

Institution: University of Hull		
Unit of Assessment: 17 Business and Management Studies		
Title of case study: Using behavioural finance research to improve financial outcomes for consumers		
Period when the underpinning research was undertaken: September 2013 to present		
Details of staff conducting the underpinning research from the submitting unit:		
Name(s):	Role(s) (e.g. job title):	Period(s) employed by submitting HEI:
Robert Hudson	Professor of Finance	2013 to present
Period when the claimed impact occurred: 2013-2020		
Is this case study continued from a case study submitted in 2014? N		
1. Summary of the impact		
<p>Hudson's research programme into behavioural finance at Hull has had financial, policy related and educational impacts in the areas of banking and financial services:</p> <ul style="list-style-type: none"> • Hudson's research has resulted in policy proposals from the Financial Conduct Authority (FCA), the main UK financial regulator, whereby UK bank customers who do not actively review their accounts, are expected to save an estimated £300 million per annum. • Hudson's research influenced all retail pension and investment policies sold or existing in the UK (over six million policies), through the Financial Conduct Authority (FCA), implementing new prescribed projected rates of return. • Hudson's research has been used as evidence leading to a Super-Complaint (class action) being made to the Competition and Markets Authority (CMA) by the Citizens Advice Bureau, with a potential benefit to consumers of about £1.2 billion per annum. • Hudson has provided an evidence base for the Financial Conduct Authority (FCA) by correcting an important misconception in the debate on cross-subsidies in the current account market, which 97% of the UK population uses. • Hudson's research has influenced public policy in Denmark and Ireland on insurance cross-selling and mis-selling. • Hudson has influenced the Actuarial profession by guiding major professional research programmes into pension freedoms and the role of pension trustees and by updating their professional exams to include coverage of behavioural finance. 		
2. Underpinning research		
<p>Hudson (with various co-authors, including, Ashton at Bangor) has conducted extensive research into how concepts from behavioural finance can be applied to practical issues in consumer finance. Hudson has conducted fundamental research into how financial consumers make decisions (2.1.) and this informs much of his other research and impact. For example, his research considers how the 'endowment effect' (a bias to the status-quo) tends to create inertia and prevent appropriately frequent reviewing of investments and policies.</p> <p>Other research by Hudson, outlined below, had the objective of identifying and understanding specific areas of customer detriment and suggesting appropriate remedies. Instances of banks and other financial services companies taking advantage of the cognitive limitations and biases of their retail customers have been numerous and sometimes extremely significant in recent decades. For example, some major scandals, which have each resulted in billions of pounds of compensation to customers, have involved the mis-selling of personal pensions, with profit-endowments and Payment Protection Insurance policies. Hudson's research has directly dealt with each of these areas.</p>		

Other key findings from Hudson's research identified specific issues relating to: the deposit market (2.2.), the personal current account market (2.3.), and the payment protection insurance market (2.4.).

2.1. The problems of heuristics in making poor financial decisions

Hudson has investigated the ways in which consumers apply heuristics (rules-of-thumb) to make financial decisions [R1]. Specific concerns have been raised by regulators (e.g. the Financial Conduct Authority), charities and consumer bodies in the UK that factors relating to suboptimal behaviour by consumers such as **consumer inertia, add-on goods and product complexity may lead to poor financial outcomes** for those consumers. Hudson's research has shown how to improve the financial outcomes of consumers in such circumstances.

2.2. Consumer protection in the UK deposit market

Hudson's research examining pricing in the UK deposit market [R2] showed that **deposit providers are taking advantage of inertia exhibited by retail customers**. Using an empirical assessment of a unique, large and comprehensive sample of UK retail instant access deposit accounts, the research found that older deposit accounts receive significantly lower interest rates than the newest deposit accounts offered by a deposit provider.

2.3. Correcting misconceptions about UK personal current accounts

Hudson's related research examining pricing of UK personal current accounts (PCA) [R3] was enabled by a grant from the Friends Provident Charitable Foundation. Overall the research provided a much more accurate picture of cross-subsidies in the personal current accounts market than did previous frameworks. In particular, the work **challenged the widely accepted view, known as the 'reverse Robin Hood effect.'** In this view, the current account pricing approaches used by banks result in relatively poor customers, who use overdraft services, subsidising payment services used by wealthier personal current account customers. Hudson's research showed that this view of bank pricing was incorrect as overdraft fees from relatively poor customers are much less valuable to the banks than the profits they gain from wealthier customers with large deposits.

2.4. Identifying consumer vulnerability to payment protection insurance

Additional work has related to the cross-selling of add-on goods such as payment protection insurance (PPI) in the provision of consumer credit and mortgages [R4 & R5]. Specifically, Hudson established that **unfair cross-subsidies arise in such markets**. The cost or quality of the core loan is reduced through the provision of overpriced additional services. This effect is detrimental to consumers and takes advantage of their behavioural biases.

3. References to the research

[R1] 'Which heuristics can aid financial-decision-making?', International Review of Financial Analysis, 42, pp199-210, 2015 (with W. Forbes, M. Soufian and L. Skerratt).

[R2] 'The Influence of Product Age on Pricing Decisions: An Examination of Bank Deposit Interest Rate Setting', Journal of International Financial Markets Institutions and Money, 31, pp216-230, 2014 (with R. Anderson and J. Ashton).

[R3] 'How much does 'free banking' cost? An assessment of the costs of using UK personal current accounts', Friends Provident Foundation, 2013, (with J. Ashton).

[R4] 'Do Lenders Cross-Subsidise Loans by Selling Payment Protection Insurance?', International Journal of the Economics of Business, Vol 21, Issue 1, pp121-138, 2014 (with J. Ashton).

[R5] 'The price, quality and distribution of mortgage payment protection insurance: A hedonic pricing approach', British Accounting Review, vol. 49, issue 2 pp242-255, 2017 (with J. Ashton).

As an indication of quality, the journals for [R1], [R2] and [R5] are all ranked 3 on the "ABS list". the journal for [R4] was also ranked 3 when the paper was accepted for publication.

4. Details of the impact

The impact of Hudson's research improved consumer protection for UK customers of: deposit account products and other financial services where customer inertia is a problem (4.1); pension & investment products (4.2); and personal current accounts (4.3). Equally, the research improved the treatment of European consumers of insurance policies (4.4), as well as influencing the research, curriculum and examinations of the Institute and Faculty of Actuaries (IFoA, 4.5).

4.1. Better consumer protection for users of deposit accounts and other financial services where consumer inertia is a problem

Hudson's research examining pricing in the UK deposit market has been influential in policy debates regarding the protection of UK consumers. Professor Hudson presented this work at the Financial Conduct Authority in October 2013, contending that policy change would be beneficial. The associated research work has subsequently been used as evidence in several policy documents from the Financial Conduct Authority. '*[Hudson's] work provided a framework for the analysis in the Cash Savings Market Study report published in 2015*' [C1: 1]. The subsequent 2020 consultation paper on proposed policy changes from the Financial Conduct Authority states: '*We noted, however, that paying lower interest rates to long standing customers is a long-running pricing strategy used by providers in the UK and internationally*' [C4: 51]. As a consequence, the regulator proposed that British banks should be required to offer a single institutional interest rate to which all deposit accounts will revert after a specified period of time [C2, C3 & C4]. The Financial Conduct Authority estimated **a benefit to customers of this policy of about £300 million per annum**.

Hudson's research has also provided evidence motivating a Super-Complaint to the Competition and Markets Authority (CMA) by the Citizens Advice Bureau [C5] which criticises the exploitation of the inertia of customers in the market for financial services. The strength of the academic literature including Hudson's research, was '*absolutely critical to encouraging regulators to act and informed [the] decision to make a super-complaint to the CMA*' [C1: 2]. The Financial Conduct Authority is working closely with the Competition and Markets Authority on the response to the Super-Complaint. To date, it has recommended major reforms of the pricing of home and motor-insurance, so that existing customers are not charged more than new customers. The Financial Conduct Authority estimated **a benefit to customers of this policy of about £1.2 billion per annum** [C6].

4.2. Risk reduction for UK pension & investment products

Hudson's body of research on heuristics and behavioural finance has impacted on consumers of UK pension and investment products. He acted as a Peer Reviewer, with an associated 'Letter of Comment' in Appendix E of the report [C7] by the Financial Conduct Authority on the rates of return to be used in prescribed projections. The Peer Reviewer role involves giving expert advice and informing the approaches to be used in the research underlying the report and formally certifying that the approaches are appropriate. The resulting rates of return are compulsorily used in projecting the returns on all retail pension and investment policies sold in the UK. There are about 6.3 million policies of this nature in force (Association of British Insurers, UK Insurance and Long-Term savings Key Facts 2018, p. 23). The use of prescribed rates of return on projections ensures that the expected returns presented to customers are realistic, thus **preventing mis-selling of investment products** by giving over-optimistic return estimates, such as was prevalent in the personal pension and endowment mortgage scandals.

4.3. Increased understanding of UK personal current accounts

Hudson's related research into the personal current account market has also been influential in policy debate. It is important partly because it rejected the widely-held view that regressive re-distributional cross-subsidies exist in this market. **This finding means that unjustified action should not be taken to penalise particular types of account holders.** The research report [R3] has been cited within both reports by consultants informing decision-making [C8] and a discussion paper published by the Financial Conduct Authority Consumer Panel [C9] and also forwarded as evidence for the Competition and Markets Authority review of the Personal Current Account market [C10].

4.4. Better regulatory and supervisory functions for European consumers

Hudson's work on consumer vulnerability to payment protection insurance (PPI) in the provision of mortgages has been influential internationally. The suggestions for better consumer protection were incorporated in an assessment in Denmark of unemployment benefits and the challenges faced by new modes of employment [C11], **resulting in a reform of Danish social security provision**. *'The reform was based on the work of a commission (Dagpengekommisionen) that provided an evidence base for the decision makers through comprehensive analysis and reviews of existing studies within the field – among others Professor Robert Hudson's study on the British mortgage payment protection insurance' [C1: 4].* Due to its *'scientific quality and relevance' [C1: 3], this research* was cited in a report funded and supported by the Central Bank of Ireland [C12], which was in turn used by the Central Bank as evidence to inform its regulatory and supervisory function.

4.5. Influence on the actuarial profession

Hudson's research on heuristics and behavioural finance has impacted on the research, curriculum and examinations of the actuarial profession which are currently taken by around 30,000 students globally. It is expected that positive impacts for present and future pensioners will evolve from the research. Hudson was a leading member of an actuarial working party which produced a report for the profession **informing their members** about the new freedoms in the retirement market introduced in 2015 [C13]. He contributed a substantial element based on behavioural approaches. The chair of the working party stated that *'Professor Hudson has been a key member of the Working Party since inception, and has provided important and substantial input into the work carried out to date. His depth of research experience and expertise in the area of behavioural finance has been invaluable' [C1: 5].*

Further, Hudson is the Chair of a Steering Group guiding research sponsored by the Institute and Faculty of Actuaries into the behaviour of pension scheme trustees. This has led to a series of papers and a major report which has been presented to the Institute and Faculty of Actuaries and pensions industry, which aim of to **improve the governance of UK pension schemes with resultant benefits for their members**. Additionally, he wrote the section on behavioural finance for the Institute and Faculty of Actuaries' professional exams on investment: *'Robert Hudson, because of his prior research and expertise in the field of behavioural finance, was asked by the Institute and Faculty of Actuaries to expand significantly the content on behavioural finance as part of a radical redesign of the 2019 Curriculum' [C1: 6].* This expansion will increase systemic understanding of this area and consequently should, inter alia, **reduce the likelihood of actions that are detrimental to consumers**. This is the first time that behavioural finance has been incorporated in a substantial way into the actuarial professional exams.

5. Sources to corroborate the impact

[C1] Testimonial Report containing testimonials from representatives of the Financial Conduct Authority, Citizens Advice, the Economics and Social Research Institute, the Danish Ministry of Employment, the Actuarial Profession Working Party on Investor Decision Making in the new Pensions Environment and the Institute and Faculty of Actuaries.

[C2] Financial Conduct Authority, 2018a, Occasional Paper 41 'Price Discrimination in the Cash Savings Market: One Rate, one solution?' <https://www.fca.org.uk/publication/occasional-papers/occasional-paper-41.pdf>

[C3] Financial Conduct Authority, 2018b, Discussion Paper DP18/6 'Price Discrimination in the Cash Savings Market'. <https://www.fca.org.uk/publication/discussion/dp18-06.pdf>

[C4] Financial Conduct Authority, 2020, Consultation Paper CP20/1 'Introducing a Single Easy Access Rate for cash savings'. <https://www.fca.org.uk/publication/consultation/cp20-01.pdf>

[C5] Citizens Advice Bureau, 2018, 'Excessive Prices for Disengaged Consumers. A Super-complaint to the Competition and Markets Authority'. [https://www.citizensadvice.org.uk/Global/CitizensAdvice/Consumer%20publications/Super-complaint%20-%20Excessive%20prices%20for%20disengaged%20consumers%20\(1\).pdf](https://www.citizensadvice.org.uk/Global/CitizensAdvice/Consumer%20publications/Super-complaint%20-%20Excessive%20prices%20for%20disengaged%20consumers%20(1).pdf)

- [C6] Financial Conduct Authority, 2020, 'General Insurance Pricing Practices'.
<https://www.fca.org.uk/publication/market-studies/ms18-1-3.pdf>
- [C7] Financial Conduct Authority, 2017, 'Rates of Return for FCA Prescribed Projections'.
Financial Conduct Authority. <https://www.fca.org.uk/publication/research/rates-return-fca-prescribed-projections.pdf>
- [C8] Ussher K., Quinn R. and Rotik M., 2014, 'Literature review on cross-subsidisation in the personal current accounts market. A report for the Financial Services Consumer Panel by Collaborate Research in partnership with Tooley Street Research'.
https://www.fs-cp.org.uk/sites/default/files/pca_literature_review_report_final_20140911.pdf
- [C9] Financial Services Consumer Panel Discussion Paper, 2014, 'Cross-subsidisation in the Personal Current Account Market'.
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/370876/Financial_Services_Consumer_Panel_discussion_paper.pdf
- [C10] CMA, 2014, 'Responses to the CMA's consultation on a possible market investigation into personal current accounts and small and medium-sized enterprise (SME) retail banking sectors and a review of the 2002 SME banking behavioural undertakings'.
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/371439/Consultation_responses_document.pdf
- [C11] Dagpengekommissionen (2015) Arbejdsrapport: Privat forsikring, supplerende ydelser og fratrædelsesgodtgørelse (**Translated as** 'Worksheet: Private insurance, supplementary benefits and severance pay from the Unemployment Insurance Commission Denmark'.
<https://bm.dk/media/6123/privat-forsikring-supplerende-ydelse-og-fratrdelsesgodtgreelserpdf.pdf>
- [C12] Economic and Social Research Institute, 2018 'Do some financial product features negatively affect consumer decisions? A review of evidence',
<https://www.esri.ie/system/files/publications/RS78.pdf>
- [C13] Institute and Faculty of Actuaries, 2019, 'Investor Behaviour in the Freedom of Choice Pensions Market'
<https://www.actuaries.org.uk/system/files/field/document/Research%20paper%20-%20Investor%20Behaviour%202019.pdf>