ECRI NEWS

Understanding Credit Markets for Europe

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BETTER UNDERSTANDING OF CONSUMERS' (FINANCIAL) BEHAVIOR

By Sylvain Bouyon, Research Fellow, Head of ECRI, CEPS

Digital technologies are transforming retail financial services at a steady pace. The increasing amount of digital data available for both consumers and service providers, as well as the fast digitalisation of the interactions between consumers and service providers are likely to change this sector for good, resulting in a potential new paradigm. One of the main objectives of ECRI in the coming years is therefore to contribute to the debate on the most adequate European regulatory framework for financial technologies, by developing both relevant research and events. In that context, ECRI in collaboration with two organisations specialised in the research on financial technologies (University College Cork and Luxembourg Institute of Science and Technology) will soon complete the study commissioned by the European Commission on "digitalisation, retail financial services and the single market".

In this Newsletter, Karel Lannoo, emphasised that digitalisation should bring further competition, by lowering barriers to entry and by allowing much easier comparison of financial products in a much shorter period of time. Nevertheless, persistent differences across countries in data protection regulation, credit databases, etc should continue to dampen the emergence of a single market for retail financial services. In parallel, ECRI continues to contribute to meaningful external projects whose purpose is to reinforce the understanding of retail financial markets and consumer's behaviour.

As such, ECRI has been involved in the Think Forward Initiative which is an initiative of ING with partners including Microsoft, EMC, Dimension Data and CEPR. As highlighted by Stefan van Woelderen in this Newsletter, this initiative brought together more than 120 academics, European and national policy-makers, consumer organisation representatives and leaders from the financial and technology sectors at the Think Foward Summit on 25 February, which marked the beginning of a programme including a series of working groups aimed at improving the understanding of consumers' (financial) decisions. This Newsletter focuses primarily on this initiative and contains several articles that cover some issues addressed during the Summit.

Firstly, Mark Cliffe emphasises that the understanding of consumer's behaviour should result from a more holistic approach. The contribution of research to improve consumer's financial decisions will indeed increasingly require the use of disciplines as diverse as microeconomics, macro-economics, psychology, sociology, social anthropology, etc. More specifically, Monica Woodley placed some focus in the role of financial institutions, economic policy and consumer regulation. Questions remain on the way consumers can integrate the policy context in their financial decisions. For instance, how the behaviour of consumers is shaped by volatile fiscal policy and the accommodative monetary policy that should continue for several years? As regards technological development, Hans Timmerman praises the positive role that can be played by a digital assistant in managing personal finances of consumers. Among the key advantages of such a tool, Mr Timmerman draws special attention to accuracy, time saving, trust, and continuous advise, information and availability.

Finally, according to Michael Haliassos and Phil Thornton, mainstream models in economics and finance will need to be significantly improved in order to help consumers make better decisions in an era of rapid financial innovation and increased responsibility for households to provide for their retirement. Models should integrate the fact that consumers are subject to many influences when processing information (emotions, physical conditions, etc). Technology can contribute significantly to help consumers better understand these different influences, notably by using predictive tools. Overall, further financial literacy and research are needed to help improve (financial) decisions of consumers. ■

IN THIS NEWSLETTER

DIGITALISATION IN FINANCE

By Karel Lannoo, CEO of CEPS

"Digitalisation" and "fintech" are rapidly dominating the vocabulary in finance. This is a positive development in itself, as it allows the financial sector to wean itself from the continuing negative post-crisis talk and constraints, and focus on long-term strategic and structural developments.

But what is digitalisation? Is it not simply the modern translation of what in earlier times the dove or the stagecoach were to messaging and distribution? Is fintech simply not a new word for the growing importance and application of technology to the financial sector, a development that is old as the emergence of IT in finance from the 1970s onwards?

The growing availability and attraction of new communication technologies are fundamentally changing the landscape for financial services providers. This is to a large extent a welcome development and one that users have also witnessed for quite some time. Bank branches are gradually disappearing from the main street and moving to our desktops and smartphones, allowing banks to drastically cut back on expensive and often inefficient agency networks and centralise operations. Today's banks compete on the basis of the user-friendliness of their websites, which consumers can easily compare. But there is more, much more going on in the sector. The challenge for banks is to integrate and amalgamate the information they receive from their existing and new clients and continuously adapt their product supply. This information, or the big data, needs to be analysed from a myriad of angles and impact the communication with the customer. Gone are the times when a bank was king of the community, and a static set of products could be offered its customers. With digitalisation, the consumer stands in the centre of the relationship.

From an EU perspective, digitalisation is a welcome development, as it brings more competition into banking and finance, and lowers barriers to entry. It allows much easier comparison of financial products in a much shorter period of time. It also permits the offering of services on a cross-border basis far more easily, and often in a virtual mode, which the European Commission has wanted to achieve since the start of the single market programme. But barriers remain. Differences in data protection regulation hamper the cross-border provision of services. Consumer protection rules may not be sufficiently harmonised to allow for a single product supply throughout the EU, or it may be used as an excuse to maintain national barriers. Consumer credit databases are currently constructed differently across member states, and do not allow for a single approach. The authorities will need to take a pro-active approach to avoid stifling a very welcome market development. ECRI has been actively involved in researching the implications of digitalisation in finance, and will gather further evidence on this far-reaching trend during the 2nd half of 2016. ■

SPECIAL EDITION ON THE THINK FORWARD INTIATIVE

http://www.thinkforwardinitiative.com/

ECONOMICS IN 3D
Towards a More Realistic View of Household Decisions

By Mark Cliffe, Chief Economist, ING

Individual consumers are typically ignored by economists in the banking industry. Instead, they concentrate their attention on macroeconomic forecasting. Looking at national and international economic developments, bank economists give generic advice on issues such as interest and exchange rates. The goal is to help clients make better financial decisions. To the extent that their advice is tailored to individual needs, the focus is largely on corporate and institutional clients. Only a sub-set of retail clients with substantial investments typically receive their direct support.

For several years, however, economists at ING have been developing analysis and content designed to help retail customers of all kinds. In so doing, we seek to support ING's customer-centric purpose of "empowering people to stay a step ahead in life and business". Our international consumer economics team, via its website eZonomics.com and ING's International Surveys (IIS), supports local financial education initiatives and produces customer-centric content, such as articles, tips and tools. Locally, we support initiatives such as Financieel Fit (Financially Fit) in the Netherlands. Our daily internet poll on consumer opinions on our retail banking website has long been the biggest poll in the country.

There can be little doubt that the need for such support is growing. People face fresh challenges and opportunities in making decisions. The financial crisis has accelerated the shift towards individuals taking more responsibility for their financial affairs. Rapid technological change, not least in the form of digital and mobile technologies, is changing how people make decisions and transact. Meanwhile, applying advanced analytics to big data promises to provide more valuable insights into consumers' finances.

Economists, inside and outside banking, have been slow to acknowledge that changing consumer behaviour may have significant effects on macroeconomic performance. Just as the state of the economic environment affects individuals, the changing behaviour of individuals can affect the economy as a whole. Macro affects micro and micro affects macro. This calls for a more holistic approach.

Recognising this, and to coincide with the launch of its Think Forward Initiative, ING has decided to step up its research into consumer economics. The first step is to deepen our understanding of the impact of economic, social, political, technological change. We intend to examine the effects on particular socio-economic segments. The second step is to analyse how individual behaviour is changing. What are the challenges and opportunities that people face? The third, and most important step is to address the question: How can we help people make better financial decisions?

Seeking ways to improve people's financial decision-making will need not just combining macroeconomics and microeconomics. It will take us beyond economics, to the tools of other disciplines. Helping people to learn or avoid mistakes will call upon psychological and educational insights. Addressing social influences on decisions will pull in other social sciences such as sociology and social anthropology.

So macroeconomics is not enough. The goal of this introductory report is to show why a richer understanding of consumer finances needs a more multi-disciplinary approach. ■

SUPPORTING GOOD FINANCIAL DESICION-MAKING

By Monica Woodley, Editorial Director, EMEA, The Economist Intelligence Unit

How can households be supported to make better financial decisions? It seems a simple, straightforward question. We all know that families need to budget for their regular household expenditures, to insure themselves against the unexpected and to save for the future. But a range of factors influence their decisions on how to accomplish these goals, and understanding those influences– and their impact – is vital to figuring out how to support good decision-making.

The Think Forward Initiative is trying to get to the heart of this question, by taking a step back and attempting to frame the challenges households face when making vital financial decisions. The recent summit brought together a wide range of experts, from economists and policy-makers to leaders from the financial and technology sectors, in a 'meeting of the minds'.

My role was to moderate one of seven break-out sessions, each focused on a key area influencing financial decisions. Specifically, what are the challenges to household decisions created by financial institutions, economic policy and consumer regulation?

My group first worked to understand the environment in which European households currently operate, focusing on the levers used by policy-makers and regulators and the financial services offered by the industry.

Monetary policy has led to very low and in some places even negative interest rates, and financial institutions have replicated these low interest rates on risk-free savings products. Considering the global economic situation, this low-interest environment is likely to last for at least several more years, which creates a dilemma for households: is it still worth it to save? And if savers need to take more risks to achieve higher yields, are they ready to take such risks? Understanding the main factors that influence such decisions is vital to figuring out how to support good decision-making. The Think Forward Initiative is trying to get to the heart of this question.

Fiscal policy also plays a role, albeit less directly. There is strong evidence that unchecked capital accumulation creates inequalities, so there is a temptation for governments to increase taxes on capital revenue and financial wealth. While households cannot easily change the wealth they have accumulated in the past, taxation on capital income and financial wealth could influence their decision on whether to consume or to save. How can they save efficiently and protect their wealth when fiscal rules change over time and taxation will probably increase (especially in countries with high public debt)?

Beyond the policy context, household decisions are also shaped by the financial services industry, which in turn is shaped by regulation. Increased regulation of financial institutions following the financial crisis has led to higher compliance costs, higher capital requirements and lower revenue for some products and services. This crunch on profitability is forcing financial institutions to evolve, but there are many other factors contributing to a disruption of the industry. Competition from FinTech and the necessity to rebuild public trust in the post-crisis period are also pointing to a need for consumer-focused financial innovation. But until that trust is rebuilt, how can households be confident that financial institutions are working in their best interests? ■

The article continues on -
http://www.thinkforwardinitiative.com/stories/supporting-good-financial-decision-making

ECRI PUBLICATIONS

The Business Models and Economics of Peer-to-Peer Lending

Alistair Milne and Paul Parboteeah, 24 May 2016
https://www.ceps.eu/publications/business-models-and-economics-peer-peer-lending

Relaunching the European Retail Finance Market: Comments on the Commission's Green Paper

Sylvain Bouyon and Karel Lannoo, 15 December 2015
https://www.ceps.eu/publications/relaunching-european-retail-finance-market-comments-commissions-green-paper

Household Final Consumption in the EU: The key driver for a sustainable recovery?

Sylvain Bouyon, 4 December 2015
https://www.ceps.eu/publications/household-final-consumption-eu-key-driver-sustainable-recovery

Understanding Credit Markets for Europe

MY OWN DIGITAL BANKER

By Hans Timmerman, CTO, EMC

Would leaving the monthly chore of managing your personal finances to a digital assistant appeal to you? Hans Timmerman, CTO of EMC Netherlands, very much likes the idea of having a personal banker at his fingertips, even if that means entrusting some of his confidential financial details to his banking partner.

As a technical kind of guy, I was never terribly interested in financial management. Sure, I did the occasional obligatory class in accountancy or personal finance at school and earned high enough marks. And later, in my professional life, I did several short MBA classes in financial management, but I knew I would never become an experienced professional in this craft. So I learned, early on, that it was much better to align myself with a financial professional in my team, who took care of the financial aspects.

Also, in my personal life, financial administration has been the mandatory homework I had to do every month. I set myself this chore, if was strictly necessary, to meet required payment terms or, sometimes also to respond reminders. Also, my tax return is always done in the final days before the last possible moment to file. So, as you see, finance is not a real hobby of mine. Sure, I'm well educated and can learn, pretty quickly, what's good or not. I also read the papers and know what's happening in the world. I have made many investments and am already living in my third home, each one financed via well-organised mortgages. So, if necessary, I have the basic know-how or can find a professional who can advise or support me through those larger financial decision-making periods.

I stayed in charge and took the final decision. But I definitely find intriguing with the idea of having my own financial assistant to whom I could delegate all those boring tasks. Paying my bills automatically, not too late but also not too early. Recognising my yearly expenditure pattern and automatically saving the needed amounts each month. Reporting when unusual trends appear or whenever potentially lucrative opportunities arise and balancing my savings and current accounts.

It's self-evident that whenever I would have to call on my digital banker, I would be open to learning new stuff and would especially appreciate receiving recommendations on lucrative possibilities. And, at the end of the day, it's just an assistant: ultimately, you would stay in charge and take the final decisions, as always.

I fondly recall annual visits in years past – before the internet age – by a representative from my local building society. These visits typically took place at our home in the evening. She would inform me about potential new opportunities and also ask if my family had any plans to move... And each time that we moved to a larger house, she was well aware of our financial situation

ECRI STATISTICAL PACKAGE 2015

For the first time, detailed data on several "emerging economies"

WHAT IS THE ECRI STATISTICAL PACKAGE?

Since 2003, the European Credit Research Institute (ECRI) has published a highly authoritative, widely cited and complete set of statistics on consumer credit in Europe. This valuable research tool allows users to make meaningful comparisons between all 28 EU member states as well as with a number of selected non-EU countries, including the US and Canada.

WHAT IS COVERED?

Two Statistical Packages are on offer. The more comprehensive product "Lending to Households (1995-2014)" contains valuable data on consumer credit, housing loans, other loans, total household loans, loans to non-financial corporations as well as total credit to the non-financial business and household sector. The 'standard' "Consumer Credit in Europe (1995-2014)" exclusively covers consumer credit data.

The 2 Packages in Fact & Figures:

• 40 Countries: EU 28, Turkey, Rep. of Macedonia, Iceland, Norway, Switzerland, Liechtenstein, Australia, Canada, Japan, the United States, India and Russia.

• 20 years data series: 1995-2014

• National accounts: GDP, final consumption expenditure and gross disposable income of households, inflation and exchange rates.

• 150 (67) tables: present time series data in nominal and real terms, and per capita, as well as breakdowns by lender, type, currency and maturity are also available for selected countries.

• 27 (13) figures: highlight credit trends in a way that allows user to make meaningful comparisons of the retail credit markets across countries.

FACTSCHEETS

The European Credit Research Institute (ECRI) provides indepth analysis and insight into the structure, evolution and regulation of retail financial services markets in Europe. Through its research activities, publications and conferences, ECRI keeps its members and the wider public up-to-date on a variety of topics, such as retail financial services, credit reporting and consumer protection at the European level.

ECRI is an independent, non-profit research institute whose interdisciplinary team of researchers and academic cooperation partners has developed a specialised body of knowledge on retail financial markets. It was founded in 1999 by a consortium of European banking and financial institutions. ECRI's operations and staff are managed by the Centre for European Policy Studies (CEPS) in Brussels.

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sylvain.bouyon@ceps.eu or at +32(0)2-229.39.87.87 and was able to give us the best advice on how to upgrade and renew our mortgage. When I look back on that personal attention and support, I appreciate that it gave my family a successful residential 'career', grounded in sound financial basics.

With the advent of the internet age, many financial institutions have scaled back on providing such active, personal care and I must say that I really miss it. I realise that deflated margins and stiffer competition sounded a death knell for simple personal services, but I lament their absence anyway. So the new opportunity to re-create my own personal financial assistant gives me new hope. I would have no reservations about sharing my personal financial data with a digital assistant from a trustworthy company. Even consolidating my financial products into fewer vendors, and accepting that their value might materialise at a later date in the future. Delegating most (or all?) of my financial administration to the assistant – and the supporting back-office systems – to relieve me of those personal financial duties. And, for sure, that relief from financial chores is worth some nominal subscription or other charges, but that's all in the game. Because it would not only release me from my boring monthly homework, but also give me the trust that I have my own personal banker at my fingertips, whenever I need him (or her)... ■

HELPING PEOPLE MAKE GOOD FINANCIAL DECISIONS: THE THINK FORWARD INITIATIVE

By Michalis Haliassos, Chair of Macroeconomics and Finance at Goethe University Frankfurt and Director of the CEPR Network on Household Finance & Phil Thornton, Lead Consultant, Clarity

This article was originally published on VOX - CEPR's Policy Portal

M. Haliassos

Mainstream models in economics and finance restrict the factors relevant for financial decisions to emotionless logic, perfect information, and impeccable mathematics. In the modern era of rapid financial innovation and increased responsibility for households to provide for their own retirement, the usefulness of this paradigm may be severely limited. Research by economists, psychologists and other social scientists has shown repeatedly that these decisions are driven by many other — often subconscious — factors, creating enormous heterogeneity of actions and of needs.

The Think Forward Initiative brings together a range of experts to find out how we make financial choices, and to find lessons for giving consumers greater financial empowerment. According to an international survey by ING, one of the founding members of the initiative, a third of people struggle to make financial decisions while three-quarters fear young people face an uncertain future and need better financial education.

On 25 February 2016 it held its first summit in Brussels that brought together bankers, business executives, economists, technology experts, policymakers, consumer organisations and academics to discuss issues relating to: human behaviour, psychology, and sociology; technology-based solutions; and the challenge of financial literacy.

To err is human

The first step is to move beyond benchmark economic assumptions that people are perfectly rational and weigh up the pros and cons of other important factors that may affect their financial choices, even under abundant information. In fact, people face information overload: one edition of a daily newspaper contains more information than a person in the 17th century would have received in their life.

P. Thornton

When it comes to processing information, people are subject to many influences. Even colour affects how likely they are to take risks. Noreena Hertz, the economist and author, cited research showing that sophisticated investors were more likely to buy a stock when the information is presented on a green background than on red. Language can also sway decision making: shares in technology company North American Natural Resources soared from $1 to $17 in 1999 when it changed its name to pinkmonkey.com.

Human factors such as emotions and physical conditions are very influential. People who are anxious or scared become more risk averse. People operating on four hours sleep a month have the same decision-making capability as a drunken person. Research shows that even informed judgement can be impaired: judges are much more likely to give parole after a meal break.

Technology: Linking the present and future self

Uncertain employment opportunities, low interest rates, and diminishing state support for pensions make saving for a decent retirement a challenge. The problem can be seen as identifying the precise relationship between someone's 'present self' with immediate wants and needs and the hardship their 'future self' will face if they do not save enough. Is this a coherent plan or a dangerous battle?

If it is indeed more of a battle, there are things that can be done to ensure longer-term well-being. According to Daniel Goldstein, Principal Researcher at Microsoft Research, one option is to change the 'default option', i.e. what happens if people do not undertake action. This has already been successful. Changing the default position on organ donations so people join the scheme unless they opt out has increased donors. Including a function in workplace pensions to automatically increase contributions means people save more.

But one can go further and change people's attitudes by making future consequences more salient to the current self.

The challenge is to help people imagine what their future lifestyle would look like depending on decisions they make now. Technological devices can simulate the future and make the future vivid, using — appropriately — a selfie.

An experiment found people save 50% more money for retirement when they are shown a selfie of themselves modified to make them look much older. Technology has the potential to devise other solutions that will prove particularly suitable for the 'information generation' who are most at risk of poor retirement. While it will need investment to create these tools, once they are built they will be easily scalable.

Financial literacy

In a fast changing and volatile world, financial literacy could be increasingly important to ensure that all people fully participate in society. People make many decisions with significant consequences for which they need basic skills.

According to the S&P Global Financial Literacy Survey, financial illiteracy is widespread: people lack knowledge of fundamental financial concepts; risk is an area about which people know least; and women and the young particularly suffer from illiteracy. Some initiatives have shown promise, according to award-winning economist and author Annamaria Lusardi. Academic economists have produced a programme that the New York Stock Exchange gives its companies to customise for their workplaces that helps people visualise risk and promote financial well-being.

Next steps: Further research

Summit participants split into breakout sessions to identify areas for further research. Here are some of the outcomes. Many points made in one session equally apply to other sessions.

- **Budgeting and spending.** People are social and do not make decisions in isolation. At the same time, people are anxious about the quality and trustworthiness of information and the way it is used. More research is needed on the most effective ways of getting information to people in a timely and personally relevant way.
- **Borrowing decisions.** People are concerned about the costs of debt, but also about their future access to borrowing opportunities. Different groups in society have different concerns and there is a need for more granular data, which would help both academics and banks understand different groups' concerns.
- **Financial literacy.** Lessons can be learned from sectors such as health, where prevention is seen as better than a cure and where people generally know where to get information. Research is needed into data solutions that can identify signs people are on a negative trajectory. Predictive guidance could potentially help. There was a call for financial education to be introduced in schools and for finding ways to enhance individuals' financial resilience and coping skills.
- **Savings, investment and retirement.** More research is needed on: how to ensure greater diversity, that is better taking into account what each individual customer in his/her full diversity actually wants and needs financially; learning from other industries; the quality of expertise with the financial professions; and how to ensure people trust that the decisions they take now will lead to long-term benefits. Research is needed on how to design trusted, tailor-made and usefully transparent financial products.
- **Responding to disruptive trends.** Research is needed on how people can get real value out of data while ensuring the use of data falls on the right side of the balance between helpful and intrusive. One clear theme was a need for greater focus on social aspects of economic decision making that are not adequately covered by the two extremes of micro- and macroeconomics, focusing as they do on the unit or on the whole economy. People's goals are not framed in isolation but shaped by their households and social circle. Humans are social animals and the importance of those interactions with relatives and peers points to a need to bring sociology, psychology, and technology further into the debate. There was clear enthusiasm to contribute to further work as part of this interdisciplinary initiative open to those with interest and expertise to help consumers realise their financial objectives and manage their risks. ■

THINK FORWARD SUMMIT - CONCLUSIONS AND NEXT STEPS

By Stefan van Woelderen, Head of International Consumer Economics, Sustainability and Innovation, Group Research, ING

The Think Forward Summit on 25 February 2016 gathered more than 120 academics, European and national policy-makers, consumer organisaton representatives and leaders from the financial and technology sectors in a 'meeting of the minds' to help people make better financial decisions.

The Summit was the official kick-off to the Think Forward Initiative, a multi-year project set up by ING, EMC, Microsoft and the Institute for New Economic Thinking. It brings together different people, disciplines and data to figure out how to help people manage the challenges and risks of the modern era in order to become – and stay – financially and economically fit.

The Summit focused on the consumer and the challenges and unknowns around household decision-making. Inspiring talks from experts such as renowned economist and best-selling author professor Noreena Hertz and award-winning economist and professor Annamaria Lusardi sparked the debates held in seven breakout sessions, where participants delved deeper into understanding the issues and identifying priority areas.

Each breakout discussion focused on a specific topic and worked to define specific challenges related to it. Although the societal and regulatory environment was largely treated as a given, one of the breakout sessions was about the challenges around decision-making created by financial institutions, economic policy and consumer regulation. This is summarised elsewhere in this ECRI Newsletter in a post-Summit article by Monica Woodley, who moderated that session.

Overarching themes. One overarching theme at the Summit was the need to learn more about differences in people's (financial) goals, with some having no explicit goals at all, and recognising that preferences and circumstances change over time. People can set their own financial goals, but the financial industry could perhaps be more effective in facilitating this when necessary. It`s worth investigating how such co-creation might work most effectively, and how people's diversity and changing needs over time can be better taken into account.

Another clear theme was a need for greater focus on social aspects of economic decision-making, which isn't fully covered by the two fields of micro-and macroeconomics. People's goals aren't framed in isolation but shaped by their families, friends, households and colleagues. This points to a need to bring sociology, psychology and technology further into the debate.

Next steps. The Summit may be over, but the Think Forward Initiative is just beginning. Participants were enthusiastic about continuing with next steps, and about 100 agreed to give their precious time and energy to working groups that will explore ways to tackle the challenges presented above. These include research and accompanying practical solutions. The content produced in these working group discussions will be published to stimulate awareness about the Initiative throughout Europe.

The Think Forward Initiative's purpose is to empower people to make smarter (financial) decisions. Ultimately, we aim to have a positive impact on the way people spend their money, on their ability to manage their risks and realise their objectives. By the end of 2016, the first steps will have been taken, the results of which are expected to be presented at the 2017 Think Forward Summit. Remember, the Initiative is 'open source', meaning that contributions are welcome from those who couldn't attend the Summit and others within the wider network of the organisers and participants.

It's like the African proverb mentioned at the Summit: "If you want to go fast, go alone. If you want to go far, go together." ■

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