

# Applying behavioural insights to regulated markets

**The Behavioural Insights Team for Citizens Advice**

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## Forward from Citizens Advice

The insights from behavioural economics are now a well-established feature of public policy debates. In fields from pension saving to healthy eating, they have allowed policy makers to nudge people towards better outcomes in light touch ways. At Citizens Advice, we see real value in these approaches. Too often, policies and processes run against the grain of human nature, and the result is policy interventions that are both ineffective and inefficient.

If there is one area of our work in which we see particular value for behavioural insights, it is in our role as consumer champion. Consumers today have to make a bewildering array of decisions on everything from energy suppliers to insurance products. We often turn to rules of thumb to make these judgments, such as 'shop around for the best price'. It's no surprise that, in some instances, businesses take advantage of these rules. Fees get hidden until the last minute, refunds are a hassle to claim, and our natural inertia is reinforced by intentionally clunky or time-consuming switching processes. As a result, we make decisions we later regret.

Behavioural economics helps us to think systematically about these problems. And thankfully, the same insights can also help with solutions. Once we know the rules of thumb people use, and the way these rules tend to err, we can design consumer protections that are both less intrusive and more effective. Default options, voluntary caps and trigger points can make choices easier—and therefore keep up competitive pressures on businesses. Meanwhile, other rules, such as long Terms & Conditions that no-one reads, can be made both less burdensome *and* more impactful for consumers.

We commissioned the Behavioural Insights Team to take examples like this and run with them, asking: how might our approach to consumer policy differ if we took behavioural insights to heart? While this is not the first work on this topic—regulators and companies themselves have thought hard about parts of this question—it is one of the fullest treatments to date. And, as we hoped, the findings are both thought-provoking and, in places, challenging too.

The implications of behavioural economics for consumer policy, as in other fields, will be argued over for some time, and there will be differing views on the ideas floated in this report. But the central insight is unarguable: consumer policy works best for both consumers and businesses when it runs with, and not against, the way people actually behave.

We would like to thank the Behavioural Insights Team for responding so creatively to the brief. We hope this report proves to be a timely and helpful contribution to the debate.

James Plunkett

**Director of Policy & Advocacy**  
Citizens Advice

*Citizens Advice commissioned the Behavioural Insights Team to write this report as a contribution to ongoing debates about the role behavioural insights can play in regulation markets. The policy positions outlined in this report do not necessarily reflect the policy positions of Citizens Advice.*

## Executive summary

Collectively the UK public is overpaying for mobile phone contracts by £355 million a year<sup>1</sup> while in the energy market millions of households could save over £300 by switching supplier.<sup>2</sup> Similarly, estimates suggest that up to 80% of consumers are missing out on the best deal for their annuity (Wells, 2014), costing consumers between an estimated £230 million and £1bn a year in terms of lost lifetime income.<sup>3</sup> Taken together these statistics present compelling evidence that markets are not delivering the best outcomes for consumers. The justification for regulatory intervention and the core role of regulators is to correct market failures and the consumer detriment arising from those failures. One explanation for why a traditional regulatory approach has not provided a complete solution in these situations is because it is underpinned by the belief that consumers act in a perfectly economically rational way, when it is clear that this is not the case.

There are two key problems with this approach. First, there is compelling evidence that consumer decision-making systematically strays from what would be expected from a 'rational actor' within economic theory. These systematic deviations, termed 'behavioural biases', can result in 'behavioural market failures', leading to poor outcomes for consumers. Exacerbating these behavioural biases is the reality that people lead busy lives, and the extent to which they are willing and able to devote time and energy to making decisions in consumer markets is limited. Additionally, suppliers are incentivised to play on consumers' behavioural biases in order to discourage consumers from switching suppliers or encourage them to buy unnecessary additional products (Akerlof & Shiller, 2015b). The terms 'irrational' and 'biases' are sometimes seen to imply a judgment on consumer behaviour. It is important to note that throughout this report we do not use these terms to make value judgements. Rather, we use them in the spirit of behavioural literature: to describe a systematic deviation from a response or decision that would be expected from a perfectly rational actor (Soman, 2015).

Second, the assumption that consumers are rational actors can lead to unnecessary, complex red tape which is inefficient for business and provides no real benefit for consumers; a good example of this is terms and conditions. Businesses are legally required to provide their customers with comprehensive information on their rights and obligations under the contract they are entering

<sup>1</sup> <https://press.which.co.uk/whichpressreleases/millions-of-pounds-wasted-paying-for-mobiles-people-already-own/>

<sup>2</sup> <https://www.gov.uk/government/publications/household-energy-savings-through-switching-supporting-evidence/many-households-could-save-around-200-per-year-through-switching-energy-supplier-basis-for-claim>

<sup>3</sup> [http://www.plsa.co.uk/PolicyandResearch/DocumentLibrary/~/\\_media/Policy/Documents/0215\\_Treating\\_DC\\_scheme\\_members\\_fairly\\_in\\_retirement\\_research\\_report.ashx](http://www.plsa.co.uk/PolicyandResearch/DocumentLibrary/~/_media/Policy/Documents/0215_Treating_DC_scheme_members_fairly_in_retirement_research_report.ashx)

into. However, very few people actually read or understand these documents, and are unlikely to divert limited time and resource away from other more enjoyable, or productive, activities to do so (ICA, 2015).

UK regulators are increasingly incorporating behavioural science into their approach. The progress to date is to be welcomed. However, there are real opportunities to build upon the foundations already laid and move towards a model of regulation which puts behavioural insights and securing good outcomes for consumers at its heart. In this report we introduce a set of principles for a new approach to regulation. We are still advocating what economics has long strived for in market design: good outcomes for consumers. However, instead of trying to make people behave more like rational economic actors, we are arguing that markets should deliver good outcomes by being designed in line with human behaviour.

This is not necessarily about introducing more regulation. Indeed, in some cases this approach may point towards the replacement of detailed regulations with principled-based regulations. These principles would set out the outcomes the regulator expects the market to deliver for consumers, but not the precise mechanisms through which they should be delivered. For example, this could involve regulators setting the criteria for non-price competition and building stronger feedback loops to send signals to the market about what good quality looks like. The ambition of this approach is that regulators can create competition on metrics that drive excellence in suppliers and intermediaries, not merely remove poor behaviour and deter abusive practices.

Regulators should be designing remedies with behavioural market failures at the forefront of their thinking, to help consumers make better choices for themselves and prevent businesses from exploiting their behavioural biases.

In this sense, regulators' primary purpose should be to facilitate markets working well by shaping remedies, testing and iterating to create the best outcomes for consumers. This is not about removing choice but instead making sure that consumers are able to make choices better in line with their true preferences. Pursuing this approach will also support and complement other regulatory goals, including minimising regulatory burden, supporting competition and ensuring reliable, sustainable markets.

This report is structured as follows:

- ◆ **Section 1** sets out the traditional justification for regulatory design, and makes the case to redefine this to reflect behavioural market failures.
- ◆ **Section 2** details the ways in which consumers' decision making systematically deviates from what would be expected from a 'rational actor' in regulated markets (specifically energy, telecoms, personal finance and pensions). It describes eight behavioural biases and explains how they influence consumer behaviour within regulated markets. These biases are: status quo bias; anchoring effects; choice overload; framing effects; present bias; temporal effects; overconfidence; and scarcity mindset. The biases are organised in order of magnitude against two measures: the amount of damage the bias causes the consumer, and the potential effectiveness of remedies. This section also briefly assesses examples of current regulatory approaches to address these biases, and concludes that a more systematic and deliberate approach is needed.
- ◆ **Section 3** puts forward a new vision for the regulation of consumer markets, focussing in on four key areas. First, set the criteria for what a well-functioning market looks like from a consumer perspective. Second, collect and publish data to see whether the market is performing on a 'well functioning' scale, and identify behavioural market failures. Third, design remedies to overcome identified behavioural market failures. These include more innovative approaches to consumer education like designing and promoting simple heuristics, setting smart defaults, creating timely and smart disclosures, aligning supplier and consumer penalties, and supporting and enabling the work of choice engines and complaint aggregators. Fourth, test if the remedies are actually leading to better outcomes for consumers, and iterate.
- ◆ **Section 4** concludes by offering recommendations for how Citizens Advice can advocate for and develop this new vision with regulatory partners, as well as directly with consumers.

## 1. Regulating with a focus on consumer behaviour

The justification for regulatory intervention and the core role of regulators is to correct market failures and any resulting consumer detriment. These standard market failures occur when resources are allocated inefficiently. This means that it can be possible to improve outcomes for some people without harming others. Examples of market failures include negative externalities, asymmetric information, or imbalance of market power. Many regulators work on the assumption that increasing competition by promoting the entry of new firms to a market will always result in a more efficient allocation of resources and maximise welfare, leading to better outcomes for consumers. This regulatory approach is predicated on the belief that consumers act in a perfectly economically rational way, consistent with the economic laws of supply and demand, rather than a more sophisticated understanding of consumer behaviour that has been informed by the behavioural sciences. This is an issue because, while regulators have questioned the assumption that more competition is always better (Huck & Zhou, 2011), this questioning has not always resulted in better outcomes for consumers. The current approach to consumer protection can also lead to red tape for businesses with no corresponding improvement in consumer outcomes.

We put forward the case for placing a sophisticated understanding of consumer behaviour at the heart of these regulatory interventions. There is overwhelming evidence that consumer decision-making systematically strays from what would be expected from a 'rational actor' within economic theory. These systematic deviations are called behavioural biases, and can lead consumers to act in ways that are not in their best economic interests. This leads to consumers incurring additional costs beyond what the classical economic framework would suggest. Some of these biases, present bias in particular, result in consumers imposing costs on themselves by taking actions that are not in their own interest. These are termed 'internalities' by economists (Herrnstein, Loewenstein, Prelec, & Vaughan, 1993), to differentiate them from 'externalities', which impose costs on others. Where biases and internalities are driving inefficient market outcomes, we argue regulators should address them and correct the behavioural market failures by designing remedies that go with the grain of consumer behaviour and tip the balance of market power towards consumers by preventing businesses from exploiting consumer biases.

Both aspects of this new approach to regulation based on a realistic understanding of consumer behaviour - behavioural biases and internalities - are explained below.



## **Behavioural biases and heuristics**

In contrast to the assumptions underlying economic rationality, a more realistic model of human behaviour argues that individuals have two modes of thinking. There are many different explanations of these modes, with the most famous being the description of system one and system two thinking (Kahneman, 2011).

System one thinking operates quickly, with little effort or voluntary control on behalf of the consumer. For example, when a consumer picks up their usual brand of crisps in a supermarket they will do so without spending much, if any, time choosing between options. Despite the fact that the consumer is unaware of the impact of system one, it plays a very large role in determining their behaviour, including guiding complex decisions.

System two thinking operates when a person is required to undertake more effortful mental tasks. For example, when a consumer is choosing between two complicated mobile phone tariffs and uses a spreadsheet to calculate which one will give them the best deal. This system of thinking is more analytical and is more in line with the processes assumed by economic rationality.

Even though the two modes of thinking operate concurrently, system one has a very large impact on behaviour, even when an individual engages in system two thinking. For example, when choosing a mobile phone tariff, system one thinking may automatically prefer a phone network which has strong brand recognition, whilst system two thinking may then kick in to consider the various options of the different plans.

This framework helps us understand how consumer thinking is not always economically 'rational', but displays systematic biases and relies on rules of thumb or 'heuristics'. While sometimes biases result in sub-optimal decision making, consumers use these rules of thumb because they are an extremely efficient way to make decisions, especially where consumers are unable to consider all the information available. Indeed, in many cases these rules of thumb work well for consumers (Gigerenzer, 2008), leading to satisfactory outcomes and freeing up their minds to focus on other more important matters.

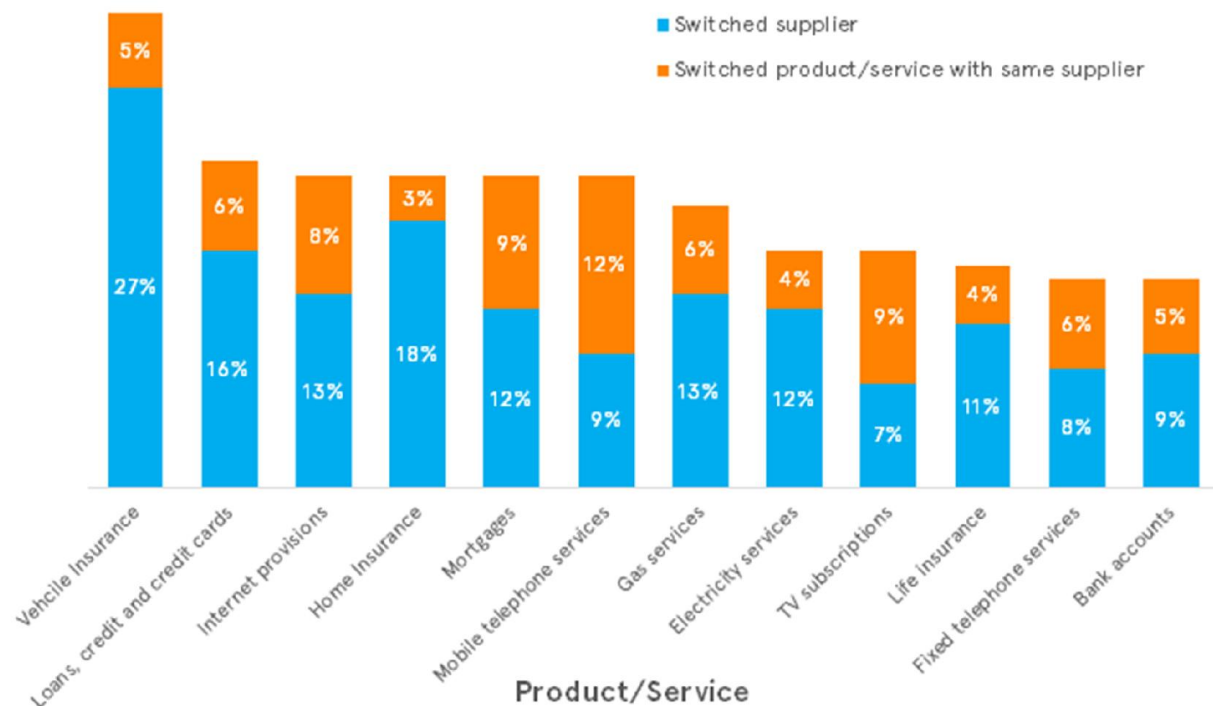
## **Internalities and behavioural market failures**

While efficient, biases and heuristics can lead consumers to act in ways that are not in their best interests. For example, they may pay for an expensive purchase on a credit card believing they will be disciplined enough to pay it off regularly, but in reality they lack the discipline or make subsequent spending decisions that

mean they do not have the resources to do this. Further, they lead consumers to act without fully factoring in all the costs to themselves, and thus incurring additional costs beyond what the classical economic framework would suggest. These costs are termed ‘internalities’. They are commonly associated with present bias and self-control problems, where the costs are high, although other behavioural biases can also involve internalities. Allcott and Sunstein (2015) suggest that it is useful to consider internalities as ‘externalities that people impose on themselves’, not least because the economic theory of regulating externalities can also be applied to regulating for internalities.

There is evidence of biases and internalities occurring throughout UK regulated markets. For example, looking across markets, very few consumers switch provider (see Figure 1.1) due to inertia and choice overload, even where they could save large sums and get a better overall deal.

Figure 1.1 Percentage of UK population switching suppliers or product/service in 2013, by product/service



Source: EUROPA consumer dashboard, 2013 data

Interestingly, Figure 1.1 also shows that services that require an annual review process (e.g. vehicle insurance) or annual fee (e.g. credit cards) have higher switching rates than on-going services. Of the 18 million UK households that use

gas and do not have a prepayment meter, well over half could save over £200 a year or more by switching. Yet only 12% of people actually switch, despite the majority knowing that switching is possible and financially beneficial. Similarly, heavy overdraft users could save on average £260 a year by switching current account, but again switching rates are very low.

The biases and internalities present across regulated markets are causing behavioural market failures, where resources are not being allocated efficiently because consumers display behavioural biases in their decision making (Bar-Gill, 2011). These behavioural market failures result in barriers to competition and deter new market entrants because of consumer inertia, resulting in consumers paying higher prices and experiencing lower quality services.

Behavioural market failures are in themselves a justification for regulation and government intervention. But it is also important for regulators to address internalities because they can, and in many cases do, exacerbate other traditional market failures. For example, providing more information to help consumers make a better choice can actually have a negative impact on how informed consumers are, as they tune out or become confused (Ben-Shahar & Schneider, 2014; Perry & Blumenthal, 2012). Hence, rather than helping consumers make a better choice by improving their knowledge, mandated disclosure may directly worsen information asymmetry. As noted above, this is not necessarily about introducing more regulation, but making regulation more effective. Indeed, in some cases this approach may point towards the replacement of detailed regulations with principled based regulations which set out the outcomes the regulator expects the market to deliver for consumers.

Competitive market structures can also lead to suppliers exploiting the biases and misperceptions of their customers (Akerlof & Shiller, 2015a). However, it is important to point out that there are some markets, which will never deliver good outcomes for all. The traditional view was that sophisticated consumers protect the naive consumers (Varian, 1980) and protection policies were only needed when there were not enough sophisticated consumers. It has long been recognised that this is an incomplete explanation and that while this might happen in some markets there are many situations, even in competitive markets with price elastic demand, where the price of add-ons will be shrouded and have large mark-ups (Gabaix & Laibson, 2006).

Of course, all consumers are not the same, and indeed have highly heterogeneous preferences and characteristics. One way regulators account for this is to create specific rules for vulnerable consumers to protect or represent their interests in

the market and avoid them suffering detriment. The level to which people display biases is also heterogeneous, and doesn't necessarily align with demographic factors or markers of vulnerability. Importantly, well-designed behavioural interventions have the added benefit of not disrupting the behaviour of less biased consumers. For example, if regulators are concerned about information asymmetry and inattention, providing timely and smart disclosures will assist disengaged consumers who may not have all of the relevant information, without affecting the behaviour of more engaged consumers (Allcott & Sunstein, 2015; Soman, 2015). This is important because the impact of biases will vary across consumers.

Regulators in the UK are increasingly thinking about consumer biases (Huck & Zhou, 2011) and designing behavioural remedies to improve consumer outcomes. For example, in addition to giving people more information to help them make decisions, there has been a lot of focus on consumer education as a way of helping consumers achieve better outcomes. Consumer education has been widely used to try and improve financial decision making however it is not clear whether these programmes help achieve better outcomes (Hastings, Madrian, & Skimmyhorn, 2013; Miller, Reichelstein, Salas & Zia, 2014). While the impact of financial education is ambiguous, recent work combining financial literacy with behaviourally informed policy approaches, such as reminders, show more promise (Abebe, Tekle, & Mano, n.d.; Drexler, Fischer, & Schoar, 2014).

Overall we think regulators can, and should, go further. While consumers do need to take responsibility for their own actions (or inaction), greater focus is needed on developing policies which align with consumer behaviour and tip the balance of market power towards consumers by preventing businesses from exploiting consumer biases. In the rest of this report we first set out some of the main behavioural biases at play in regulated markets before setting out a set of principles for a new approach to regulation. We believe these principles would help make regulation more effective because they take account of how people act in reality, rather than in an idealised economic model.

## 2. Behavioural biases in regulated markets

There is a strong evidence base that consumer decision-making systematically strays from what would be expected from a 'rational actor' within economic theory (DellaVigna, 2009). This section introduces eight behavioural biases that consumers display in regulated markets and sets out examples of the current regulatory approach to accounting for these biases.

The biases are organised in order of magnitude against two measures: the amount of damage the bias causes the consumer, and the potential effectiveness of remedies. The key behavioural market failures in consumer markets are inertia and choice overload. These are the focus of discussion in this section, and also underpin the major remedy recommendations in section 3: smart defaults, smart and timely disclosures, and enabling choice engines and complaints aggregators. Appendix A provides more detailed examples of the types of interventions regulators could use to address market failures arising from, or exacerbated by, behavioural biases.

This review finds that although regulators have sought to address behavioural biases there are opportunities to do more to help consumers to make better decisions within regulated markets.

### A. Many consumers will stick with the default

#### **An explanation of the status quo bias**

One of the strongest forces in consumer behaviour is inertia; in many cases, consumers will maintain a default or perceived default, even where there may be benefits from switching (Samuelson & Zeckhauser, 1988; C. Wilson, Price, & Others, 2005). This tendency to stick with a previous decision, or simply not acting, is termed status quo bias by psychologists (Samuelson & Zeckhauser, 1988).

As a result, the design of choice architecture can have a significant impact on consumer outcomes, even where a consumer's economic interests are clear. This is the case for the choice of pension fund, as well as contribution and investment decisions within pension funds. If consumers do not want to think about the choice or engage with the product, they will expend the minimum effort required and maintain the status quo if they can.

For the same reasons consumers often stay with their provider for utilities such as energy, or financial services such as insurance or banking, even when there may

be significant savings from switching. The explanation that consumer satisfaction accounts for low switching rates appears unlikely, at least in energy markets. Recent Competition and Markets Authority (CMA) evidence suggests that low rates of switching are not due to high satisfaction with energy suppliers, as complaints to energy suppliers increased fivefold between 2007 and 2013 (CMA, 2015). A more likely explanation is that there are high and deliberate friction costs associated with switching suppliers. Some academics have also argued that consumers may perceive the current default as the recommended course of action set out by policymakers (e.g. the opt-in default of joining the organ donor register could be perceived as an implicit recommendation to not join) (McKenzie, Liersch, & Finkelstein, 2006).

### **Regulatory approach to status quo bias**

Although not a change initially instigated by a regulator, one of the clearest examples of changing defaults to impact consumer behaviour is automatic enrolment into pensions. In 2012, starting with the largest employers, the UK Government switched the default from one in which employees had to actively choose to sign up for a pension scheme ('opt in') to one in which they are automatically enrolled into workplace pension schemes but can choose to opt-out if they so desire ('opt out'). This change was made in part because the number of people saving into workplace pensions was falling despite rising tax concessions and other economic incentives to save for retirement. A recent evaluation report found that opt-out rates have been lower than the Department for Work and Pensions (DWP) originally estimated, with between 8 and 14% opting out, rather than the 28% the Department expected. However, the actual opt out rates were in line with estimates from behavioural literature drawing on the US experience with 401K accounts (Choi, Laibson, Madrian, & Metrick, 2004). Over 5.4 million UK residents were automatically enrolled into new workplace pensions between October 2012 and August 2015 (National Audit Office, 2015). By 2019, nine million people are expected to be newly saving or saving more in qualifying workplace pensions as a result of automatic enrolment. The Pensions Regulator now plays a role in making sure that employers adhere to their duties in providing automatic enrolment to their employees.

A new vision for smart defaults that maximise consumer welfare without impeding competition is set out in section 3C.

## B. Consumers can be heavily influenced by anchors

### An explanation of anchoring effects

In fields where consumers are required to make a choice along a numerical spectrum (for example, deciding on how much of a loan to repay) they can be heavily influenced by anchors (A. Tversky & Kahneman, 1974). These anchors can result in substantial shifts in consumer behaviour, meaning that the presence of seemingly trivial or irrelevant information can have relatively large impacts on consumer behaviour. Research from the US and the UK has found that increasing the minimum payment amount displayed on a credit card statement tends to see an increase in the average payment amount (Navarro-Martinez et al., 2011). Displaying the amount it would take to pay off the balance in a given time (for example, 36 months) also leads to a spike in payments that match that amount. Another lab-based experiment found that displaying the minimum payment on a credit card bill led to less people choosing to pay off the simulated debt in full (Stewart, 2009).

### Regulatory approach to anchoring effects

In 2011, the credit card industry came to an agreement with the UK Government to introduce a new lender voluntary code of practice to increase the minimum payment amount on credit card debts.

Since 1 April 2011, credit card companies must set the minimum payment at a rate that reduces the consumer's balance by 1% each month. Additionally, since 2013, credit card providers have added the following wording on bills as part of the Lending Code: 'If you make only the minimum payment each month, it will take you longer and cost you more to clear your balance.' In Australia, a more extensive Minimum Payment Warning has been developed (Figure 2.1), which shows the consumer how much in extra charges they will pay if they only pay the minimum payment each month.

Figure 2.1 Australian Minimum Repayment Warning

**Minimum Repayment Warning:** If you make only the minimum payment each month, you will pay more interest and it will take you longer to pay off your balance. For example:

	If you make no additional transactions using this card and each month you pay...	You will pay off the Closing Balance shown on this statement in about...	And you will end up paying estimated total interest charges of...
<b>A</b> PAY THE MINIMUM	Only the minimum payment	19 years 4 months	\$2,161.53
<b>B</b> PAY	\$95.54	2 years	<b>\$292.98,</b> a saving of <b>\$1,868.55</b>

Source: (Westpac, 2012)

A study in the United States found that repayment warnings had little impact on repayment behaviour (Salisbury, 2014) but information about an alternative course of action, including a larger repayment amount, did influence repayment decisions. However, the effect of adding these enhanced repayment warnings to credit card statements has not been assessed in the UK or Australia to see if it has actually changed consumer behaviour. Our suggested approach for testing and assessing new formats of disclosure is set out in section 3C.

### C. More choices does not necessary mean better outcomes

#### An explanation of choice overload

Giving consumers more options when they are making decisions does not necessarily lead to better outcomes, and can in fact lead to a situation where they experience 'choice overload' (Lyengar & Lepper, 2000). Increasing the number of choices increases both the desire to delay decision-making, and also the likelihood of choosing the default option (Amos Tversky & Shafir, 1992). This means that, when facing choice overload, consumers may become paralysed and not make a choice, or may even make worse choices (Gourville & Soman, 2005; C. Wilson et al., 2005). Contrary to orthodox theories of rational economic decision-making, these responses occur even where the choice set is improved and can be particularly pronounced on those who have less knowledge or are less financially sophisticated (Morrin, Broniarczyk, & Inman, 2012).

A recent meta-analysis (Chernev, Böckenholt, & Goodman, 2015) found that choice overload is more likely to occur when consumers are faced with time constraints, complex sets of choices, and a lack of expertise in judging the benefits or costs of different options.



In addition, increasing the number of dimensions over which choices differ (for example, amount, time period, optional extras) also has the subtle effect of increasing the effort required to compare all of the alternatives, which can deter individuals from making a thorough search – this is referred to as comparison friction (Kling, Mullainathan, Shafir, Vermeulen, & Wrobel, 2012). As a result, where consumers are deterred from making a full search, it is likely that the choice they make will result in a suboptimal outcome. Indeed, there is significant evidence that this is exploited by firms, who have an incentive to deliberately create additional and more confusing options, as this has been shown to lead to higher prices (Carlin, 2009; Kalayci, 2011; Kalayci & Potters, 2011).

### **Case study 2.1: Choice overload when switching energy tariffs in the UK**

Researchers analysing historic data of consumer switching in the UK energy market found that consumer decisions are less efficient (they save less money than the maximum amount they could have saved) in regions of the UK where the number of competitors is larger. This suggests that consumers do make poorer decisions when they have more options to choose from (C. Wilson et al., 2005). The same researchers also found that a third of consumers who switched energy supplier ended up on a more expensive plan (C. M. Wilson & Price, 2010). While some of those switching to more expensive plans might be choosing a particular supplier for reputational reasons, this data suggest that at least a portion of consumers are struggling to find cheaper plans when switching.


### **Regulatory approach to choice overload**

A significant focus for regulators has been making the process of switching supplier as easy as possible, and simplifying choices to try to increase competition by increasing consumer engagement. Regulation has been designed to overcome consumer inertia, reduce the friction in the switching process and provide timely prompts to switch.

In the retail banking sector, the Current Account Switch Service (CASS) was launched in 2013 as one means to reduce friction in switching for Personal Current Accounts, charities, and most Business Current Accounts. It aims to facilitate all aspects of switching, and the process (including transferring Direct Debit details) is guaranteed within seven days.


Figure 2.2 Current Account Switching Guarantee

## Current Account Switch Guarantee



We have designed the Current Account Switch Service to let you switch your current account from one bank or building society to another in a simple, reliable and hassle-free way. It will only take seven working days. As your new current-account provider we offer the following guarantee.

- The service is free to use and you can choose and agree your switch date with us.
- We will take care of moving all your payments going out (for example, your Direct Debits and standing orders) and those coming in (for example, your salary).
- If you have money in your old account, we will transfer it to your new account on your switch date.
- For 13 months, we will arrange for payments accidentally made to your old account to be automatically redirected to your new account. We will also contact the sender and give them your new account details.
- If there are any issues in making the switch, we will contact you before your switch date.
- If anything goes wrong with the switch, as soon as we are told, we will refund any interest (paid or lost) and charges made on either your old or new current accounts as a result of this failure.



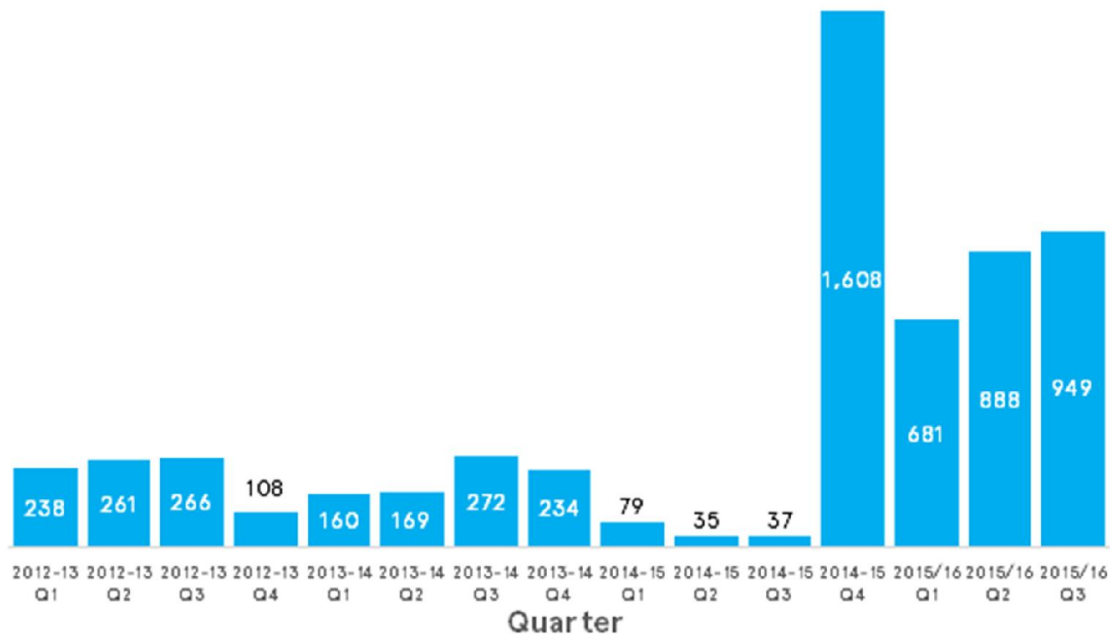
The telecommunications market is behind the energy and retail banking markets in terms of ease of switching, with the lack of a provider-led switching system and no obligation to inform consumers at the end of the minimum contract. While networks are required to provide Porting Authorisation Codes (PAC) to ensure number portability, many frictions remain in the switching process. The Office of Communications (Ofcom) is consulting on proposals to automate the process for obtaining a PAC and putting in place a provider-led process (Ofcom, 2015).

Despite the regulatory changes discussed above, switching rates across energy, telecoms and personal current accounts remain quite low<sup>4</sup> (see Figure 1.1 above) suggesting that regulatory changes have only partially addressed behavioural biases. For example, the introduction of ‘simpler choices’ in energy markets does not appear to have led to significantly higher consumer engagement, as evidenced by higher switching rates. Citizens Advice has recently seen an uplift in consumers seeking advice about switching suppliers (Figure 2.3), which may be due to Government advertising between February and March 2015 and in the winter of

<sup>4</sup> 7% of consumers in the UK claim to have switched bank account in the past year, compared to 21% for mobile phones and 17% for energy. Source: Social Market Foundation 2015.

2016 promoting switching, including switching prompts that were included in Winter Fuel Payment notifications. It could also be indicative that the process is not made easy enough or is perceived as being difficult or risky by consumers.

**Figure 2.3 Number of Citizens Advice cases regarding consumers seeking advice on how to change energy supplier, by quarter**



Source: Citizens Advice 'Advice Trends' data, 2012-2016

In addition, the current regulation does not focus enough on removing the type of frictions that matter to consumers. Current regulation appears to pay less attention to the costs borne by consumers in the switching process itself even though we know from other research, for example on college financial aid applications in the US (Bettinger, Long, Oreopoulos, & Sanbonmatsu, 2009), that consumers are deterred from complicated processes even when it is clearly in their economic interest to engage. In the UK, the Office of Gas & Electricity Markets (Ofgem) is putting in place governance to allow for next day switching. While this is an improvement from the current switching times of 17-21 days, we argue consumers are likely to be less deterred by the time it takes the supplier to transfer the account, and more concerned with how long they need to spend on the switching process itself (either on a Price Comparison Website (PCW) or over the phone), and how difficult that process is.

## D. How information is presented can radically affect choices

### An explanation of framing effects

The way that information is presented can significantly affect consumer preferences and the decisions that they subsequently make. Researchers use the term 'framing effects' to describe the phenomenon of individuals' preferences shifting when the same choice is framed in different ways (Tversky & Kahneman, 1981). For example, if an individual is choosing if they want to take out a mobile phone contract to get a new iPhone 6s handset, they may make a different decision if the contract is presented as '£50 a month with the handset costing £250 upfront' compared to if the contract is presented as '£50 a month with a half price handset (£250 compared to the usual £500)'. In both cases the handset costs £250, but framing the handset as 'half price' may make the consumer more likely to take out the deal.

Similarly, there is evidence that presenting the cost of a loan as an interest rate (e.g. 15% APR) has an effect on consumer preferences, as compared to displaying how much interest in pounds they would pay in a year on a £1,000 loan (e.g. £150 a year). This may not be simply because of framing effects, but because consumers lack the knowledge to understand what interest rates mean, or they find it hard to calculate the actual cost implications of an interest rate. The UK Financial Capability Survey 2015 found that a third of respondents struggled to calculate an interest rate correctly. One third couldn't correctly calculate the balance at the end of the year if £100 was paid into a savings account at guaranteed 2% interest per year (Money Advice Service, 2015), and people especially struggle to calculate compound interest, which has huge implications for consumer debt.

There is also a burgeoning research literature studying how individuals make choices online (Benartzi, 2015). Early studies show that consumers choose differently based on whether options are compared horizontally or vertically, with the former tending to promote improved decision-making. Pilot studies testing individuals' ability to successfully answer financial literacy questions can even depend on whether we are filling them out using pen and paper, a tablet, or a computer.

## Regulatory approach to framing effects

This is an area where regulators have arguably made the most progress in addressing consumer biases. There are multiple examples of where UK regulators have put in place remedies that seek to present information to consumers more effectively. In particular, regulators have sought to make sure that prices are transparently presented to consumers and that particular terms of contracts are disclosed plainly so that consumers can make an informed decision. However, there is still scope to go further, particularly with regards to timing and format of disclosures.

Within energy markets, Ofgem introduced a Tariff Comparison Rate in 2010 as part of the Retail Market Review to assist consumers in comparing the value for money of different tariffs within and across suppliers. These interventions have partially, but not fully, addressed the underlying issue of consumers over-simplifying complex pricing decisions in ways that lead to errors. For example, while the energy Tariff Comparison Rate aims to allow easy comparison between different standing and unit charges, its success has been limited because it is heavily caveated due to the assumptions used in its calculation.

Across regulated markets there are strict rules for what information suppliers need to disclose to consumers, as well as the form and timing of the disclosure. The objective of disclosure requirements is to provide consumers with product-relevant information that will enable them to make better decisions about their purchases and use of services (FCA, 2014b). However, more disclosure can sometimes have a negative impact on how informed consumers are, as they tune out or become confused (Ben-Shahar & Schneider, 2014; Perry & Blumenthal, 2012). Hence, rather than helping consumers make a better choice by improving their knowledge, disclosure may actually worsen the problem it is trying to address.

In April 2014, Ofgem announced new rules to improve supplier communications as part of their Retail Market Review. However, these changes increased both the complexity and volume of information on bills, without any observable gain in consumer engagement as measured by switching rates between suppliers (Citizens Advice, 2015b). In response to this failure of disclosure, the recent CMA Energy Market Investigation recommended Ofgem establish an ongoing programme of identifying, testing and implementing measures to promote consumer engagement. In particular, to intervene to influence the form, content and frequency of communication between suppliers and their customers (CMA, 2016a).

In the mobile telecoms market there have been recent changes to levels of disclosure. The regulations specify that consumers should be given one month's notice of any change to their contract which causes 'material detriment' and in 2014 Ofcom ruled that any increase in the 'core subscription' price (i.e. monthly tariff) would count as material detriment. At this point, consumers have the chance to exit their contract without penalty. There are two problems with this disclosure. The first is that the requirement does not necessarily apply to increases in individual call rates (i.e. cost per minute), hence consumers are not notified when the value of what they receive as part of their monthly subscription is decreased, only when the total subscription price changes. The second failure is in the way that the disclosure is monitored and enforced by Ofcom, with Citizens Advice receiving anecdotal evidence from consumers that suppliers do not fulfil this requirement.

There is huge scope for improvement in developing disclosures that assist consumers to making better decisions within regulated markets such as energy, telecoms and personal finance. Our new vision for the design of smarter, more timely disclosures is detailed in section 3.

## E. Consumers are more focused on the present than the future

### An explanation of present bias

A wealth of research shows that consumers place disproportionate emphasis on the present and heavily discount the future (Laibson, 1997; Samuelson & Zeckhauser, 1988; Thaler, 1991). We tend to focus on the salient, present features of a product or service and may ignore the implications for future consumption (Barber, Odean, & Zheng, 2006; Liebman, 2004). In particular, the contribution of behavioural insights has been the fact that this discount has a hyperbolic nature - in effect, consumers have a very high discount rate between the present and the immediate future, but a much lower discount rate between two similarly spaced points in the future. As a result, if the benefits of a product are experienced in the present while the costs are deferred, or vice-versa, a consumer will focus on the features that are more immediate and not fully weight the more distant features.

This is compounded by what is commonly referred to as the 'exponential growth bias' - this results in people intuitively treating an exponential growth function as though it were linear when making predictions (Stango & Zinman, 2009). In short, it means that people underestimate the effect of compound interest; they underestimate how quickly debt will increase, and similarly underestimate the benefits of saving early.

For example, credit cards allow consumers to enjoy immediate gratification while deferring the costs to a future date. If the card includes a 'teaser rate' that changes to a higher ongoing rate, then consumers may be even more likely to over consume without taking into full account the ongoing costs (DellaVigna & Malmendier, 2004).

### **Case study 2.2: Credit card teaser rates in the USA**

Between 1995 and 1997, researchers in the United State ran a large-scale experiment where 600,000 consumers were randomly assigned to get different credit card offers. The six offers had different introductory interest rates and different durations e.g. 4.9% for 6 months or 7.9% for 12 months. After the introductory rate, all the offers reverted to a 16% post-introductory rate. The researchers looked at the next 24 months of usage of the credit cards and found consumers were 13% more likely to accept a low introductory offer for a short period even when they would have been better off with a slightly higher interest lasting for a longer period (Shui & Ausubel, 2004).

### **Regulatory approach to present bias**

Regulators have sought to reduce the costs that are incurred by consumers who do not switch after teaser rates end by making sure that consumers are notified when teaser rates come to an end, so that they are aware of how much they are now paying (or saving) and can assess if they should switch providers. In December 2015, the Financial Conduct Authority (FCA) issued final rules relating to their savings accounts investigations. They ruled that a bank must contact the customer when the 'teaser interest rate' comes to an end. The supplier may choose the medium in which the reminder is provided, but they should take account of any preferences expressed by the banking customer about the medium of communication used. As these recommendations have not yet been implemented, we cannot say if they have been effective at reducing the costs incurred by consumers.

## **F. The timing of interventions is crucial**

### **An explanation of temporal effects**

Along with how information is presented (discussed in section 3A), when information is given is also consequential. While we know that reminders are effective (Madrian, 2012), there is also evidence that individuals are more likely to

take action at the start of a new month or year, or on a meaningful date, such as on their birthday (H. Dai, Milkman, & Riis, 2014). Other interventions are more likely to be effective when they are presented at a precise time that will be relevant to the consumer's decision making process.

Many individuals save more if they are reminded to at timely moments (Karlan, McConnell, & Mullainathan, 2016). Similarly, one study found that very high anchors (in the form of peer savings rates) were generally not effective at shifting behaviour, as they are perceived as unrealistic. However, if the anchors were presented when individuals receive an annual bonus – thus making saving a high percentage a realistic option – the anchors become more effective, and result in an increase in savings rates (Choi, Haisley, Kurkoski, & Massey, 2012).

### **Regulatory approach to temporal effects**

Within the energy market, Ofgem has regulated to ensure that consumers receive a notice 42-49 days before the end date of their fixed term tariff to inform them that their current tariff is coming to an end. This timely reminder to consumers to reconsider their contract could be implemented across other regulated consumer markets; for example, when mobile phone contract fixed terms come to an end. However, the effect of this notification has not been formally assessed to see if it is effective and it is likely that the most effective period will vary, perhaps by industry or by different consumer groups.

The FCA has undertaken analysis of banking customer data to see if timely notifications from text message alerts and mobile banking apps help consumers reduce the amount of overdraft charges they incur. They found that text message alerts reduced monthly unarranged overdraft charges by 6%, mobile banking apps reduced monthly unarranged overdraft charges by 8% and signing up to both services reduced monthly charges by 24% (FCA, 2015b).

Our suggested approach for testing and assessing new timely disclosures is set out in section 3C.

## **G. Consumers tend to be overconfident**

### **An explanation of overconfidence bias**

Consumers tend to over-estimate their own abilities and knowledge (Kahneman & Tversky, 1996), which can lead them to being overconfident and making riskier decisions than they would otherwise (Ho, 2011). In particular, those who are least knowledgeable tend to be the most overconfident, while those with the most



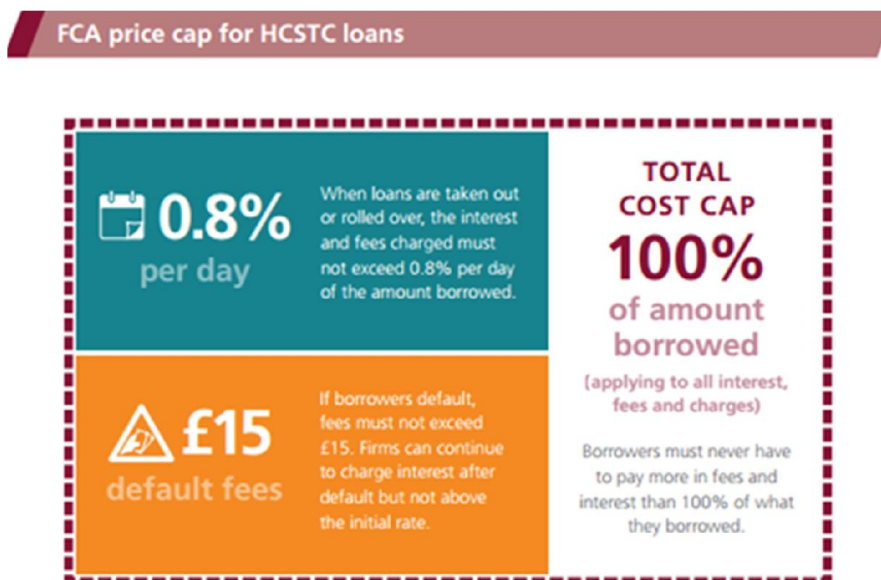
knowledge will in fact occasionally exhibit underconfidence (Lichtenstein & Fischhoff, 1977).

Researchers have found that roughly 30% of consumers overestimate their credit score, with only 4% underestimating (Perry, 2008). More broadly, if they are overconfident, consumers may enter into contracts that are unsuitable; for example, they may believe their risk of incurring contingent fees is low when in reality their risk is high. Or, they may take out a loan believing they will be disciplined enough to pay it off regularly, but in reality they lack the discipline (Heidhues & Hoszegi, 2010).

### Regulatory approach to overconfidence bias

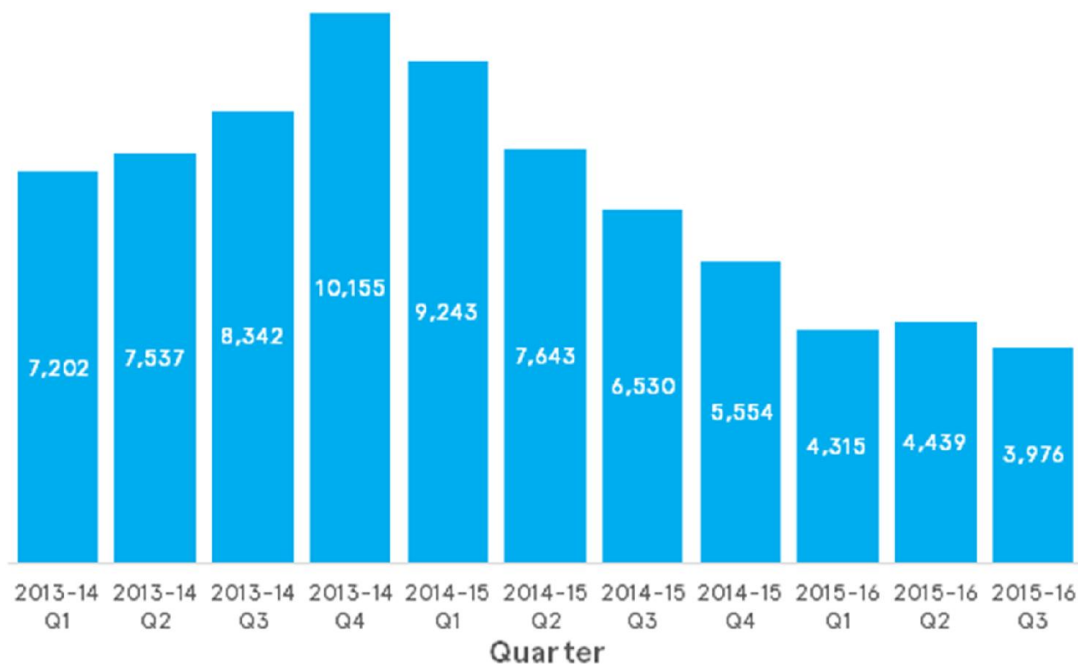
Regulators have sought to reduce the harm that is caused by consumers overestimating their ability to pay back loans within an agreed time frame. In January 2015, new rules came into force regulating high cost short term credit (HCSTC) in the UK (including payday loans). The new rules mean that customers will not be charged more than £15 in fines if they fail to pay back a HCSTC loan on time and consumers will never have to pay more than twice their original debt (FCA, 2014a).

Figure 2.4 FCA price cap for payday loans



Early assessments suggest that these new HCSTC regulations have been effective, which is reflected in the sharp reduction in the number of payday loan problems reported to Citizens Advice. Figure 2.5 shows that reported problems have halved since the regulations came into force (Citizens Advice, 2015c).

**Figure 2.5 Number of Citizens Advice cases regarding payday loan debts, by quarter**



Source: Citizens Advice 'Advice Trends' data, 2013-2016

However, there is concern that consumers will turn to other high cost credit products in the absence of payday loan provision such as logbook loans (Citizens Advice, 2015a). The FCA has done some modelling looking at the effect of the change in regulation. They have found that consumers who are now unable to access HCSTC on average use less formal credit than they were using before, and in one quarter of cases they borrow from friends and family instead. In half of all cases, people reduce consumption in the short-term, and a consumer survey shows that HCSTC loan denial does not cause people to use illegal lenders. However HCSTC loan denial increases the likelihood a consumer exceeds their arranged overdraft limit in the first month after loan denial (FCA, 2014c).

## H. Are some consumers particularly vulnerable to behavioural biases?

Each regulator has a technical definition of vulnerability that guides their approach to vulnerable consumers in the market. For example, the FCA defines a vulnerable consumer as someone who, due to their personal circumstances, is especially susceptible to detriment (FCA, 2015a). Consumers can be vulnerable for a number of different reasons, including age, income, disability, and geographic location.

It is important to note that this is a strict interpretation of vulnerability. The behavioural science literature suggests that even high income, highly educated individuals display behavioural biases that favour fast, automatic decision-making over more reflective thoughtful deliberation (Frederick, 2005), and can be disadvantaged as they participate in regulated markets. The sections above highlight the common behavioural biases that can cause vulnerability in these markets, making consumers less able to protect their own interests. This section, however, delves into the more common understanding of vulnerability and argues that consumers who are on low incomes may be more likely display particular behavioural patterns such as 'scarcity mindset'.

### **An explanation of scarcity mindset**

There is some evidence to suggest that when people are living with less than they need, they think and act differently. In their work *Scarcity*, Sendhil Mullainathan and Eldar Shafir explore what they call a 'scarcity mindset'. They suggest that when people are preoccupied by scarcity, they have less attention to give to the rest of their lives. This scarcity mindset consumes brainpower, or 'mental bandwidth', which leaves less cognitive capacity for important tasks such as planning ahead and problem solving (Mullainathan & Shafir, 2013).

An example of this would be a person not having enough money to pay an unexpected bill. Mullainathan and Shafir document how in this situation, the problem is likely to become 'top of mind' for that person, meaning that they end up focusing on the problem in hand at the expense of other areas of their life. For example, by focussing on or 'tunnelling' in on the unexpected bill, they may forget to withdraw £20 cash from their bank when they were in town, meaning they have to pay extra charges to use a cash machine near their home.

Mullainathan and Shafir explain how experiencing scarcity makes people less insightful, less forward-thinking and less controlled. Their studies show that reminding people of money worries just before taking an IQ test reduces a

person's cognitive capacity more than going one night without sleep. In other words, it is not that the poor have less mental bandwidth to begin with; it is that the experience of poverty would reduce anyone's bandwidth.

As well as having more mental bandwidth available (due to not having money worries), richer consumers may also have a larger financial buffer if they do make a mistake, as compared to poorer consumers. This research paints a bleak picture for poorer consumers, suggesting they may have more cognitive limitations when acting in the market compared to richer consumers. However there is evidence that, in some instances, poorer consumers, behave more savvily than richer consumers and are less susceptible to behavioural biases such as framing effects. For example poorer consumers are more price aware for certain products and therefore are less likely to pay more in different contexts. Research suggests lower income groups know the cost of everyday items such as a pint of milk (Rosa-Díaz, 2004) and are unlikely to pay more for it in different contexts such as a corner shop compared to a large supermarket (Shah, Shafir, & Mullainathan, 2015).

What is not clear is whether poorer consumers are acting more or less rationally than richer consumers in regulated markets – it may be the case they are acting more in line with economic models in some contexts, but not in others. Recent research by the CMA for the Energy Market Investigation found that of those with an income of less than £18,000, 77% reported having not switched energy supplier in the past three years compared with 72% overall. This suggests they are not acting optimally in this particular area. However, there are many other reasons why these consumers may not have switched. For example they may have a prepayment meter, or have debts, which prevent them from switching supplier.

### **Regulatory approach to scarcity mindset**

There are many examples of regulators acting to safeguard low income or particularly vulnerable groups. In the energy market, energy supply and distribution network companies have an overarching responsibility to protect customers in vulnerable situations through statutory obligations placed on them in their licences. In 2013, Ofgem published a Consumer Vulnerability Strategy (CVS) setting out their approach to identifying and tackling consumer vulnerability. In this strategy Ofgem recognised that vulnerability is about the situations and circumstances that consumers find themselves in, rather than just about individual characteristics.

Ofgem has sought to protect vulnerable customers in specific ways (such as making sure their energy cannot be cut off). However, the fact that a large

majority of people with an income of under £18,000 a year had not switched in the last three years (and are therefore highly likely to be over paying for energy) suggests that not enough has been done to help vulnerable customers reduce their costs (GfK, 2015). The recently published CMA remedy to introduce a transitional price control for domestic customers on prepayment meters is anticipated to lead to a reduction in the average bills paid by prepayment customers of over 8% (CMA, 2016b). However, the CMA has stressed that the cap will be implemented because of a lack of competition in the prepayment market, not simply to protect vulnerable customers. Additionally, not all prepayment customers are vulnerable and many vulnerable customers are not on prepayment meters<sup>5</sup>.

The behavioural literature described above suggest that attention is a scarce resource and therefore regulation should go beyond vulnerable consumer strategies to design systems that ensure inaction does not cause detriment to consumers. This is discussed in section 3C which encourages regulators to look at smart defaults, rather than rely on individuals to make multiple complex decisions.

<sup>5</sup> Approximately 22% of prepayment customers in England are fuel poor, compared to 7% of direct debit (DD) customers and 16% of standard credit (SC) customers (DECC, 2015).

### 3. A new vision for the role for regulators

Regulators can play a pivotal role in shaping markets so that they work well for consumers. As regulators are increasingly recognising, this involves an evolution of what it means to regulate and a shift towards interventions which have a sophisticated understanding of consumer behaviour at their centre. We are still advocating what economics has long strived for in market design: good outcomes for consumers. But instead of trying to make people more like rational economic actors we are arguing that markets should deliver good outcomes by being designed to go with the grain of human behaviour.

This is a more nuanced approach that does not imply more intervention, but requires regulators to shift their focus beyond competition and supply side dynamics to include an alternative measure of success. This success would occur where markets are delivering the same outcomes that would be delivered if consumers were making the kinds of choices they would make if they were informed and not displaying behavioural biases. This involves regulators setting the criteria for non-price competition, for example customer satisfaction, and building stronger feedback loops to send signals to the market about what good quality looks like. The ambition of this approach is that regulators can create competition on metrics that drive excellence in suppliers and intermediaries. It achieves this while maintaining consumers' freedom of choice. This approach can also deliver good outcomes for businesses as this shift may lead to a reduction in red tape as detailed regulations are replaced with outcome-based principles.

We make the case for designing remedies that account for biases and externalities and correct behavioural market failures to help consumers to make better choices for themselves, and ideally create a 'self regulatory dynamic' where it is more difficult for a supplier to exploit consumer biases. The role of companies is to innovate and compete, developing ever better value products and services that appeal to consumers. The regulator, meanwhile, can avoid hindering this innovation and competition with unnecessary red tape, and help ensure competition runs smoothly with the grain of human behaviour. For example, this could be achieved by ensuring prices are comparable, switching is quick and easy, and consumers get prompted to make choices at timely moments. Regulators can also test whether remedies are working well (through suppliers and third parties) and iterate to create the best outcomes for consumers.

As discussed in section 1, it is also important to note that some markets will never deliver good outcomes for all consumers. Even in some competitive markets with price elastic demand, the price of add-ons can be shrouded and have large mark-

ups (Gabaix & Laibson, 2006). However, preventing exploitative behaviour is one way to promote better outcomes for all consumers. In an exploitative market it is possible to sell products for well above their economic value due to shrouded attributes and abusive practices. To illustrate, even if a consumer valued an apple at £10,000, because they erroneously believed it would save their life, this error would be costless in a competitive market because the market prices sells apples at £1 to everybody. However, if the consumer believes that only one apple seller grows 'life saving' apples, the same error may cost £10,000 if that apple seller exploits this misinformation and makes a 'take it or leave it' offer (Laibson, 2013).

We propose that regulators consider adopting the following framework:

- A. Fully incorporate consumer outcomes into the criteria for a well-functioning market
- B. Collect and publish data to see whether the market is performing on a 'well functioning' scale, and identify behavioural market failures
- C. Design remedies to overcome identified behavioural market failures
- D. Test if the remedies are actually leading to better outcomes for consumers and iterate

Below we explore each step in more detail.

### **A. Fully incorporate consumer outcomes into the criteria for a well-functioning market**

Regulators already have well developed criteria for assessing markets and identifying market failures. However, regulators should consider whether there is scope to adapt and add to these criteria to ensure that they are based on a sophisticated understanding of how consumers behave and the reality of the consumer experience and outcomes.

The ambition is for regulators to send clear signals indicating what a well-functioning market looks like to suppliers, third parties like PCWs, consumer groups, and consumers. This means regulators would set specific consumer outcomes that they will assess a market on, and their ambitions for reaching certain benchmarks within each criteria.

We suggest three criteria to assess consumer markets, noting that no single criteria will be sufficient to indicate whether the market is performing well as a whole.

**1) Primary criterion: Percentage and distribution of consumers not getting a 'bad deal'**, the aim here is to reduce the proportion of consumers who are paying too much because they are sticking with defaults or making ill informed choices. Regulators could, for example, set a maximum proportion of consumers who could save money by switching supplier or tariff. This is a measure of how many consumers are engaged and the price outcomes of engaging in the market by switching. For example, in the energy market, the CMA found that '70% of customers are on the relatively expensive default tariff' and that 'there are material, persistent gains from switching supplier, tariff and/or payment method that go unexploited by many customers' (CMA, 2016). Ofgem estimate that gain at around £200 per household on average, with some consumers able to save even more.

There is also an important distributional consideration here, as regulators should be concerned with whether the percentage of people not getting bad deals is consistent across vulnerable and non-vulnerable consumers.

**2) Consumer comprehension**, for example the percentage of people who have understood the key pieces of information on a bill. This would ideally be tested (perhaps in a laboratory) rather than self-reported comprehension.

**3) Consumer satisfaction**, for example the number of consumers who are making complaints and the number who are satisfied following a complaint resolution.

In each market these criteria should act as key performance indicators. These criteria will overlap and interact. While there should always be a role to regulate markets appropriately to ensure the best interests of consumers, in the context of this report, the key question is whether consumers are getting outcomes as they would if they were fully informed and not suffering from behavioural biases. Regulators could, for example, publish data to an online dashboard showing performance against each criteria. Consumer groups can play an important role in this process, for example by suggesting the target levels of consumer satisfaction and consumer comprehension in each market and how these should be measured, for example through a cross-sectional campaign or international benchmarking.



If consumers have high satisfaction rates and high comprehension rates within a market, yet are not switching when they could save a certain amount of money, they may simply be 'choosing not to choose' (Sunstein, 2014). In some cases this is an explicit choice, where consumers actively outsource their choice to someone else (e.. using a weekly vegetable delivery service where the choice of vegetables is made by the supplier). In other cases this may be an implicit choice, where consumers are aware they could save by switching suppliers but still choose to do nothing. This could be for a number of reasons: they might worry about making the wrong choice, they may not be aware of their lack of information, or they may have their own behavioural biases. On a similar note, if there are a large number of people who are not on the best deal, it may be that they are using a 'satisficing' approach (Simon, 1956), and have settled on a 'good enough' deal for them.

Satisficing and choosing not to choose may be acceptable, however regulators should be wary that suppliers can provide lower quality products and make profits from consumers who do not switch providers and as such, they are incentivised to encourage people not to switch (Akerlof & Shiller, 2015b). They can do this in ways that the regulator may determine acceptable, for example by providing additional loyalty benefits (such as early access to booking high demand sporting events), which in turn boosts consumer satisfaction. However, they may also do this in ways that regulators should consider addressing, for example by presenting their usage and billing in a way that makes it hard for consumers to understand whether or not they would save money if they switched provider (Which?, 2015).

These three criteria should be considered alongside the approach regulators already use on the supply side. That is, making sure that the market structure is one that supports and promotes competition, including by considering barriers to entry and expansion. However, we believe that there are further opportunities for regulators to promote new entrants (offering good value and innovative services) to be able to not only enter, but thrive without the practices of existing suppliers preventing their expansion. In some markets existing practice, for example complex pricing, make it difficult for new firms to win new customers despite offering good value. Our concern here is that companies in some markets are incentivised to play on consumer biases, such as exploiting short-sighted consumers who do not anticipate that they will need the expensive add-ons when they sign up for a tariff (Gabaix & Laibson, 2006). New suppliers who seek to enter a market and provide products that do not play on consumer biases, such as highly transparent pricing structures, are often unable to compete with existing suppliers to maintain market share. Regulators should be seeking to create a market where these new entrants can enter and survive.

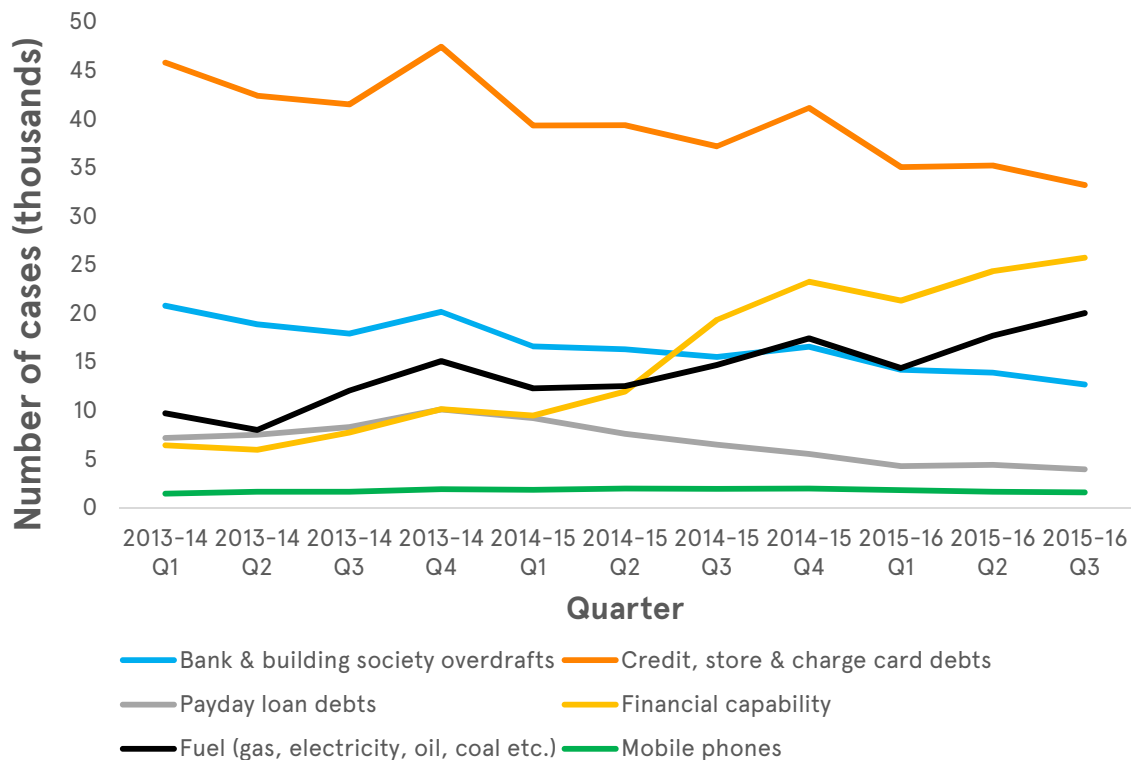
## **B. Using data to actively and directly inform consumers and market players about market performance, and identify behavioural market failures**

Like consumers, regulators also suffer from imperfect information and should consider ways to optimise the information they and others collect, and use it to set expectations of quality to drive excellence. Aggregating existing data and collecting new data can help regulators to develop a more complete understanding of markets, identify where behavioural (and traditional) market failures may be occurring, and address problem areas before they escalate.

Importantly, publishing this information in an accessible way creates a strong feedback loop between regulators, suppliers, intermediaries and consumers. This sends signals to suppliers and consumers about regulators' expectations for quality of service in the market (in line with the recommendations in section 3A) and allows consumers to relay their experience and complaints in an easy and timely fashion. Regulators' ambitions should be to create competition on metrics that drive excellence in suppliers and intermediaries, as well as clipping poor behaviour and deterring abusive practices. This is different from an accreditation scheme, which deters poor behaviour but does not incentivise suppliers to perform better than the accreditation threshold. The speed at which this data can be collected and analysed can aid regulators in developing remedies more quickly and in a more targeted way.

Consumer organisations, charities and complaint aggregators can partner with regulators to share existing data about patterns of advice sought by consumers and uplifts or drops in complaints in particular areas. For example, Citizens Advice publishes its data in a range of formats, including through its quarterly 'Consumer Advice Trends' and policy research publications. As shown in Figure 3.1 below, Citizens Advice provides large numbers of consumers with advice on issues across regulated markets. It also shares more detailed analysis with regulators and Government on a regular basis. It is constantly seeking new opportunities to share this unique data with new audiences and in new, more user friendly and impactful formats. For example, it may be possible to publish more granular data about the nature of the advice or complaint.

Figure 3.1 Number of Citizens Advice cases regarding a range of regulated products, by quarter



Source: Citizens Advice 'Advice Trends' data, 2013-2016

Regulators should also partner with complaint aggregators like Resolver and customer review aggregators to make use of their rich data to identify trends in complaints. This would help identify the factors that affect service quality and the impact that regulation has on this.

Customer review websites, complaint aggregators, and social media are a rich source of data that leverage the wisdom of the consumer crowd (W. Dai, Jin, Lee, & Luca, 2012; Surowiecki, 2005). Several economists (Kang, Kuznetsova, Luca, & Choi, n.d.) have explored the opportunity to harness the information on restaurant cleanliness provided by customers on Yelp.com to better target public health inspections, and improve disclosures to customers. This same approach can be employed in regulated markets, where consumers share their experiences of customer service, satisfaction and quality while they are consuming the products. Because each supplier and product is reviewed many times by diverse customers and then aggregated by the website, it is likely that the reviews on these websites will be illustrative and predictive of areas of behavioural market failures. In addition, Resolver has the capacity to record complaint resolution rates as well the total number and nature of complaints. Publishing this type of complaint

resolution data is a quick and elegant feedback mechanism to drive excellence in customer service amongst suppliers.

An important aspect of market monitoring is the regular deployment of mystery shopping exercises across switching sites and suppliers to track the quality of customer experiences. Mystery shoppers are briefed in advance to experience and measure the customer experience by acting as a customer and completing a series of tasks. The shoppers then assess their experience against specific criteria in a consistent and comparable way. Consumer groups and regulators have used this technique to good effect, and should continue to seek opportunities to do so in the future.

### C. Design remedies to overcome identified behavioural market failures

When markets meet the threshold required for intervention – where they are performing poorly against the consumer outcomes outlined in section 3A and behavioural market failures have been identified – regulators should then consider how best to a) address internalities and correct behavioural market failures, and b) avoid traditional market failures being exacerbated by behavioural market failures.

Regulators should design interventions that are well matched to the biases they are seeking to address. Importantly, well designed behavioural interventions have the added benefit of not disrupting the behaviour of less biased consumers. For example, if regulators are concerned about information asymmetry and inattention, providing timely and smart disclosures will assist ill-informed, inert consumers without affecting the behaviour of more mindful, informed consumers (Allcott & Sunstein, 2015; Soman, 2015). This is important because the impact of biases will vary across consumers. To account for this heterogeneity, interventions can be targeted to consumers with characteristics associated with larger bias. For example, to identify customers that are struggling to pay their energy bills, regulators could identify groups whose Direct Debit payments have bounced more than twice in the last 6 months. An intervention could then be formulated and tested on this specific target group to encourage them to switch supplier to lower their costs or to move their Direct Debit payment to a time when they are more likely to have money in their account (e.g. after a regular payday).

Applying this behavioural lens would require regulators to use a wider and more nuanced set of remedies than they have previously employed, which can work with the traditional regulatory tools. These are explored below in a hierarchy of increasing complexity, from education, to direct regulation of products and providers, to collaboration with third party intermediaries.

## 1. Consumer education: promoting simple heuristics

There has been a lot of focus on consumer education as a way of helping consumers achieve better outcomes, however it is not clear whether these programmes help achieve better outcomes (Hastings et al., 2013; Miller, Reichelstein, Salas & Zia, 2014). A more effective and behaviourally informed approach may be to help people develop a series of heuristics or rules of thumb, which will be generally reliable in the absence of full advice or information. For example, when switching providers, some rules of thumb might include 'always use a PCW', 'use your QR code to access your data', and 'consider a minimum of 3 deals'. This type of approach has been shown to work in a business support context (Drexler et al., 2014).

The role of regulators may be to not only identify effective heuristics, but actively market them to consumers. Public health providers have done this in several campaigns, for example 'eat 5 a day', 'slip, slop, slap', 'always look twice', and in the consumer sphere: 'pay half your age into your pension'. These rules of thumb should be developed in conjunction with consumer bodies like Citizens Advice, using the findings from the mystery shopping exercises suggested above. Citizens Advice could then lead on providing these rules of thumb to consumers when they are seeking advice. The recent Financial Advice Market Review, led by the Treasury and the FCA recommended that a task force be set up to design and test a set of rules of thumb and nudges (HMT and FCA, 2016). For example, have three months' income available in an instant access savings account to help you cope with unexpected circumstances.

## 2. Direct regulation of products or suppliers

Regulators have existing powers or regulatory scope to ban specific product features. As the FCA has acknowledged, using a behavioural approach means that products can be banned where they 'appear designed or otherwise likely to exploit consumer mistakes to their detriment' or products can be required 'to contain specific features to address the risk of detriment arising from such mistakes' (Erta, Iscenko, Hunt, & Brambley, 2013). This approach can also be applied to the regulation of suppliers. We focus here on the features that can reduce the risk of detriment arising from consumer mistakes.

### a) Smart defaults

As discussed in section 2A, because of inertia, status quo bias and implied endorsement, many consumers will stay with a default option even where there are benefits of switching. To address this, regulators could consider setting 'smart defaults' that maximise consumer welfare, particularly for vulnerable groups, but do not unduly impede competition (Smith, Goldstein, & Johnson, 2013).

Recently, the CMA considered defaulting all consumers who had not switched energy supplier recently onto a 'safeguard tariff' to cap the costs they pay for energy. For this kind of remedy there is a concern that consumers would react to this cap by switching tariffs even less than before, as they are now 'safeguarded' from the highest prices. Indeed, the phrase 'safeguard tariff' may imply to the consumer that they are 'safe' and do not need to take action. Regulators need to consider if this kind of default actually disincentivises desirable consumer action (e.g. switching tariff) and reduces the number of consumers who are actively choosing tariffs and benefitting from learning from past decisions as they make these choices. As part of the consultation, we recommended an alternative approach, with the tariff named the 'emergency' or 'transitional' tariff, rather than the 'safeguard' tariff to encourage higher levels of action by consumers to move off this tariff by highlighting the exceptional nature of the tariff.

Another avenue for defaults is to allow delegation of choice to a third party, for example through automated switching. At the moment there are few opportunities to delegate choices to a third party, that is, to explicitly choose not to choose but to ask someone else to choose on your behalf. There has been a shift towards this, for example, the Cheap Energy Club<sup>6</sup> provides a service where consumers can be notified if there is a better deal for them, but it requires consumers to make the switch themselves rather than allowing it to be automated. Midata and Application Programming Interfaces (APIs) can take this model to the next level, making it possible for a consumer to pay an annual subscription fee to be regularly switched onto the best deal, based on pre-set preferences and across multiple regulated markets.

#### **b) Timely, smart disclosures**

As discussed in section 3A, there is huge opportunity to improve the timing, content and format of disclosures. For example, Dilip Soman classifies three specific ways in which suppliers can fail to provide consumers with the most appropriate information while making choices: outright failure, delayed or distant disclosure, and shrouding or obfuscation (Soman, 2015). There is huge potential to improve the staging and timeliness of disclosures to make them more relevant, salient and effective.

Regulators adopting a behavioural insights centred approach would not anticipate that consumers will proactively search out information, but rather think about what consumers are already doing within the market and put the information in

<sup>6</sup> <http://www.moneysavingexpert.com/cheapenergyclub>

front of them at a salient point. Within personal banking, consumers could be asked if they want to extend their overdraft limit when they are close to reaching their limit, or when they first experience a charge – rather than expecting them to anticipate that they will need an overdraft facility when they first open a bank account. Similarly, for credit cards and savings accounts, different ways of notifying consumers that their initial introductory interest rate has now come to an end could be trialled.

Smart, timely disclosures also begin to address issues with a class of consumption behaviours that the individual typically does not anticipate but that are widely expected by firms. These are types of consumption that, when entering the contract, consumers likely overestimate their ability to avoid due to overconfidence and optimism bias. This is an important variation on information asymmetry, with the supplier and consumer having different levels of understanding of the consumers' own behaviour. For example, many consumers do not think they will need an overdraft on their personal current account. However, from the perspective of the provider, they expect a portion of their customers will regularly incur fees for unarranged overdrafts, not least because of the significant revenue streams these fees generate<sup>7</sup> (OFT, 2008). While most providers offer increased control through text alerts and mobile applications, most do not offer consumers the ability to opt-out of unarranged overdraft facilities at the point when they are about to incur fees. Arguably, providers may even be exploiting consumers' optimism about avoiding these overdraft fees.

This does not mean that consumers should be protected against all instances of unanticipated consumption. However, if suppliers were required to prompt their customers, or shift the decision points to a more relevant time (as outlined in the overdraft facility above) this could effectively address the behavioural market failures that flow from overconfidence and optimism bias. These types of interventions are ripe for testing through randomised control trials to understand how these prompts affect consumer behaviour. This is discussed further in section 4D.

Another important aspect of disclosure is that it is only as effective as the tools consumers have to help them use the disclosed data (Soman, 2015; Thaler & Tucker, 2013). Technological advances create significant opportunities to collect and intelligently use data, including for disclosure.

<sup>7</sup> In their 2008 market study the OFT found that unauthorised overdrafts (UOC) represented a significant revenue stream, with personal current account (PCA) providers earning £2.6 billion (31 per cent) of their PCA revenues from UOCs in 2006.

Since 2011, the UK Government has pursued the Midata initiative, which works with businesses to increase access to personalised consumer data in electronic formats. Midata is designed to redress the imbalance of information between consumers and firms by providing consumers with information about their consumption over the previous year. The six big energy firms are now required to provide consumers with the information they need to switch supplier through a Quick Response (QR) code printed on the bill. This allows individuals to compare tariffs based on their usage data, takes away some of the complexity and friction costs associated with choosing and switching. However the way in which energy firms have chosen to present the information varies and in many cases it is still very confusing with little explanation about what the QR code is for. All the large banks now give consumers the option to download their Midata but take-up has been low because of the complicated process required to download data. HM Treasury has worked with industry to develop Midata into a banking API that should be launched by Q1 2019 and will remove much of the friction in the current process (OPI, 2016).

### **c) Asymmetric penalties**

A common feature of many markets is that penalties usually apply to the consumer for non-compliance with agreed usage or behaviour. For example, most firms have some sort of charge for missed or late payments, and others may have additional penalties for engaging in the individually unanticipated but collectively expected behaviours discussed above. However, in most instances, firms do not face equivalent automatic penalties if they fail to meet their obligations under the contract. For example, a mobile phone company that has a system outage is not required to directly compensate customers for the outage. While firms can be penalised, it is usually through regulatory action, and does not necessarily involve a penalty that is paid back to the consumers. The risk of being fined may be low and firms may even build the risk of fines into their business costs. Moreover, while some system outages or other such failures might be unanticipated by firms, we would argue that if consumers are to be penalised for unanticipated behaviours, then arguably firms should be as well. An alternative is that if firms are not penalised then consumers should be given a grace period. For example, consumers would not have to pay any fines the first time they go into an unauthorised overdraft.



### 3. Collaborating with third parties

#### a) Choice engines and intermediaries

Tools that help people navigate markets are a key part of any market, and are becoming more so. The CMA plans to undertake an analysis of price comparison websites during 2016, supplementing the work done by the UK Regulatory Network (UKRN, 2014). Among the issues to be considered will be whether there is a case for a common accreditation framework; whether lack of access to free, readily-available tariff data is a barrier for innovative and new price comparison websites; and whether price comparison websites in specific sectors should be subject to more rigorous propriety and transparency standards.

One area where we think more could be done to support consumers is using data to provide meaningful comparisons. Using aggregated data and mystery shopping, regulators or consumer organisations could run 'meta price comparison websites'. These sites would rank the relative performance of different PCWs on metrics such as average price savings achieved, and ease of use as ranked by customers. This would enable consumers to make more informed choices about the PCW they are using to choose their supplier and tariff, including which PCWs provide a 'most favoured nation' status to particular suppliers. While participation in the meta PCW would be voluntary, PCWs that fail to provide information to feed into these meta-PCWs would be disadvantaged, as consumers would not see any information about the site, or the PCW would end up at the bottom of the comparison. Consumers will of course have varying preferences and priorities when choosing a supplier or PCW and rating the quality of service. One way to account for and respect this heterogeneity is allow consumers to sort the ranking of the meta-PCWs and supplier league tables by the metrics they particularly care about.

Further, regulators should consider enabling PCWs, with customer permission, to access consumer data after a consumer has already switched in order to provide an updated view on potential savings available. PCWs could continue to prompt consumers to switch in the future (particularly because they know when a tariff they switched the consumer to is coming to an end). This ability to make switching salient and continue to prompt in a timely manner is likely to facilitate switching. While QR codes are now required on energy bills, suppliers are not displaying them in a consistent way or with the necessary contextual information. Ofgem should 'own' the portion of the energy bill where the QR code is displayed, and require suppliers to include a prescribed switching message and set of instructions next to the QR code.

Regulators can also selectively provide choice engines with customer data to enhance their ability to target disengaged consumers. As part of the ongoing Energy Market Investigation, the CMA has suggested that a database of the contact details of disengaged customers could be opened up to rival suppliers (CMA, 2016a). The CMA's intention is that this would enable suppliers to contact consumers who could make the largest savings by switching. An alternative to avoid flooding disengaged consumers with direct marketing from suppliers, is to identify the three best performing switching sites and suppliers each quarter and give them the ability to contact a subset of disengaged customers on the database. The mechanics of the approach could also be handled by an intermediary so that the contact details are not given to the switching sites/suppliers until consumers respond. At the same time, the three worst performing suppliers might be required to send prompts to their customers about switching, detailing their performance against rival companies. This approach could be successfully employed across regulated markets including telecoms and personal finance.

#### **b) Low-friction complaining**

In most sectors, the only direct remedy that consumers have against a specific firm is through a complaints mechanism, by switching, or cancelling their contract. While all firms are required to have a complaints mechanism in place, there may be scope for regulators to formally acknowledge the role that third-party complaint processes (for example, Citizens Advice and Resolver) can play beyond bringing forward super complaints<sup>8</sup>, namely to facilitate low friction complaining and aggregate complaints. This has two advantages. First, suppliers do not work to a common definition for complaints. In contrast, third parties can create a common way to record and present complaint data across suppliers. Second, these bodies are likely to provide a much easier way to complain about a firm. Since reducing the 'hassle factor' is key when attempting to encourage a consumer behaviour, a more involved process is very likely to deter complaints. Importantly, having a large number of complaints go through a single body creates a capacity to detect problems that may be relatively small at an individual level, but widespread across the community.

Regulators could provide greater support to these bodies by semi-formally recognising their role, and developing mechanisms for them to formally feed into

<sup>8</sup> A 'super complaint' is defined by section 11(1) of the Enterprise Act 2002 (EA02), as a complaint submitted by a designated consumer body that 'any feature, or combination of features, of a market in the UK for goods or services is or appears to be significantly harming the interests of consumers'.

the regulatory process. For example, monitoring the types of complaints that third-party bodies receive would provide regulators with another source of intelligence, and a formal relationship might see regulators getting involved in particular sectors when a particular threshold of complaints was met. Further, by providing formal recognition including links from regulator websites, it would also give these bodies greater legitimacy in the eyes of consumers and industry. This would encourage consumers to use these more and thus provide greater intelligence on the key issues affecting them, and encourage firms to respond more proactively to consumer concerns. It also potentially lowers the burden on regulators and ombudsmen themselves, enabling them to focus on strategic issues and unusual cases.

#### **D. Test whether remedies are actually leading to better outcomes for consumers**

The size and impact of behavioural biases is often context specific, and the potential for any specific remedy to overcome a particular bias cannot be perfectly predicted. Consumers are complex and multifaceted and markets have many feedback loops and ways of responding. Testing can enable a more accurate cost-benefit analysis of any given change, ultimately improving outcomes for consumers and reducing regulatory burden. For these reasons, we strongly advocate routinely testing and iterating of remedies. This empirical approach is increasingly being used across governments to evaluate policy and regulators are starting to adopt the approach too. Encouragingly, the recent CMA provisional decision on remedies for the energy market investigation included a strong endorsement of testing in partnership with energy suppliers:

Our proposed remedies therefore call for a more evidence-based approach to developing such interventions in the future, through the use of rigorous testing and trialling, where appropriate through Randomised Controlled Trials, with a recommendation to focus such trials on a shortlist of measures. If such trials are to provide relevant information that can provide a robust basis for regulatory changes, it is essential that suppliers be required to participate, where the trial design requires it, and our remedies therefore seek to ensure such participation (CMA, 2016a).

There are several models to embed testing within the regulatory culture and move towards voluntary supplier participation. One promising model for testing is for regulators to grant suppliers derogations from current regulations to test alternatives. This is the model that the Department of Energy & Climate Change (DECC) are currently using to allow suppliers to test alternatives to the mandated provision of In Home Displays (DECC, 2016), and the CMA has recommended a

similar approach to test messaging on energy bills (CMA, 2016a). A potentially better long-term model is one of principles based regulation that incorporates scope for testing within the spirit of the regulation. Regulators can set consumer outcomes for the market, for example threshold customer satisfaction ratings in line with what is suggested in section 3A, and allow suppliers to test alternative approaches to achieve these outcomes. Suppliers could be required to share trial results and other supporting data with regulators to demonstrate that they are achieving these outcomes.

We strongly suggest conducting randomised control trials in the field to test the impact of information provision in particular, instead of relying on focus groups or internal testing. While there are complexities involved with running field experiments, it can be relatively cheap and straightforward to run randomised controlled trials as field experiments in a policy setting especially where they link into an existing process. For example, bills, annual statements, and product end notifications, as well as the ways terms and conditions are communicated, can benefit greatly from the use of randomised controlled trials to test the most effective messages to promote consumer engagement. The most obvious and appealing outcome measure would be switching rates. However, there is also scope for testing the level of customer understanding of notifications; for example a notification might be deemed 'successful' if 75% of customers understand the information included and are able to demonstrate a clear understanding of what steps they need to take to compare current accounts.

Testing comprehension of a communication can also sometimes be done in a lab, which is often cheaper and quicker than field trials. In the energy market, as recommended in the CMA's Energy Market Investigation, Ofgem should work with energy suppliers to test different prompts to increase consumer switching. As well as testing different messages, this might also include testing the impact of different messengers, which has been shown to affect consumer responses (Dolan, Hallsworth, Halpern, King, & Vlaev, 2010).

The findings from these field and lab experiments can be used to inform and refine future regulatory approaches. Ideally, the data and results should be published to allow other market participants to learn from best practice and foster a culture of empiricism.

## 4. Conclusion

Across regulated markets consumer biases, and the exploitation of these biases by businesses, result in consumers needlessly paying substantial amounts of money each year. Collectively the UK public is overpaying for mobile phone contracts by £355 million a year<sup>9</sup>. In the energy market, DECC estimate that 9.5 million households could save over £300 by switching.<sup>10</sup> These figures cannot be explained purely by high consumer satisfaction with suppliers, as almost half of customers of the Big Six energy companies are not satisfied with supplier service.<sup>11</sup> Behavioural science offers both explanations and solutions to these patterns of behaviour.

In the 2016 Queen's Speech the Government set out its intention to bring forward a Better Markets Bill. One of the aims of this Bill is to 'make economic regulators work better'. The design and passage of this Bill through parliament will inevitably lead to debates around the role of economic regulators and which regulatory approaches lead to optimum outcomes for businesses, consumers and the economy. In this timely report we have argued that placing behavioural insights at the heart of regulation will reap significant benefits for consumers and businesses.

Building on positive steps they have already made, we propose a new approach for regulators to help consumers make better decisions for themselves. We have argued that putting behavioural insights at the heart of regulation would allow for more effective problem diagnosis and more effective, though not necessarily more frequent, regulatory interventions. We have also set out a number of practical ways regulators could take this new vision forward - for example adapting criteria for well-functioning markets to more closely reflect the reality of the consumer experience and ensuring that interventions go with the grain of consumer behaviour. All remedies would be rigorously tested to ensure that they are actually leading to better outcomes for consumers.

Citizens Advice and other consumer groups have an important role to play in supporting regulators to take these steps, for example in collaborating with regulators to determine what a well-functioning market looks like from a consumer perspective. Citizens Advice are well placed to advise on how to measure criteria such as consumer satisfaction, as informed by advice trends, and to determine what level of consumer satisfaction constitutes a well-functioning market. Secondly, Citizens Advice can continue to proactively collect and share

<sup>9</sup><https://press.which.co.uk/whichpressreleases/millions-of-pounds-wasted-paying-for-mobiles-people-already-own/>

<sup>10</sup><https://www.gov.uk/government/publications/household-energy-savings-through-switching-supporting-evidence/many-households-could-save-around-200-per-year-through-switching-energy-supplier-basis-for-claim>

<sup>11</sup> <https://www.ofgem.gov.uk/chart/customer-satisfaction-six-large-electricity-suppliers>

data (such as trends and granular advice data) with regulators to feed into setting and measuring these success criteria. These data can be used to both highlight areas of potential concern, as well as to inform whether implemented remedies are having a positive impact.

It is the regulator's role to identify why a market is not performing to the desired level on particular criteria, and to develop remedies aimed at resolving this. Citizens Advice can contribute to shaping proposed remedies through formal and informal consultation, and share experience and expertise about how these could be implemented.

Once remedies have been developed, Citizens Advice could become the vehicle to deliver remedies, for example by designing and promoting simple heuristics for consumers.

Finally, Citizens Advice could also take an active role in trialling and testing remedies. For example by collaborating with both regulators and suppliers to run lab and field experiments to test the policy ideas set forward in this report and measure whether they fulfil the goal of enabling consumers to make better choices for themselves.

## Appendix A: Detailed examples of behaviourally-informed interventions

Recommendation for behaviourally-informed intervention	Illustrative example
<b>Consumers tend to stick with the default</b>	
<p>Mandate suppliers to work with regulators to test different salient prompts to consumer (variations of messaging, format and messenger).</p>	<p>As recommended in the CMA’s Energy Market Investigation, Ofgem should work with energy suppliers to test different prompts to increase consumer switching. This process should be systematic, transparent and rigorous.</p> <p>Similar testing could also be done by Ofcom to notify consumers that their mobile contract is now over and they can save by moving to a sim-only plan.</p>
<p>Selectively provide access to databases of disengaged customers to top performing suppliers, and have a corresponding penalty for poorly performing suppliers.</p>	<p>In the energy market, the CMA has suggested a database of the contact details of disengaged customers could be opened up to rival suppliers.</p> <p>To avoid flooding disengaged consumers with direct marketing from suppliers, a better model is to identify the 3 best performing switching sites and suppliers each quarter and give them the ability to contact a subset of disengaged customers on the database. The mechanics of the approach could also be handled by an intermediary so that the contact details are not given to the switching sites/suppliers until consumers responded.</p> <p>At the same time, the 3 worst performing suppliers would be required to send prompts to their customers about switching, detailing their performance against rival companies.</p>

Recommendation for behaviourally-informed intervention	Illustrative example
<b>Consumers heavily influenced by anchors</b>	
Regulators should facilitate trialling different anchors presented on consumer-facing communications.	The FCA should routinely test different ways of presenting anchor points, for example they should test to see if the Australian Minimum Payment Warning <sup>12</sup> featured in Figure 2.1 is effective in the UK context when encouraging consumers to pay off higher proportions of their credit card debt.
Change minimum repayment anchors.	Increase the minimum payment baseline on UK credit cards so that it reduces the consumer's balance by more than 1% each month.
<b>More choices doesn't necessarily mean better outcomes</b>	
Suppliers should be required to provide machine-readable consumer data to help consumers find products that are best for their usage. Ideally this would be a secure API, which any application or service could access with permission.	<p>Scanning QR codes printed on energy bills has recently enabled energy customers to find energy tariffs that are cheapest taking into account their past usage. As QR codes are not a widely used technology, APIs should be developed to allow consumers to access their data in easier ways e.g. unique customer number.</p> <p>In the interim, new requirements should be introduced to make it easier for consumers to find their Midata files. For example, for personal current accounts we suggest requiring that a representative sample of consumers should be able to find and download their files within 2 mouse clicks or within 1 minute of logging into their online banking. The 'Midata button' should be required to be prominently displayed on all personal banking log-in pages.</p>

<sup>12</sup> [https://www.westpac.com.au/docs/pdf/pb/Westpac\\_Ignite\\_Minimum\\_Repayment\\_Warning\\_Brochure.pdf](https://www.westpac.com.au/docs/pdf/pb/Westpac_Ignite_Minimum_Repayment_Warning_Brochure.pdf)



Recommendation for behaviourally-informed intervention	Illustrative example
<p>Regulators should publish the information that they collect on customer satisfaction, complaints and other quality indicators, which can should then be displayed on price comparison websites. Suppliers themselves could also be mandated to collect certain feedback metrics to allow comparison.</p>	<p>Within the energy market, Ofgem should make the outcomes of their monitoring publicly available. This information must be provided in a format and at a time when it can be used by individuals making decisions, for example it may be sensible to provide it directly to PCWs to be displayed with search results.</p>
<p>Consumer bodies can help consumers to make the choice of which switching site to use by developing league tables of switching sites (utilising data from complaints and mystery shopping exercises).</p>	<p>Consumer bodies could develop league tables of the switching sites that have the highest customer satisfaction and highest customer savings.</p>
<p>Prompted within supplier switching.</p>	<p>Where a consumer's usage pattern is such that there is another product that the firm offers that the consumer could have instead purchased and saved money, then the firm would be compelled to show that information on a bill to the consumer for the next period.</p>
<p>Automated switching.</p>	<p>Using Midata and the proposed energy API, consumers should be able to delegate their switching choices to a third party provider, who would then ensure that the consumer is always on the best tariff. The Cheap Energy Club<sup>13</sup> currently provides a service where consumers can be notified if there is a better deal for them, but it currently requires consumers to make the switch themselves rather than allowing it to be automated.</p>
<p>Regulators should publish the information that they collect on customer satisfaction, complaints and other quality indicators, which should then be displayed on price comparison websites.</p>	<p>Within the energy market, Ofgem should make the outcomes of their monitoring publicly available. This information must be provided in a format and at a time when it can be used by individuals making decisions, for example it may be sensible to provide it directly to PCWs to be displayed within searches.</p>

<sup>13</sup><http://www.moneysavingexpert.com/cheapenergyclub>

Recommendation for behaviourally-informed intervention	Illustrative example
<b>How information is framed can radically affect choices</b>	
Suppliers should be required to work with regulators to test different presentations of information on consumer facing communications e.g. bills, product end notifications, and sales literature.	As recommended in the CMA's Energy Market Investigation, Ofgem should work with energy suppliers to test different ways of formatting bills (and other correspondence) to increase consumer comprehension and ability to switch. This process should be systematic, transparent and rigorous.
Disclose and seek agreement to terms and conditions at the time that extraordinary usage occurs (e.g. overdraft fees, mobile roaming fees), rather than at the start of a contract.	Disclose and seek agreement to the terms and conditions of overdraft facilities at the point in time where the consumer is first about to go into overdraft. For example, where their account balance falls under £5.
<b>Consumers are more focused on the present than the future</b>	
Suppliers should be required to make the long term, or hidden, costs more salient at the point of decision-making.	Mobile phone handset list prices should be made available when consumers are buying a monthly contract with a reduced price handset, so they can see how much they are paying additionally by not buying a sim-only plan and buying the handset upfront.
Test varying upfront incentives to encourage desirable consumer behaviour.	Energy suppliers are currently only allowed to provide non-cash incentives such as vouchers to encourage switching (unlike other markets). As cash incentives are effective at driving switching, these could be trialled in the energy market (through a derogation process led by Ofgem), to check that consumers are not choosing more expensive tariffs in the long term.
Notify consumers when teaser rates come to an end.	Consumers should receive communications letting them know when promotional offers have expired. The effectiveness of these communications should be systematically tested through rigorous trials.

Recommendation for behaviourally-informed intervention	Illustrative example
<p>Restrict the level to which teaser rates can revert.</p>	<p>To avoid consumers being drawn into 0% interest rate credit cards, only for the rate to jump to 20% after a few months, we suggest that regulators should trial setting a limit on the acceptable gap between a teaser rate and ongoing interest rate for credit cards e.g. a teaser rate cannot be more than 10 percentage points lower than the ongoing interest rate once the introductory offer is over.</p>
<p><b>The timing of interventions is crucial</b></p>	
<p>Test the timeliness of switching prompts</p>	<p>Prompting people at the beginning of the new year, new month, or even contacting people immediately after their birthday or when they have recently moved house may be points at which people are especially disposed to switch providers. As described above, regulators should work with suppliers to systematically test these ideas to see what works. Larger consumer campaigns such as 'switching weeks' could also be evaluated to see if they are effective timely prompts.</p>
<p><b>Consumers tend to be overconfident</b></p>	
<p>Consumers should be prompted to choose whether to buy products such as overdrafts or 'text message bundles' that help reduce costs of unanticipated usage the first time higher costs are incurred or when they come close to incurring a charge.</p>	<p>Consumers should be asked if they want to extend their overdraft limit when they are close to reaching their limit, or when they first experience a charge - rather than expecting them to anticipate that they will need an overdraft facility when they first open a bank account. Similarly, when consumers routinely exceed the monthly allowance for data or text messages on their mobile phone contract they should be prompted to change their plan or buy 'data bundles' to avoid this happening in the future.</p>

Recommendation for behaviourally-informed intervention	Illustrative example
<b>Scarcity mindset</b>	
<p>Terms and conditions should be simplified and written in plain English. Different formats could be tested with consumers to test comprehension.</p>	<p>Lab experiments could assist regulators such as Ofgem in testing different terms and conditions and then subsequent consumer behaviour or comprehension.</p>
<p>Vulnerable consumers should be given greater slack when making payments and fulfilling terms of contracts, but with salient reminders and deadlines.</p>	<p>When a direct debit bounces, the bank should send a text message to the consumer telling them they have 48 hours to deposit money into their account to avoid charges. Currently banks have varying degrees of leniency for customers. This should be tested to see what is the optimal amount of time to give someone and what is the optimal way of letting them know (for example, a phone call or a text message, what is the optimal wording for a message).</p> <p>Similarly with mobile phone contracts that require customers to send back their bills to receive cashback payments, consumers should be given some leniency in sending back the bills on time - rather than cashback programmes becoming invalidated if a consumer does not send back every bill on time.</p>
<p>The most vulnerable customers should be protected by regulators through smart defaults</p>	<p>As recently suggested by the CMA, if vulnerable consumers, such as those on prepayment meters, do not actively choose to switch provider they should be protected from disproportionately high energy prices by being defaulted onto a price capped plan.</p>

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