

Testing Times

One of the key outcomes stipulated by the FCA under its forthcoming Consumer Duty concerns consumer understanding. Firms will have to ensure that communications support and enable consumers to make informed choices about financial products and services.

This doesn't necessarily mean firms need to show consumers always make the 'right' choice – this is subjective, and, in the case of advised clients, they have the benefit of a planner to provide them with a recommendation anyway.

But providers must be able to show that communications allowed them to make their choice on an informed basis. In the FCA's words, firms must be able to show consumers had 'the information they need, at the right time, and presented in a way they can understand.'

Information overload

Let's break that down, starting with the 'information they need'. The financial services industry is rarely accused of providing too little information, so we can be confident that consumers will get a volume of information covering each of the risks they ought to be aware of. But the important question is do they get it at the right time and is it presented in a way they can understand?

That's something we're keen to understand better ourselves, not only to meet our own obligations under the Consumer Duty, but also to benefit our customers and advisers. The difficulty is you can't just ask people if they've understood something.

The same goes for consumer understanding of financial products and choices. We need to be clear about what knowledge they actually need, as well as when they need that information and how can it be communicated in a way that makes sense to them.

The consumer understanding element of the Duty is not about making communication more detailed. It about making the details that are included better and more relevant for the audience to enable understanding.

Testing

That's where testing comes in. The FCA wants firms to be able to 'demonstrate consumer understanding and show they have 'tested it and made improvements to their communications, where appropriate, to support good outcomes'.

The question is how do you demonstrate someone has understood something? As above, people don't know what they don't know. So, a simple survey asking people for a 'yes/no' answer to whether they understand financial paperwork won't do.

That is why we're planning to dig deeper through working with a behavioural economics expert, Professor Richard Whittle.

This work takes the form of a series of randomised control tests, or 'RCTs' to help to cut through the different biases and influences that can affect customers' understanding. Richard explains:

"During lockdown there was a rise in people using smartphone apps to make investments, often making choices based on influencers (financial influencers) and social media trends. You may have heard of the famous GameStop Short Squeeze where an online investment community grouped together to buy a particular stock, significantly affecting the market price and nearly bringing down a large hedge fund. Economists even developed a name for this type of trading, The Bored Market Hypothesis, as people may have been acting more like they were playing computer games rather than making serious financial decisions.

Understandably, regulators around the world want to make sure that people really understand their financial choices and the products they hold. We can ensure that consumers have the information they need. This in isolation is very simple,

however this is hugely problematic in practice. If I gave you all the information ever written on the combustion engine, would you automatically be able to choose the right replacement part for your car? In many cases of information overload we use heuristics or shortcuts to make the decision. In practice you are likely to ask an expert.

The shortcuts we use for information are varied. Rather than receive all possible information about financial products, we use terms and conditions or key facts documents to get the most important and relevant information to the consumer.

So then, if we are confident that consumers have the information they need in these documents, are we equally confident that they are fully understanding them to make informed decisions? Here behavioural science can really help.

Interestingly, if you ask someone if they understand their finances there is a marked tendency for them to say that they do. Who wants to look like they don't really understand something important? Depending on who does the asking we are even more likely to say we understand something, for instance if we are asked by someone younger than ourselves or by someone in a more junior role.

Testing if someone understands something gets past this. Using cutting edge techniques from Behavioural Science we can actually see if a group of people have a general level of understanding of the information we provide. Broadly we will use a range of questionnaires, interviews and focus groups to test understanding under different contexts. People will answer the same baseline knowledge and understanding questions but some may see the information online, some in hard copy and so on. We will be able to see if different approaches to information delivery impact understanding as well as test knowledge retention.

Using behavioural science, we will get a rigorous overview of customer understanding and maybe even things that we could do to improve this.”

Our work with Richard will help us recognise the extent to which customers truly understand product disclosures and communications and, where improvements can be made, to implement them.

Informed decisions

Let's take it back to the start – informed decisions. If we can get all this testing right, it should lead to better-informed consumers. That should mean today's advised clients will be better equipped to make sense of their policy documents, leading to fewer questions and clarifications required.

And non-advised clients will be better informed about the range of financial choices available to them and, in some cases, the dangers that may lurk behind those choices. That should mean they are primed to recognise when they may need a professional to help them weigh those choices dispassionately.

As we learn we'll be sharing the findings with advisers and the wider industry too, in the hope that the research can inform how other firms improve their own communications and, ultimately, meet their obligations under the consumer understanding pillar of the Consumer Duty.