

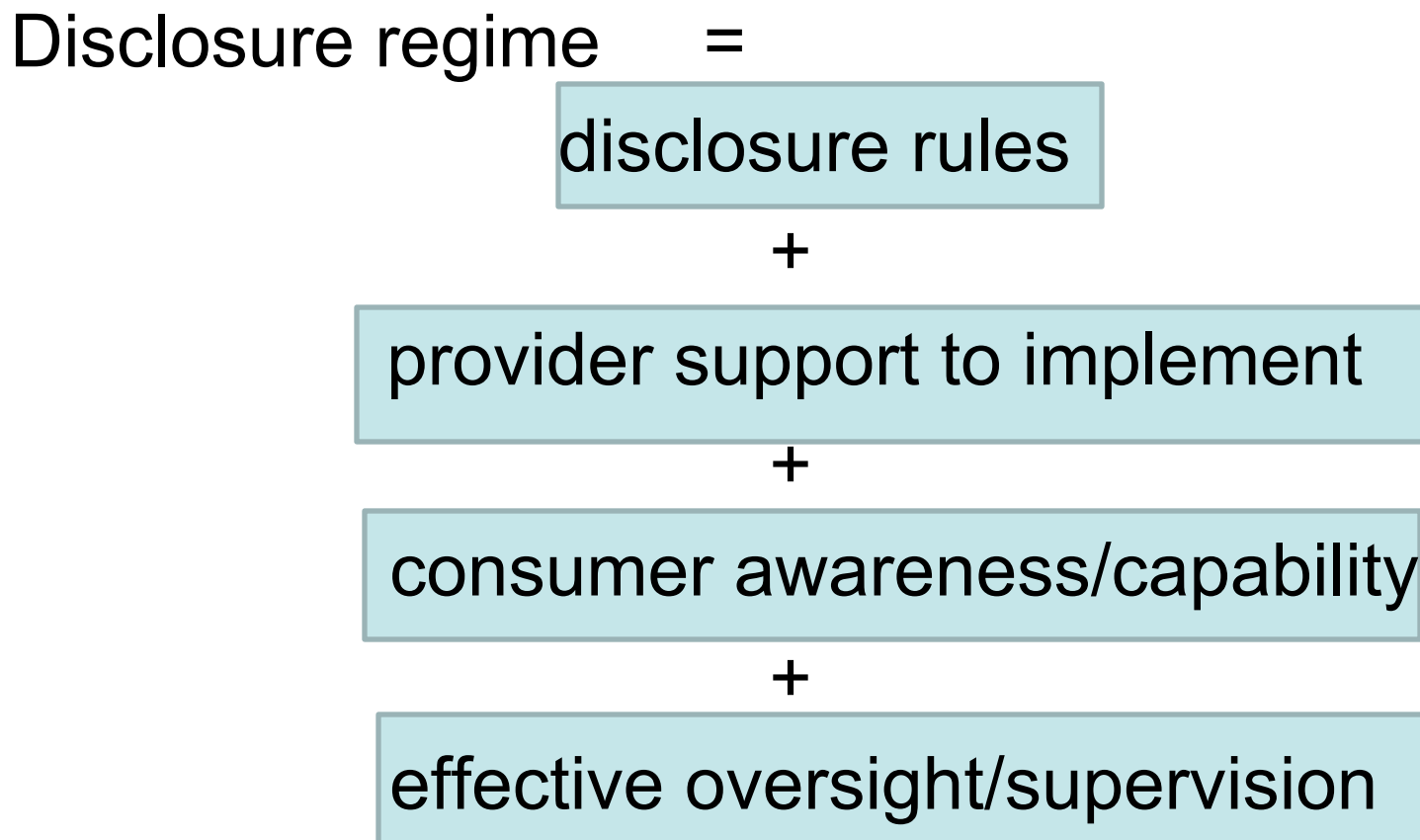


Advancing financial access for the world's poor

Sizing up the Potential for a “Smart” Disclosure Approach in Base-of-Pyramid Markets

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IFMR Financial Systems Design Conference
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“Disclosure regime”



Basically a “sturdy” version of caveat emptor

Standard case for disclosure-based approach

- Reduce information asymmetries
- Enable improved consumer comparison/selection
- Help consumers avoid higher-risk products/providers
- Promote more transparent/competitive markets
- Market-friendly (i.e., direct burdens on providers, consumers, supervisors is relatively low)

HOWEVER . . . The effectiveness of disclosure-focused approaches in financial markets around the world is mixed at best.

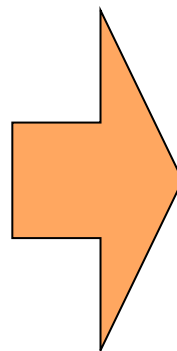
The “why,” “what” and “how” of information disclosure?

Increasing Consumer Comprehension

- Consumer understands full cost and terms/conditions of what they are buying
- choose appropriate product for their individual circumstances

Increasing Market Competition

- Consumers can comparison shop
- Basis for more effective provider competition + extra-market pressure
- leads to lower prices and improved quality of products



Three main dimensions of disclosure regimes

- 1) What information does the individual consumer need to understand the offer?
- 2) How should information be disclosed to facilitate the individual consumer’s comprehension?
- 3) What information should be disclosed to the public (e.g. general consumers, competing providers, media and regulators), and how, so as to encourage market competition?

International trends in disclosure regimes

Overall FCP trend → more robust legal/regulatory framework, financial authorities in lead, typically start with disclosure

Specifically, trends in disclosure

- More specific rules and formats (e.g., mandatory plain language, Key Facts)
- Standardization of prices/terms (by product type)
- Extension of coverage (by product, provider type)
- Consumer testing and behavioral insights to improve effectiveness

Disclosure Principle (from G20 FCP Principles)

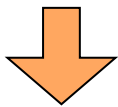
- Financial services providers and authorised agents should provide consumers with key information [on] the fundamental benefits, risks and terms of the product. . . [and] conflicts of interest [related to authorised agent]
- Information should be provided on material aspects of the financial product . . . at all stages of the relationship with the customer.
- All financial promotional material should be accurate, honest, understandable and not misleading.
- Standardised pre-contractual disclosure practices (e.g. forms) should be adopted where applicable and possible to allow comparisons between products and services of the same nature.
- Specific disclosure mechanisms, including possible warnings . . . developed to provide information commensurate with complex/risky products/services.
- The provision of advice should be as objective as possible . . . in general based on the consumer's profile considering the complexity of the product, its risks, . . . and the customer's financial objectives, knowledge, capabilities and experience.
- Recommends use of consumer testing

Incorporating consumer behavior in disclosure design

Need to understand consumer's decision-making processes

Cash flow and household finances

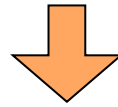
- Consumers often think in terms of household budget and cash flow when selecting a product
- Disclosure must be linked to consumers' own timeframes (e.g., monthly budget/billing cycles)



- ☀ Consumers focus on payments, not total cost
- ☀ Show costs as they accrue over life of product —key for savings, credit
- ☀ Temptation: Often the question is not “should I?”, but “can I?” afford this product?

Standardization and familiarity

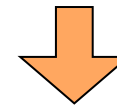
- Consumers more easily ID key terms/info when formats are standard, or they have seen them before
- Payment tables have high recognition and comprehension amongst microcredit consumers



- ☀ Standardize formats, including payment tables for credit products
- ☀ Monetary value resonates more than percentages
- ☀ Price anchoring makes value easier to assess (comparative instead of inherent value)

Disclosure across product cycle

- Need disclosure earlier in shopping process
- Fine print can help for post-purchase comprehension and redress



- ☀ Consider advertising rules, not just disclosure at point of sale
- ☀ Require simplified disclosure (e.g., Key Facts) + copy of contract
- ☀ Include non-price info: rights, recourse, key risks, other (e.g., seller incentives, deposit insurance)

Consumer biases relevant to disclosure regime design

Common behavioral biases

- Focus on short-term over long-term (*finance the television now, pay for it later*)
- Over-confidence in future outcomes (*I can afford this, or I can maintain the minimum balance*)
- Information overload and aversion to complexity (*I don't understand what these percentages mean anyway*)
- Over-reliance on non-expert advice and non-financial aspects (*they treat me well when I walk into the branch*)

In addition to usually-cited constraints of literacy/numeracy, financial capability, asymmetries of information/power

Smart disclosure can affect consumer behavior and produce better outcomes

Field experiment (Bertrand and Morse 2010):

Can psychologically-guided information disclosure de-bias payday borrowers and reduce uptake of high-cost credit?

- Tested 3 info treatments (varied messages, framing, formats) + savings planner tool (self-control)
- Most effective: information that reinforces the “adding up” effect of payday loan fees in \$ vs other financial options (typical: \$15-17 fixed fee per \$100 borrowed)
 - 11% reduction in borrowing over 4-month period
- Stronger effect on those with no college education + with higher (reported) self-control
- Study supports theory of borrowers’ cognitive bias
- Savings planner tool had no effect

FORMAT OF DISCLOSURE STATEMENT ON
LOAN/CREDIT TRANSACTION

(Business Name of Creditor)

DISCLOSURE STATEMENT ON LOAN/CREDIT TRANSACTION
(As Required under R.A. 3765, Truth in Lending Act)

NAME OF BORROWER _____
ADDRESS _____

1. LOAN GRANTED (Amount to be financed) P _____ (A)

2. FINANCE CHARGES

4.

Not Deducted From Proceeds of Loan	Deducted From Proceeds of Loan
------------------------------------	--------------------------------

1. Interest _____ % p.a. from _____ to _____
() Monthly () Quarterly () Annual () Semi-Annual P _____ P _____

b. Service Charge _____

c. Other charges incidental to the extension of credit (Specify):

Total finance charges P _____ P _____ (B)

2. NON-FINANCE CHARGES

a. Insurance Premium P _____ P _____

b. Taxes _____

c. Documentary/Science Stamps _____

d. Notarial Fees _____

e. Others (Specify) _____

Total non-finance charges P _____ P _____ (C)

4. TOTAL DEDUCTIONS FROM PROCEEDS OF LOAN (B plus C) P _____ (D)

5. NET PROCEEDS OF LOAN (A less D) P _____

3. PERCENTAGE OF FINANCE CHARGES TO TOTAL AMOUNT FINANCED (Total of B divided by A) _____ %

1. 7. EFFECTIVE INTEREST RATE _____ % p.a.
See Computation (Annex A-1.1)

8. SCHEDULE OF PAYMENT

a. Single payment due on _____ P _____
(Date)

b. Total Installment Payments
Payable _____ in months/year
(no. of payments)
at P _____ each installment. P _____
See Amortization Schedule (Annex A-1.2)

9. COLLATERAL

This loan is wholly/partly secured by (check)
 real estate chattels deposit hold out
 government securities deed of assignment
 chattels unsecured

10. ADDITIONAL CHARGES IN CASE CERTAIN STIPULATIONS ARE NOT MET BY THE BORROWER

Nature	Percentage	Amount
a. Penalty	_____	_____
b. Others (Specify)	_____	_____

CERTIFIED CORRECT:

(Signature of Creditor/Authorized Representative Over Printed Name)

Position

I ACKNOWLEDGE RECEIPT OF A COPY OF THIS STATEMENT PRIOR TO THE CONSUMMATION OF THE CREDIT TRANSACTION AND THAT I UNDERSTAND AND FULLY AGREE TO THE TERMS AND CONDITIONS THEREOF.

(Signature of Borrower over Printed Name)

Date _____

Notice to Borrower: You are entitled to a copy of this paper which you shall sign

LOAN/CREDIT TRANSACTION

(Business Name of Creditor)
DISCLOSURE STATEMENT ON LOAN/CREDIT TRANSACTION
 (As Required under R.A. 3765 Truth in Lending Act)

SUMMARY INFORMATION

NAME OF BORROWER : _____
 ADDRESS : _____

1. LOAN AMOUNT PHP _____ LOAN TERMS _____
 TOTAL CHARGES PHP _____ Amount of regular payment PHP _____
 TOTAL DEDUCTIONS FROM LOAN AMOUNT _____ Frequency of payment _____
 AMOUNT RECEIVED PHP _____ Number of Payments _____
 2. EFFECTIVE INTEREST RATE % PER ANNUM From _____ to _____ Length of loan term: _____

IN CASE OF PROBLEMS OR QUESTIONS PLEASE CONTACT:

3. 1. Name and title of lender representative: _____
 Contact information (including phone and address) _____
 2. If questions or problems cannot be resolved by lender, contact of government agency overseeing this lender (please check one that applies)
 () Bank / pawnshop Name: _____
 () Financial cooperatives Contact information: _____
 () NGOs _____
 () Non-bank financial institution _____

REPAYMENT SCHEDULE

The effective interest rate is the PRICE you pay for the use of money expressed in Percent per Year. It is the total of interest, fees and all other finance charges divided by the AVERAGE amount of money you get to use over the loan period. It is expressed as a percentage. The AVERAGE amount of money you get to use is reduced by the deductions from the loan amount and by more frequent repayments. For explanation of the payment formula used to calculate interest rate, refer to the bottom of Page 2.

EFFECTIVE INTEREST RATE PER MONTH _____%

Week	Payment Date	Principal	Interest	Amount of regular payment	Outstanding Loan Balance
					5,000.00
1	4/9/15	179.43	44.58	224.00	4,820.58
2	4/16/15	181.02	42.98	224.00	4,639.55
3	4/23/15	182.64	41.36	224.00	4,456.91
4	4/30/15	184.27	39.73	224.00	4,272.65
5	5/7/15	185.91	38.09	224.00	4,086.74
6	5/14/15	187.57	36.43	224.00	3,899.17
7	5/21/15	189.24	34.76	224.00	3,709.93
8	5/28/15	190.93	33.07	224.00	3,519.00
9	6/4/15	192.63	31.37	224.00	3,326.38
10	6/11/15	194.35	29.65	224.00	3,132.03
11	6/18/15	196.08	27.92	224.00	2,935.95
12	6/25/15	197.83	26.17	224.00	2,738.13
13	7/2/15	199.59	24.41	224.00	2,538.54
14	7/9/15	201.37	22.63	224.00	2,337.17
15	7/16/15	203.16	20.84	224.00	2,134.00
16	7/23/15	204.96	19.02	224.00	1,929.03
17	7/30/15	206.80	17.20	224.00	1,722.23
18	8/6/15	208.65	15.35	224.00	1,513.58
19	8/13/15	210.51	13.49	224.00	1,303.07
20	8/20/15	212.38	11.62	224.00	1,090.69
21	8/27/15	214.26	9.72	224.00	876.41
22	9/3/15	216.19	7.81	224.00	660.23
23	9/10/15	218.11	5.89	224.00	442.11
24	9/17/15	220.06	3.94	224.00	222.05
25	9/24/15	221.99	2.01	224.00	0.06
TOTAL		4,999.94	600.06	5,600.00	

5.

DETAILS

1. FINANCE CHARGES MANNER OF COLLECTION OF CHARGES
 1.1. Total interest charges PHP _____ With loan payment deducted from loan amount
 1.2. Service charge PHP _____ With loan payment deducted from loan amount
 1.3. Other charges incidental to The extension of credit (specify) PHP _____ With loan payment deducted from loan amount

TOTAL FINANCE CHARGES PHP _____ = PHP _____ + PHP _____
 With loan payment deducted from loan amount

2. NON-FINANCE CHARGES MANNER OF COLLECTION OF CHARGES
 2.1. Insurance premium PHP _____ With loan payment deducted from loan amount
 2.2. Taxes _____
 2.3. Documentary/Science stamps _____
 2.4. Notarial fees _____
 2.5. Others (specify) PHP _____ With loan payment deducted from loan amount

TOTAL NON-FINANCE CHARGES PHP _____ = PHP _____ + PHP _____
 With loan payment deducted from loan amount

3. TOTAL CHARGES (Finance and Non-Finance) PHP _____
 4. COLLATERAL This loan is wholly/partly secured by (check)
 real estate chattels deposit hold out
 government securities deed of assignment
 chattels unsecured
 5. ADDITIONAL CHARGES IN CASE CERTAIN STIPULATIONS ARE NOT MET BY THE BORROWER:
 5.1. Penalty _____% /month on overdue amount
 5.2. Surcharges _____
 5.3. Others (specify) _____

CERTIFIED CORRECT

 (Signature of Creditor/Authorized Representative over Printed Name)

 (Position)

I ACKNOWLEDGE RECEIPT OF A COPY OF THIS STATEMENT PRIOR TO THE CONSUMMATION OF THE CREDIT TRANSACTION AND THAT I UNDERSTAND AND FULLY AGREE TO THE TERMS AND CONDITIONS THEREOF.

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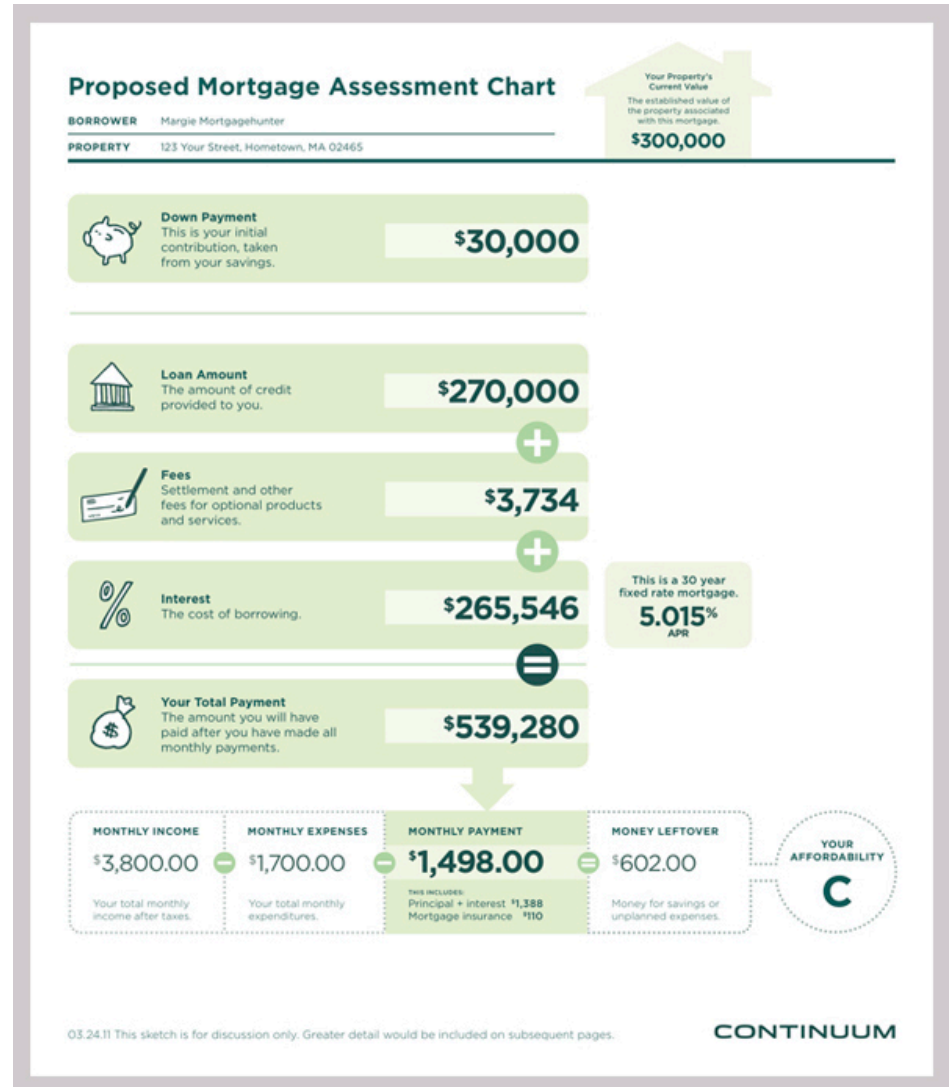
 (Date)

Notice to Borrower: You are entitled to a copy of this paper which you shall sign.

EFFECTIVE INTEREST RATE FORMULA	
Loan amount	x $\frac{i(1+i)^n}{(1+i)^n - 1}$
EIR on Installment Loans	= $\frac{2 \times \text{Annual no. of payments} \times \text{Interest}}{(\text{Total no. of payments} + 1) \times \text{Principal}}$
	= $\frac{62,406.67}{130,000.00}$
	= <u>48.01%</u>

Value of consumer research and testing

Public call for improved mortgage disclosure formats -- sample entry (US)



Cost and Comparability: What really works?

Total Annual Cost = 267%

¡Con EQUIPA-T mi negocio está bien surtido!

FINANCIERA **equipa-T**
www.equipat.com.mx

Préstamos desde **\$4,000.00 pesos.**

¡Festeja con nosotros equipando tu negocio!

EN ESTAS FIESTAS PATRIAS QUEREMOS APOYARTE

Solicita tu crédito y llévate un regalo sorpresa*

Les Maria
55 42 42 7746

¡Pregunta por nuestros microseguros!

Acércate. Somos tu solución.

CAT DESDE EL 267% INFORMATIVO, CÁLCULO AL 15 DE AGOSTO DE 2011.
*REGALOS LIMITADOS A CLIENTES CON CRÉDITO APROBADO EN SEPTIEMBRE Y HASTA AGOTAR EXISTENCIAS.

Préstamos para tu negocio, fácil y rápido.
5080 5050 Ciudad de México 01800 508 0505 Lada sin Costo

Total Annual Cost = 107%

FINANCIERA **equipa-T**
www.equipat.com.mx

Préstamos desde **\$7,000.00 pesos.**

¡EQUIPA-T me ayuda a impulsar mi negocio!

Obtén un préstamo con pagos a tu medida para hacer crecer tu negocio

TE PRESTAMOS	PAGOS QUINCENALES PRÉSTAMO A 6 MESES	PAGOS QUINCENALES PRÉSTAMO A 9 MESES	PAGOS QUINCENALES PRÉSTAMO A 12 MESES
\$7,000	\$866	\$661	\$548
\$8,000	\$1,012	\$755	\$627
\$9,000	\$1,139	\$850	\$705
\$10,000*	\$1,265	\$944	\$783
\$12,000*	\$1,518	\$1,133	\$940
\$15,000*	\$1,898	\$1,416	\$1,175
\$20,000*	\$2,530	\$1,888	\$1,567
\$25,000*	\$3,163	\$2,360	\$1,958
\$30,000*	\$3,795	\$2,832	\$2,350

¡Pregunta por nuestros microseguros!

Acércate. Somos tu solución.

CAT DESDE EL 107% INFORMATIVO CÁLCULO AL 15 DE AGOSTO DE 2011.
*SUJETO A LA CAPACIDAD DE PAGO. SE REQUIERE UN CRÉDITO SOLIDARIO PARA PRÉSTAMOS MAYORES A \$10,000.

Préstamos para tu negocio, fácil y rápido.
5080 5050 Ciudad de México 01800 508 0505 Lada sin Costo

Standardization in practice (Mexico mystery shopping)

Q from Shopper: “What does this term, TAC [Total Annual Cost], mean?”

A from bank staff:

- *“It is the Tax Administration Cost”*
- *“Here we don’t use the TAC”*
- *“That if the interest rate changes, the TAC helps you so the interest rate does not rise”*
- *“It is prohibited to give this type of information to merchants, who maintain a code of privacy”*
- *“It is the total annual costs, but it’s already included in the interest rate”*
- *“That its interest is the lowest in the market”*

Findings:

- **Implementation of standard measure very imperfect in practice**
- **Perceived customer capability affects outcome**
- **So does staff capability/comprehension**

Do we need to “market” disclosure?

CARÁTULA DE CRÉDITO			
(1) Nombre comercial del Producto: Tipo de Crédito:			
CAT (Costo Anual Total) (2) Sin IVA Para fines informativos y de comparación	TASA DE INTERES ANUAL (3)	MONTO O LINEA DE CREDITO (4)	MONTO TOTAL A PAGAR O MINIMO A PAGAR (5)
PLAZO DEL CREDITO: (6)	(7) Fecha límite de pago: Fecha de corte:		
COMISIONES RELEVANTES (8)			
<ul style="list-style-type: none"> • Apertura: • Anualidad: • Prepago: • Pago tardío (mora): 	<ul style="list-style-type: none"> • Reposición de tarjeta: • Reclamación improcedente: • Cobranza: Para otras comisiones consulte		

Required disclosure form in Mexico for term credit products

Vs.

Advertisement for credit product (does not include cake slices they were handing out at the branch when we visited)

En Crédito Familiar
¡Cumplimos 15 años!
 celébralos con nosotros

Aquí sí te resolvemos

luego luego

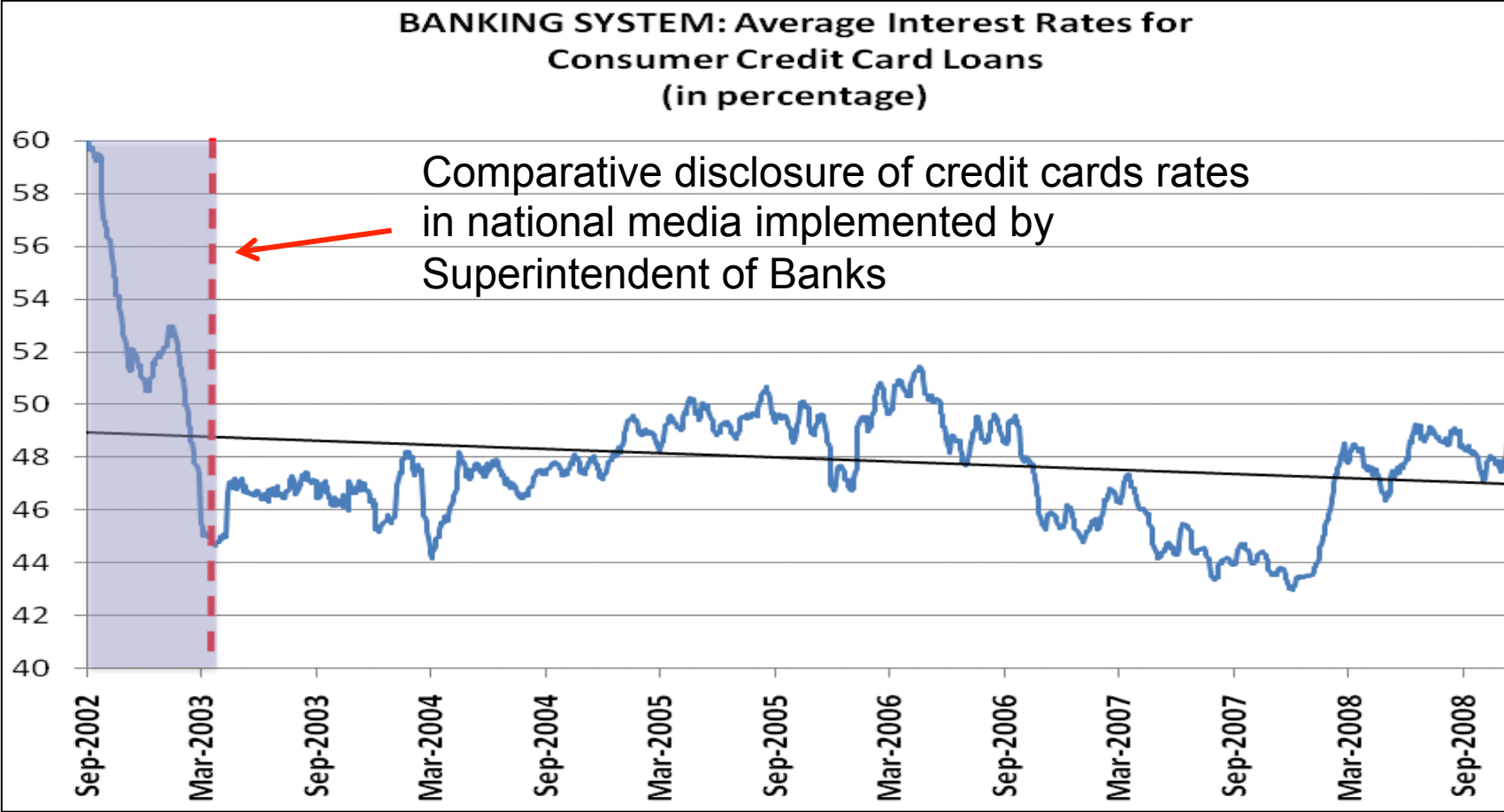
Créditos desde
\$2,000 hasta \$70,000 pesos

LLAMA AL TELÉFONO DEL EFECTIVO
01 800 101 2222

CAT promedio 158.29% para crédito Regular, 153.552 para Regular PB, 101.803 para Premier PB, 73.145 para Profesional. NB, 77.91% para Profesional PB, 55.41% para Platino. Sin IVA. Tasa fijo. Cálculo al 30 de junio del 2011. Para mayor información consulta www.creditofamiliar.com.mx. Requisitos de contratación, comisiones y características del crédito en la sucursal más cercana. Crédito Familiar para su constitución y operación con el carácter de SOFOM, S.A., no registra su actividad de la SHCP.

15 Años
Crédito Familiar
 SIEMPRE UNA SOLUCIÓN

Evidence on market competition effects (Peru)



Graphic and information courtesy of World Bank Global Program on Consumer Protection and Financial Literacy

Disclosure \leftrightarrow Innovation and inclusion?

A well-designed and effectively-implemented disclosure regime can be relatively market-friendly

- **Lighter touch (prescriptiveness, provider costs)**
- **Leave providers space for innovation while strengthening their incentives for improved products and responsible behavior**
- **Provide the basis for higher-quality providers to distinguish themselves**
- **Create a more level playing field among diverse providers offering similar products**
- **Reduce consumer missteps while building trust and confidence \rightarrow higher uptake**

Limitations of a disclosure-focused regime as the sole/primary solution for consumer protection

Effectiveness depends on many factors and is likely to work better for some products and product types than others, depending on, e.g.,

- Inherent product features (e.g., credit vs. insurance product, variable deposit products, whether and how customer behavior/choices affect product terms)
- Complexity of the product features, pricing, risks
- The longer the contract term, the more difficult to convey/assess its value & risk

Provider incentives, consumer financial capability, and consumer biases also challenge effectiveness of disclosure.

Policy Considerations in Implementation

- Consumer testing should inform design of disclosure formats, key terms, and points of intervention
- Standardize not just the terms, but the actual physical presentation of information
- Be cautious about how much oral disclosure requirements will work—or be enforceable
- Don't forget the non-financial aspects of disclosure, such as rights and recourse information, competition effects
- Monitor effectiveness of reforms through mystery shopping, mandatory publication of contract copies, and other supervision techniques

Degree of difficulty of different CP approaches

Is the disclosure approach less demanding than ensuring independence or suitability?

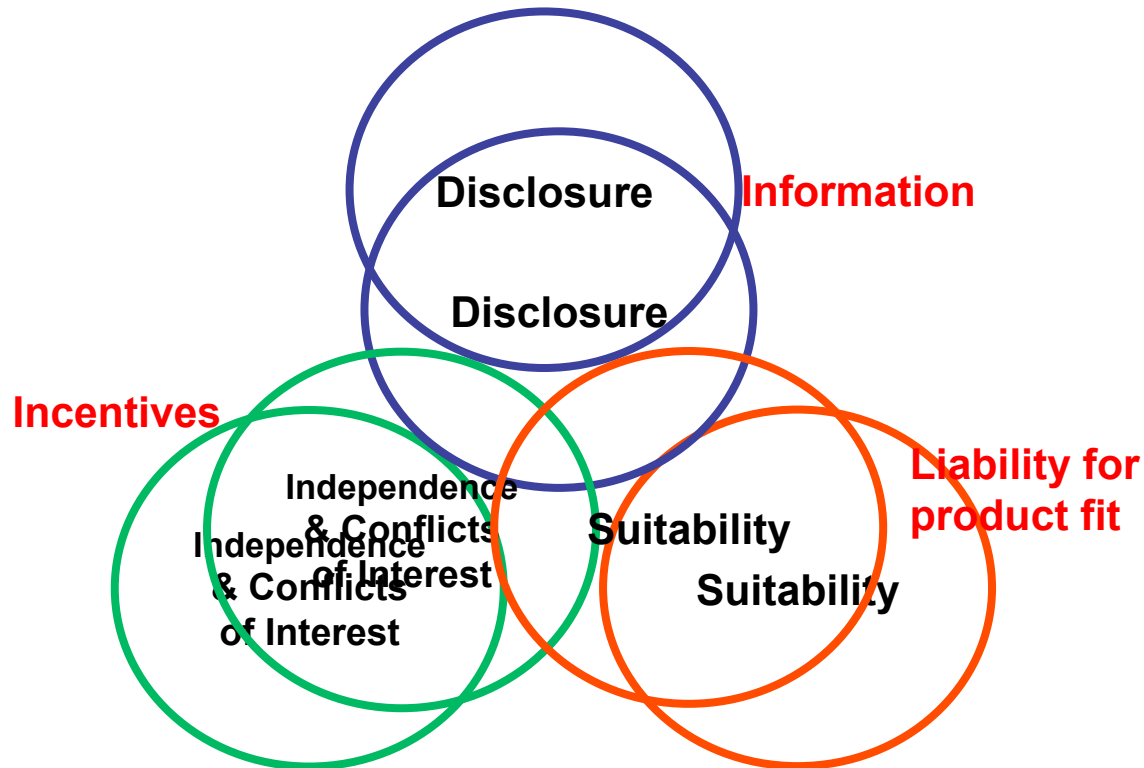
	Disclosure	Independence	Suitability
Changes to Laws/Regs	Low	???	???
Cost/complexity (to provider)	Low	???	???
Required regulatory/supervisory capacity	Low	???	???
Monitoring & enforcement tools	Low	???	???

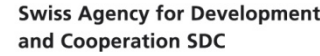
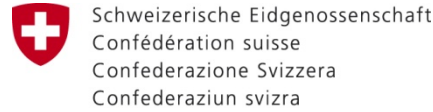
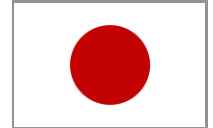
In conclusion . . .

Even the best-designed of disclosure regimes still basically rely on caveat emptor. Is this defensible in India in light of . . .

- rapid pace of inclusion and new-user profiles?
- insights from behavioral research?
- market structure + typical market conduct?
- political economy of financial regulation?

Towards integrated consumer protection





Advancing financial access for the world's poor

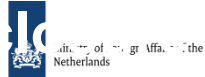
www.cgap.org

www.microfinancegateway.org



MINISTRY FOR FOREIGN AFFAIRS OF FINLAND





Study of whole-life insurance in India (Anagol, Cole, Sarkar, 2012)

- Mystery shopping study in Indian life insurance market
- Two product types (whole-life vs. term-life)
- Whole-life: poorer value for most consumers, but greater agent incentives due to higher commissions
- 60-80% of visits, agents recommended unsuitable whole-life product
- “Customers” more likely to receive appropriate recommendation if they signal they are more knowledgeable + specifically express interest in the more suitable product (though most still receive bad advice).