

Consultation on principles regarding choice architecture

Expectations of the AFM regarding choice architecture

Publicatiedatum: 21-nov-2019

Classificatie: AFM - Publiek

Autoriteit Financiële Markten

De AFM maakt zich sterk voor eerlijke en transparante financiële markten.

Als onafhankelijke gedragstoezichthouder dragen wij bij aan duurzaam financieel welzijn in Nederland.

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About the AFM's 'principles'

The Dutch Authority for the Financial Markets (AFM) publishes 'principles' for specific policy areas under its supervision. Principles provide guidance for financial services companies on aspects that the AFM believes contribute to the development of the sector. In this way, the AFM hopes to increase the predictability of its supervision. Companies determine themselves how they implement the principles. The implementation and application of these principles can differ from company to company, depending on their size, as well as the types of services and the kinds of products they provide.

The aim of this particular set of principles is to communicate the AFM's expectations with respect to the consumer choice architecture. The principles do not replace legal requirements. The principles offer guidance in the interpretation of legal requirements, in these cases where the AFM views this as added value.

1. Introduction

The AFM has developed these Principles to clarify its expectations regarding the design of the choice architecture created by financial services companies. Financial services companies have a great deal of influence on the way in which choice architectures are designed and implemented. The sector can contribute to the appropriate handling of customers through better designed choice architecture. These principles will help financial services companies and pension funds to achieve the following main objective:

At every stage in the financial decision-making process, consumers should be presented with a choice architecture that takes their interests into account. This means that the choice architecture should enable consumers (whether consciously or unconsciously) to make decisions that benefit their own financial well-being.

Individual consumers also have their own responsibilities when it comes to making the right financial decisions. However, consumers are sometimes inclined to make decisions that are not in their own interest. In some cases, a better-designed choice architecture can prevent an inappropriate decision from being taken. The way in which consumers are presented with a choice can, for instance, (unconsciously) influence the decision that is ultimately made. Research also shows that people's capacity to act in a rational way is fairly limited: this is known as bounded rationality. There is no such thing as the 'typical consumer': every person is different. The AFM expects financial services companies to apply insights into consumer behaviour. The 'consumers' of financial services companies are not limited to those companies' existing (or prospective) customers, as well as those taking part in a pension scheme, but also include former customers.

In order to achieve this main objective, the AFM relies on financial services companies and pension funds to apply these principles when designing the choice architecture. It is up to the companies themselves to decide how to put these Principles into practice and incorporate them into their services, products and information. When looking at the choices made, the AFM will look at how companies are contributing to suitable decisions about financial products or services by consumers.

1.1 Who are the principles regarding choice architectures for?

The principles for choice architectures apply to financial services companies which provide products or services to consumers and to pension funds. For the sake of brevity, in the remainder of this document this group will collectively be referred to as 'financial services companies'. These principles offer guidance for all companies, regardless of their size, range of products and services and whether these are provided online or offline.

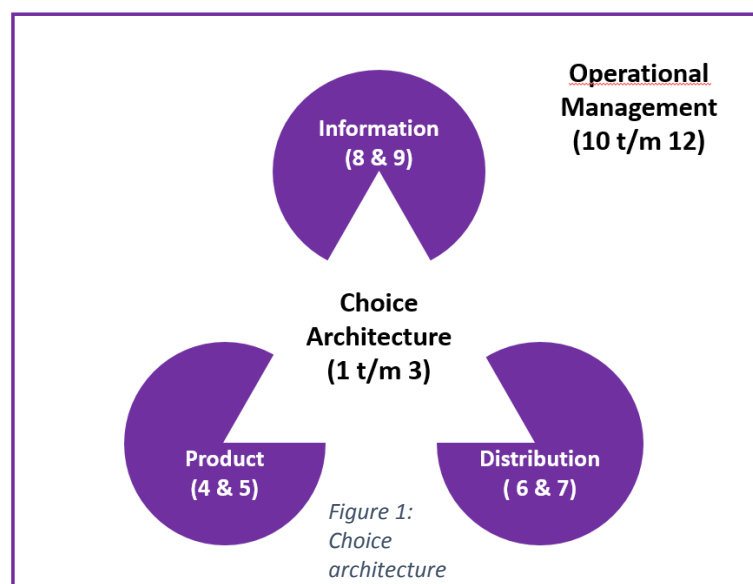
The AFM expects the efforts made by financial services companies to be proportionate to the size of the company and the type of products or services that it provides. If the design of the choice

architecture leads to significant risks for consumers, the AFM expects a greater effort to be made than for designs that involve a lower potential risk.

1.2 What is choice architecture?

The choice architecture includes the way in which choices and information are presented to consumers, both implicitly and explicitly, in combination with the product or service being offered and the method of distribution.

Figure 1 illustrates the elements that make up the choice architecture: information, product and distribution. The numbers indicate which elements each subset of the principles applies to. The principles are shown alongside those elements.



Principles regarding the 'product' concern the target market, method of presentation and choice options for certain products or services. Principles regarding 'information' relate to how consumers process information and the fact that the information provided facilitates the decision-making process. 'Distribution' refers to the way in which a product or service is provided to consumers: this must be appropriate. 'Distribution' includes aspects such as the number of alternative choices presented, which default options are applied, preferred settings, the use of language, the design of a website, options for comparing services and products, and which product features are or are not mentioned. The principles regarding distribution will expand on this further.

1.3 How does the decision-making process work?

Figure 2 illustrates the various phases of the decision-making process with respect to (changes to) a product or service. The decision-making process not only includes the decision regarding the purchase of a financial product, but also the steps that precede that decision, and the steps that follow it.

The choice architecture plays a role in all phases of the consumer's decision-making process. Consumers behave with bounded rationality and do not always go through the decision-making process in the order shown. Consumers may frequently miss out a particular phase entirely. Mapping out the decision-making process helps us to think about the different potential phases that the consumer may go through.

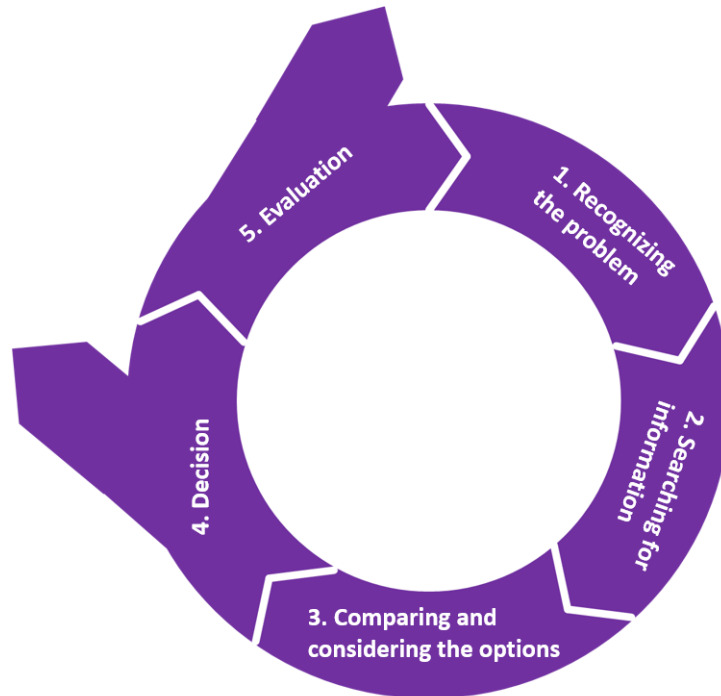


Figure 2 The decision-making process

- **Step 1.** The decision-making process starts by recognising a need which a particular financial product or service may provide a solution for.
- **Step 2.** The consumer then does some basic research on the options available and looks for information about the possible solutions. Financial services companies can for example identify the needs of the customer during these phases.
- **Step 3.** The options are then considered and possibly compared. In this phase, one or more financial services companies may present different proposals. The consumer needs to choose between these.
- **Step 4.** Both the financial services company and the consumer make a choice. They choose whether or not to accept a proposal.
- **Step 5.** Once the consumer has chosen a product or service and that choice has been accepted by the organisation, the decision can be evaluated. It may take some time before this evaluation takes place. In the evaluation phase, the consumer examines whether the choice still matches his or her needs. This may result in a switch to another product or a different service provider. It is also possible that the original need no longer exists and that the consumer withdraws.

2. The 12 Principles for choice architecture

There are twelve Principles for choice architecture. These principles are linked to various different aspects of the choice architecture. The first three principles focus on the choice architecture in general. The next six principles focus on specific aspects of the choice architecture: products and services, distribution and information. Finally, the last three principles are an important requirement for the proper implementation of the other principles. These three principles focus on the design of policy and business processes.

A number of examples may be provided for each principle. These examples are not exhaustive or prescriptive in nature, but are simply there to provide an illustration.

2.1 Three general principles

1. Realistic views are held regarding consumers' knowledge, skills and behaviour.

Insights from behavioural science increasingly allow us to understand how and why people make decisions that are not entirely rational. Consumers vary in their requirements, preferences, motivations, capacity to process information and susceptibility to behavioural manipulation, for instance. People may be systematically prone to deviate from rational decisions (they have biases). Generally, time constraints and limited motivation mean that consumers' decision-making behaviour is influenced by such biases, as well as by the use of rules of thumb. In addition, consumer decision-making may be dependent on the situation and context.

The AFM expects financial services companies not to take advantage of bounded rationality of consumers, but instead to utilise this knowledge and insight to the advantage of the customer. The AFM also relies on financial services companies to consider which rules of thumb and biases may be relevant when they design the choice architecture that encourages their clients to make appropriate financial decisions.

2. All phases of the consumer's decision-making process must take adequate account of the behaviour and interests of consumers.

Every phase in the decision-making process receives an appropriate amount of attention when providing services to the consumer. For example the choice architecture is not solely focus on the purchase phase. Once a product or service has been purchased, the choice architecture must also take the interests of the consumer into account. For example, consumers may be offered the opportunity to evaluate whether the product or service continues to meet their needs or expectations. Banks already do this with respect to mortgages, for example, by providing a tool that consumers can use to calculate whether they could save money by repaying their mortgage.

In addition, the AFM relies on financial services companies to ensure that consumers do not encounter unreasonable financial or non-financial barriers in case they want to change their product or service provider, cancel a service or file a complaint or claim.

3. Steering in the choice architecture must take account of the consumer's interests in a demonstrable way.

There is no such thing as a neutral choice architecture. The choice architecture always has an effect on consumer behaviour. It can be used to steer consumers towards decisions that are not (fully) in their own interests. There are various methods of 'nudging' consumers in a particular direction. The use of a default option, for example, can have a powerful effect.

The AFM encourages financial services companies to carefully consider these steering options and to utilise these so that consumers can identify an appropriate product or service. They consider to what extent it is desirable to steer customers on the basis of information that the company has about that consumer.

2.1.1 Products and services in the choice architecture

4. The selected characteristics of the target group are relevant, enable differentiation and are logically consistent with the characteristics of the product.

One important step in the design of the choice architecture is to find out which groups of consumers correspond to the products and services being offered. Identifying and formulating target groups also provides greater clarity about which target groups certain products or services are not intended for.

The characteristics of the target group are relevant when it comes to differentiating between the target group and consumers whom the product is not intended for. The AFM relies on financial services companies to be able to demonstrate that they use the characteristics of the product or service to create a logical, unambiguous and clearly argued set of shared characteristics for that target group and its relevant knowledge and capabilities. Scenario analyses and other (consumer) research can help to achieve this.

5. The product options and the manner in which they are presented correspond to the behaviour, knowledge and capabilities of the target group.

The AFM relies on financial services companies to provide a clear offer of products and services that connects with the behaviour, knowledge and capabilities of the target group. For example, companies may leave out inappropriate options for a particular consumer, if they know that this consumer does not belong to a specific target group. In addition, it is important that the options are presented in a way that is consistent with the way in which specific consumers are likely to process information and make decisions. For example, it may be decided that certain products or services are only suitable for a particular limited target group, and that these will therefore not be displayed prominently to a wider audience in marketing or on websites.

2.1.2 Distribution in the choice architecture

6. The design of the distribution should help consumers to identify their own needs and preferences.

It is not always easy for consumers to recognise or understand their needs and preferences ('What do I want?'). A well-designed distribution can help them to with this.

One complicating factor for consumers when it comes to identifying their own preferences is that these preferences will not necessarily remain stable over the long term. To help consumers to identify their own needs and preferences, financial services companies will often collect information. It is important that this information is collected as objectively as possible. Tools or personal interaction can also help consumers to understand their own preferences. In addition, information does not always have to be collected actively in order to be useful for how the product is distributed. Analysing consumer behaviour on a website, for instance, may provide useful pointers for its design, which should facilitate consumers in the process of identifying their own needs and preferences.

7. The design of the distribution helps consumers to identify an appropriate product or service.

Due to the many different financial products and services that are available, it is not always easy for consumers to choose the right path and arrive at an appropriate product ('What do I need?'). The AFM encourages financial services companies to help consumers to navigate their way through the various options. This can be done by, for example, informing consumers of relevant criteria and by ranking or scoring products based on these criteria. In this way, consumers can determine whether particular products or services are suitable for them. Another example would be offering a personalised offer to a consumer based on a sufficient amount of collected information. For example, new communication technology services can offer the option of tailoring the offer made to consumers based on their needs and preferences with respect to data processing. This could include features that enable more online interaction, such as a chatbot or an app. As with principle 6, the AFM expects even those financial services companies that do not actively collect information to ensure that consumers can decide whether a particular product or service is appropriate for them.

2.1.3 Information in the choice architecture

8. The information provided to consumers should be consistent with the way in which people process information.

Information plays an important role in the choice architecture for consumers. One fundamental requirement is that all information provided is correct, clear, balanced and not misleading. But the provision of information must also reflect the behaviour, knowledge and capacities of the target group.

There are several reasons why consumers may fail to assimilate information that is relevant to them. Complexity, abstraction and presenting large amounts of information in one go can prevent the information provided from being taken in properly. Consumers may also fail to realise that particular information is relevant to them. In addition, the information provided may not match the questions they have, or the purpose for which they want to use the information. All of these factors can lead to decisions that are not in the interest of the consumer. The AFM encourages financial services companies to make changes to the information presented and to their marketing statements on the basis of the insights acquired into how information should be presented to consumers.

9. The provision of information helps consumers to arrive at an appropriate decision.

Simply providing information is not enough, in itself, for consumers to make the right decisions. This constitutes a specific aspect of the choice architecture, in addition to the distribution and characteristics of a product or service. Good information can help consumers to arrive at an appropriate decision. One precondition for this is that information is consistent across the different phases of the decision-making process. In addition, the information provided should not steer consumers towards unsuitable choices. Good information can simplify the choice architecture and help consumers to determine which criteria they should be basing their decision on. For instance, standardising the information presented about different products can help consumers to compare and contrast products, helping them in their decision-making.

2.2 Principles for choice architecture - operational aspects

The principles discussed above all relate to the design of the choice architecture in the various phases of the decision-making process. They are aimed at visible results for the consumer. The final three principles focus on an important additional aspect: the structure of the financial services company. This can ensure a careful application of the principles for the choice architecture. These principles are:

10. There is enough knowledge available able to apply insights into consumer behaviour in the interests of the customer.

When it comes to applying the principles for the choice architecture, sufficient knowledge should be available on consumer behaviour and on how to apply these insights within the organisation. This knowledge may be acquired by financial services companies themselves, by researching whether their own assumptions about consumer behaviour are actually correct. External research or external expertise may also be used if this knowledge is not available internally. The AFM encourages financial services companies to utilise this expertise in order to make the right design choices with respect to the choice architecture that they create.

11. Governance and business processes must be structured in such a way that they lead to the effective application of insights into consumer behaviour.

Designing the choice architecture appropriately is an integral part of organisational policy, strategy and implementation. The AFM relies on financial companies to take responsibility for integrating the process of reflecting on the choice architecture into their business operations. The design should take account of insights into consumer behaviour. For instance, the appropriate application of these behavioural insights could become an integral part of their strategy and policy regarding the (ongoing) development of products and services.

It is also integrated into corporate governance when designing business processes and implementing company policy. Business processes and policies ensure that these principles are applied in practice and that the real-life behaviour of consumers is taken into account.

12. Insights into consumer behaviour form part of the evaluation and continuous improvement of the choice architecture.

When developing a choice architecture for new products and services, there will inevitably be existing assumptions regarding whether these meet the needs of consumers. It is important that financial services companies evaluate these assumptions closely. The AFM encourages them to examine these assumptions and to use this process to arrive at more realistic expectations regarding the decision-making behaviour of consumers and the possible risks that may arise from this behaviour. On the basis of this realistic view, the choice architecture can be designed in such a way that it encourages consumers (whether consciously or unconsciously) to make decisions that benefit their own financial well-being.

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