“I wish you a pleasant trip”

Financial Inclusion: a wider definition

International symposium on Financial Inclusion (20 September 2017)

By: Femke de Vries

Ladies and Gentlemen, esteemed organisation,

thank you for your invitation to speak at your international seminar on Financial Inclusion. I see there are guests from various parts of the world here. The Philippines, Yemen, Georgia, Sri Lanka, South Korea, Tanzania...

Welcome one and all! I hope you had a pleasant trip. Some of you have flown for more than 10 hours.

My journey was a bit shorter. 10 minutes on tram 10. Sorry . I hope you will forgive me. Actually I also have just stepped off a flight, returning from my vacation in the sunshine.

So I am fully relaxed. Although it took some time initially. I don’t know about you, but I can never immediately switch off my working self.

I can’t do it. Not after so many weeks of intense work. And certainly not at Schiphol, our national airport. An ants’ nest of travellers, among them the De Vries family.

It was horrible. I don’t like such busy places. But what I do find interesting is to observe the behaviour of travellers. That’s just as well, because otherwise I would not be suited to my job at a behavioural science supervisor like the AFM.

I like watching how travellers move and behave at an airport. If you are part of the crowd, it looks like chaos, but I can assure you … if you look from above, you can see patterns.

Of course, the pattern of checking in and out. Otherwise you wouldn't have come here at all.

But the customer journey at an airport involves more than this. Imagine you are this person. After going through customs, do you go straight to the gate? I'm willing to bet that you don't. SeeByFly has an offer of buy 2 books and get a third one free …. You go and take a look. Ralph Lauren fragrance is on special offer? Two bottles for 49 euros. No VAT of course . I saw that the shelf was almost empty already. And then you probably go to Starbucks for a coffee and a muffin. With the muffin, the coffee was 'cheaper'.

And if you think all this is based on decisions you have made yourself, I'm afraid you are mistaken. Our national Consumers' Association actually accused Schiphol of using sales tricks at the end of July. Everything is worked out to the tiniest commercial detail. The signposting, the location and even the spreading of nice smells direct you and your spending patterns. And folders suggesting that you will not find these products at a better price anywhere else ... you are continually being influenced in a certain direction.

It's exactly the same when it comes to financial services. Here too, consumers are being nudged, as we call it at the AFM. For instance, the banks regularly put up a default option for the repayment term of a loan. This leads to consumers paying more than they have to. Hardly in the consumer's interests. This kind of negative nudging is really an under-exposed aspect of financial inclusion.

And wrongly so. These nudges can have a huge impact. So I want to argue for a broader definition of Financial Inclusion than the current one.

But before I go into that … what is the actual status of Financial Inclusion? Has there been any progress since 2015, the last time that this symposium was organised? Has knowledge of complex financial products increased around the world? Is the provision of financial services more accessible around the world?

To answer this properly, we need to look at the current trends in the financial world. The AFM sees three trends directing the financial sector in this ever more rapidly changing world:

1. <u>Technological developments and digitalisation;</u>
2. <u>The internationalisation of the financial markets</u>;
3. <u>And most obviously, the continuing low level of interest rates.</u>

These developments are generally beneficial when it comes to increasing access to financial services.

The speed of development of technology and digitalisation is radically changing the financial sector. We are seeing new players and new earnings models, both from here in the Netherlands and from across our borders.

In addition, internationalisation means that money, products, services and data are flowing freely across national borders and across the boundaries of the traditional sectors.

Owing to this, consumers are being offered more and more access to the financial playing field. They no longer have to rely on a financial provider in their town or country. Financial business can be arranged from the couch with a mobile phone, with access to national and international providers of financial products and services. In other words, fewer barriers and the possibility of taking decisions quickly online at any time you wish.

This sounds like a good thing, right?

But there is another side …

Innovation can also led to exclusion. How? Think about the eldery people or people with low digital knowledge. Banks – the ones with bricks – are disappearing. And due to the fact that banking system goes digital ATM's are disappearing as well.

And what to think about the prominent role data plays in our financial system.

system. All this data is linked together. It becomes a valuable digital

thumbprint. This information can be used to influence the customer, tempt

them and guide them.

There are so many providers, so many products, so much information …. Who can assure me that consumers are making the right decisions? Yes, all the information is available somewhere online, but do people actually read it? Who can assure me that consumers choose the product or service that best suits their personal situation?

For example, we see that consumers are looking for higher returns because of the low level of interest rates. They are willing to take on more risk and in some cases they purchase products without carefully reading the brochure. Research also shows that investors who see a proposition with a brochure showing a picture of a nice young couple will on average invest 1,000 euros more than if the brochure shows only neutral visual material.

I think this is a cause for concern.

This is why I am arguing for a broader definition of Financial Inclusion than the current one.

Yes, we need to increase knowledge of complex financial products and increase access to financial services. But we definitely need to take another look at the design of online decision-making environments.

These need to be designed in such a way that consumers are assisted in making financial decisions that best suit their financial situation.

It is really very naive to believe that consumers are always able to make rational decisions. Legislation and regulation in most countries is currently designed mainly with the quality and availability of financial information in mind. This is based on the notion that if the information is of sufficient quality and adequately available, consumers will make sensible financial decisions. But this is a mistaken assumption. The chance of a mistake becomes much greater for instance when consumers are not willing - or able - to devote enough time to financial decisions.

Of course, making a quick decision online is nice and easy. But haste increases the likelihood that the decision will be wrong. Haste can make you buy something that you don’t really need. For instance, the book or the fragrance you just bought at the airport.

You may ask whether we are interfering too much in the individual’s freedom of choice if we assist him when making certain decisions. Maybe, in the short term. But in the longer term, a responsible decision-making architecture will benefit consumers.

Why? The best way I can illustrate this is from research into decision-making with respect to loans. We intend to further research these insights ourselves in practice.

But it will be interesting at this point to provide some insight into a number of factors that potentially affect the vulnerability of consumer credit customers. It is very important that we expose these insights. Proper insight enables supervisors and business to improve the decision-making architecture in such a way that responsible lending is encouraged.

And this is definitely needed for a large group of vulnerable consumers. Just for the record, such people do not live only in Africa or Asia. No, there are plenty of them in Germany, Belgium and right here in the Netherlands. We see this every day at the AFM.

So let us return to the customer journey in consumer credit. This is shown here in four phases.

In phase 1, the consumer takes the decision to take out a loan.

Phase 2 concerns the choice of provider.

Phase 3 is when the consumer repays the loan.

In the final phase 4, the loan is repaid and we hope that the consumer can meet his new obligations and wishes out of his own resources from then on.

Each phase involves risks. There is no disaster as long as the consumer himself is able to properly assess all his risks. To assess the value of the available information himself. To take the right decisions himself.

But unfortunately this is not always the case. For too long, we have believed that risks will be removed if the consumer is provided with enough information.

For me, a typical example of this are the findings of the research into the effectiveness of the warning ‘Please note! Borrowing costs money’. A message that lenders in the Netherlands are obliged to include in their advertising. As you can see: You can’t miss it. But do you think the message was effective? Unfortunately not. The warning had no immediate effect on the behaviour and attitude of consumers taking out loans online.

We need a different approach. The AFM set up its Expertise Centre in 2016 to obtain insight into this issue. Our Expertise Centre is developing instruments and methodologies in order to gain better and timelier insight into desirable and undesirable behaviour at financial enterprises.

But insight alone is not enough. I hope you will play an active part in influencing the behaviour and attitude of consumers. How? I will offer a few suggestions that can contribute to positive nudging. First of all, carry out a small-scale test first to see how these suggestions for changing the decision-making environment of your bank and/or country work in practice. The context in which the decision is made actually determines how effective the intervention is.

1. My first suggestion concerns the first phase, in which the consumer considers whether he needs a loan or not. My suggestion: do not offer a loan as a standard option immediately at this stage. Taking a loan should not be an automatic choice.
   Secondly: simplify the choice for the right type of loan. A huge product offering simply confuses people. Good understanding of financial housekeeping is needed to be able to decide whether a loan, and what type of loan, is appropriate in a person’s own situation. All of us know that not everyone has this. And when a consumer has a choice from a wide range of loan types, it is highly likely that the wrong choice will be made.

2. My second suggestion concerns the phase in which the loan is arranged. We can help consumers by making all the costs of a loan visible. From arranging the loan to repaying it. Research in America by Bertrand and Morse (Information Disclosure, Cognitive Biases, Payday Borrowing – 2011) has shown that people are less likely to choose a more expensive loan if they have a clear view of the absolute costs and a comparison with alternative loan types.

3. My third suggestion relates to the repayment period. In the field of consumer credit, providers should have to provide their customers with an annual overview of cheaper and equally reliable alternatives. Consumers would be offered the option of transferring their loans without incurring too much expense. That would really be acting in the customer's interests!

4. My final suggestion concerns the period in which the loan has already been repaid. Would we not prefer a situation in which consumers can meet their obligations and fulfil their wishes from their own resources? So let's making saving easier. You could for instance offer consumers the option of having part of their salary automatically paid into a savings account. Or have consumers set objectives for their savings account. This is an option already offered by some banks in the Netherlands. You see your target, you know what you are saving for … this has an encouraging effect.

You need possibilities to influence the attitude and behaviour of consumers so that they arrange loans in a responsible way. Just like at the airport, everything is designed to tempt you to buy things.

I have used loans as an example. But positive nudging is possible throughout the financial chain. This could prevent many problems.

Here in the Netherlands, the AFM's task is to contribute to sustainable financial prosperity as a supervisor. And if consumers get into difficulties with payments because they took out an inappropriate loan .... that's not sustainable!

In the Netherlands, we are looking for solutions by keen supervision and using insights from behavioural science. Together with the sector. And this stage offers me a great opportunity to express our message internationally as well.

More knowledge and more access …. Let's go forward together. It's a very important part of financial inclusion. But let us also guide the consumer through the financial playing field in a responsible way. Besides investing at the front end, let's also focus at the context in which consumers take their financial decisions. Keep in mind that an important part of their financial future is in your hands.

Ladies and Gentlemen,

I hope you enjoy the rest of the seminar, and later on, I wish you a pleasant trip home.

And should you be tempted at the airport to buy a book, a fragrance or munch on a muffin, I hope you will remember my story.

Thank you for your attention.