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Becoming Behavioral Regulators

Federal Trade Commission Economic Conference on Marketing and Consumer Protection

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Columbia Business School –Marketing and Center for Decision Science

Consumer Financial Protection Bureau (Usual Disclaimer Applies)

Federal Trade Commission Economic Conference on Marketing and Consumer Protection

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Agenda

- Introduction: Why be behavioral?
- A contrast from Mortgage Decision Making
- Observations about Disclosure

If we are not behavioral, we ignore…

- Empirically grounded models of Time Preferences
- Empirical models of Risk Preferences
- Limitations on Information Processing
- Traditional analysis of market failures are often attributed to lack of information.

- Result can be regulations that produce unwanted consequences.
- These can not only produce reductions in social welfare, but have the perverse effect of harming more vulnerable consumers the most.

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Time Preferences, Being Underwater and Walking Away

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Stephen A. Atlas

John W. Payne (JMR, in press)

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Choosing between an ARM and a FRM is an Time Preference Problem: A principle agent vs. a behavioral analysis. (Mayer and Johnson, 2011)

Characteristics of a 2/28	Characteristics of a 30 year fixed.
Low initial payments 7.6% $1000	Higher Initial Payments
Move into the house soon	Need to save first--$15000-$30,000: 10-20% down
No Money Down	No prepayment penalty
Payments will increase (Libor + 6.25%) 11% or $1400	I'm okay if I can afford the house now
I can refinance when prices go up	Future does not depend on me improving.
I can clean up my credit act	

Results:

- Setup: Using representative surveys *and* a sample of mortgage holders, we measure time preferences using a quasi-hyperbolic discounting model (Laibson, 1997, DEEP, Toubia, Johnson, Johnson, Evgeniou and Delquié, MS, 2013)
- Build a 'toy' model that suggests:
  - Present Bias and impatience will be more likely to choose adjustable mortgages
  - They will more likely be underwater
  - *BUT* they will be less likely to walk away from that mortgage (see Della Vigna and Passerman 2005)
- Results: Confirm all three hypotheses (3SLS, Present bias *reverses sign*).
- Consistent with the observation that HARP 1.0 was a failure.

Privacy and Disclosure

- Privacy is an *assembled* value
  - Much affected by defaults.
  - People want it all:
    - Customization
    - Anonymity

Figure 1. Checkbox format questions for participation in health surveys.

No-Action Question	Default	Participation
1. Notify me about more health surveys.	Not Participate	48.2%
2. Do NOT notify me about more health surveys.	Participate	96.3%

From Bellman, Johnson and Lohse, CACM, 2001

- Disclosure is providing information not otherwise easily available
  - It can have perverse effects: “Now that its disclosed, I think the discloser is ok.”
  - It raises processing costs, can have differential effects (Ben-Shahar and Schneider, 2011)
- Solutions? *Lower* processing costs using choice architecture.