Pricing, Consumer Behavior and Public Policy in Household Finance

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A Big Question in the Wake of the Crisis

- What constitutes sound public policy toward banks and other financial service providers?
  - Activities in which firms can engage
  - Information/disclosure from firms to consumers
- Tremendous political pressure to <u>do something</u> right now:
  - Rule-making and laws (CARD Act, overdraft opt-in)
  - Reorganization/broadening of regulatory authority (CFPA)
- The critical question: do we know enough about how consumer financial decision-making to understand the costs and benefits of these changes?

Two Views

- “Consumer confusion relating to inadequate price and fee information is likely to arise more frequently…”
- “In recent years there has been an explosion in competition and innovation…Consumers have reaped substantial benefits in the form of greater choice and lower prices.”
- Not a debate unique to payments/banking!

Why the Complexity/Confusion?

- <u>Technological</u> innovation has spurred innovation in how banks/firms <u>price</u> services/products
  - Fees-for-service as driver of revenue (e.g., overdrafts)
  - Finer risk-based pricing (credit card penalty rates)
  - More "nonlinear" prices (e.g., checking account fees)
  - More complex "menus" of prices (e.g., on checking accounts)

- The tradeoff for consumers: increased choices, greater complexity
  - No clear answer about net effects on consumers
  - Nor, a clear answer about what to do on the policy front

Two Preliminaries Informing the Debate

1. We believe that many consumers make decisions that seem bad after the fact, but we do not know much about:
   - Why they make such decisions
   - Which consumers make those decisions

2. Traditional policy tools may fail to improve matters or make them worse
   - Price controls: often have adverse consequences
   - Mandated disclosure: a “more information is better” approach may not solve the fundamental problem (complexity) faced by consumers

Some New Evidence on "Bad Decisions"

- "What Do People Really Pay on Their Checking and Credit Card Accounts?", Stango and Zinman, *American Economic Review* (May 2009)
  - Uses new administrative data set covering millions of checking and credit card transactions, thousands of statements, thousands of panelists
- Primary finding: people seemingly leave lots of money on the table in day-to-day household finance
  - Not necessarily left by the natural suspects (e.g., the rich leave more than the poor)
  - Why do we see this? What to do?

Some New Evidence on Information/Disclosure

- "Limited Attention, Salience and Checking Overdrafts," Stango/Zinman working paper

- How does sending consumers simple and non-informative reminders affect the likelihood of overdrafting?
  - One-shot reminders have a temporary effect that dissipates very quickly
  - A series of reminders (3 or 4/year) has a stronger and long-lasting effect

- What does this imply for public policy that favors one-shot (data-rich, complex) disclosure?
  - Or, for firms that compete in part on helping consumers avoid mistakes?

Conclusions

- Complexity in pricing for payment/financial services is a natural by-product of technological innovation
- The tradeoff: choices/innovation vs. complexity/confusion
- We are just now starting to answer the essential questions about consumer behavior
- Even then, the correct policy response may be non-standard relative to what has been done in the past