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Lessons Learned from Recent Board Consumer Testing Products

Ellen Merry:
Thank you. As Jeanne mentioned, this is work that is drawn from a paper that we've written. We hope it will be out in a Bulletin article in a few months. It's trying to synthesize at a very high level a lot of consumer testing research that the Board has done. I think I counted up and it's somewhere on the order of, you know, a dozen or 18 or so different reports. So obviously, I'm not gonna be able to cover a lot of details. It is a pretty high level kind of thing. If you're interested, this stuff is buried in press releases on our website. We can send you an electronic list if you're curious about some of this work. But I think you'll hear in some of this, and I'll try to point out some links back to things that have already been discussed this morning. So some of these ideas are--that we've been discussing today are making their way in the policy, but more of them need to. And so, I hope--I'm offering this in the spirit of we're gonna have this discussion time in the afternoon. So sometimes, providing concrete examples can spur different kinds of thoughts, and hopefully, that will do this for us today. Of course, I have to issue the normal disclaimer that everything I'm saying is just my opinion even though I'm talking about Board product—projects, I'm not speaking for the Board or for the staff in any of this.

Alright, background, a lot of you are familiar with regulatory development work, but some of you aren't. So let me give you a quick overview of the kind of thing that--why we're doing this and why I'm talking about it. The Board--and we've already talked this morning, Susan talked at length about the privacy notices project which is an interagency project. So sometimes, we're working with other agencies, has worked in recent years on required disclosures for a number of different financial products: credit cards, mortgages, this privacy we've already talked about, overdrafts, private student loans, payroll cards, leasing. Why are we doing this? Delegated authority. So in the past, we've had delegated authority from Congress for Truth and Lending Act, that's a really big one, that's what's driving this credit card and mortgage work. But a number of other acts as well--Susan mentioned Gramm-Leach-Bliley.

How? We've already—also alluded to methodologies a little bit. I won't talk in detail about that. But qualitative methodologies, we’ve used focus groups and interviews, this kind of iterative design process for developing disclosures. As well as quantitative--to date, the methods we’ve used quantitatively have been mall intercept, and there have been two of those. One is in the privacy notices project that Susan was talking with--about, and the second one was in the credit card study. But the bulk of what I'm talking about here is really coming out of the qualitative iterative development process. And let me also just make a parenthetical remark that some of these projects, you know, take a long time, a number of years. Sometimes they happen in a short period of time and that's sometimes because the law requires that they happen in a short of period of time. Yeah, there are laws that get passed that says the Fed will in the course of the next year do X. And so, sometimes, that affects your research design when Congress has set a hard deadline on you.

Alright, lessons learned. So these are some of the things that we talk about in the paper. I can't actually give you examples of all of them in the time that I have here, but it gives you a flavor for the kinds of examples that I'm gonna show. So we've been working--the Fed, as you might imagine, you know, has a lot of economists and a lot of lawyers, but--and we've been working with outside market research firms that have expertise in design and the plain language to help us implement some of the requirements of the law and try to make disclosures more useful to people. So we're--you know, finding that plain language really helps, I'll give you an example of that, but it's not all there is to this business, you know. And design helps, context, providing context for people, I'll talk a little about neutrality. Standardization is a great idea, and we're starting to delve a little bit into that. But sometimes standardization can obscure things that you really want people to be able to differentiate. I won't have time to talk about online and the privacy notices project, but as the first foray into sort of moving from what has been a print disclosure, but all the other stuff we’ve done has been print--into an online form. Less can be more, it's just talking about information overload. And I'll mention--you know, there are cases when we’ve--basically, disclosure hasn't worked, so we had to go with other [inaudible].

Credit cards, let me give you a couple of examples here. So back in 2006, we started working on the TILA--the testing associated with the credit review, and this is a credit card solicitation, the new one, the revised one. A couple of points about this. One, design. When we--in the initial testing we tested the credit card disclosure that was then in use and found that people recognize this distinctive tabular structure, sometimes dubbed the Schumer box. And it worked pretty well, so we stuck with it. And one of thing that came out of the testing was that people really, really gravitated towards the box. And so, when you put things in the box, they noticed it; when you left things outside of the box, they got a little bit more neglected.

There were some changes that came out of the testing though. Breaking the box into two parts, separating the rate and fee information and grouping it, that was one of the results of the iterative testing that improved comprehension. One thing that used to be in the box but moved out was the balance calculation method. In terms of the consumer decision making, that was not as important as some of the rate and fee information. So it was--rather than giving it prime real estate in the box, it got moved out outside of the box.

Now, one other comment about balance calculation and the limits of plain language kinds of work, there was a balance calculation method called double cycle billing that we tried at various attempts at plain language explanations for what this thing was, and it never really worked really well. So in the end, the Board decided that a disclosure wasn't gonna be effective for communicating that content, and they decided to ban that particular billing practice. So that's an example of--disclosure isn't the right answer for every problem and we have other examples of things we've tried that haven't worked, but that's one in the context of credit cards.

Here's a plain language example that I think is kinda interesting. So prior to the implementing these changes, firms would sometimes refer to the rate that you would be charged if you were late or go over your credit limit, as the APR you'll be charged, as the “default APR” for going--like going over or something like that. But people in testing interpreted that sometimes as meaning like the default setting on your computer, like the standard setting, so the terminology “penalty APR” was a clearer way of communicating that content.

In the interest of time, let me skip over those and go onto privacy notices. Now, Susan's already talked about this in depth, but I wanted to use this to kind of contrast the issue of choice architecture, and we referred--that's come up a number of times this morning. And Susan noted in her remarks that the law gave consumers the right, the banks had to offer them the right, to opt out of certain types of sharing arrangements. So note that in the--and then was a lot of effort extended on this table in sort of making it neutral within that opt out structure. But the point I wanted to make is that the law in this case set up a particular right, that it was structured as an opt out. Now contrast that with the case of overdrafts. So when we were doing the overdraft testing, the issue that we were wrestling with was--had to do with--yeah, how do people want their overdrafts handled. There are a couple of issues we have to wrestle with. One is that this is not about--this is about banks overdraft practices if you don't sign up for any kind of special plan--not a linked savings account, or line of credit or things like that. And that was the first hurdle that we had to cross, was helping people to understand this is about what will happen to overdrafts if you don't sort of elect to get into a plan. So we had to--first of all that's part--I don't have it marked, but we had a sort of--what is this disclosure about problem that had to happen before explaining the options. But in talking to people about how they wanted their overdrafts handled, a lot of people in the testing said, well, they would like to have, you know, big things like their mortgage check or recurring utility payments, they'd like the bank to pay those if they were gonna go over. But they didn't want the bank--they would rather their transaction be denied if they were at an ATM or if they were at Starbucks, you know, buying a cup of coffee, what we dubbed in these disclosures every day debit card purchases. So--but the law didn't set up a particular right, opt in or opt out in this case, and banks had different practices about how they would handle such transactions. So in order to structure a disclosure, we had to first create a right, you know, if you want this--and that involved the attorneys sort of writing rules that basically created a right for an opt in. The default was ATM and every day debit card transactions would not be covered, unless--if the bank wanted to offer it, they would have to offer it as an opt in kind of thing. So point is that choice architecture could happen, but sometimes, the law dictates the way it is, sometimes you have to learn what preferences are, and that--then that has--that takes some extra work before you ever get to the disclosure.

Now, everything that I've talked about so far has to do with things that have been issued in final rules. So these things are, you know, in place or going into place in the market. The mortgage examples that I'll show you are a proposal that the Board put out in 2009 as a part of the closed-end review for TILA mortgage disclosures. And Dodd Frank has actually has provisions in it that the new Consumer Protection Bureau is going to integrate the TILA mortgage disclosures, which these are, along with the RESPA disclosures that HUD has had responsibility for. So these were in the Bureau--the folks at Treasury have announced it's a top priority thing. So what these will show is some of the challenges and wrestlings that go on in sort of trying to make decisions about how to revise disclosure.

First of all, let me show the current TILA statement. So you would get this a few days after you applied for a mortgage. Notice that it's one page, it's short, and--but the problem with it isn't so much of its length, I'll tell you some of the problems that we did and found in the initial runs of testing, but it's--it has to do with comprehension. And I'll come back to that one at length issue when I get to the revised one.

Let me point out a couple of things here. Very prominent on the current disclosure are these 4 boxes. These highlight things that are in the statute that should be given prominence on the disclosure. A particular--a central part of the TILA statute has to do with the APR as a disclosure of the cost of credit. And the APR’s come up, I think earlier this morning. Betsy was talking about it. So it's intended to be--it gives people an all-in measure of the cost of credit, the interest payments, but also the upfront cost over the life of the loan. There is let me note--not an--a contract interest rate does not appear on this form. The rate that you get on this form is this APR.

Some of the things that we found in testing were that people really--even--that we've tried in different plain language attempts, there's general--not a strong comprehension of what the APR is. It's kind of a confusing concept to people. They kinda get that it's different from the interest rate, but it's hard thing to get across. And typically, they gravitate towards information on the form that is more intuitive or more familiar to them, things like payment or even interest rate. So they don't have--they don't necessarily have a ready context for this. And I mention that because I think some of the vision behind TILA was the idea that you would give people information in the standardized form, so that when they were shopping they could compare across products. It's already been mentioned this morning from one of the findings that came out of our testing too, and these are interviews with people who have gotten mortgages in the past few years, is probably about half the people had only consulted with one originator of mortgages. So they implicate--and even the ones who maybe--can talk to a couple, they probably only made one application. Well, you're not gonna get one of these forms unless you apply. And the implication is you're not--unless you're comparing to say, advertised APRs in the newspapers, something like that, you may not have a ready context for evaluating is 7.41 a good deal or not.

Another issue on the current TILA statement that I wanna highlight and some changes with this is the payment table. Right now, the current TILA has a very standardized payment table structure. You just list all the payments over the life of the loan, if they change, you can go with that. And for adjustable rate mortgage, this is presented under the assumption that market rates don't change. So in this case, it is an ARM, the reason it's changing is because you have a teaser rate at the beginning, and as that sort of falls off, it goes up. And a lot of people would infer that a mortgage was an ARM, not because they notice the variable rate feature thing later on the page, but it was because the payment was changing. But that--you can have a mortgage that payments change, that's not an ARM. And you can actually have an ARM for which the payments do not appear to change, because if you had an ARM with no discount at the beginning, you know, it may just look like one payment over the life of loan. So point being that it's a very standardized structure, but it can obscure some very meaningful differences that people ought to be alerted too.

Here is what we put out--here is one of the examples of the forms we proposed in 2009. Note first, I made a note of the length. This is a little bit longer than what we had--the original--the current TILA statement and there are a couple of reasons for that. One is that we've devoted more space to trying to explain some content, and I'll go into that in a minute. Another is that we've actually incorporated some content from some early disclosures into this form. So what I didn't mention earlier when I said it’s one page, you might get, if you had expressed an interest in ARMs, some other earlier generic disclosures about ARMs and about the particular ARM program of the lender you're talking to. But there are certain things they can't tell you until you actually apply, like what's the margin on your loan or things like that. And the way that those early disclosures were incorporated in the current TILA is by reference. Hey, remember awhile back, you got those ARM disclosures. So some of what we're trying to do here was to sort of put--to condense the information into one space. And so, this--what this highlights is--I mean, there are multiple ways you can actually address this problem, but there are real tradeoffs between length, comprehension, and comprehensiveness when you're putting together a disclosure, and--that you have to wrestle through.

Alright, let me highlight a couple of things that we did, that we were working within in this proposal. Alright, I mentioned the problem of context, so what we tried to do is to provide people some context in the form. If you may not have more than one of these forms, how could we give you some sense of where you fell in the market and perhaps a little prod to look around more, you know? And that was the intent of this. And it does cause people to, I think, notice the APR more, however, it's still true in decision-making exercises with this form that they gravitate towards the information that is more familiar like payment or rate. But, you know, as alluded to this morning about, you know, trying to think about other sorts of techniques to aid people in the decision making, here's something that we've been wrestling with. And this--and policy makers have to weigh sort of cost and benefits of trying to implement things like this.

Alright, payment table, this is very different structure than what the current payment table is. There are a couple of reasons for that. One is that we wanted to highlight--given--in light of all the problems and the crisis and people not understanding what they were signing up for, there's affordability kind of content in here about looking at, knowing sort of what your mortgage payment contains, and in fact, the FTC study had found the people likes sort of seeing a breakout of their payment. The FTC did a mortgage study, I think somebody's alluded to this morning.

But also, consumers wanted, and actually, the law requires now, that ARM--that maximum payment on a--ARM be disclosed. And people generally got that. They would often use the words, oh, yeah, this is the “worst case scenario.” And the reason for the middle column was to show--for issues of payment shock at first adjustment and what might happen there. So there's a little--you don't have the complete sequence of payments, but you have a few relevant markers there. And incidentally, this part--I did mention that the Mortgage Disclosure Improvement Act requires this content be disclosed. So actually, this type of payment table will go into effect in January of next year. Now what this--what you lose in this is some of the standardization, because for a hybrid ARM, which is what this is, you need 3 columns. For a fixed rate mortgage, you only need one--a 30-year fixed or something like that. But in losing some of the standardization, you gain some more relevant details for each product.

Caveats, I won't spend time on this 'cause I'm out, but all this work has been done in sort of what Jeanne kind of referred to this morning, as the implementation stage. You know, it's been done in the trenches of policy, developed sometimes under deadlines. Ideally, as Adair was talking about earlier, we wanna know sort of what's gonna happen when you actually put this under practice. And so, I think there's definitely--but that's gonna be challenging to do. Doesn't mean we shouldn't try, and that's part of why I have this slide in here is that I think that’s some of what we need to be thinking about, is as this things roll out, you know, how do we determine what kind of effects they're having. And that will feed into future policy development work. But it's very hard to measure these sorts of things.

So to recap, some of the testings of disclosure shows both some of the potential for improvements, but it also shows limitations as well and where you need to go with other techniques. Disclosure is gonna be an ongoing important part of consumer protection policy. It's you know, a key part of certain statutes. But also, you know, in light of the limitations, it's gotta be complemented by some of these other things, financial education, substantive regulations and things like that for sort of a total package. So, thanks.