

Information Acquisition and Privacy Protection in Financial Markets

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ABSTRACT

In 1999, Congress enacted the Gramm-Leach-Bliley Act, allowing a variety of financial institutions to sell, trade, share, or give out nonpublic personal information about their customers unless consumers direct that such information not be disclosed. We study a model in which firms offer financial products to individuals, such as mortgages, post prices for their products, and screen consumers who apply to purchase them. Despite competition, we find that firms search for too much information in equilibrium. When information obtained in the screening process can be traded to downstream firms selling related products, consumers are offered lower prices, and although they face higher screening intensities and rejection rates, they are overall better off.

We apply the results to the US mortgage market. By exploiting variations in the adoption of local financial-privacy ordinances in five California Bay Area counties, we are able to provide simple estimates of the effects of stricter financial-privacy laws on the denial rates of applications for home-purchase loans and loan refinancing during 2001-2004. Consistent with the model's predictions, we show that denial rates for both purchase loans and loan refinancing decreased in counties where opt-in privacy ordinances were adopted. Moreover, we find that during the financial crisis of 2007-2008, estimated foreclosure rates were higher in counties where the privacy ordinance was adopted.

This Privacy Workshop talk will in part be about making the connection between traditional models of consumer privacy and privacy in the presence of price commitments, and will in part describe the papers “Price Commitments, Screening Incentives, and Privacy Protection: A Theoretical and Empirical Analysis” (joint work with Jin-Hyuk Kim, available at: <http://goo.gl/Yo05W>) and “Information Acquisition in Competitive Markets: An Application to the US Mortgage Market” (joint work with Curtis Taylor and Jeremy Burke, available at: <http://goo.gl/pzL2F>).