

To: Productivity Commission

From: Stephanie Raill Jayanandhan and Avi Karnani, Hazards and Compass

Re: Service Sector Interim Report Submission

23 August 2013

Dear Productivity Commission:

Your First Interim Report covers a broad scope, encompassing many productivity issues in the service sector. We are writing on the specific issue of information asymmetries, with a focus on the financial sector, our area of expertise. Stephanie is a New Zealander by birth and our consultancy, Hazards and Compass, designs tools and advises on financial services initiatives that benefit consumer interests. Projects we have worked on include Thrive, an online money management tool that provided consumers with free financial advice, the FinCapDevComp, a competition to develop mobile apps that improve financial capability, and GetRaised.com, a tool that helps people determine whether they are underpaid compared to market salaries for their role, and create a customized raise request.

In the First Interim Report, you note that “Information asymmetries can be more pronounced in service transactions than goods transactions, due to the difficulties in assessing service quality before or after purchase, and in obtaining remedies for poor service quality.”¹ This is particularly true when one party to the transaction (the service provider) has a high degree of domain knowledge and conducts many similar transactions, and the other party (the consumer) may only conduct one or two similar transactions in their lifetime. Examples include selecting a mortgage type and provider, making an investment or choosing a KiwiSaver plan, and choosing among bids to complete a job.

Industry guidelines and legislation about disclosure are made to try and address these information asymmetries. The premise of these rules is that if enough information is provided to the consumer, the effect of the information asymmetry will be reduced. However, too much information has the opposite effect - it overwhelms the consumer and leads to incorrect weighting of information. In their paper “The Failure of Mandated Disclosure” (2010), Omri Ben-Shahar and Carl Schneider describe a study showing that “as knowledge of the [APR of a credit card] increased, knowledge of the finance charge itself, expressed in dollars, declined.... As a result, [consumers] consistently miscalculate the finance charges to be twice the actual amount”².

¹ New Zealand Productivity Commission. Boosting productivity in the services sector: 1st Interim Report (2013), p. 32.

² Ben-Shahar, O, and C Schneider. The Failure of Mandated Disclosure. 159 University of Pennsylvania Law Review 647 (2010), p663.

Even initiatives to simplify disclosure terms can be overwhelming. The US Consumer Financial Protection Bureau (CFPB) has created a sample credit card agreement³, but at 2 pages long, with a separate list of definitions accessible on the CFPB website, it too is overwhelming and incomprehensible to many consumers.

One initiative that has shown promise is the pilot testing of a Financial Facts box conducted by Mission Asset Fund in San Francisco.⁴ This box borrows the familiar format of the food nutrition label to convey information about financial products. In pilot testing, surveyed members of the public were able to quickly and accurately identify the required monthly payment of a loan.

A quick-reference summary format that is required and standardized by a regulatory body allows consumers to easily compare the key information needed to make a decision, even when they do not understand the nuances of the contract terms, and to refer back to that information at a later date. Consumers who want more detailed information can easily access it by reading the specifics of the agreement.

The specific content, design and format of disclosure summaries like the Financial Facts label should be carefully tested to ensure efficacy in the short term (eg. helping consumers choose among loan products) and long term (eg. helping consumers understand how long the loan will take to pay off). Public-private partnerships and crowdsourcing competitions are two ways to gather a variety of submissions to be tested. These partnerships allow experts from the public, such as graphic designers and financial advisors, to provide domain knowledge, while government regulation provides the impetus for businesses to correctly use the most effective format.

New Zealand's market size and regulatory environment make it an ideal place to implement innovative initiatives and processes quickly and effectively. Helping New Zealanders understand KiwiSaver program details, mortgage and insurance terms, and other complex consumer agreements will increase service sector productivity and the general wellbeing of New Zealand consumers.

³ Available at <http://www.consumerfinance.gov/credit-cards/knowbeforeyouowe/>

⁴ An example is available at <http://www.missionassetfund.org/images/Financial%20Fact%20Label%20with%20Explanation.pdf>. The report is available at <http://www.missionassetfund.org/images/MAF%20special%20report%20-%20Just%20the%20financial%20facts%20please%20V.5.pdf>.

If you would like further information or to speak with one of us, Stephanie can be reached at stephanie@avikarnani.com, and Avi can be reached at avi@avikarnani.com. We look forward to reading the upcoming iterations of the report.

Stephanie Raill Jayanandhan

Avi Karnani

Hazards and Compass