Financial (Dis-)Information: Evidence from a Multi-Country Audit Study
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World Bank
Motivation

• The combination of technology, financial liberalization and public and private partnerships have brought about a proliferation of financial products.

• About 2,000 million individuals could enter the financial system in the next 20 years.

• Yet, it is not clear that individuals are well-equipped to make sound financial decisions

  • Financial consumers may not necessarily choose the most cost-effective product or the one most suitable to their needs
Motivation

• Mistakes in financial decision-making would not be a concern if market forces led to a set of relatively cheap financial products.

• But this is rarely the case…
# The cost of financial services

<table>
<thead>
<tr>
<th></th>
<th>Mexico</th>
<th>Peru</th>
<th>Ghana</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>N</td>
<td>Mean</td>
<td>p25</td>
</tr>
<tr>
<td><strong>Credit Product</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Annualized Cost with unavoidable fees only</td>
<td>46</td>
<td>102.96%</td>
<td>34.49%</td>
</tr>
<tr>
<td>Total Annualized Cost inclusive of avoidable fees</td>
<td>46</td>
<td>113.72%</td>
<td>35.86%</td>
</tr>
<tr>
<td>Number of Products per institution</td>
<td>3.3</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Investment Account</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Annualized Yield with unavoidable fees only</td>
<td>35</td>
<td>1.01%</td>
<td>0.75%</td>
</tr>
<tr>
<td>Total Annualized Yield inclusive of avoidable fees</td>
<td>35</td>
<td>0.50%</td>
<td>0.38%</td>
</tr>
<tr>
<td>Number of Products per institution</td>
<td>1.9</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Checking Account</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Annualized Yield with unavoidable fees only</td>
<td>90</td>
<td>-7.51%</td>
<td>-7.20%</td>
</tr>
<tr>
<td>Total Annualized Yield inclusive of avoidable fees</td>
<td>90</td>
<td>-9.25%</td>
<td>-9.58%</td>
</tr>
<tr>
<td>Number of Products per institution</td>
<td>5.0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Consumer Protection

• In the United States, in 1968, the “Truth in Lending Act” (TILA) was passed,
  • By which consumers have to be informed of the APR/YPR of the product they are to purchase.

• In 2009 Mexico introduced similar disclosure requirements through modifications to the Law for Transparency and Regulation of Financial Services

• Yet, problems persist, and it is unclear whether these disclosure modifications are effective
Example: Credit
Example: Credit

CAT = 267%

CAT = 107%
Why aren’t financial products transparent?

• Financial products are inherently complicated
  – But then firms would have an incentive to make simpler products or to provide information
  – Is government intervention needed in this case?

• Firms purposefully make products more complicated to maximize profits
  – Firms make more money when pricing is not transparent
  – In this case, firms will resist transparency initiatives
What do we do?

• Implement two studies to answer the following question:
  – What is the *quality of information* provided to low-income customers interested in savings and credit products?
    • Does information vary by the type of consumer?
    • Are financial institutions complying with the new transparency rules? Are they offering the cheapest products that meet the customer needs?
Study 1: Audit Study

- Trained low income “shoppers” interested in credit and savings products visit financial institutions to assess the (quantity and quality of) information provided by the staff.

- Savings Scripts differed along:
  - **Specific savings needs**: Around USD 400 in a Checking account or Fixed Term deposit.

- Credit Scripts differed along:
  - **Over indebtedness**: Asked for a loan representing 20% or 70% of their household income.
Audit Study

• Both Scripts differed along:
  • Financial Literacy: Neophytes and Experienced
  • Awareness of Competition: Among experienced shoppers, half mention a previous high interest rate offer, the other half mentioned a low interest rate.
  • Formal dress: Shoppers were encouraged to dress formally on alternate interactions with the lender.
Setup

• Collaborative effort with CONDUSEF (Mexico), SBS (Peru) and Bank of Ghana
• Peri-urban areas in the capital city and 2 other cities per country.
• 111 FIs
  – Commercial Banks, Low income banks, MFIs
  • SOFOMS, SCAPS, SOFIPOS (Mexico), Cajas Financieras (Peru)
Audit Study

• Trained 76 low income “shoppers” interested in credit and savings products visit financial institutions to assess the (quality of) information provided by the staff

• Savings Scripts differed along:
  • **Specific savings needs:** 780 USD in Peru, 350 USD in Mexico and 215 USD in Ghana in a Checking account or Fixed Term deposit.

• Credit Scripts differed along:
  • **Over indebtedness:** Asked for a loan representing 20% or 70% of their household income.
Audit Study

• Both Scripts differed along:
  • Financial Literacy: Neophytes and Experienced
  • Awareness of Competition: Among experienced shoppers, half mention a previous high interest rate offer, the other half mentioned a low interest rate.
  • Formal dress: Shoppers were encouraged to dress formally on alternate interactions with the lender.
Savings

**Interview Time**

<table>
<thead>
<tr>
<th></th>
<th>With experience</th>
<th>Without experience</th>
<th>Investment</th>
<th>Checking</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minutos</td>
<td>20.17</td>
<td>15.64</td>
<td>19.08</td>
<td>16.55</td>
</tr>
</tbody>
</table>

**Product aligned with needs**

<table>
<thead>
<tr>
<th></th>
<th>With experience</th>
<th>Without experience</th>
<th>Investment</th>
<th>Checking</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>80.20%</td>
<td>79.10%</td>
<td>81.82%</td>
<td>77.20%</td>
</tr>
</tbody>
</table>
Credit

Interview time

<table>
<thead>
<tr>
<th>Minutes</th>
<th>With experience</th>
<th>Without experience</th>
<th>High indebtedness</th>
<th>Low indebtedness</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>23.13</td>
<td>18.68</td>
<td>21.89</td>
<td>20.03</td>
</tr>
</tbody>
</table>

Difference between loan amount asked and received

<table>
<thead>
<tr>
<th>USD</th>
<th>With experience</th>
<th>Without experience</th>
<th>High indebtedness</th>
<th>Low indebtedness</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>-126</td>
<td>-164</td>
<td>-267</td>
<td>-39</td>
</tr>
</tbody>
</table>
Transparency Index

Transparency Index - Savings

<table>
<thead>
<tr>
<th>Index</th>
<th>With experience</th>
<th>Without experience</th>
<th>Investment</th>
<th>Checking</th>
</tr>
</thead>
<tbody>
<tr>
<td>With experience</td>
<td>74.27%</td>
<td>60.30%</td>
<td>76.15%</td>
<td>56.18%</td>
</tr>
</tbody>
</table>

Transparency Index - Credit

<table>
<thead>
<tr>
<th>Index</th>
<th>With experience</th>
<th>Without experience</th>
<th>High indebtedness</th>
<th>Low indebtedness</th>
</tr>
</thead>
<tbody>
<tr>
<td>With experience</td>
<td>70.53%</td>
<td>47.40%</td>
<td>55.33%</td>
<td>61.52%</td>
</tr>
</tbody>
</table>
Savings: Products offered

**Difference with best APY possible, w/ usage fees**

- **With experience**
  - Investment: 0.75%
  - Checking: 1.36%
- **Without experience**
  - Investment: 1.02%
  - Checking: 0.49%

**Difference with best APY possible, w/o usage fees**

- **With experience**
  - Investment: 0.78%
  - Checking: 1.37%
- **Without experience**
  - Investment: 0.89%
  - Checking: 0.42%
Summary of Results

• Despite the difference in regulatory frameworks, staff across countries behave similarly.
  – Staff does not disclose information unless prompted, resulting in too little voluntary provision of product information

• Misalignment of incentives between staff and potential client
  – Potential client typically ends up with more expensive product