Ad Hoc Expert Meeting on Financial Consumer Protection

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Behavioural Economics to Support Financial Consumer Protection

Presentation

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Behavioural Economics to support Financial consumer protection

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Behavioral Economics

- Behavioral economics seeks a more accurate understanding of consumer behavior and the factors that influence human decision-making processes- (psychological, emotional and social)

- It studies the enablers and inhibitors such as mental effort and faulty reasoning that impact consumer intentions and perceptions

Classical/Traditional Economics

- Classical economic theory assumes consumers act rationally, making informed choices using available information to maximize utility.

- BE proponents challenges this traditional assumption of a rational man, emphasizing the importance of comprehending deviations from rationality
- Bounded/imperfect rationality- decisions are limited by the inability to foresee the future, time, income and information constraints. Heuristics -mental shortcuts, rules of thumbs and biases leading to fast but suboptimal choices
- Behavioral economics also emphasizes the impact of framing (positive and negative), where the presentation of choices influences decisions. E.g. 90% low fat or 10% fat

Behavioural Economics Concepts/theories

- **Nudging**

Predictably influencing consumer behavior from default choices towards more suitable and valuable options. E.g. healthy fruit on eye level

- **Herd behavior**

Group imitations irrespective of the validity of decision or available information. Driven by social norms or a group think.

- **Overconfidence**

Unwarranted belief in one's ability to achieve goals, succeed in business ventures, and overcome challenges.

- **Hyperbolic discounting**

Short-term gratification over long-term rewards delaying long-term planning and decision-making. E.g. age of applying for pension plans

- **Trust**

Reliance on others e.g. trading partners without individually verifying available information

Behavioural Economics- Biases

Subconscious psychological, sociological or physiological influences on decisions

- **Loss/Risk Aversion**

Sensitivity to losses than gains of similar magnitude. Forgoes potential future wins. E.g. $1000 win or loss

- **Cognitive Bias**

Focus on immediate needs, overlooking long-term considerations due to the depletion of cognitive resources

- **Optimism Bias (Overconfidence)**

Rushed judgements due to overestimation of abilities and underestimation of risks

- **Confirmation bias-** Tendency to prefer information consistent with one's beliefs
- **Familiarity bias-**Tendency to return to what people know without exploring new options
- **Status Quo Bias-** Resistance to change and preference for current or past situations

Debiasing strategies- Actions that reduce/eliminate the biases to achieve more rational value maximizing choices (cooling-off periods/information disclosure)

Application of Behavioural Economics to the finance sector

- **Nudging**

Personalized notifications for automated saving transfer and to increase investment notification

- **Herd Behavior**

Workplace pension programs influenced by colleagues

- **Loss Aversion**

Framing of mortgages to protect homeowners against unexpected losses

Application of Behavioural Economics to the finance sector cont.

- **Overconfidence**

Information disclosure, assessment and cooling-off periods for overconfident borrowers that may underestimate the impact of high-interest rates and ability to repay.

- **Hyperbolic Discounting**

Pension plans offering an immediate tax benefit to address the preference for short-term rewards. FSPs incentivizing savings and investments using gaming

- **Trust**

Blockchain by peer-to-peer lending platforms to eliminate intermediaries and build trust. Insurtech companies to create an immutable record of policies and claims

Legal and ethical challenges to consumer protection

Information Transparency and Full Pricing Disclosure

Legal frameworks often mandate FSPs to provide transparent information to consumers (T&Cs, fees, risks and pricing structures of financial products/services

Imbibe fairness and honesty and trust to consumers make informed decisions, autonomous decisions that align with their preferences and values.

Information overload, complexity of financial products and standard contracts.

Legal and ethical challenges to consumer protection

Information Asymmetry and Aggressive Advertising

Legal frameworks need to reduce information asymmetry, ensuring that transacting parties have access to relevant information to make informed decisions

Regulations should curb deceptive or misleading advertising practices. Advertising should be fair, honest, reasonable and non-discriminatory

Online lending platforms- notifications

Legal and ethical challenges to consumer protection

Informed Consent and Autonomy

Implementing behavioral interventions without clear and informed consent infringe autonomy. E.g. automatic enrollment in financial products (default bias), without full understanding

Manipulation and Exploitation

Behavioral strategies- designing user interfaces or using targeted ads to encourage impulsive spending is unethical for being manipulative or exploitative

Could impact certain demographics more than others, exacerbating financial disparities

Privacy Concerns

Gathering and using behavioral data for financial decision-making raise privacy concerns.

Business Implications/Recommendations

Implement clear and straightforward communication of financial terms and conditions.

- Simplify complex information in simple, fair, accessible and easily understandable language to improve consumer understanding.

Promote Consumer Autonomy in applying BE concepts

- Respect consumer autonomy in decision-making processes
- Build trust and foster ethical guidance

Encourage Consumer Awareness and Activism

- Promote financial literacy and capability
- Encourage and respond to consumer feedback to improve services and build trust
- Establish efficient and consumer-friendly mechanisms for dispute resolution.

Utilize Technology Responsibly including Ethical Advertising

- Leverage technology to transparently communicate product benefits and enhance understanding without exploiting biases
- Prioritize consumer welfare by aligning advertising with ethical standards

Policy implications/recommendations

Enhance Transparency and Mitigate Information Asymmetry

- Enforce regulations that mandate clear and transparent disclosure of financial terms and conditions.
- Implement measures that promote autonomy and fairness in financial transactions

Promote consumer protection and encourage activism

- Support platforms for consumer activism, and mandate the creation of clear and accessible dispute resolution channels
- Collaborate with industry experts to ensure regulations adapt to the evolving financial landscape while prioritizing fairness and autonomy.

Educate and Empower consumers

- Support and incentivize financial literacy in collaboration with educational institutions and private entities
- Establish clear guidelines for businesses on the responsible implementation of behavioral nudges.

Address Biases Fairly

- Develop and review guidelines to identify and rectify biases in financial products and services.
- Develop guidelines for the responsible use of technology in financial services.

Concluding remarks

Behavioural economics concepts can improve consumer services is employed fairly and effectively

Striking a delicate balance between consumer protection, education, and autonomy is paramount, to foster fairness in an increasingly complex and digital financial landscape.

Thank you!

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