

Regulatory Techniques in Consumer Protection

Lecture 2:

Disclosure

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2013

Two forms of information regulation

- Regulation Voluntary Disclosure
 - Anti-fraud and anti-deception law
 - Truth in advertising: regulation of terminology
- Mandated Disclosure
 - Affirmative obligations to provide information
 - Duties to warn

Regulation of Voluntary Disclosure

Economic rationale of truth-in-advertising

- Reduce search costs
 - Sellers are “least cost avoiders” of confusion
- Distinguish products of different qualities
 - More efficient consumption decisions
 - Better incentives to produce high quality products

➔ Deception is like theft:

- Zero-sum transfer
- But forces victims to engage in costly precautions

Mandated Disclosure of Information

- Require the informed party to affirmatively disclose the information to the uninformed party
- Some information is exempt from disclosure
 - Information acquired through deliberate and costly effort, which has productive value
 - Rationale: incentives to acquire the information
 - Information about mineral deposits? - Yes
 - Information about future prices? - No
 - Information about new zoning restrictions?

Mandated Disclosure: A Regulatory Technique

It responds to a very common problem: people have to make decisions on matters unfamiliar to them, dealing with more informed parties who have other (sometimes conflicting) interests: Firms, Sellers, Employers, Websites, Insurance companies, government, police . . .

Without good information, the decisions people make could be disastrous.

Solution: require the informed party to disclose all the relevant information → Mandated Disclosure

Mandated Disclosure: A Regulatory Technique

Mandate Disclosure is an attractive technique:

- It addresses a real problem: complex choice
- It conforms to the two fundamental ideologies
 - Free Markets
 - Autonomy of citizens
- Easy to enact, costs little
- Even if it fails, there are ways to fix it
- Harmless

Mandated Disclosure:

The Most Common Regulatory Technique

- Consumer financial protection: credit, banking, investment
- Residential Real Estate transactions
- Informed consent in health treatment
- “Opportunity to Read” in contract law
- Product warnings in tort law
- Privacy protection
- Food labeling
- Advertising disclaimers

Mandated Disclosure: A Failed Regulatory Technique

- Literacy and Numeracy
- Overloaded
- The “Accumulation Problem”
- Decision Aversion
- Behavioral biases
- ➔ Failure is due to complexity
 - Complexity of the decision (mortgage, medical treatment)
 - Complexity of the disclosure

Literacy and Numeracy

Federal Reserve: To choose a mortgage, people need to understand

“indexes, margins, discounts, caps on rates and payments, negative amortization, payment options, and . . . most importantly, . . . what might happen to your monthly mortgage payment in relation to your future ability to afford higher payment.”



Closing Documents

1. FEDERAL TRUTH IN LENDING DISCLOSURE
2. BORROWER'S PROMISE TO PAY NOTE
3. SETTLEMENT STATEMENT (HUD-1)
4. UNIFORM RESIDENTIAL LOAN APPLICATION
5. ADDENDUM TO HUD-1 SETTLEMENT
6. ADDENDUM TO HUD-1
7. GENERAL CLOSING INSTRUCTIONS
8. SPECIFIC CLOSING INSTRUCTIONS
9. ADDENDUM TO CLOSING INSTRUCTIONS
10. ITEMIZATION OF AMOUNT FINANCED
11. PAYOFF SCHEDULE
12. CREDIT SCORE DISCLOSURE
13. HAZARD INSURANCE AUTHORIZATION REQUIREMENTS
14. REQUEST FOR TAX RETURN
15. REQUEST FOR TAXPAYER IDENTIFICATION NUMBER AND CERTIFICATION
16. CERTIFICATION ADDENDUM TO HUD-1 SETTLEMENT STATEMENT
17. BORROWER'S CERTIFICATE OF NET TANGIBLE BENEFIT
18. ACKNOWLEDGMENT OF RECEIPT OF APPRAISAL REPORT
19. APPRAISAL DISCLOSURE
20. CERTIFICATE OF LOANS TO BORROWER
21. OWNERS AFFIDAVIT AND INDEMNIFICATION AGREEMENT
22. BORROWERS COMPLIANCE
23. LEGAL DESCRIPTION
24. DISTRIBUTION FORM
25. USA PATRIOT ACT CUSTOMER IDENTIFICATION VERIFICATION
26. FEDERAL EQUAL CREDIT OPPORTUNITY ACT NOTICE
27. FAIR CREDIT REPORTING ACT DISCLOSURE
28. OCCUPANCY AND FINANCIAL STATUS AFFIDAVIT
29. PAYMENT LETTER TO BORROWER
30. PRIVACY DISCLOSURE STATEMENT
31. QUALITY CONTROL RELEASE AND AUTHORIZATION TO RE-VERIFY
32. SERVICING DISCLOSURE STATEMENT
33. SIGNATURE AFFIDAVIT
34. TAX DESIGNATION FORMS
35. INTER VIVOS REVOCABLE TRUST AS BORROWER AKNOWLEDGEMNET
36. ADDENDUM TO NOTICE INTER VIVOS REVOCABLE TRUST
37. INTER VIVOS REVOCABLE TRUST RIDER
38. ILLINOIS BORROWER INFORMATION DOCUMENT
39. NOTICE OF RIGHT TO CANCEL
40. MORTGAGE
41. FIXED INTEREST RATE RIDER
42. ILLINOIS CIVIL UNION ADDENDUM TO UNIFORM RESIDENTIAL LOAN APPLICATION
43. EVIDENCE OF JOINT APPLICATION
44. COLLATERAL PROTECTION INSURANCE NOTICE
45. ILLINOIS NOTICE OF CHOICE OF AGENT INSURER
46. PAYMENT INSTRUCTIONS
47. ILLINOIS MORTGAGE ESCROW ACCOUNT
48. ESCROW WAIVER
49. ILLINOIS ESCROW DISCLOSURE STATEMENT
50. FAILURE TO CLOSE WITHIN SPECIFIED COMMITMENT DISCLOSURE

Emotional Aversion to Decisions

Freud was once asked what he thought a normal person should be able to do well. . . .

He is reported to have said:

“Lieben und arbeiten”

(to love and to work).

Behavioral Biases: Conflicts of Interests Disclosure

Cain et al, *Journal of Legal Studies* (2005):

Experiment: Guess how much money in jar

-“subjects”: have to make guess;

- Get paid if guess is **accurate**

-“advisors”: give subjects advice

- Based on longer examination
- Get paid if subjects’ guess is **high**
- Advisors have conflict of interests



Treatment group: advisors disclose conflict

Control group: advisors do NOT disclose conflict

Prediction: disclosure of conflict of interests would

-Induce advisors to be LESS biased

-Subject would rely LESS on advice

Results: in the disclosure group -

-Advisors are MORE biased (“Yell louder”)

-Subjects are worse off

Follow up study:

-Subject rely MORE(!) on advice



Can Mandated disclosure be saved?

If the problem is complexity, two solutions:

1. Education

- Financial literacy (investment, loan-taking), health care, insurance, privacy, safety, environmental issues, nutrition, legal rights . . .

2. Simplification

- How do you simplify the complex?

How do you simplify this:

A drug's side effects includes:

excess stomach acid secretion, irritation of the stomach or intestines, vomiting, heartburn, stomach cramps, bronchospasm, stomach ulcers, intestinal ulcers, hepatitis, stomach or intestinal bleeding, inflammation of skin, redness of skin, itching, hives, rash, wheezing, trouble breathing, life-threatening allergic reaction, giant hives, rupture in the wall of the stomach or intestines, hemolytic anemia, large skin blotches, decreased blood platelets, decreased white blood cells, and loss of appetite.

Can Mandated disclosure be saved?

If the problem is complexity, two solutions:

1. Education

2. Simplification

- How do you simplify the complex?
- How do you simplify the accumulation problem?

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The Appeal of “Scores”

“Targeted Transparency”

Restaurant hygiene grades

- Jin & Leslie (QJE 2003): reduced food-borne illness by 20% in Los Angeles
- Ho (Yale LJ 2013):
 - All restaurants receive “A” grade
 - All restaurants that fail get re-inspected and get “A”s
 - Distorts the resources of the inspection agency
 - Overall, no increase in health

If disclosures fail, why so common?

- Mandated disclosure is consistent with all political ideologies
 - Easy to pass through legislatures
- Does not require budget or bureaucracy
- A logical response to “trouble story” or crisis
 - If injury occurred to uninformed people, and had they been informed the injury would not have occurred, the logical response is . . .
 - Evaluated in hindsight, with disregard to overload or accumulation
- “Overgrazing the disclosure commons”

The Unintended Harms of Mandated Disclosure

“At worst, harmless”?

(1) Make Regulation Worse

- The harm of panaceas, of one-size-fits-all solutions

The Harm of Panaceas

Bloodletting



The Unintended Harms of Mandated Disclosure

“At worst, harmless”?

(1) Make Regulation Worse

- The harm of panaceas, of one-size-fits-all solutions
- Undermining other consumer protections
 - Anti Fraud Law
 - Product Safety
 - Unconscionability
 - Warnings: “breed disrespect for all signs.”

The Unintended Harms of Mandated Disclosure

(2) Make Information Worse

- Crowd out other information
- Improve disclosed aspects, neglect others

(3) Make Markets Worse

- Undermining self-protection
- Frivolous release from transactions
- Anticompetitive

The Unintended Harms of Mandated Disclosure

(4) Inequitable

Anatole France wrote that the law, “in its majestic equality, forbids the rich as well as the poor to sleep under bridges, to beg in the streets, and to steal bread.”

- Make the rich better-off
- Make the poor worse-off

Example: Hospital Report Cards

The Unintended Harms of Mandated Disclosure

(5) Make other social enterprises worse

Example: Informed consent for human research subjects

- 15% of medical research budget goes to compliance with IRBs
- Study of blood thinners as response to heart attack
 - Efficacy: 20,000 potential patient every month, 5.6 mortality reduction → 800 lives saved per month
 - To comply with “informed consent” (1750 words), American researchers needed 8 months longer than other countries
 - 6400 lives

Conclusion

- The most common regulatory technique
- The least successful regulatory technique
- Cannot be fixed
- It grows, never shrinks
- It causes unintended harms

Conclusion

*Lawmakers should stop using it, commentators should stop proposing it, and interest groups should stop advocating it unless they can convincingly show that this time it **really** is different.*

Forthcoming in

Omri Ben-Shahar and Carl Schneider

MORE THAN YOU WANTED TO KNOW: THE
FAILURE OF MANDATED DISCLOSURE
(Princeton University Press)

The End