Institute and Faculty of Actuaries

D2: To be more like Captain Kirk and a little less like Mr Spock

Applying Behavioural Economics at the FCA

Kathy Byrne

March 2015


£5
FIVE
£20
TWENTY
Pounds
Bank of England
FIFTY
Pounds
20

Agenda

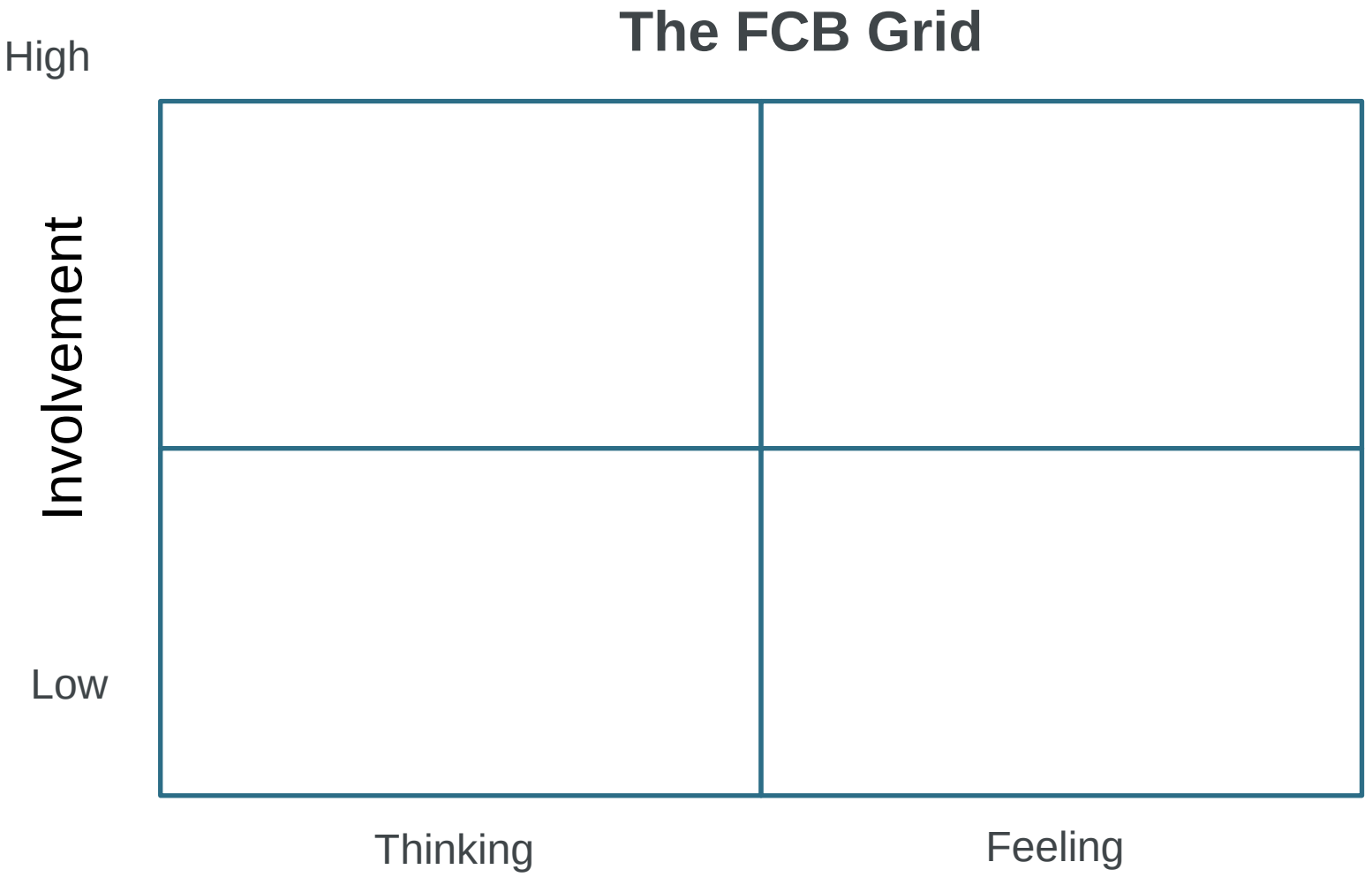
- Introduction to Behavioural Economics
  - Financial decision making
  - Biases impacting financial decisions
- FCA's use of Behavioural Economics in Regulation
  - FCA Occasional Paper 1
    - Structured Products example
    - Customer sophistication and cross subsidies
  - FCA Occasional Paper 2
  - MS 14/1 GI Add on products & FCA Occasional Paper 3
- Video – changing behaviour
- Summary & Questions

£10,000 Investment

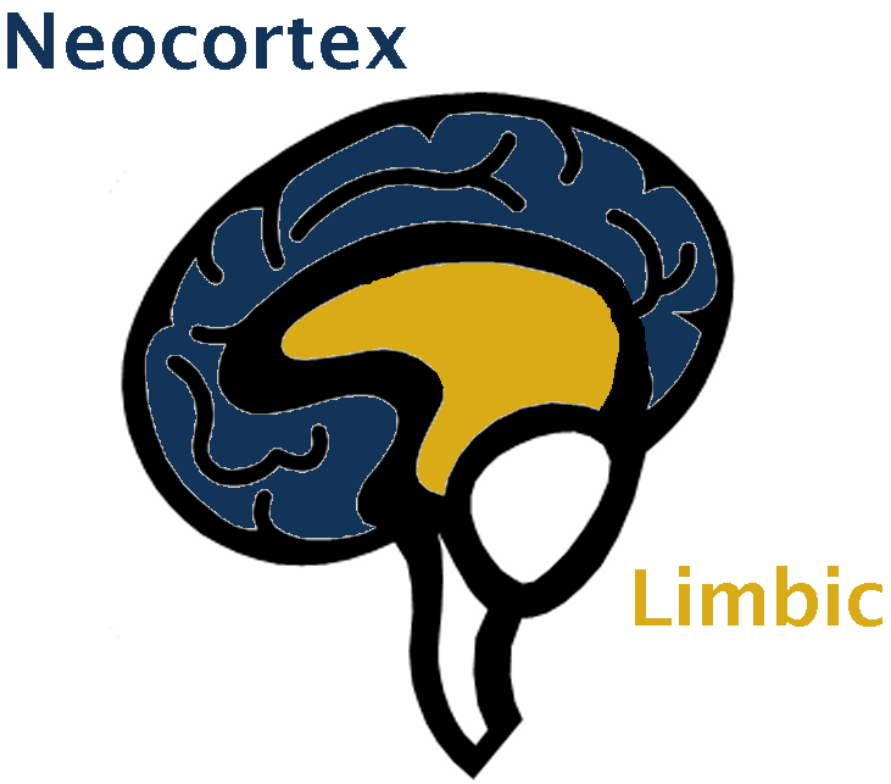
Questions

1. Do you think this is an important decision?
2. Do you think this decision will need a lot of thought or can you decide what to do in just a few minutes?
3. Do you think that you would have a lot to lose if you choose the wrong product?
4. Do you think the decision would be mainly logical or objective?
5. Do you think the decision would be mainly on functional facts?
6. Would you make a decision that would express your personality?
7. Would you make the decision based on a lot of feeling?

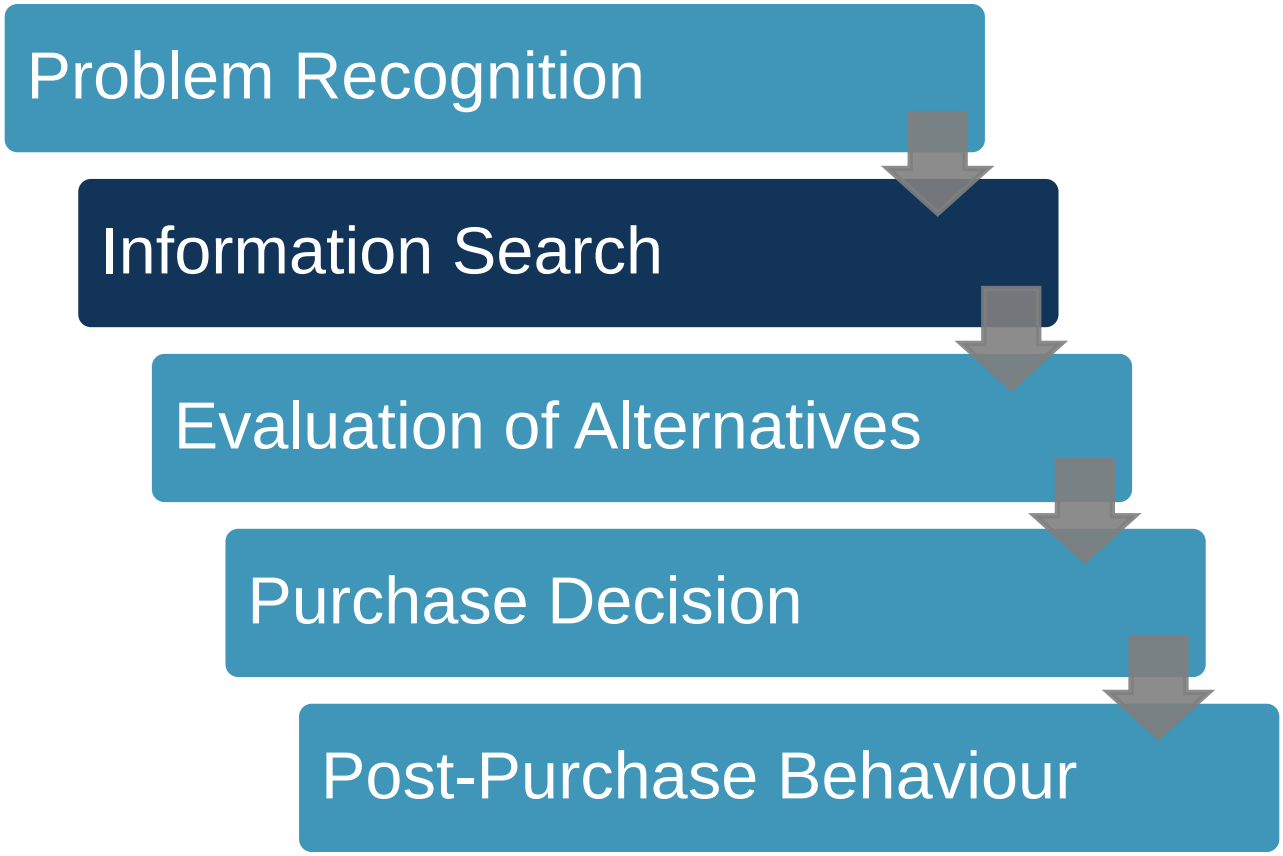
Financial Decisions



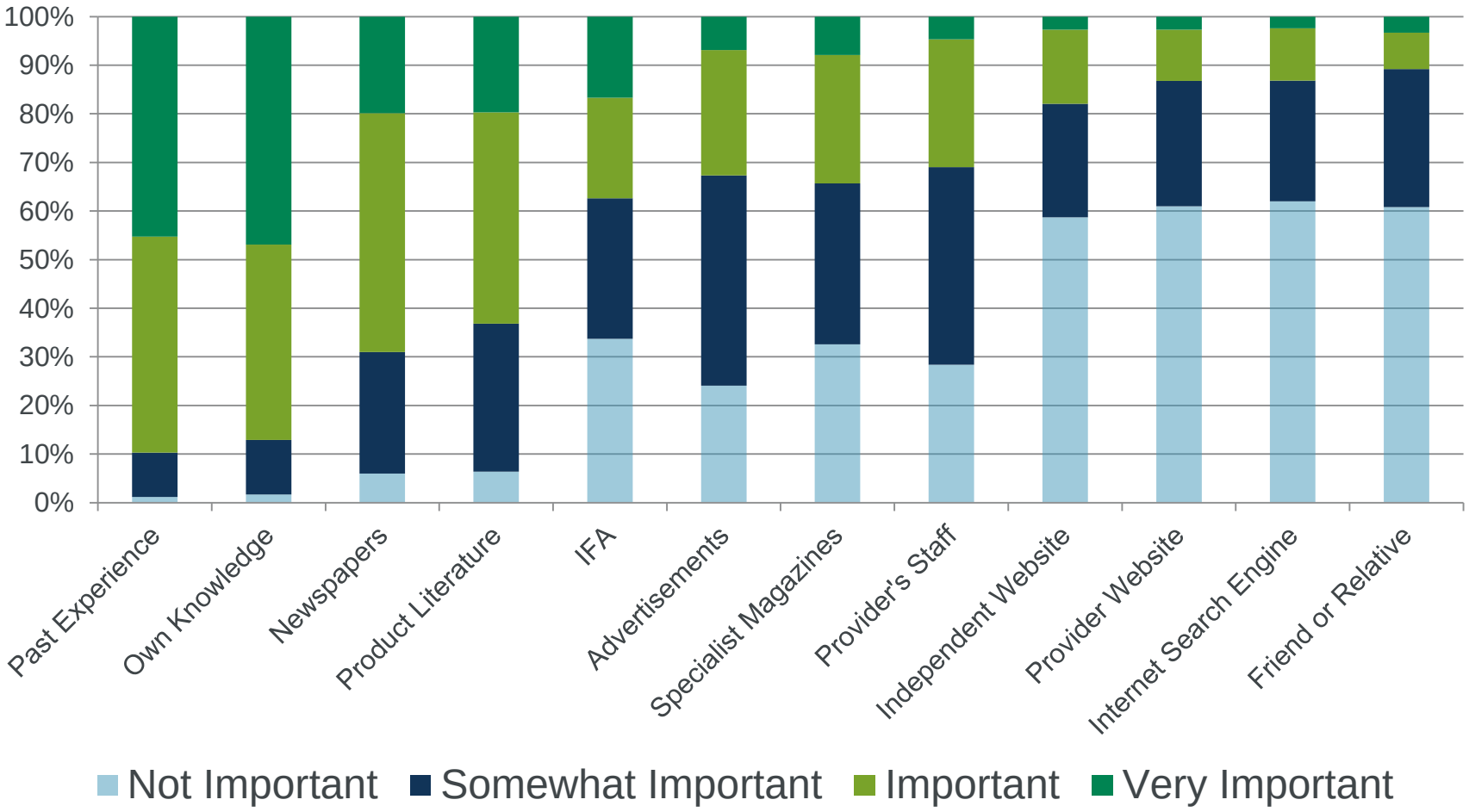
Thinking vs Feeling



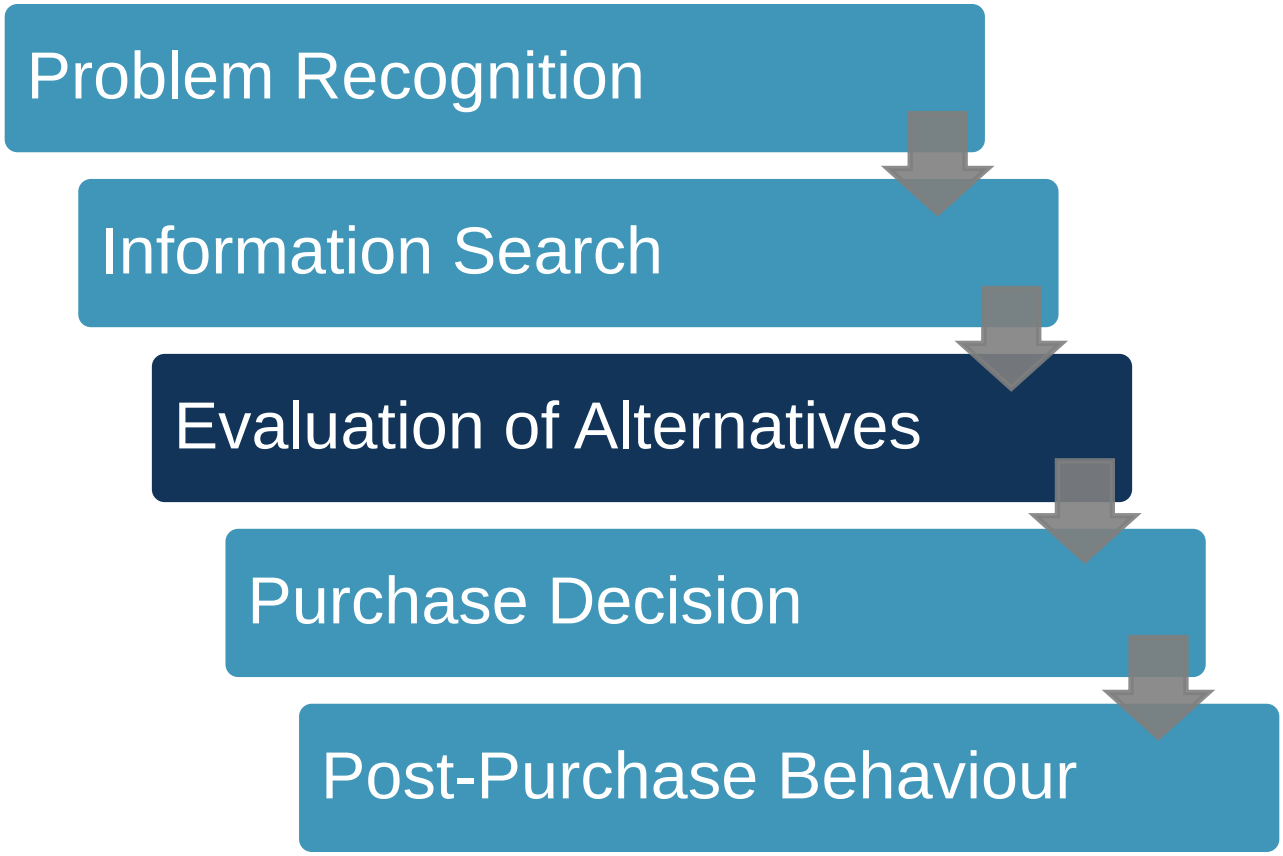
Decision Making Models



Information Sources



Decision Making Models



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Questionnaire



Q1. Avian Flu Programmes

The UK is preparing for an outbreak of avian flu which is expected to kill 600 people. Two alternative programmes to combat the disease have been proposed.

Programme A

or

Programme B

Q2. Linda

Linda is 31 years old, single, outspoken, and very bright. She majored in philosophy. As a student, she was deeply concerned with issues of discrimination and social justice, and also participated in anti-nuclear demonstrations. Which is more probable?

A Linda works in a bank.

B Linda works in a bank and is active in the feminist movement.

Q3. Causes of Death

Which causes more deaths in the UK amongst women aged 20 to 29?

Q4. Cash Returns

What do you think the rate you earn on your cash savings will be over the next year?

Q5. Capitals

What is the capital of Kentucky State in the USA?

Q6. Legacy

You have been left £10,000 by your Great Aunt. How will you invest it?

Hindsight Bias

Surely, Pinnacle should have known that 24/11/99 the FTSE was at its peak, also that world terrorism was prominent at that time, and obviously going to have an impact on world stock markets, should there be a 10/11 situation. PINNACLE SHOULD HAVE PREDISPOSED

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Practical Application



Structured Product Example

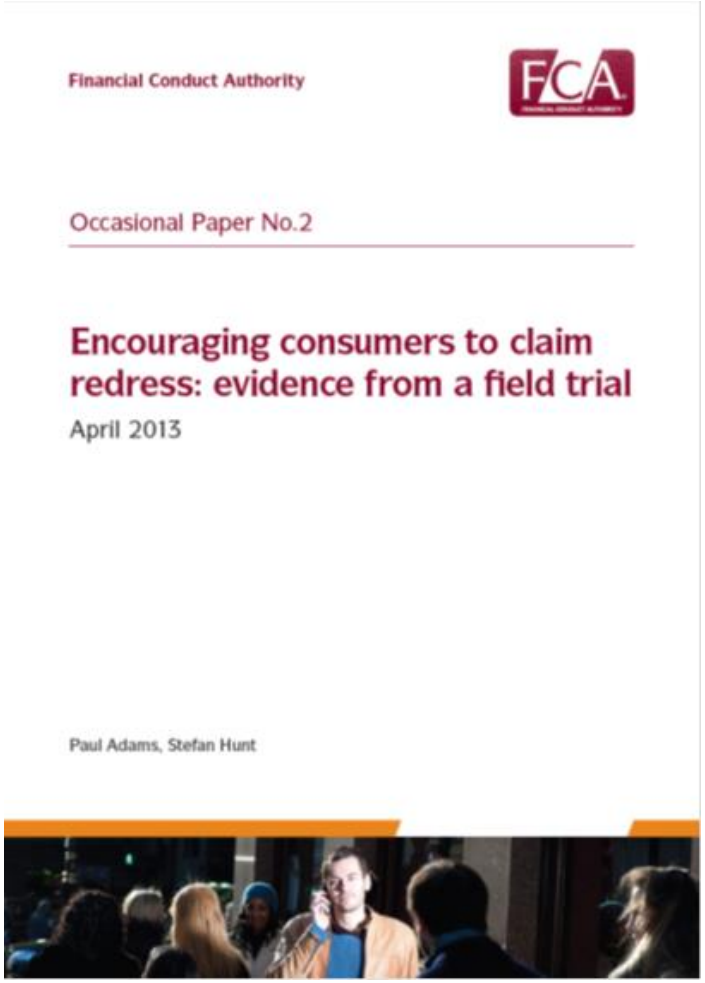


It is our aim at Pinnacle to offer products which provide solutions to some very real problems. It goes without saying that we develop good value products, but we also aim to make them as clear and simple to understand as possible. The Premier Bond II answers the needs of investors who have seen interest rates fall considerably over the last 2 years. However, higher returns necessitate a higher risk to your capital than a traditional Deposit account. We have designed the Premier Bond II such that we believe the increased risk to your capital isn't unduly high, but more importantly, so that the risk is clearly understood. If you need a greater degree of security for your capital you may be interested in our guaranteed income bond. The rate over 4 years (as at 1st June 1999) is 4% to 4.25% p.a. If you have any questions you would like answered before investing in the Bond, please talk to either your Financial Advisor, or contact us on 0181 207 9007, or at the address at the back of this brochure.

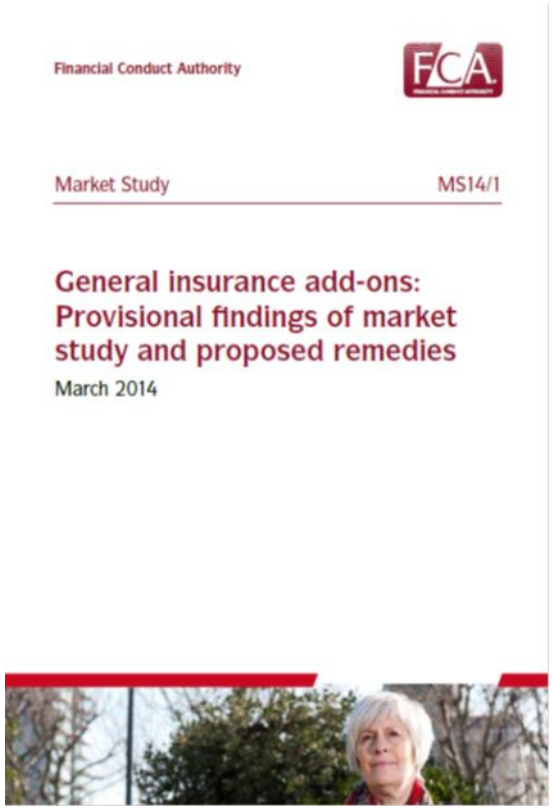
Cross Subsidies & Customer Sophistication

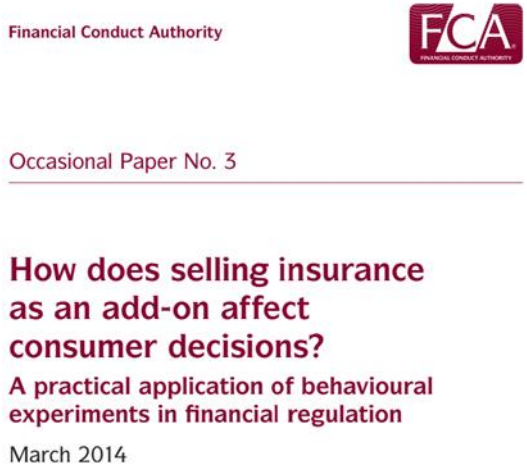


FCA Occasional Paper 2



Add On Products







Movie

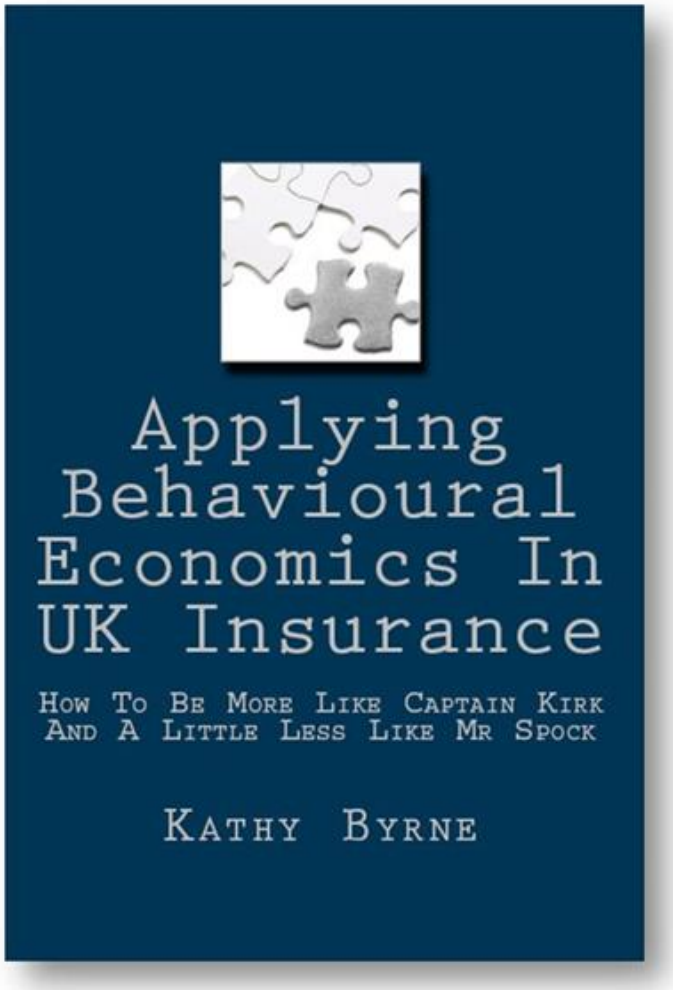


Summary



- Behavioural Economics
  - Decision Making
    - Emotional
    - Rational
  - Practical Applications
    - Structured Product
    - Cross Subsidy & Customer Sophistication
    - Add on products

Being more like Captain Kirk



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Behavioural Economics

Kathy Byrne

uk.linkedin.com/in/kathybyrne

@CashAdviser

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