CAPCO

BEHAVIOURAL SCIENCE:
A KEY INGREDIENT IN YOUR CONSUMER DUTY STRATEGY

INTRODUCTION

Coming into force this summer, the FCA's new Consumer Duty rules set higher and clearer standards of consumer protection across financial services and require firms to put their customers' needs first, with a new Consumer Principle requiring that firms act to deliver good outcomes for retail customers.

The FCA's new Consumer Duty is the biggest shift in conduct regulation seen by the industry for a decade. The rules require firms to consider the background of their customers, including those with characteristics of vulnerability, how they behave at every stage of the customer journey, and understand and evidence whether the Consumer Duty outcomes are being met. With the rules for new and existing products or services set to come into force on 31st July 2023, the window for compliance is closing fast[1].

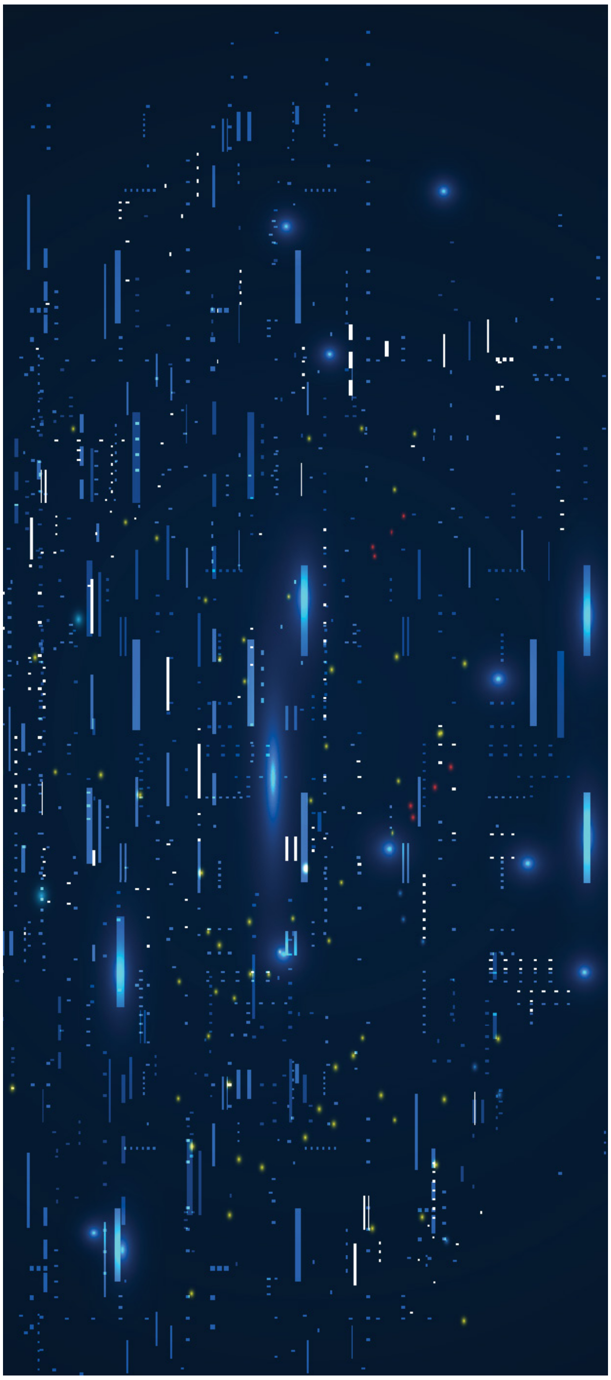
[1] https://www.fca.org.uk/publications/policy-statements/ps22-9-new-consumer-duty

BEHAVIOURAL SCIENCE AND ITS RELEVANCE TO CONSUMER DUTY

Sitting at the intersection of psychology, neuroscience, sociology, and economics, Behavioural Science explains how and why individuals make conscious and unconscious decisions that lead them to act in a certain way. Unconscious decisions are sometimes driven by cognitive biases, which are mental shortcuts which may save time but can ignore key data that is required to make informed decisions in changing environments.

Behavioural Science explores how individuals can be motivated to bypass their cognitive biases and instead process the available information rationally, with a view to ensuring better decision making. Accordingly, when addressing customer biases, such insights can provide firms with additional guidance to protect customers and optimise their outcomes.

This understanding has application in respect of the Consumer Duty – whilst acknowledging that consumers are ultimately responsible for their own decisions or actions, the Duty effectively obliges firms to protect customers from the cognitive biases that may cause them to make decisions that are not in their own best interest[2].



[2] https://www.fca.org.uk/publication/finalised-guidance/fg22-5.pdf

USING BEHAVIOURAL SCIENCE TO SUPPORT CONSUMER DUTY OUTCOMES

The Duty is composed of four outcomes relating to (1) products & services, (2) price & value, (3) consumer understanding and (4) customer support. Behavioural Science can support the successful implementation of these four outcomes by providing key behavioural insights needed to effectively design customised behavioural interventions.

1. Products and Services

Firms are required to ensure all products and services are fit for purpose, for a defined target market, and distributed appropriately. Behavioural Science can support this outcome by clarifying how consumers make decisions when purchasing products or services.

Behavioural insights are drawn from data to identify cognitive biases that affect consumers when deciding whether to purchase products or services. Examples of these biases include:

- **Affect Heuristic** – This occurs when consumers make decisions to purchase products based on their emotional reactions, rather than making objective evaluations based on the available evidence (e.g. entering into a gambling transaction because they are feeling lucky, or withdrawing money from long-term investment funds to make an impulse purchase they had not budgeted for). Providing an opportunity for individuals to step back and think through their decision more carefully can prevent them from making rash or emotionally driven choices.
- **Limited Attention Bias** – A consumer sees an advertisement for a product and only remembers the most attention grabbing details, such as the price or a familiar brand. They may not notice or consider other important information, such as fee information buried in the small print, and accordingly make their decision based on incomplete knowledge.

2. Price and Value

Firms must ensure that the price the customer pays for a product or service is reasonable relative to the overall benefits. This is not just in respect of monetary value (i.e. quantity), but also about value for money (i.e. worth) (e.g. unsuitable features which may lead to inconvenience or unnecessary stress for the customer). Behavioural Science can support this outcome by identifying what factors influence consumers' perceptions around price and value for money.

Behavioural insights can highlight consumers' cognitive biases when assessing the price and the perceived value of products and services. Examples of biases include:

- **Loss Aversion** – Consumers place a greater importance on the impact of losses over potential gains. Even if a pricing structure is positioned with equal focus on the costs and the features (benefits), the customer will place more importance on the lost money rather than on the gained benefits.
- **Decoy Effect** – The framing of products and pricing structures can influence which product is viewed as best value by the customer, leading them to make a choice which may not be in their best interest. For example, positioning a product in between two others which on the face of it seem to offer worse value (decoys) will lead the customer to choose that middle option.

3. Consumer Understanding

This outcome requires that all communications enable customers to clearly understand products and services on offer, their features and risks, and the full implications of any decisions they take. Behavioural Science can support this outcome by identifying areas where there exists a lack of knowledge or even confusion which must be addressed. This understanding can also be used to shape more effective marketing strategies, design better customer experiences, and develop targeted communications that resonate with customers.

Behavioural insights can clarify consumers' understanding of products and services. Some examples of biases include:

- **Salience Bias** – When receiving a communication, such as an email, a customer's attention will jump to what they perceive as the most salient piece of information, and are unlikely to read all the content. It is therefore important to ensure that the key message and action points are clearly and prominently presented to draw the customer's attention without too much effort.
- **Anchoring Effect** – A customer might see a product for the first time advertised at a higher price than its real market value. The customer then assumes that such price is the product's actual price and it becomes an 'anchor point'. Therefore, when the customer sees the product advertised at a relatively lower price, their perception is that the price is below market value and decide to buy it as "it is a good deal". However, if they hadn't relied on that initial information and instead done market research, they might have found that the price is actually still above market value and decided not to buy the product.

4. Consumer Support

The Duty requires that firms provide support to customers across the lifecycle of a product and customer relationship. In addition, businesses should strive to provide clear terms of service and accurate information about their products. Behavioural Science can support this outcome by illuminating consumers' needs and motivations and providing evidence-based solutions to address them.

Behavioural insights can clarify consumers' needs in relation to a firm's products. It is worth noting that there can be a gap between what the customer needs and what the customer wants. Biases might include:

- **Inertia** – Consumers prefer to stick with the way things are now. This leads to procrastination when embracing change, deterring customers from switching bank accounts, cancelling products or trials, or comprehensively searching for the products that best meet their needs. Similarly, a consumer may initially open an instant access saving account with a low interest rate with the intention of upgrading later, but due to inertia they don't trade up to a fully-fledged savings account with better interest rates, and end up leaving their entire life savings in these sub-optimal accounts.
- **Confirmation Bias** – A customer assumes that their personal information is secure because the company has stated they have strong security measures in place. Because the customer believes that the information is secure, they ignore any reports or warnings about potential vulnerabilities that are inconsistent with their beliefs, even though these could put their data at risk.

HOW BEHAVIOURAL INSIGHTS CAN DRIVE ETHICAL BEHAVIOURAL INTERVENTIONS

Behavioural insights can be used to inform the design of behavioural interventions that help protect consumers from the potential risks associated with certain products or services. One way to achieve this is via ‘nudges’, which alter the environment in which someone makes a decision in order to influence behaviour without taking away an individual’s freedom of choice.

Nudges can address more than one cognitive bias and support more than one Consumer Duty outcome at a time. Scientific methods that rely on data are used to assess their effectiveness. Examples of nudges that align with the Duty’s outcomes include:

- Screen pop ups incorporating neutral third-party reviews that highlight the product’s benefits and risks prior to the payment screen, allowing the customer to make an informed decision
- Automated reminders or notifications highlighting when a product trial is about to expire or when renewal dates are approaching, allowing customers time to properly review their options
- Providing a comparison of similar products on the market to allow customers to customize their choices based on their specific needs and preferences
- Issuing communications that are short and to the point, incorporating clear calls to action to ensure all customers (including vulnerable individuals) can understand and process any relevant information
- Incorporating a cooling off period for riskier products or transactions (e.g. temporarily blocking gambling transactions or savings account withdrawals). These blocks can only be lifted by contacting customer services and having a conversation about the reasons for proceeding and the potential drawbacks.

It is important to note that the ethics of nudges are key, particularly within the financial ecosystem. Nudges should respect freedom of choice and not remove options or significantly change economic incentives. A ‘light’ nudge is deemed ethical, as it steers the customer to make a decision that is in their best interest, whereas a ‘dark’ nudge serves morally unsupportable goals (such as abusive selling) and are centred around a firm’s own interests rather than those of the customer.

To ensure a nudge is ethical, transparency is vital. This can be accomplished by involving the target audience in the design of a nudge and determining their opinion after experiencing it. Monitoring the nudge through the testing and documentation of the end result can enhance the final impact.

Financial institutions need to review and remove any ‘dark’ nudges that may be inadvertently weaved into their products. Ed Smith, the FCA’s Head of Competition Policy, has stated that firms are taking advantage of customers’ behavioural biases. An example might include attracting customers at the point of sale through impulse purchase add-on products that don’t meet customer needs and can represent poor value. In this example, the ‘bundling’ of such add-ons will need to be reviewed and likely removed.

Capco’s Behavioural Science methodology identifies behavioural insights, and designs tailored and ethical behavioural interventions that provide controls to protect consumers and ensure they have good outcomes.

Our Behavioural Science practice identifies dark nudges across the four Consumer Duty outcomes and replaces them with light nudges. This approach leads to increased customer satisfaction, improved customer loyalty and trust, better product or service adoption rates, increased sales revenue and profits, and reduced complaints and refunds.

At Capco, we believe that we are well placed to partner with you to help co-design and implement your Consumer Duty strategy. To learn more, please contact us.

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ABOUT CAPCO

Capco, a Wipro company, is a global technology and management consultancy focused in the financial services industry. Capco operates at the intersection of business and technology by combining innovative thinking with unrivalled industry knowledge to fast-track digital initiatives for banking and payments, capital markets, wealth and asset management, insurance, and the energy sector. Capco's cutting-edge ingenuity is brought to life through its award-winning Be Yourself At Work culture and diverse talent.

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