

John Campbell and Tarun Ramadorai

How to Make Personal Finance Work for Everyone

On Monday, October 27, John Campbell and Tarun Ramadorai joined Markus' Academy for a conversation on their book, [Fixed: Why Personal Finance is Broken and How to Make It Work for Everyone](#). Campbell is the Morton L. and Carole S. Olshan Professor of Economics at Harvard University. Ramadorai is Professor of Financial Economics at Imperial College London.

A few highlights from the discussion.¹

- **[6:12] The problem**
 - The book begins with the five stories of people that have had hurtful encounters with the personal finance system, from:
 - (1) excessive student debt
 - (2) undiversified retirement savings
 - (3) little wealth at retirement because they saved in money markets and rates declined
 - (4) worthless mortgage payment protection insurance
 - (5) high-fee life insurance + investment bundles
 - These problems are systemic and growing as more people around the world enter the global middle class and are asked to solve harder personal finance problems (longer retirement, more expensive housing and education, fewer informal insurance mechanisms)
 - People's first encounters with the financial system can determine their trust in the financial system and market economy institutions
 - Distrusting the financial system, people may turn to informal alternatives like loan sharks, which will worsen capital allocation in the economy
 - The literature has shown that the poor earn lower (risk-adjusted) returns on their wealth, while they also pay more on their debt (Campbell et al., [2019](#); Bach et al., [2020](#))
 - People struggle with financial decisions because human intuition is poorly suited to these. We anchor on salient numbers, and do not think about exponential growth. We extrapolate from the small samples of personal experience (Malmendier and Nagel, [2011](#)), and confuse luck and skill
 - Important decisions are infrequent, so there is little experiential learning. We cannot learn much from others because shocks are correlated, while others avoid talking about times they lost money. Social learning exacerbates FOMO
 - Because of their difficulty people procrastinate taking these decisions, and do so only when they are under pressure to do so, often acting emotionally
 - Competition alone cannot solve these issues. Institutions supply the products demanded, not those in people's interests

¹ Summary produced by Pablo Balsinde (PhD student, Stockholm School of Economics)

- Rather than competing to reduce prices and increase quality, suppliers engage in unproductive competition (e.g. excessive bank branches, more realtors during real estate booms)
- They also actively obfuscate, offering complex and bundled products to prevent comparison
- Financial literacy alone isn't enough, as many products have regressive cross-subsidies embedded in their offering
- For example, in the UK adjustable-rate mortgages offer low initial payments (teaser rates), but inattentive borrowers end up paying more once their loan switches to a standard variable rate, effectively subsidising the attentive who refinance before the switch (Fisher et al., [2024](#))
- **[38:45] The specifics: what goes wrong in personal finance**
 - Personal finance currently fails to help people smooth life's ups and downs. With volatile incomes and limited savings or insurance, many are forced into costly short-term borrowing, often leading to debt traps
 - The lack of equity market participation is endemic, while the system also fails at helping people make crucial decisions like choosing a student loan repayment plan, or choosing a fixed vs variable rate mortgage (overcomplicated by the points system in the US)
 - Managing retirement has also become harder. People are living longer, receiving less family support, and must manage their own assets as defined-benefit plans give way to defined-contribution schemes. Persistently low real interest rates make funding retirement even more challenging
 - We are failing at having people reach the recommended wealth-to-income ratio of 6x at retirement, and of 4x at age 50
 - Many retirees are "house-rich but cash-poor". This is the annuity puzzle (Modigliani, [1986](#)), where too few people buy lifetime income annuities
 - The annuities market is in a bad equilibrium: products that might convert illiquid housing wealth into income like reverse mortgages face high marketing costs, low consumer understanding, and are not standardised
- **[48:02] Solutions: shove, don't just nudge**
 - Technology can lower fixed and search costs, and can allow for product customization. However it also makes it easier to exploit behavioral biases through things like gamified trading; it can also make it easier to price discriminate
 - Alipay for example offers mutual funds to people by ranking them by past performance, encouraging performance chasing
 - Financial education is valuable but insufficient. The industry keeps evolving, introducing new terms, tricks, and traps faster than education can keep pace
 - Teaching finance in high school is abstract, as students are not yet making major financial decisions
 - Nudges can deliver striking short-term results but often fade over time. They can also have unintended effects. Automatic enrollment in 401(k) can boost retirement savings, but this can be offset by increasing household debt

- Further interventions are needed. Consumer protection authorities should have the ability to “name and shame.” Regulators should have tools to change prices, including price caps if necessary
 - A litigation safe harbor can also help reduce costs for suppliers. Regulatory action has often been retroactive, only punishing products ex post
 - Regulators should impose a fiduciary duty on all financial advisors to mitigate conflicts of interest. However doing so on the entire financial sector is likely to hurt innovation and raise costs
 - Market power can be curbed by requiring standardized product offerings and regulating units in which prices are quoted
 - We can also fight biases with biases, promoting savings accounts aligned with mental accounts or prize-linked savings
 - Direct government provision of financial services is ill-advised in today's high-tech world
- **[1:04:49] A new vision: a personal finance “starter kit”**
 - Regulators should design standardized products and ensure it is mandatory to make them available: a personal finance starter kit. These products would become cheaper to market and easier to comparison-shop
 - 4 design principles: simple, cheap, safe and easy. Having simple price structures would facilitate comparison shopping
 - An example is the Basiskonto in Germany, a basic payment account. Transaction accounts today do not pay interest nor charge fees. This is confusing. Accounts should pay money market interest and charge clear fees
 - APRs are hard to follow, and should be complemented with scenarios where dollar costs can be quoted
 - Loans should avoid tripwire fees, such as overdraft charges or late fees, that trigger large penalties for minor delays. Fees should be continuous
 - Credit should be linked to borrowers' capacity to repay, their future income, rather than to current spending, resembling a paycheck advance rather than “buy now, pay later” schemes
 - In mortgage markets, teaser rates (UK) and upfront points (US) should be eliminated. Ideally there would be automatic refinancing
 - Insurance products should clearly disclose eligible claims and payouts
 - Retirement saving is fragmented across a plethora of account types: profusion leads to confusion. There should be a single, standardized account with automatic enrollment starting at first employment
 - These problems are serious not only because of their direct impact on individuals, but because the unpopularity of finance spills over into distrust of the market economy and the institutions that sustain it
 - Personal finance is a structural societal issue, not just a self-help problem
 - There have been proposals covered in the media to include private equity in 401(k) plans. The argument is that people should invest in the “market portfolio,” and that private assets should naturally be included
 - However, these proposals should be approached with healthy skepticism. Individuals would likely not hold these private assets directly. They would do so through high-fee funds that may engender adverse selection, receiving

lower-quality private investments than those of large institutions or ultra-wealthy investors

- Moreover, if participants can set their own portfolio weights, they are likely to overallocate to private equity, attracted by its artificially smooth reported returns. Universities have tended to overinvest in private assets for the same reason

Timestamps:

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[1:04:49] A new vision: a personal finance “starter kit”