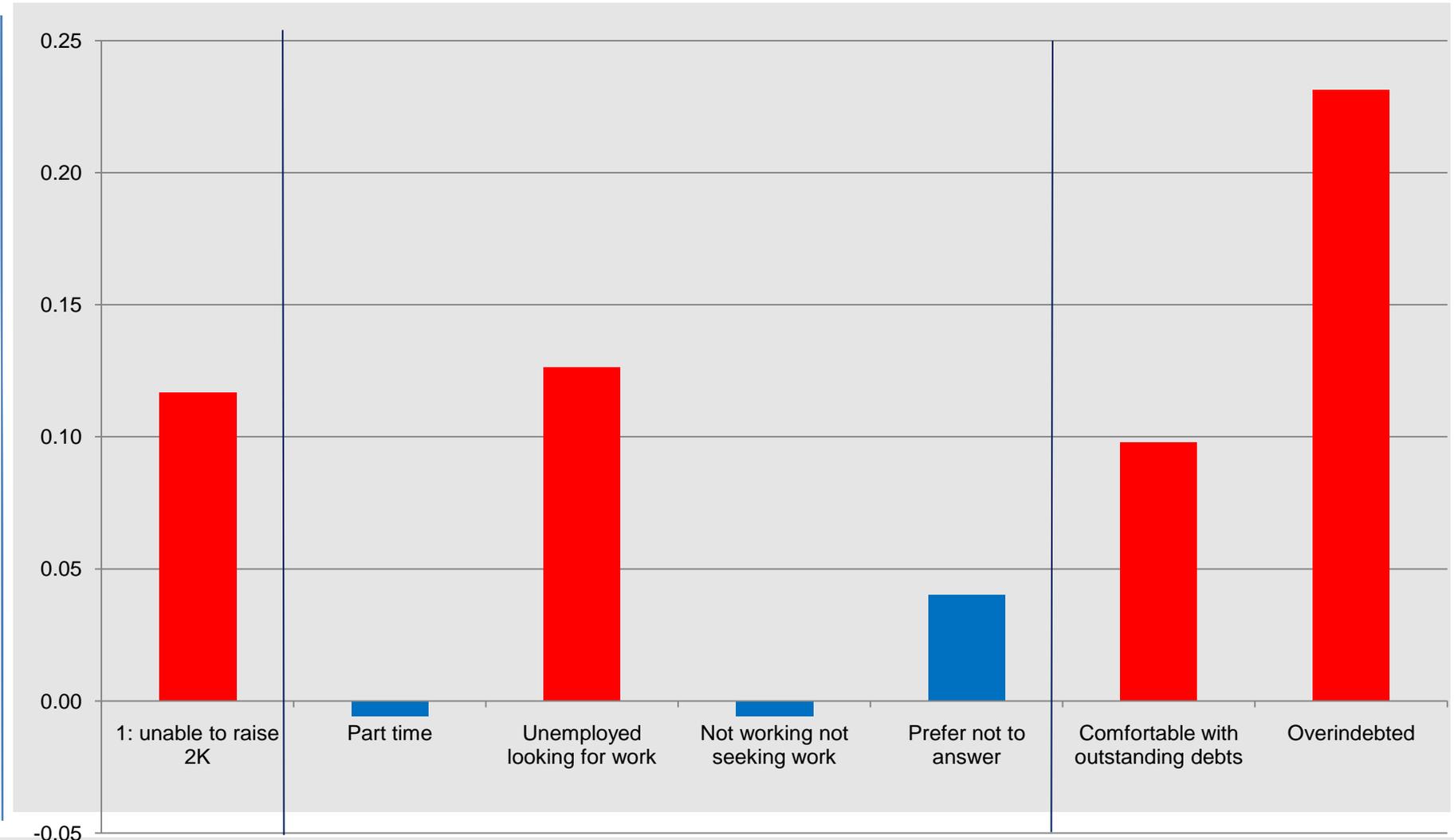
Cross Sectional Variation in Dissatisfaction

- **What do you expect would drive levels of dissatisfaction?**
 - Usage of certain types of products?
 - Income and wealth?
 - Financial fragility?
 - Overindebtedness?
 - Debt literacy?
- **Univariate differences and “kitchen sink” approaches**
- **Marginals: Percentage point increase in dissatisfaction**
 - Show for P-values < 0.05 for univariate (but robust in multivariate specifications.)
 - Overall, explain little total variation

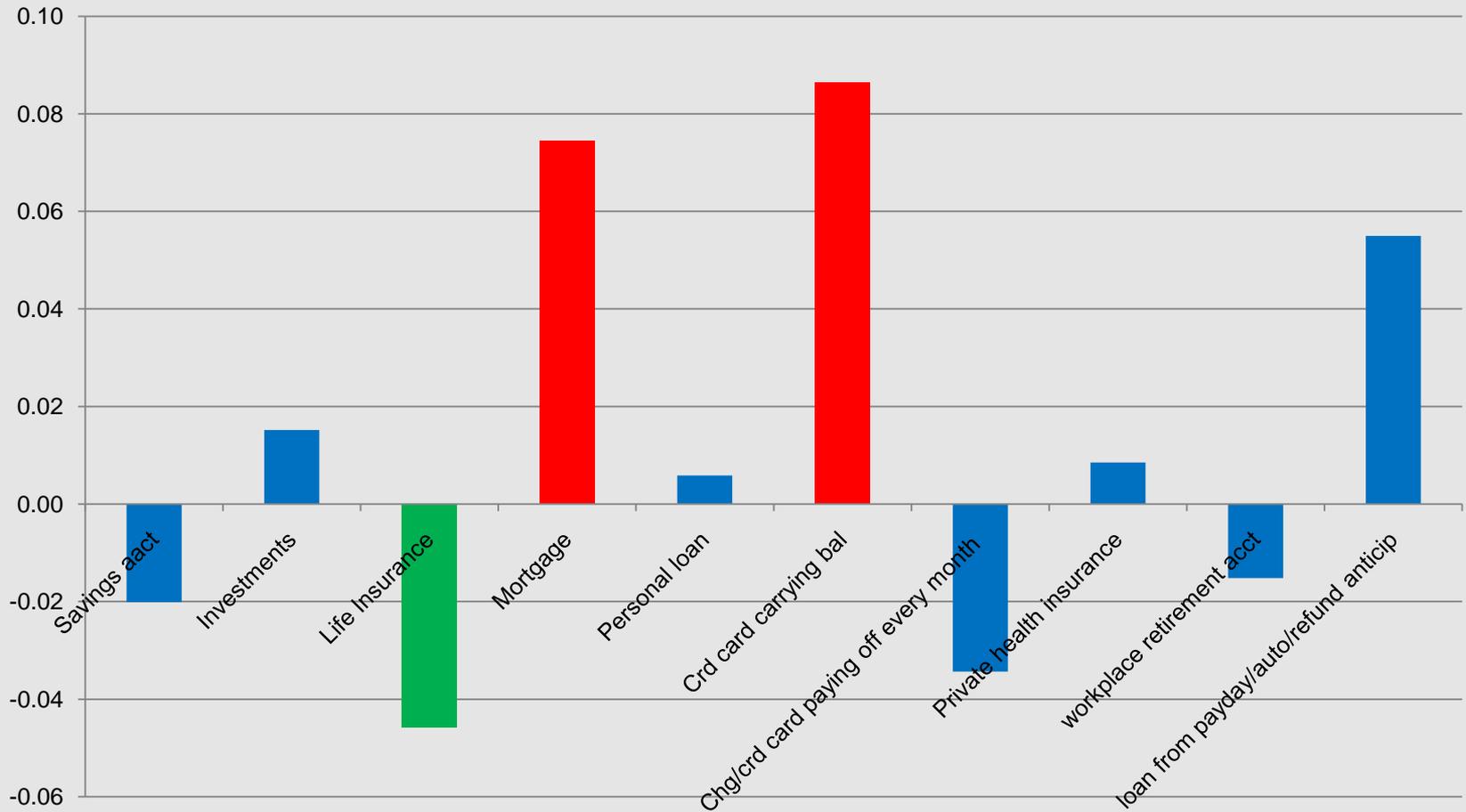
Relatively few differences among traditional demographic breakdowns



But considerably greater dissatisfaction among the financially fragile...



And among users of various credit products...



Who feels less well protected?

- **Financially fragile people**
 - Little ability to cope with emergencies
 - Over indebted
 - Unemployed
- **Have credit cards and mortgages**
- **Traditional demographics not so informative, but still overall predictability is low.**

Identification of specific pain points

- **“The financial landscape is likely to change over the coming years. Independent regulators and businesses will be carefully examining many issues to determine where they should focus attention. Suppose you could talk directly to them about how satisfied you are with the current financial landscape, as it relates to credit cards, personal loans, mortgages, banking, credit scores, debt management, investments, retirement accounts and financial skills and advice. For each of the following (46) choices, identify how satisfied you are...”**

Examined 46 possible pain points

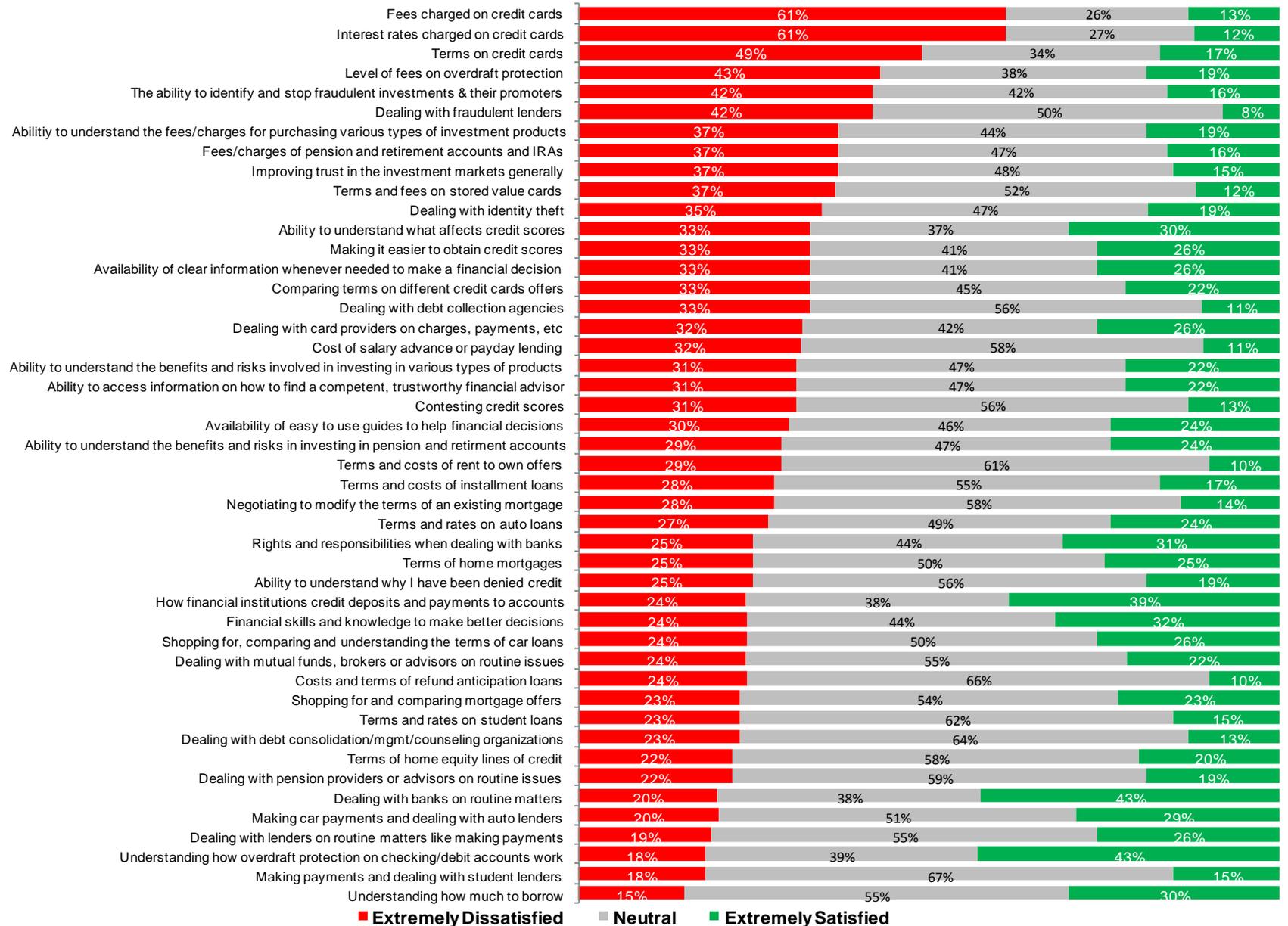
- **Roughly divided into two dimensions:**
 - **Types of products: credit cards, personal loans, mortgages, banking, credit scores, debt management, investments, retirement accounts, financial skills and advice**
 - **Cost, terms, service levels, fraud, understanding**

	Cost	Terms	Service	Understanding	Fraud
All Credit					
Credit cards					
The terms on credit cards			x		
The interest rates charged on credit cards	x				
The fees charged on credit cards	x				
Dealing with card providers on charges, payments, lost cards, etc.			x		
Comparing terms on different credit card offers				x	
Personal loans					
The terms and rates on auto loans	x	x			
Shopping for, comparing and understanding the terms of car loans				x	
Making car payments and dealing with auto lenders			x		
The terms and rates on student loans	x	x			
Making payments and dealing with student lenders			x		
AFS					
The costs of salary advance or payday lending	x				
The terms and costs of installment loans	x	x			
The terms and costs of "rent to own" offers	x	x			
The costs and terms of refund anticipation loans	x	x			
Mortgages					
Shopping for and comparing mortgage offers				x	
The terms of home mortgages			x		
Dealing with home lenders on routine matters like making payments			x		
Negotiating to modify the terms of an existing mortgage			x		
The terms of home equity lines of credit			x		
Credit scores					
The ability to understand why I have been denied credit				x	
Making it easier to obtain credit scores				x	
Understanding how much to borrow				x	
The ability to understand what affects credit scores				x	
Contesting credit scores				x	
Debt coll/consol					
Dealing with debt collection agencies				x	
Dealing with debt consolidation/management/counseling organizations				x	
Fraudulent lending					
Dealing with fraudulent lenders					x

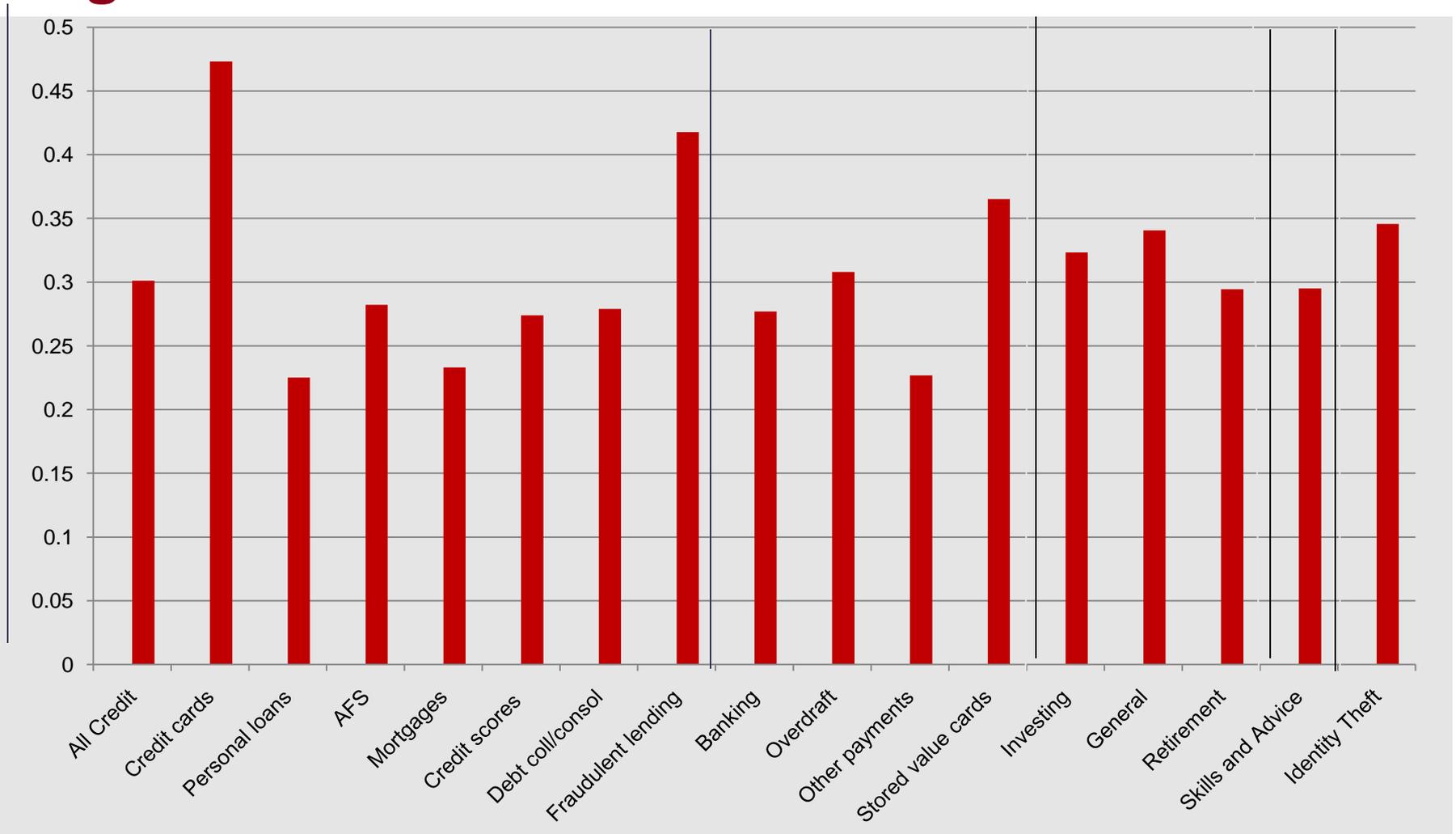
	Cost	Terms	Service	Understanding	Fraud
Banking					
Overdraft					
Understanding how overdraft protection on checking/debit accounts work					x
The level of fees on overdraft protection			x		
Other payments					
How financial institutions credit deposits and payments to accounts					x
Rights and responsibilities when dealing with banks					x
Dealing with banks on routine matters, e.g. about errors on your statements					x
Stored value cards					
The terms and fees on stored value cards					
Investing					
General					
The ability to understand the benefits and risks involved in investing in various					x
The ability to understand the fees/charges for purchasing various types of		x			x
The ability to identify and stop fraudulent investments and their promoters					x
Dealing with mutual funds, brokers or advisors on routine issues					x
Improving trust in the investment markets generally					x
Retirement					
The ability to understand the benefits and risks involved in investing in pensions					x
The fees/charges of pension and retirement accounts and IRAs		x			
Dealing with pension providers or advisors on routine issues					x
Skills and Advice					
The financial skills and knowledge to make better decisions					x
The availability of clear information whenever needed to make a financial decision					x
The availability of easy to use guides to help financial decisions					x
The ability to access information on how to find a competent, trustworthy financial					x
Identity Theft					
Dealing with identity theft					x

Dis-Satisfaction with Current Financial Landscape

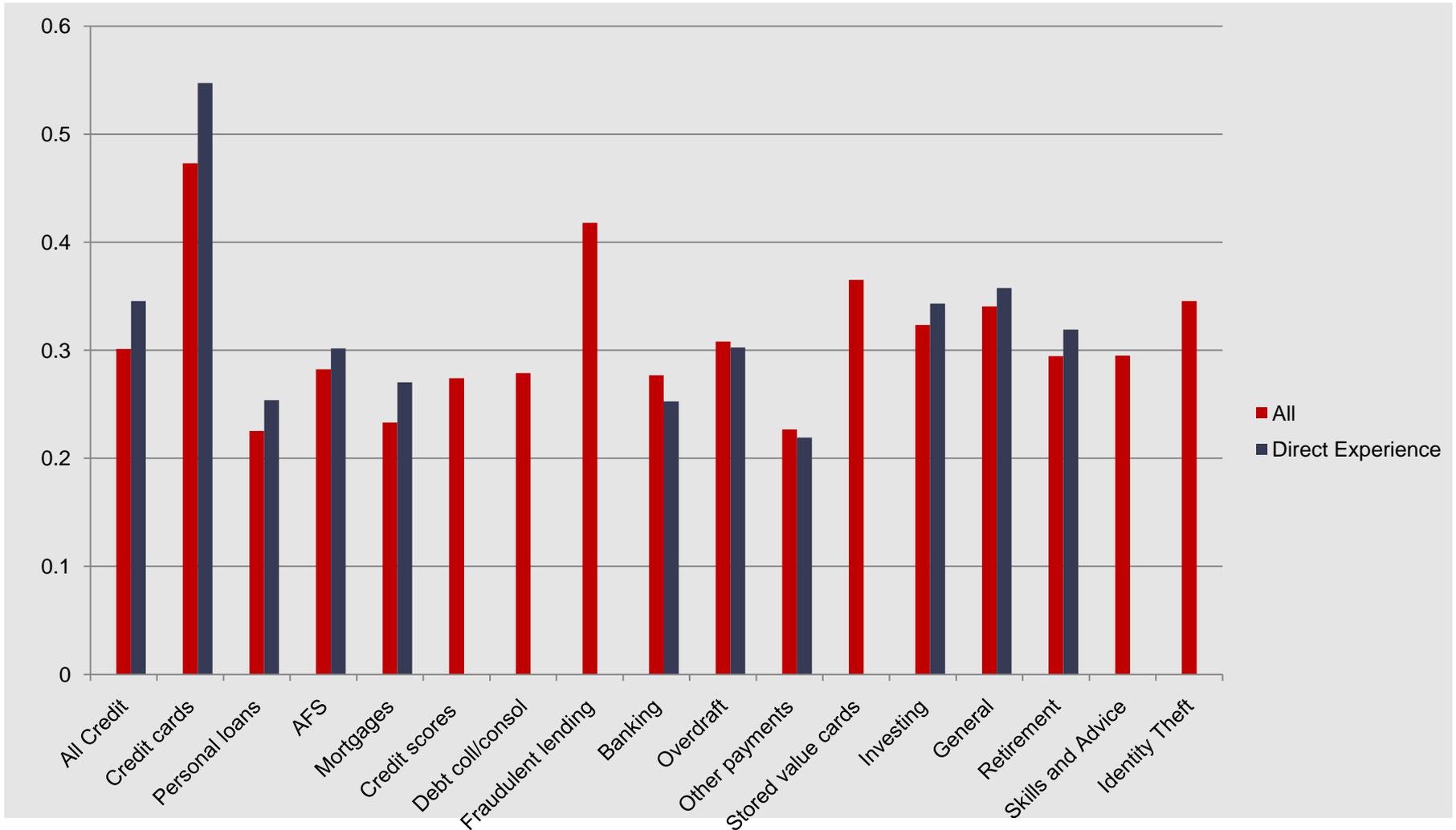
Total Population, aged 18-64



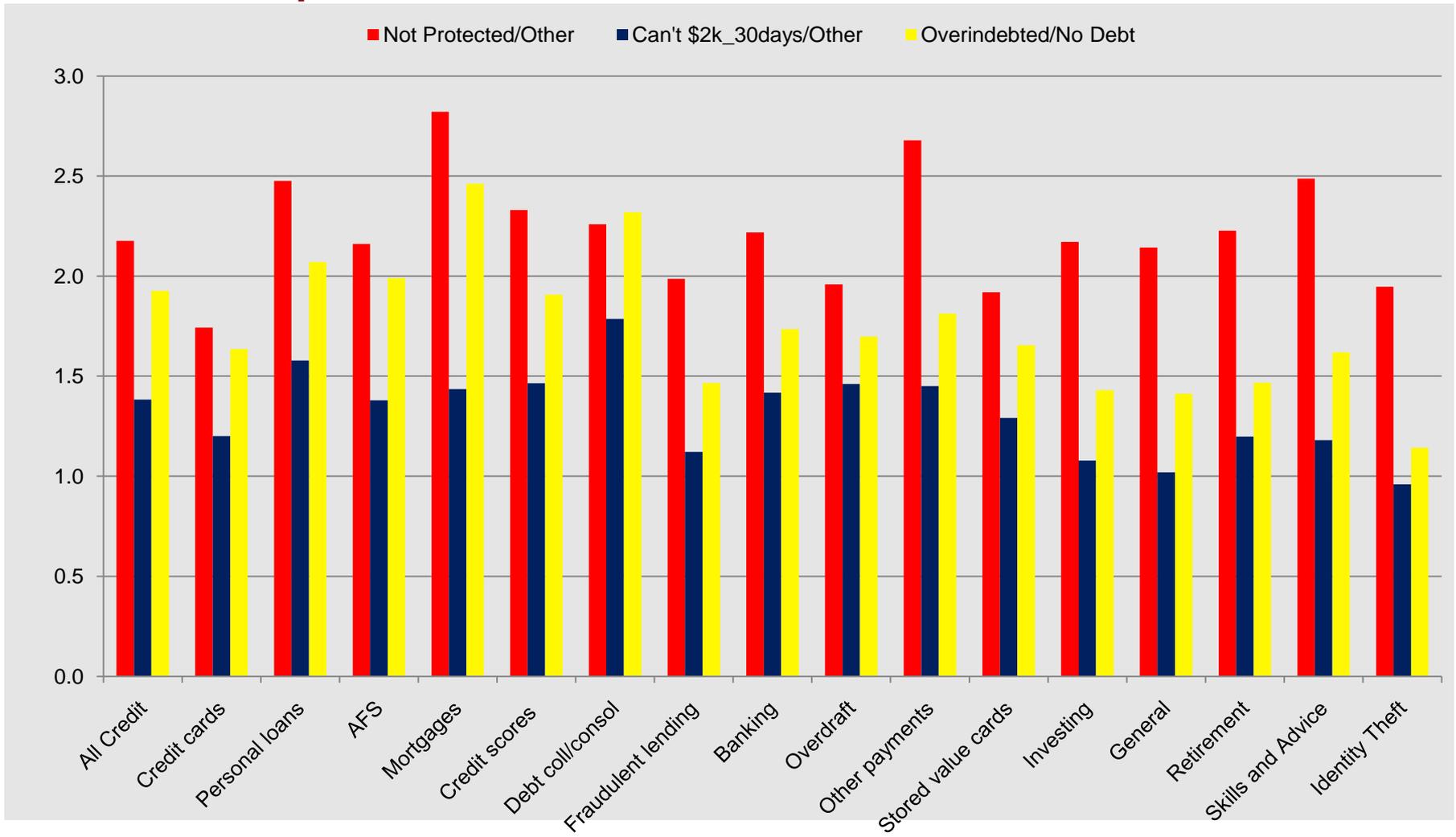
Dissatisfaction Percentages *by Product*: Highest for credit cards



Those with direct experience are *generally* similar to others



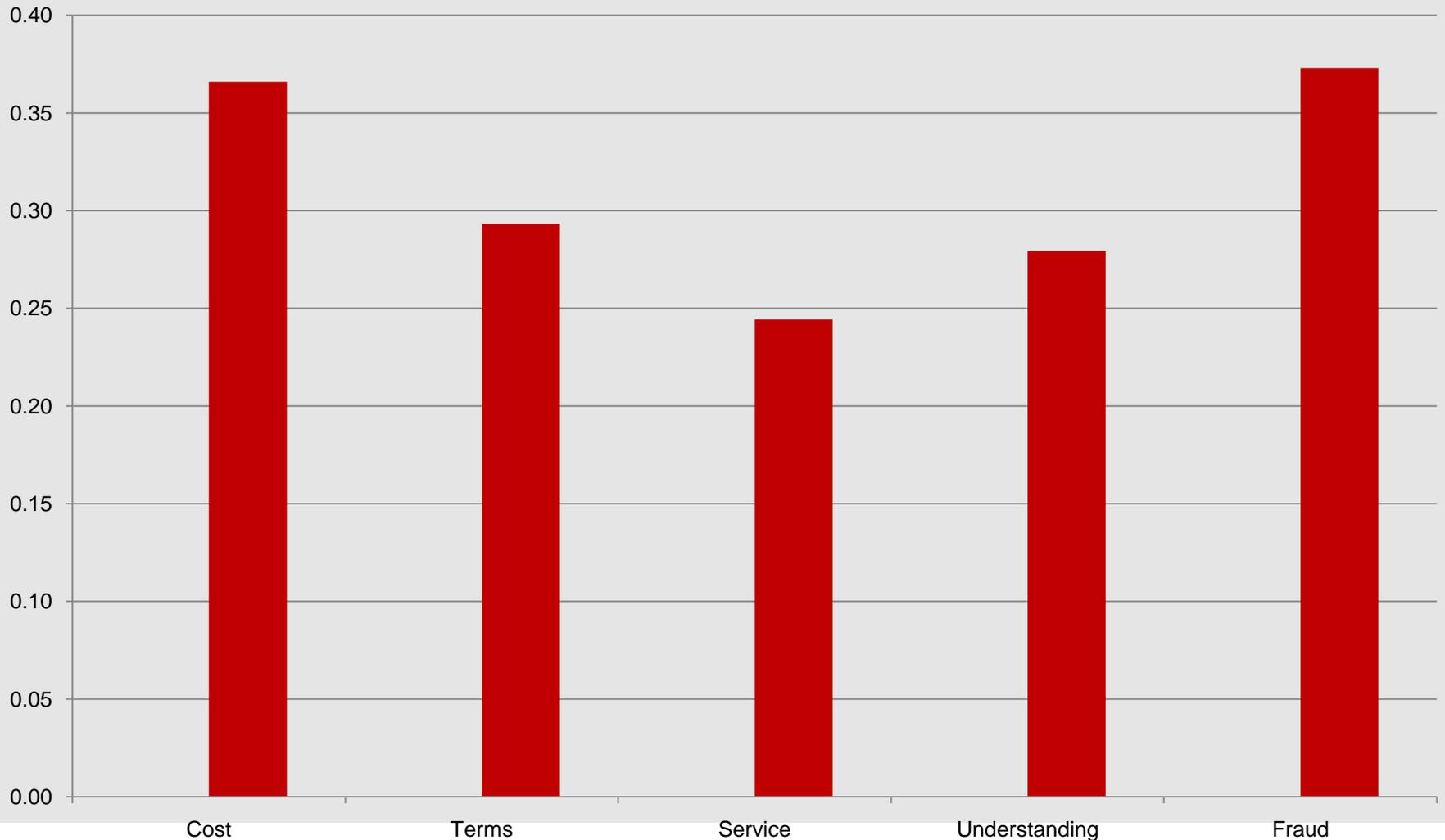
Relative Dissatisfaction Ratio = $(Dis\%_{Group1}) / (Dis\%_{Other})$



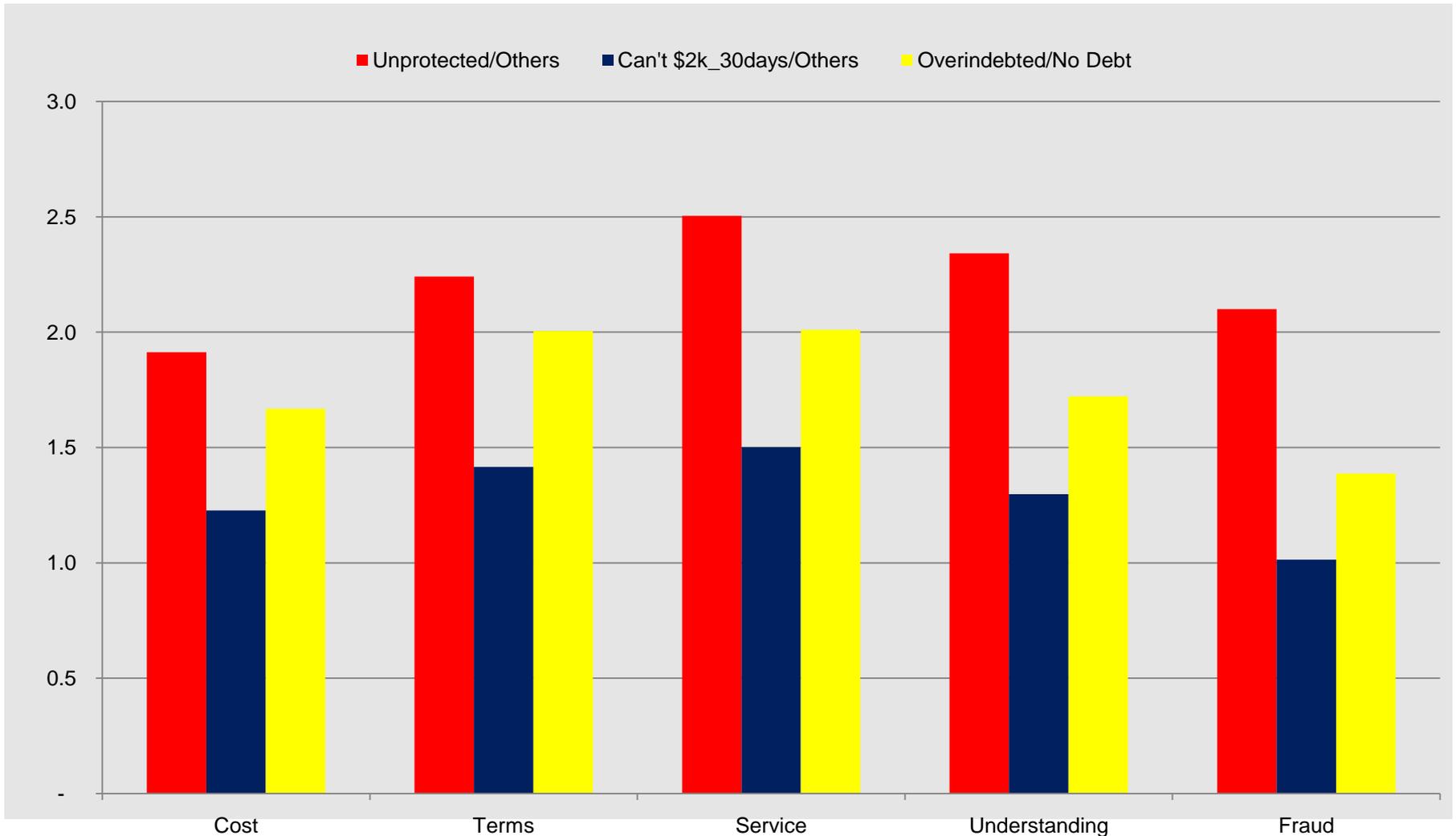
Type of fragility and top relative pain points

- **Generally unprotected:**
 - Mortgages, general banking, personal loans, getting advice
- **Can't raise \$2k:**
 - Overdraft, debt collection/consolidation, personal loans
- **Over indebted:**
 - Mortgages, debt collection/consolidation, personal loans

Dissatisfaction Percentages *by Element*: Fraud, followed by Fees and Costs



Fragile are less satisfied by elements: Dissatisfaction Ratio of Fragile/Others



Identify people who feel unprotected generally and dissatisfied in particular...so what?

- **Preliminary findings: Role for additional research**
 - Oversample among non-internet groups
 - Deeper investigations into specific issues
 - External validity
- **Role for policy judgment**
 - Whose problems matter most?
 - How much do you care about what people say?
- **Metrics: How would you measure the “success” of CFPB?**