Consumer Information Processing and Mortgage Disclosures

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Not a Mortgage Expert

- Have done no research on mortgage decisions
- "Consumer psychologist" / "behavioral economist" studying consumer information processing
  - Study biases in memory, attention, perception below awareness
  - Key themes are how choices are determined by influencing
    - Consideration set – which alternatives out of hundreds are actively considered
    - Selective activation of criteria for evaluating considered options
  - Also study how information changes markets & consumer welfare in work on effects of internet shopping. Effects driven by changing consideration sets & comparisons among considered alternatives
- Recent work on "intertemporal choice" – preference for smaller sooner over larger later rewards & larger later over smaller sooner costs
  - e.g., "discounting" of some future resource a function of (mis) perceptions of opportunity costs of that resource now vs. in the future
  - Now applying this theory to procrastination in saving for retirement

Mortgage & Retirement Policy Contrasts

- Focus of our panel has been on information remedies for errant mortgage decision making

- In retirement arena, trend is to help consumers by providing *less* information, not more or better information

- Thaler & Benartzi (2004) Save More Tomorrow ™
  - Ask people to precommit to save future raise money for retirement
  - Increase annual savings from 3.5% to 13.6% over 40 months

- Choice architecture (Thaler & Sunstein 2008)
  - "smart defaults" – auto-enrollment in life cycle fund with opt out
  - Limit 401-K plan choice (Iyengar, Huberman, Jiang 2004)

What's Different?

- In retirement savings, key mistakes are errors of omission (fail to choose & procrastinate)
  - Hence, make it simple to act
- In mortgage decisions, key mistakes are errors of commission
  - choose wrong loan or more house than one can afford given shocks
- In retirement, employers play key role as benevolent agent steering employees choices
- For mortgages, no benevolent agent, lots of self-interest for sellers to exploit consumers' information overload

Consideration Sets, Screening & Comparison

- For a mortgage option to be chosen
  - It has to be considered
  - Buyer must not consider better liked option
  - Choice outcomes far more influenced by content of consideration set than by processing of considered alternatives
- Can FTC or HUD affect enhance competition & welfare by affecting consideration stage – e.g., personalized screening agent website for best alternatives in region?
- Complex comparison tables don't help unless alternatives very similar (Lynch & Ariely 2000)
  - Hence, won't help compare 30-year fixed to balloon mortgage
- Screening agents reduce dimensionality by
  - boiling down comparisons to a single number
  - Making it easier to consider good rather than bad options
- Improved disclosures solve none of these problems

Nudges

- Changes in choice contexts & defaults to make the most likely mistakes less likely
  - *Not* education

- Most useful when decisions:
  - Hard
  - Infrequent
  - No feedback
  - Don't know our preferences
  - Markets won't correct mistakes

- Can benevolent smart agent arrange better choice context?
  - Screening for best options
  - Simplified comparison
  - Warning signs about risks
  - Pseudo-feedback to make pitfalls salient

Richard H. Thaler
Cass R. Sunstein

Nudge

Improving Decisions
About Health, Wealth,
and Happiness