Study finds minimum payment warnings nudge credit card payments up and down

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If you were warned how much extra credit card interest you'd pay by only making the minimum payment every month, you might want to increase your payments to retire the balance earlier, right? Not necessarily, according to a study by a Boston College marketing researcher who found that telling customers about the high cost of repaying the monthly minimum had little impact on repayment decisions. But when credit card consumers were shown a three-year payoff time frame with accompanying lower interest costs, this information "nudge" had both a positive and negative effect.

"Warning people about paying the minimum doesn't seem to change behavior in terms of making people more or less likely to pay the minimum," says Boston College Marketing Professor Linda Salisbury, author of the study that appears in the current edition of the *Journal of Public Policy & Marketing*. "But that three-year payoff is what seems to move people and move them to different payments."

Salisbury's study was done in the wake of the 2009 Credit Card Accountability and Responsibility Disclosure (CARD) Act, a law requiring that a "minimum payment warning" be included on all monthly credit card statements. The research asks: how effective are these regulations at changing payment behavior and helping consumers to better manage their debt?

Titled, "Minimum Payment Warnings and Information Disclosure Effects on Consumer Debt Repayment Decisions," the study analyzes data from 667 U.S. consumers and found they were more likely to choose the three-year payment amount when that option, with its lower interest cost, was shown on the credit card statement.

"When the three-year information appears on the statement, you see a lot of payments move towards the three-year amount," says Salisbury . "You start to see a spike in three-year payment amounts. One of the findings is the minimum warning doesn't do much but the three-year amount nudges, to use a behavioral economics term, nudges people toward that three-year amount."

But the payoff rate went in the OPPOSITE direction and slowed down when consumers were shown only the three-year payoff payment, but not the corresponding lower interest costs.

"In another words," says Salisbury, "instead of the three-year payment always encouraging people to pay more, there's some segment of people that it's actually encouraging to pay less. I wasn't expecting that.

"You can think of this three-year payment target as an anchor kind of weighing things down. It's sort of bringing payments toward it - some are doing what the regulation intended which is increasing people's payment but it's also doing this unintended thing which is bringing some payments down. They're paying less than they would have otherwise."

Salisbury's research did not focus on why people would choose to slow down and lower their credit card payments, but she suggests some possible explanations:

"Some people, once they realize the dollar amount that will get them paid off in three years, think 'Oh, I'm paying more than I need to get it paid off in three years. Three years seems like a pretty reasonable amount' and that might decrease their payment; it gives them some more cash flow for the month, so that's a possibility. Also, sometimes these nudges can be perceived by consumers as implicit recommendations like 'Oh, they're telling me this three-year amount. Three years must be a good target range for me to pay it off so I think maybe that's a good idea and I'll pay it off in that time frame."

Salisbury says the study's findings have important implications for regulatory policies and lender practices: simply informing borrowers about the detrimental effects of repaying the minimum required may do little to change behavior; instead, a nudge is more likely to change repayment behavior.

"At the same time," says Salisbury, "policymakers and firms need to consider that calling attention to alternative repayment amounts also comes with an accompanying risk that borrowers' repayments could decrease if the salient alternative repayment is lower than what the consumer would have chosen to repay had no information been disclosed at all."

Information disclosure of this type, whose objective is to reduce consumer debt levels, may achieve its objectives for some consumers, but have the opposite effect for others. The research suggests that information disclosure is likely to be most effective when it is tailored to different credit card customer segments.

"One of the big takeaways is that the same kinds of interventions might have different impacts on different segments of consumers," says Salisbury. "In this case, it might make people who tend to pay very low amounts more likely to increase. But it may unintentionally lead people who would have paid more to pay less because this information somehow nudges them downward.

"In an ideal world, we'd have public policy targeted to different segments of the consumer population," notes Salisbury. "Financial products are just difficult for many consumers to understand well, even well educated people have challenges with a lot of different financial products, whether it's credit card agreements, mortgage products, car loans, or checking accounts. It's an area where regulators are trying to help consumers make better educated decisions and so there's a lot of work trying to understand what can help consumers become more financially literate. My research asks, how can we help them at the point of the decision making to make choices that will improve their financial well-being?"

Provided by Boston College

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