



# Tools to enhance consumer decision-making in financial services: Pros and cons

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Disclaimer: These are not necessarily the views of any organisation with which I am associated.

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# Introduction

- ❖ Increased focus in financial services regulation (as elsewhere) on behavioural economics.
- ❖ Reflected in ongoing FCA consultation on ‘Our Future Approach to Consumers’:

*“Behavioural research shows us that consumers are not the economically rational “super consumers” research models might assume.*

*We will continue to base our interventions on how individuals in markets behave in practice, rather than just according to theory.”*



# Behavioural economics: Three key points

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- A. Behavioural economics doesn't imply chaotic or even unpredictable behaviour. In fact, we observe *systematic* biases in human behaviour.
  - This in turn means that it is possible to include behavioural economics within IO theory models, and also that
  - Empirical work can allow us to better understand, but also predict, behaviour.
  
- B. Behavioural biases may not be 'irrational', but a rational response to the fact that fully logical cognitive thought takes time and energy:
  - See Daniel Kahneman, Thinking Fast and Slow
  
- C. Behavioural biases aren't restricted to more vulnerable (or less intelligent or well-educated) members of society:
  - We can – and do – all exhibit such biases, albeit to differing amounts.

# My research work

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- ❖ Commissioned by consumer body Which? to review available evidence on the use and impact of interventions which are designed to enhance consumer decision-making (I call these ‘demand-side remedies’ or DSRs)
- ❖ Evidence is mostly (but not exclusively) from UK: Drawing on *ex post* evaluations and follow-on reviews, as well as academic research and *ex ante* remedy-testing evidence.
  - Lots of evidence from FS, but also from other sectors.
- ❖ Covered:
  - What are the potential pros and cons of DSRs?
  - What do we see in practice?
  - What can we learn?

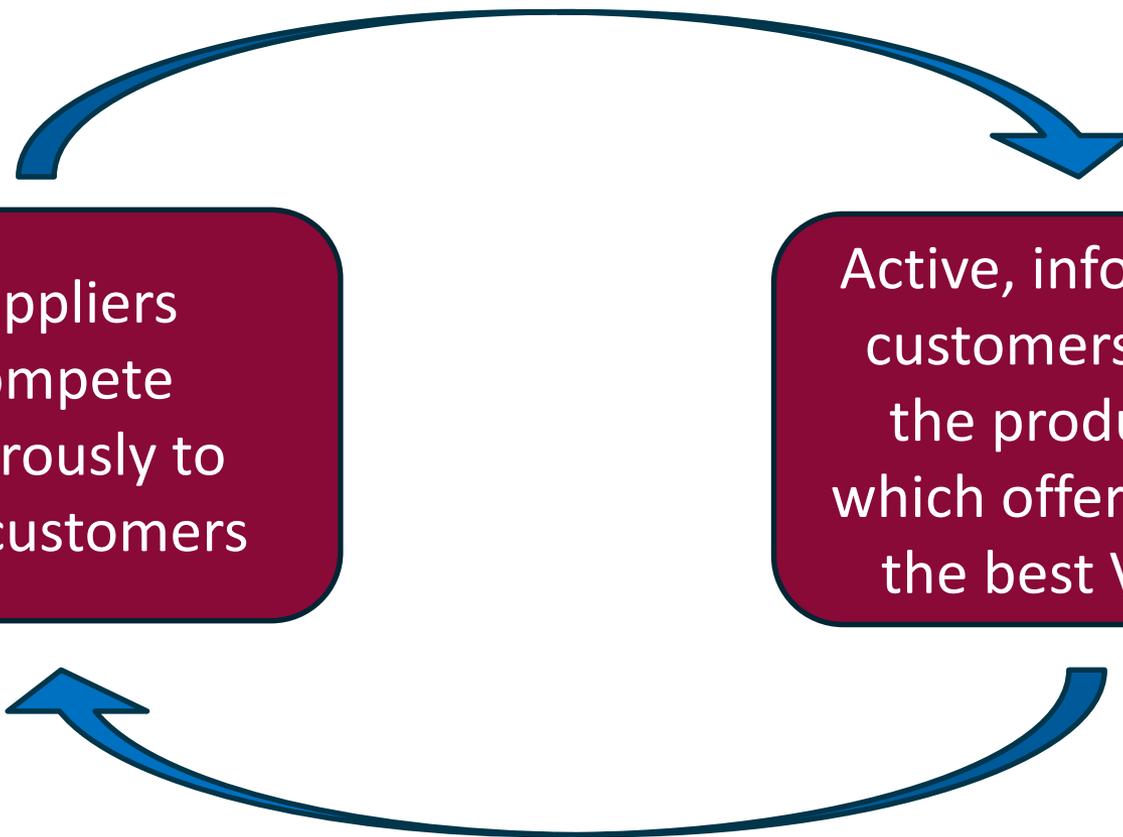
# Can think of well-functioning competitive markets can be seen as a virtuous circle

SUPPLY SIDE

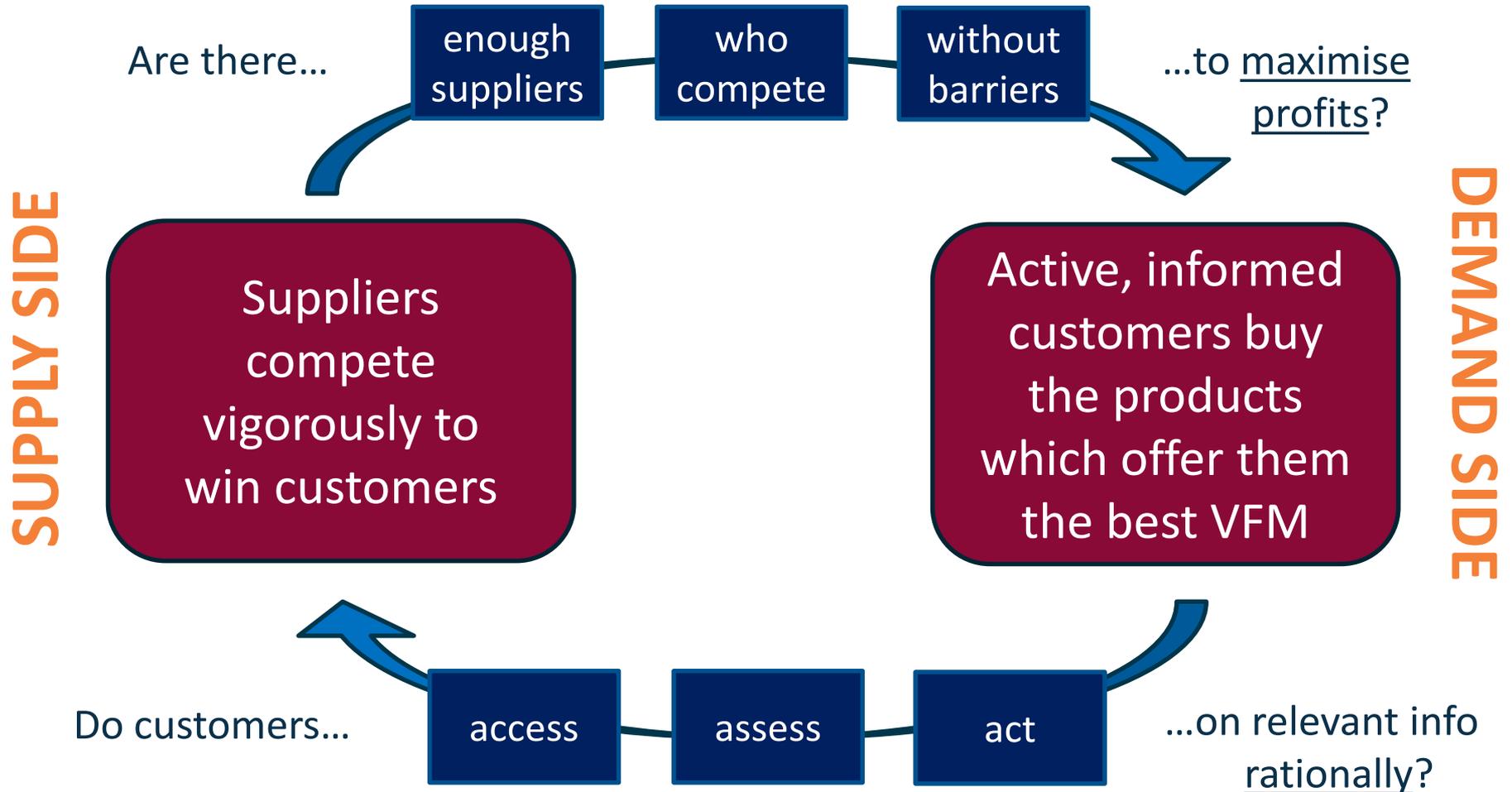
Suppliers  
compete  
vigorously to  
win customers

Active, informed  
customers buy  
the products  
which offer them  
the best VFM

DEMAND SIDE



# But the circle only works fully effectively under certain conditions



# Interaction with already well-known D-side info issues and costs...

	We already knew...	Added impact of biases...
<b><u>Barriers to Access:</u> Asymmetric information</b>	Consumers may know less about products than their suppliers.	AI issues worsened if customers find it hard to digest info received!
<b><u>Barriers to Assess:</u> Shopping around (search) costs</b>	It may be costly to seek out product information across suppliers.	Search worsened if customers find it hard to compare info!
<b><u>Barriers to Act:</u> Switching costs</b>	Switching product or supplier can be costly.	Switch costs worsened with customer inertia or status quo bias!
<b>Other behavioural biases</b>	Customer can be 'myopic', lack self-control, 'over-confident', loss averse, poor at assessing risk.	

# What are DSRs?

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- ❖ Tools to enhance decision-making by real consumers.
- ❖ Some DSRs involve direct action by regulators.
  - Eg consumer awareness campaigns
- ❖ More typically, DSRs are imposed on firms.
  - Affect how firms engage with consumers.  
  
(NB Gives rise to a tension, given that firms often understand best how to engage effectively with their customers)
- ❖ Traditionally, DSRs involved giving consumers tools to improve decision-making (eg better information, lower search and switching costs).
- ❖ More recently, and especially since 2008-10, observe a greater focus on how consumers really behave, leading to a more focussed interventions in terms of 'choice architecture', or 'nudges'.

# Key categories of demand-side remedies – and the impact of Behavioural Economics

## 1. Disclosure remedies

- Pre 2008: Focus on asymmetric info issues
- Since 2008: Recognition that more info may not be enough, and could even be harmful. Focus on 'smarter consumer communications'

## 2. Shopping around remedies

- Pre 2008: Focus on reducing search costs
- Since 2008: Greater focus on triggering shopping around and facilitating good decision-making

## 3. Switching remedies

- Pre 2008: Focussed on reducing switching costs
- Since 2008: Greater focus on overcoming behavioural barriers to switching

# 1. Disclosure remedies – Key sub-categories

i. Disclosure to purely address asymmetric information

- Domestic bulk LPG (info on prices)
- Care homes (info on prices/quality)
- Doorstep selling (info on rights)

ii. Disclosure to improve consumer awareness

- **Store cards (font size)**
- **Cash savings ('one click' to rates)**

iii. Disclosure to facilitate comparison across products

- **Consumer credit: incl. use of APRs**
- **Unarranged overdrafts: 6 scenarios**
- Printer ink: Standard for comparison

iv. Disclosure remedies to stop consumers being misled

- Payment surcharges for airlines
- Broadband advertising

v. Disclosure to aid use of product by existing consumers

- **Unarranged overdrafts: Text alerts**

## 2. Shopping around remedies

### – Key sub-categories

i. Remedies that facilitate collation of information to enhance search/comparison (eg PCWs or other TPIs)

- **Home credit/extended warranties: Industry to set up PCW**
- **Payday: Suppliers to provide data to PCW**
- **Rules/accreditation to enhance PCW standards: Energy vs payday**
- **Home credit: Data sharing with CRAs**
- **Banking/energy: Midata initiative**

ii. Remedies that enhance effectiveness of TPIs

- Heating oil: Coverage claims
- **Payday: Rules around display of results**
- **Motor Insurance: Ban on wide MFNs**
- **Financial advice: Commissions**

iii. Remedies that trigger, de-risk or require shopping around

- New car warranties campaign
- **Cash savings: Interest notifications**
- **GAP: Point-of-sale sales ban**
- Microsoft Internet Explorer

### 3. Switching remedies – Key sub-categories

i. Switching remedies that involve changing contractual provisions

- Energy: Ban on termination fees for default tariffs
- **Home collected credit: Limit on early settlement fees**
- Domestic bulk LPG: Decoupling of LG supply from ownership of tank
- New cars/printer inks: Dropping of warranty restrictions

ii. Remedies that make switching quicker, easier, more reliable or more attractive

- Telecoms: Gaining provider led switching and mobile number portability (MNP)
- **PCAs: 7-day switching service (CASS)**
- **Cash savings: 15 day switching**
- **Cash savings/pensions: Move towards 'aggregators'**

# DSRs: What are the potential downsides?

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- ❖ *DSRs may be unnecessary*
  - Consumers may learn. Or suppliers/the market may solve the problem
- ❖ *DSRs may be ineffective or only partially effective*
  - If implemented badly, if non-compliance or if badly designed
  - Or may inherently be only partially effective, especially in markets characterised by price discrimination.
- ❖ *DSRs may be disproportionately costly*
  - In absolute terms, or in terms of opportunity costs and changed incentives.
- ❖ *Supply-side reactions can make DSRs less effective or even harmful*
  - Tick-box approach to compliance or more subtle price effects
- ❖ *DSRs can create losers as well as winners*
  - E.g. a change in choice architecture that reduces over-purchase by some can lead to under-purchase by others. Supply-side reactions also relevant.

# 1. Disclosure remedies – Effectiveness

What worked?

- Domestic Bulk LPG: 57% compared prices
- **Store cards: usage, balance and APRs all fell. Warnings for APR>25% effective. NB Some benefit during review!**
- Printer ink: Much used in mags (albeit not instore)
- Text alerts for unarranged overdraft charges
- Payment surcharges likely to have worked well

And what didn't?

- **Extended warranties: patchy compliance (35%)**
- Care homes: Info on quality provided too late
- TCRs: Limited consumer awareness (18%) and lack of clarity about how to use them
- **UOCs charging scenarios: Too complex, hard to find**
- **APRs: Too simple to convey what matters in some cases**
- Doorstep selling: Less shopping around!

## 2. Shopping around remedies – Effectiveness

What worked?

- **Financial advice: Significant decline in sales with higher commissions post-RDR**
- **Extended warranties: 74% know can shop around; 15% do**
- Microsoft Internet Explorer: More substantial drop-off in market share in EU than in US.
- **Cash savings notifications likely to work (based on RCTs)**

And what didn't?

- **Home collected credit PCW: Low and falling usage, partly due to low awareness and no click-through functionality**
- **Extended warranties: Only has one stand-alone supplier!**
- Heating oil: PCWs still lack transparency and functionality
- **Home collected credit requirement to provide data: Limited impact partly due to cost of data**
- **Midata: Limited impact due to cumbersome process**
- New car warranties: Limited reach – only 6% of buyers

### 3. Switching remedies – Effectiveness

What worked?

- New cars/printers inks: Removal of warranty restrictions very effective.
- Domestic bulk LPG: Initial signs good when reviewed
- Energy: Ban on termination fees for default tariffs presumably positive, since CMA has extended to SMEs!
- Telecoms: Cho et al (2014) find MNP to have reduce prices by around 8%

And what didn't?

- **PCAs: Limited awareness and confidence in CASS. CMA has now proposed long-term promotion campaign. Also longer re-direction and provision of transaction history.**
- **Cash ISAs (CMA remedies): Limited awareness or actual switching. Led FCA to reduce time further but also put in place a further package of remedies**

# Key lessons - General

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- ❖ Disclosure can enhance consumer understanding and awareness, comparison across products, and trigger engagement. But...
- ❖ Compliance matters.
- ❖ Consumer behavioural biases matter. The effectiveness of disclosure can be affected by *how* the disclosure is presented, *who* does the disclosure, and *where*, and *when*. Sometimes it can be better to disclose less!
- ❖ In ensuring that disclosure really facilitates comparison across products and providers, rules may have to be fairly prescriptive.
- ❖ Consumer testing can be hugely valuable in assessing how consumers really use information to make decisions, and worth spending time on.
  - NB CMA requirement on firms to cooperate in energy/banking.
- ❖ It is important to consider the supply-side response to any remedy.

# Key lessons – Digital Comparison Tools

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- ❖ DCTs can be valuable in enhancing consumer decision-making. But...
- ❖ Regulators need strong understanding of relevant technology, and likely developments, while remaining humble about ability to predict future.
- ❖ Good ongoing governance of a remedy can enhance its flexibility.
- ❖ It can be better to facilitate or trigger creation of commercial PCWs than to mandate their existence or for regulators to create them themselves.
  - NB a requirement to provide data to PCW is different to a requirement to provide a smooth ‘customer journey’.
- ❖ Data-sharing remedies likely to work better when data is provided directly to PCWs, with consumers’ permission, rather via consumers.
- ❖ Incentives of commercial PCWs may not be fully aligned with consumer interests, so there may be a rationale for regulating PCWs. Accreditation is a useful tool, but only if affects practice across the market.

## Further general conclusions – Substance

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- ❖ Pure information asymmetry and switching costs do matter – It is important not to get too carried away with behavioural economics.
- ❖ When behavioural biases *are* important, the BIT’s ‘EAST’ mnemonic is useful. That is, remedies should be **E**asy, **A**tttractive, sensitive to **S**ocial influences and **T**imely.
- ❖ Remedy design should be considered early, and with a strong focus on being precise about the issues consumers face.
- ❖ Given the complexity of issues, it is unlikely that any one remedy will provide a complete solution. Packages of remedies will be needed.
- ❖ It can take time – and frequent revisiting of the market – to make remedies as effective as possible.
- ❖ Remedy review is also valuable, through sunset clauses, commitment to future review, or a robust programme of *ex post* evaluation.

# To conclude (on DSRs)

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- ❖ The tone of debate around DSRs is important.
  - Regulators should avoid appearing to blame consumers, or suggesting they are behaving irrationally.
- ❖ We are not in a world of first best solutions. DSRs can be valuable, where they are effective, but they are unlikely to be a panacea.
  - Almost all interventions will have costs as well as benefits – as well as winners and losers.
- ❖ As such, regulators face difficult choices in this area. There may be a role for outcome control remedies (as for payday lending), but caution is needed!
- ❖ See further: Amelia Fletcher (2016) “The Role of Demand-Side Remedies in Driving Effective Competition: A Review for Which?”:
   
<https://www.staticwhich.co.uk/documents/pdf/the-role-of-demand-side-remedies-in-driving-effective-competition-456067.pdf> .



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