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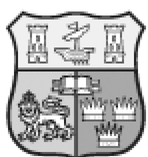

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Do consumer warnings on financial products work?

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With an accelerated move to online banking due to the pandemic, the challenge of remote credit decision-making for consumers will likely increase

Opinion: a range of protections are given to consumers accessing credit and financial products online, but how effective are they?

By Olive McCarthy and Noreen Byrne, UCC

With evidence of an accelerated move towards online banking during the Covid-19 pandemic, and advancements by fintechs and challenger banks into the personal lending market, consumer protection around digital financial services comes into sharp focus. A range of protections are given to consumers to enable them to make informed decisions in accessing credit online, including the provision of credit warnings. But how effective are warnings in protecting consumers of financial services?

EU directives seeking to protect consumers of financial services include the Distance Marketing of Consumer Financial Services Directive, which applies to financial services more generally, and the Consumer Credit Directive, which is more specific to precontractual information and credit contracts for consumer loans between €200 and €75,000. The Distance Marketing of Consumer Financial Services Directive has requirements that consumers receive detailed information from financial services providers before a contract is concluded. It prohibits cold calling and spamming and also allows for a cooling off period of 14 days.

The Consumer Credit Directive puts the onus on credit providers to give standard information that enables the consumer to make an informed borrowing decision. This includes showing the representative annual percentage rate in an illustrative manner, with examples of the total cost of credit, number and frequency of repayments and any related fees.

Consumers must have a right to repay their loan early and, importantly, lenders must also highlight the consequences to consumers of late payments or failure to repay. The latter usually takes the form of a short, clearly worded and emphasised statement that failure to make repayments will result in arrears which will potentially affect a consumer's credit rating and might limit access to credit in the future.

From RTÉ Radio 1's Morning Ireland, Financial Services and Pensions Ombudsman Ger Deering on the number of customer complaints against banks his office receives and their implications for the wider financial sector

Do consumer warnings work? Most of the research into the effectiveness of consumer warning labels has been conducted on cigarette smoking. In general, mandatory warnings on cigarette packets are seen to be effective, but pictorial warnings are deemed considerably more effective than text only warnings.

But applying the learning from warnings on cigarette smoking to less risky consumption can be problematic. An article in the Harvard Business Review suggests that a proliferation of consumer warnings about relatively minor risks creates information overload and a scepticism about all warnings in general. In other words, warnings are so prevalent that they are often ignored.

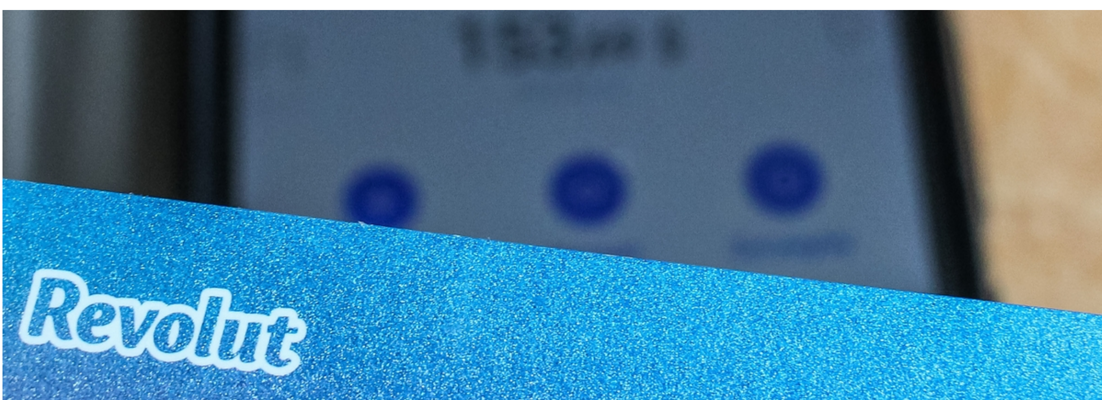
It is also difficult to distinguish between the impact of warnings on behaviour and the effect of other measures which might influence behaviour, such as increased taxes. As the article points out, it is possible that the use of warnings intended to influence consumer behaviour can also positively influence producers' behaviour and lead to product or service re-design.

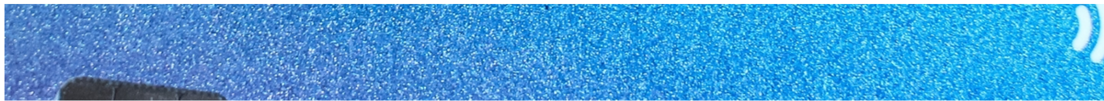
From RTÉ Radio 1's Morning Ireland, Grainne McEvoy from the Central Bank on new moneylending rules to boost consumer protections

Can credit warnings be made more effective and would providing additional information enable a more informed lending choice? Despite the presence of widespread information, behavioural economists state that consumers often make decisions that are not in their best interests because of bounded rationality. It is likely, then, that the presence of a credit warning is, at best, read and then ignored because the consumer has already made a decision to apply for a loan even with incomplete information.

The European Banking Federation has highlighted the potential for credit consumers to suffer information overload - information which is now more often read on digital devices - leading to decision fatigue or ambiguity aversion. The UK Financial Conduct Authority has recognised that financial consumers make mistakes and engage in contradictory financial behaviour because of behavioural biases. Financial consumers respond to urges for immediate gratification and can often suffer from decision regret.

The use of nudges to change the way information is presented and enable consumers to make more-informed decisions is a better proposition. At a practical level, this might include the provision of short case studies of 'ordinary borrowers' who went into arrears and how this impacted their access to future loans and/or their credit record. Nudges might also suggest that consumers consider borrowing a smaller amount or save small amounts simultaneously with each loan repayment, as is standard practice in credit unions.





From RTÉ Radio 1's News At One, The Irish Independent's Charlie Weston on why Revolut is proving so popular with its one million Irish customers

From a financial services' perspective, it could be argued that the Directives encourage the meeting of minimum requirements rather than promoting a culture of building consumer resilience and welfare. Fostering a customer-centric approach in the design of credit services might offer more benefits than meeting a minimum standard in service provision.

With new banks such as N26 and Revolut moving into the personal lending market, the challenge of remote credit decision-making for consumers will likely increase. Coupled with the access of fintechs to spending, saving and other personal data, including information held on the customer's device, such as contacts list, social media profile, services used or being searched for, and length of time spent on webpages, the potential to orientate consumers towards or away from certain types of borrowing is greatly heightened.

READ: does cash have a future?

While it's still too early to predict the longer-term impact of the pandemic on consumer borrowing, greater consumer protection measures taken now can ensure better consumer borrowing decisions. These measures such as enhanced warnings on the risks associated with falling into arrears can build financial resilience among consumers. They can also orientate financial service providers towards greater consumer centricity and welfare in the months and years ahead.

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