

## COMPETITIVE MARKETS AND CONSUMER WELFARE

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# BEHAVIOURAL CONSUMER REGULATION

**The government's consumer policy strategy – *Consumer in a digital world* – has a strong focus on how rules and legal requirements affect both businesses and consumers in the new digital reality. The strategy has prompted the Competition and Consumer Authority to review all consumer-related legislation from a behavioural perspective.**

The strategy launches a novel approach to consumer policy based on specific insights into consumer behaviour. The purpose of the behavioural approach is to ensure that consumer-related regulation will have the intended impact in the market.

Among other things, the strategy introduces three principles for behavioural consumer regulation that aim to ensure an effective and uniform approach to consumer protection across the responsible ministries.

The strategy also focuses on maintaining a high level of consumer protection without adding unnecessary regulatory burdens for businesses.

**O**n 25 May 2018, the Danish Government published its new strategy for consumer policy – *Consumer in a digital world*. The strategy comprises a total of 24 initiatives that, among other things, aim to make it easier for consumers to navigate in an increasingly digital marketplace. The strategy is strongly focused on how rules and requirements affect consumers and businesses and whether or not regulation is working as intended.

### A novel approach to consumer policy

As part of the strategy, the Danish Competition and Consumer Agency has reviewed all consumer-related legislation from a behavioural perspective. This consists of a new approach, where the consumer policy strategy is directly based on insight into consumers' actual behaviour.

The behavioural approach serves as an operational framework that highlights the interaction between consumers and businesses. It has the potential to enhance understanding of how consumers act in the market and how regulation works in practice.

#### Box 1 Nobel Prize for Economics 2017

In 2017 the Nobel Memorial Prize in Economic Sciences was awarded to the American Economist Richard H. Thaler for his contributions to behavioural economics. Thaler received the prize for his studies of how various psychological mechanisms affect our ability to make financial decisions and for his major contribution to the proposition that governments should actively use behavioral insights to enhance their policies.<sup>1</sup>

<sup>1</sup> [https://www.nobelprize.org/nobel\\_prizes/economic-sciences/laureates/2017/press.html](https://www.nobelprize.org/nobel_prizes/economic-sciences/laureates/2017/press.html)

### Principles for behavioural consumer regulation

The consumer policy strategy introduces three principles for behavioural consumer regulation, cf. Box 2. These principles are intended to support like-minded thinking and a shared approach to consumer policy within the ministries and agencies responsible for consumer regulation in Denmark.

The three principles for behavioural consumer regulation are intended to contribute to a high level of consumer protection while supporting implementation of regulation that makes it easier for consumers to be active and make well-informed choices for their own benefit.

When consumers are active they will enjoy lower prices and better quality. At the same time, more active consumers spur competition between businesses to the benefit of consumers in general.

Finally, the three principles support the use of established empirical and experimental research on consumer behaviour when new consumer-related regulation is formu-

lated.

The purpose of the principles is thus to increase the focus on how regulation is actually implemented and functioning

#### Box 2 Three principles for behavioural consumer regulation <sup>2</sup>

##### PRINCIPLE 1: Consumer-related regulation should support simple and action-oriented consumer information

It is important that consumers get accurate, action-oriented and simple information if the information is to be used in their decision-making.

In order to create the best level of information, it may be necessary to divide up the information, for example by presenting a short introductory overview with easy access to more comprehensive information for those who want it. This will make it easier for consumers to compare the information across products.

##### PRINCIPLE 2: Consumer-related regulation should ensure that consumer-related information is being presented at the right time in the consumers' decision-making process

Consumer-related regulation should ensure that consumer-related information is being presented at the right time in the consumer's decision-making process. Otherwise, the information will only have a limited effect. Three phases can be distinguished in the consumers' interaction with businesses:

- Prior to concluding a contract (e.g. information for marketing purposes)
- During the conclusion of a contract (e.g. contract information)
- After conclusion of a contract (e.g. "feedback" to the consumer in the form of annual statements and the like)

If, for example, the information is presented in order to help the consumer compare products the relevant information must be provided before the actual conclusion of the contract.

On the other hand, basic rights and obligations that are not up for negotiation and not a competitive parameter for the business can usefully be provided as contractual information.

If the information is meant to help the consumer stay continuously informed with respect to the original agreement (e.g. a subscription scheme), then the information should be provided as continuous feedback after the contract is concluded. Among other things, this requires the information to be provided at a time when the consumer is ready to make a decision about the agreement and not, for example, when the payment has already been made.

Box continues on the next page ..

<sup>2</sup> [www.adfaerdsprincipper.dk](http://www.adfaerdsprincipper.dk) in practice.

.. continued

### PRINCIPLE 3:

**Consumer-related regulation should be based on the best available knowledge of consumer behaviour**

Both behavioural theory and experiments can be used to inform the implementation of new consumer regulation before it is finalised. A distinction can be made between documented effects at three levels, depending on how certain the effect of a particular action is assumed to be.

### Documented effect on the specific market

Key elements of the bill's impact on consumer behaviour are explicitly tested in, for example, experiments where the effect on consumer behaviour has been confirmed and where the implementation may, if necessary, have been adjusted in light of the results. An example is laboratory testing of consumer understanding of the information contained in mortgage offers. Here, the experiment shows that more consumers find it easier to take in the key information when it is highlighted on a cover page<sup>3</sup>.

### Documented effect from other markets

The expected effect of the bill on consumer behaviour is supported by previous trials or other statistical documentation from other markets where similar solutions have been tested and results judged to be transferable. For example, analyses of consumer choice of health insurance policy show that complexity results in more passive consumer behaviour. The fact that complex mandatory information requirements reduce active consumer behaviour will, in this situation, be transferable to other markets, even if the markets are not on the face of it comparable<sup>4</sup>.

### Theoretical justification for anticipated effect

The bill has been designed based on general knowledge of consumer behaviour, but not in the specific area, e.g. from other legal areas or comparable countries. There is thus theoretical evidence of the anticipated effect of the bill on consumer behaviour in general.

3 Competition Council's analysis of the mortgage market, 2017

4 Frank, RG & Lamiraud, K., 2009

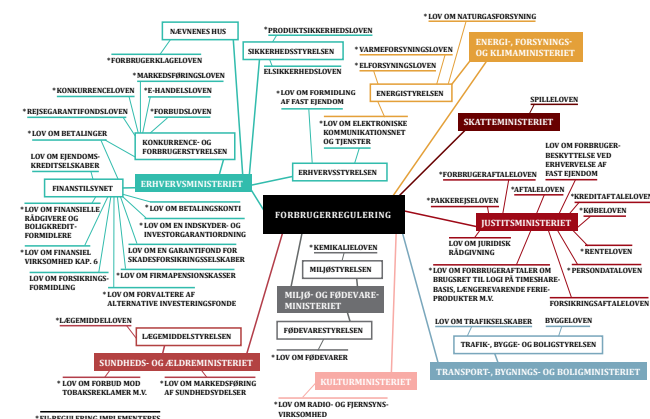
## Review of consumer-related legislation

As part of the consumer policy strategy, the Danish Competition and Consumer Authority reviewed consumer-related legislation from a behavioural perspective.

The legislative review focussed on regulation which specified rules for how consumers and businesses interact with each other. This type of legislation is found in many sectors, and the responsibility for the consumer-related regulation is therefore divided between a number of ministries and agencies, cf. Fig. 1.

In many cases our consumer regulation comes from the EU. A shared foundation for consumer regulation is important, both for the internal market, and for consumer protection in a digital world where the importance of national borders decreases. However, it also means that large parts of the regulation cannot be changed in Denmark alone.

**Figure 1**  
Graphics on consumer-related regulation at legislative level



The legislative review identified various challenges with consumer-related regulation, including the fact that the formal information requirements are extensive and as such provides a poor framework for active consumer behavior, cf. Box 3.

The legislative review aimed to provide a catalogue of initiatives that could ensure a better prospective framework for active consumer behaviour.

## General findings from the legislative review

- Extensive information requirements for contractual terms and conditions
- High levels of complexity
- Lack of timeliness in the provision of information
- Limited consumer mobility in several markets
- Information requirements are complex for businesses to comply with
- Information requirements limit the possibility of developing new innovative products for the benefit of consumers

So far, the results have been brought together in 12 specific initiatives in the consumer policy strategy focusing on, among other things, activating consumers through more targeted information requirements. Additionally, the experiences gained from the legislative review were summarised in the three principles of behavioural consumer regulation, cf. above.

The specific work flowing from the legislative review is described at the end of the article.

## Research has provided new knowledge about consumer behaviour

The need for a review of consumer-related legislation should be seen in light of the fact that research in consumer behaviour has challenged traditional approaches to consumer-related regulation.

Both in Denmark and in the EU, consumer-related regulation has traditionally focused on obliging businesses to thoroughly informing consumers, believing that this enables them to make their own consumption choices on an informed basis.

Studies show, however, that copious and complex information can be difficult to process and is often not actively used in the consumer's decision-making. For example, consumers may be affected by so-called information overload, where the provision of all information does not work as intended because important aspects of the information are crowded out.

Too much and too complex information may also cause consumers to stick with the status-quo thus remaining in a contract when potentially better products are on the market.<sup>5</sup>

A survey commissioned by the EU Commission showed that only about 9,5% of European consumers open terms and conditions in online transactions if it is optional to do so. This suggests that consumers are not using this information to a very large degree, even though the terms and conditions may hold important information on delivery costs, return rights, etc.

The EU Commission has used similar methods to test consumer policy issues, in relation to pre-checked fields for additional purchases, cf. Box 4.

#### Box 4 EU Examples

One example of the use of behavioural science to design regulation is the Consumer Rights Directive's ban on pre-checked fields for additional purchases. Since default settings or pre-defined choices exert a significant influence on our behaviour we will in most cases choose the default setting if multiple options are available. The ban in the Consumer Rights Directive thus aims to limit the ability of businesses to exploit this consumer behaviour.

Another example is the EU Commission's requirement for Microsoft to allow consumers, when installing a Windows operating system, to choose a web browser other than the one provided by default with Microsoft's operating system. The aim was to create increased consumer awareness of the different options and increased competition between the various providers.

The Competition and Consumer Authority has previously identified various types of transactions that, despite their significant benefits to consumers, entail a risk that consumers may become passive and find it difficult navigating the markets (depending on design), cf. Box 5. The types of transaction may cause what has been called *behavioural market failures*.

#### Box 5 Transaction types<sup>6</sup>

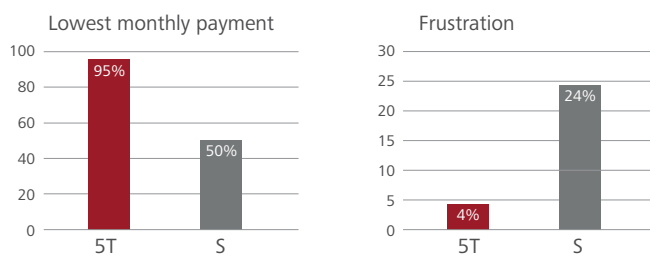
- Automated transactions
- Guidance-based transactions
- Bundled transactions
- Lock-in transactions
- Deferred transactions
- Third-party-funded transactions

6 <https://www.kfst.dk/media/47124/ny-indsigt-om-adfaerdsbaserede-markedsfejl.pdf>

This insight into behavioural market failures was used inter alia in connection with the Competition Council's analysis of the mortgage market from 2017<sup>7</sup>. In a laboratory test, two groups of consumers were asked to compare mortgage offers from three financial institutions. One group had access to a cover page where key information was presented in a simple format whereas the other group only had the loan information supplied by the bank. The consumers' response patterns were measured using eye-tracking and facial expression analysis techniques.

The test demonstrated that 95% of the participants who received the simple cover page were able to identify the mortgage offer with the lowest monthly instalments compared to only 50% of respondents in the control group. In addition, the test demonstrated that participants became significantly more frustrated when they were asked to review the original mortgage offer as supplied by the bank.

**Figure 2**  
Experiment with simple mortgage cover page The Compe-



tion and Consumer Authority has similarly conducted a laboratory test on how terms and conditions in online trade can be presented in a manner so that consumers are better able to compare essential aspects of these when trading online<sup>8</sup>

5 Martin J. Eppler & Jeanne Mengis: The Concept of Information Overload: A Review of Literature from Organization Science, Accounting, Marketing, MIS, and Related Disciplines (2010).

7 <https://www.kfst.dk/analyser/kfst/publikationer/dansk/2017/20170818-konkurrencen-paa-realkreditmarkedet/>

8 [https://www.kfst.dk/media/50713/20180621-improving-the-effectiveness-of-terms-and-conditions\\_ny4.pdf](https://www.kfst.dk/media/50713/20180621-improving-the-effectiveness-of-terms-and-conditions_ny4.pdf)

This experiment demonstrated that consumers are significantly more aware of terms and conditions when these are presented in a simpler format and on the product page.

When terms and conditions were presented in a simpler format the test participants answered 94 pct. of the control questions about terms and conditions correctly for a simulated purchase. For comparison, test participants only answered 68 pct. of these questions correctly when presented with the current terms and conditions.

## Steps in the legislative review proces

### Step 1:

#### ***Mapping of consumer-related regulation and initial screening.***

The Competition and Consumer Authority initially identified all consumer-related regulation and performed an initial screening in order to select laws and executive orders that were relevant for inclusion.

The selection included regulation that aimed to regulate the interaction between private businesses and consumers. Regulation, specifying what businesses may sell, whether for safety, health or environmental reasons, was excluded from the review. Regulation, defining framework conditions for businesses, such as requirements for certifications or similar, was excluded as well.

### Step 2:

#### ***Questionnaire survey of responsible authorities, stakeholder involvement and data processing***

Subsequent to the initial screening, responsible authorities received a questionnaire designed to provide an overview of the specific provisions that regulate the interaction between businesses and consumers. The questionnaire divided the interaction between consumers and businesses into three temporal phases.

#### **Phases of interaction between business and consumer:**

1. The period prior to the consumer's choice of product or service, including the initial contact with the business.
2. The period where an agreement between the consumer and the business is concluded.
3. The period after the conclusion of an agreement between the consumer and the business.

For some authorities this analytical step involved considerable work. Therefore, an essential prerequisite for the process was to establish contact with the specific employee responsible for the responses. These employees were offered continuous sparring with employees from the Competition and Consumer Authority.

#### **Data processing:**

The questionnaire responses covered 495 provisions of consumer-related regulation and were systematised on the basis of an estimate of the following parameters:

1. The regulation impedes consumer activity in the market
2. The regulation has no practical consumer protection effect
3. Information requirements mandated by the regulation are not timely related to the consumer's decision-making process
4. The regulation is not technologically appropriate
5. The regulation burdens businesses
6. The regulation is not fully harmonised within the EU and could be amended in national law

In parallel to the questionnaire survey, a number of interviews were conducted with stakeholders to identify where the businesses and consumers experienced specific challenges.

In summary, the questionnaire survey and stakeholder involvement offered an initial picture of which parts of regulations that proved difficult for consumers and businesses to navigate and implement.

Based on the above, three consumer domains were selected for follow-up studies.

These were:

- E-commerce
- Mortgage
- Utilities

These domains share features that are relevant for a digital agenda and future consumption patterns. The prioritisation did not suggest that other areas did not contain legislation that could or should be revised.

**Step 3:*****Supporting studies in selected areas***

Subsequent studies were initiated to confirm or deny the results from the provisional legislative review and support the development of initiatives that could strengthen consumer welfare in the selected areas.

At the same time, these studies aimed to explore how business implementation of consumer legislation aligned with insights from research on consumer behaviour in the selected areas.

Finally, the supporting studies aimed to document if specific regulation could be viewed as an unnecessary burden for businesses.

**Deliverables for supporting studies:**

1. Catalogue of businesses' implementation of the selected legislation in practice, Hatch and Bloom, June 2017
2. Desk research of research-based knowledge of consumer behaviour in the selected areas, iNudgeyou, June 2017
3. National representative survey of 1,000 consumers with a view to clarifying the challenges and potentials of existing regulation and potential proposals, Wilke, July 2017

**Step 4:*****Preparation of the general catalogue of proposed initiatives***

The supporting studies were part of an overall behavioural analysis. Based on the analysis, a general catalogue of proposed initiatives was drawn up that could form part of the consumer policy strategy.

**Figure 3**

Steps in the legislative review process

