



NEWSLETTER 2022|19

CALENDAR

Lunch Seminar

Florian Exler (University of Vienna)

“Naïve Consumers and Financial Mistakes”

Wed, July 27

12:00 - 13:00

H 26



ABSTRACTS AND FURTHER INFORMATION

Lunch Seminar

Florian Exler (University of Vienna)

“Naïve Consumers and Financial Mistakes”

Financial contracts are complicated and consumers often do not grasp them in their entirety. This may lead to financial mistakes. We develop a quantitative theory of unsecured credit and equilibrium default where borrowers can sign debt contracts that trade off interest rates for penalty fees. These fees make unforeseen financial shocks—such as paying late or borrowing over limit—costly. The economy is populated with sophisticated and naïve borrowers. Naïves face higher financial uncertainty without internalizing this fact. They make financial mistakes as they choose inefficiently high penalty fees. In equilibrium, these fees cross-subsidize interest rates for sophisticates. We use this framework to analyze two unexplored features of the CARD act: transparency requirements and penalty fee limits. More transparency leads to less financial uncertainty for naïve borrowers, while fee limits constrain everyone. Both policies reduce financial mistakes and increase the welfare of naïves. The effects on sophisticates, in contrast, are negative: If naïves make fewer mistakes due to clearer language, sophisticates lose cross-subsidization and experience welfare losses. The same holds true in the case of fee limits. When high-fee contracts are banned, expected revenue from naïve fee payments falls and interest rates rise. As a result, sophisticates experience a welfare loss.

Info:

in person



CONFERENCES, PRESENTATIONS AND ANNOUNCEMENTS

Lutz Arnold's paper "Financial Trading versus Entrepreneurship: Competition for Talent and Negative Feedback Effects" (joint work with S. Zelzner) is accepted for publication in the "Quarterly Review of Economics and Finance".

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