

Becoming Behavioral Regulators

Federal Trade Commission Economic Conference on Marketing and Consumer Protection



Eric J. Johnson

Columbia Business School –Marketing and Center for Decision Science

Consumer Financial Protection Bureau (Usual Disclaimer Applies)

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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.





Time Preferences, Being Underwater and Walking Away

Eric J. Johnson

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

AT THE VERY CENTER OF BUSINESS

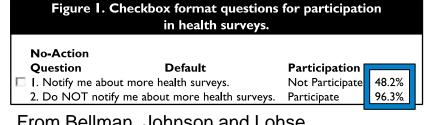
Results:

- 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



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.

