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# Shop Right: Loan Shopping for Consumer Financial Health

We know that saving is supposed be our best bet for planning for the future, but could smart shopping for debt be more important?  According to Jonathan Zinman, Director of IPA's US Household Finance Initiative (USHFI), "Despite all the focus on asset management and asset-building, it seems to me that liabilities are where the money is for most American households."

Zinman's conclusion is backed up by new findings from his research with Victor Stango (UC-Davis), "Borrowing High vs Borrowing Higher: Sources and Consequences of Dispersion in Individual Borrowing Costs." Stango and Zinman find that choices about credit card contracts and interest rates can vary as a result of different card shopping styles. And the results are dramatic: self-reported shopping styles can account for interest rate differences comparable to moving an individual from being in the bottom ten percent of credit scores, ranging from 460-520, to the top ten percent of credit scores, ranging from 800-820 (numbers from Center for Responsible Lending). As many subprime borrowers know, moving from what's considered "poor" to "perfect" credit scores is neither quick nor easy. And having bad credit is costly: according to FICO's loan calculator, on a single, fixed interest rate $235,000 30-year loan (the 2012 average mortgage amount), moving a credit score from the 620-639 range (the lowest option on this calculator) to the 760-850 range would lead to an **overall savings of $81,114** (through an APR drop from 5.57% to 3.98%).

Unfortunately, inefficient loan shopping isn't just a problem with credit cards. This issue is widespread and high-stakes, as has been demonstrated with mortgages and mutual funds.

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Richard Thaler, behavioral economist and “Nudge” author, last year in the New York Times lamented that most borrowers could save thousands just by getting one more quote for their mortgage. Research has shown that not even Wharton MBAs understand how to most efficiently buy mutual funds, suggesting significant room for improvement in disclosures and shopping in this arena, as well.

Behavioral factors such as self-control, limited attention, and price misperceptions, as well as financial illiteracy and innumeracy, can lead to undershopping and overpayment in upfront contract choices, as well as failure to refinance. Targeting these behavioral factors, there is reason to believe that both informative appeals and emotional appeals could be incorporated in smart loan shopping tools to help consumers reduce principal balances and choose more appropriate contract terms.

Loan shopping platforms are proliferating online in credit card debt, mortgages, auto loans, and student debt, but many operate on the kickback model. In Zinman’s recent presentation to the Behavioral Finance Forum at RAND, he presents ideas on personal loan shoppers, with transparent pricing, as one alternative model with untapped potential.

Here at IPA’s US Household Finance Initiative, we are focused on innovating and evaluating behaviorally-informed strategies to manage and reduce debt. Innovations in loan shopping are an underresearched avenue with great potential. USHFI is working with partners developing new kinds of products that use an understanding of the psychology of financial decision making to help consumers improve their household balance sheets and avoid drowning in debt.

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