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Beware Online Loan Calculators

The default settings could influence consumers to choose more expensive loans, a new study finds



Research shows that people have a tendency to stay on or close to default settings. PHOTO: PETER OUMANSKI

By Lisa Ward

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Loan calculators on financial websites often have a default setting that shows the amount, interest rate and payment period for a hypothetical loan. But those default settings—which provide an intuitive example of how the calculator works—could do more harm than good.

According to a study published online in the *Journal of Behavioral and Experimental Finance* in June, borrowers unconsciously could be manipulated into choosing a more expensive loan, depending on the calculator’s default settings.

The researchers found that people were almost two times more likely to choose a longer-term loan if their online calculator’s default setting had a five-year loan or longer, compared with participants who had a one-year loan as the default setting on their calculator. Extending a loan even just for a single year can have a big impact on what borrowers end up paying.

In the study, which was conducted in Ireland, participants had to pay the equivalent of about \$522 extra when choosing a four-year loan over a three-year loan, according to Shane Timmons, one of the study’s co-authors and a post-doctorate research fellow at the Economic and Social

Research Institute in Dublin, Ireland. The other authors were Peter D. Lunn, founder of the Economic and Social Research Institute's Behavioral Research unit and an adjunct professor at Trinity College in Dublin, and Féidhlim P. McGowan, a former research assistant at the Economic and Social Research Institute who is now working on a doctorate.

The study builds upon behavioral-economics research showing that people have a tendency to stay on or close to the default setting and use reference numbers to make choices, even if those numbers are totally random.

Researchers have used these insights to encourage employees to set aside more in their 401(k)s or taxpayers to save a certain percentage of their tax refunds. There has been much less research on how defaults influence which loans borrowers choose and how lenders might subtly influence their choices, though previous research from Dr. Lunn has shown that when the size of a monthly repayment is highlighted, consumers tend to choose longer-term loans, but when the amount of accrued interest is highlighted, they pick loans with shorter repayment schedules.

The Irish Competition and Consumer Protection Commission funded the study. Before the research began, the commission along with the study's authors, compared the default setting on lenders' online calculators with those on independent websites' loan calculators. They found that lender calculators tended to display longer loans—five years, on average—than those on independent sites, where the default settings typically showed loans lasting a single year.

In their study, the researchers gave participants a loan calculator and asked them to search for a €10,000 (\$11,170) loan.

The 180 participants were randomly put into two groups. One group used calculators with a one-year default setting, and the other group used calculators with default settings of five or more years. Most participants chose to evaluate several loans with their online calculators.

Dr. Timmons had two theories as to why the default setting had the effect it did. First, he says, the calculator's default setting may have acted as a starting point to compare other loans. Second, participants may have attached meaning to the default setting, seeing it as either a social norm, telling them the most popular choice, or as a prescriptive norm, a recommendation on the best choice.

Understanding how people interpreted the default setting could help researchers design better interventions. But for now, consumers might be better off if they make decisions about loans or other types of financial products by using online tools from independent websites that have no prepopulated information in its online calculator. Only when consumers know exactly the product they want to purchase does Dr. Timmons advise going to the lender's website to shop for a loan.

Ms. Ward is a writer in Mendham, N.J. Email her at reports@wsj.com.

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