Behavioural insights for information disclosure

James Suter, London Economics

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- I am an experimental and behavioural economist at London Economics (a consultancy firm)
- These areas of economics can provide useful insights on how to help individuals (retail investors) make informed (investment) choices
- In very brief terms, behavioural economics says that:
  - How information is provided can be as important as what is provided
  - Heuristics and biases may lead individuals to filter out/fail to notice relevant information, and affect how we process information
  - These biases interact with the way that firms structure their disclosures and interactions with clients – so-called ‘choice architecture’

Traditional economic theory

(We rationally assess all information available to us)

$$\max_{x_i^t \in X_i} \sum_{t=0}^{\infty} \delta^t \sum_{s_t \in S_t} p(s_t)\, U(x_i^t \,|\, s_t).$$

Behavrioural economics

(We're affected by biases and how information is presented affects our choices)

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Some context from the FCA's Investment Platforms Market Study:

- A well-functioning platform market should help consumers make informed choices between funds
- In light of recent improvements in the presentation of fund charges and an industry initiative to improve the comparability, the FCA decided against further intervention on disclosure
- Nonetheless, it noted that firms can still improve the clarity and prominence of fund charges information, so they will review progress in 2020/21 and consider appropriate regulatory intervention if needed (market study final report, p42)
- The regulator pointed to past research that firms may find relevant in designing changes to the way they communicate, including *Occasional Paper No. 32*

This paper is based on a behavioural experiment London Economics conducted for the FCA, which tested disclosure treatments on investors' decisions and understanding of charges

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- We tested different ways of presenting information about charges, including written warnings and informative graphics, as well as the timing and prominence of information
- We found that behaviourally informed changes to information disclosure can improve retail investors' choices and understanding and awareness of charges
- In summary:
  - A prominent, concise warning message (*Check how much you are paying… charges can significantly impact investment returns*) had a significant impact
  - Combining this with a chart showing the impact of charges on net returns further improved decision-making
  - The warning message plus a summary of charges and a chart comparing the fund's charges to the market average, at the point of confirmation, had the greatest impact on decision-making and understanding
- Importantly, none of the tested interventions appeared to change the importance placed on other fund characteristics (e.g. performance or risk)

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- In an overarching sense, the key insights are:
  - Shows the importance of well-thought-out visual and graphic presentation of information
  - Use simple, concise messages
  - Prominence and timing of information (the 'choice architecture') is essential
- Examples of good practices that fit with these insights (from the FCA's MiFID II costs and charges disclosures review):
  - Technological innovation in disclosing costs and charges, including interactive sliding scales showing the impact of charges on investments over adjustable investment amounts and timescales
  - Making breakdowns of charges easily accessible (e.g. via pop-ups and hyperlinks)

Thank you

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