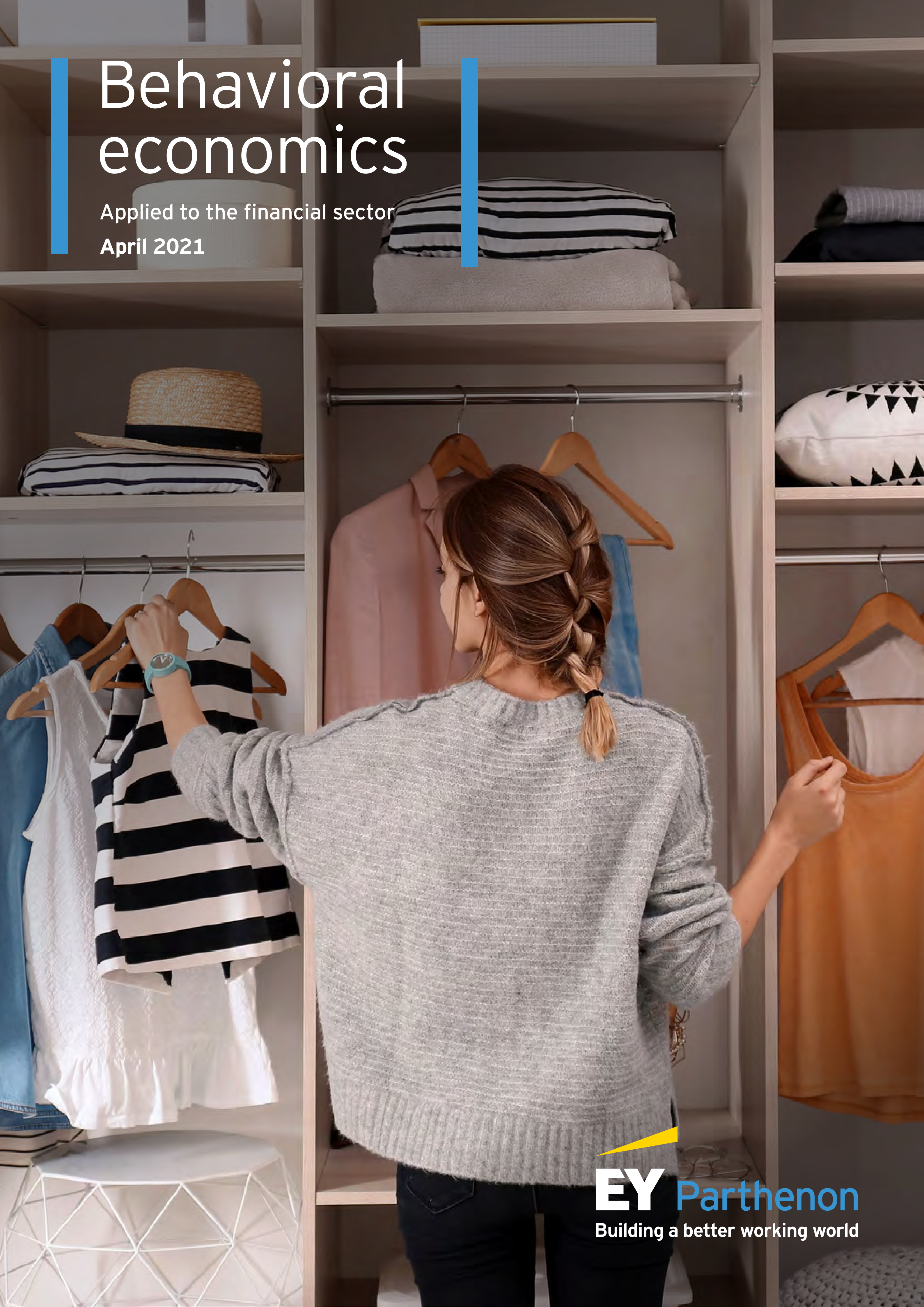
Behavioral economics

Applied to the financial sector

April 2021



EY Parthenon

Building a better working world

Summary

1

Introduction to behavioral economics

Behavioral economics goes beyond the theories raised by traditional economics; it understands the limitations and weaknesses of human nature, and tries to take advantage of them so as to change human behavior positively.

> Behavioral economics is the study of judgment and choice; it looks at how we make decisions. It was created as an alternative approach to the economic models that tried to explain the behavior of consumers, but which presented certain deficiencies as anomalies – because they didn't take into account the human factor.

If we all abided by the principles of traditional economic theory, we would all be fit, as we would follow a healthy diet and exercise daily. We would all have more money, since we would save regularly and avoid unnecessary expenses. According to the logical model of traditional economic theory, the main reason why people don't always achieve their personal goals is due to lack of information. However, in the case of sport or saving, who doesn't know that exercising and healthy eating are important? Or that saving regularly can ensure a more financially secure future?

Behavioral economics is based on how humans actually behave rather than how they should behave. It investigates and tries to predict human behavior and irrationality in order to influence the behavior positively. The actions that take advantage of this knowledge, and which are used to provoke or promote certain behaviors, are known as "nudges".

Daniel Kahneman, psychologist and recipient of the 2002 Nobel Memorial Prize in Economic Sciences, and his longtime collaborator Amos Tversky are considered the founding fathers of behavioral economics. Together, they identified a series of heuristics and behavioral biases that affect us when making decisions.

Heuristics are simple mental shortcuts that we generally use to make decisions, especially when faced with problems that are too complex and in which we tend to focus on elemental aspects alone.

This way of thinking makes us "fall," many times, into errors called cognitive biases.

Let's look at an example. We evaluate the frequency with which an event occurs based on the ease with which we can think of an example of it (availability heuristics). That is why more people are afraid of flying than driving, even though the probabilities of having a car accident are much higher than the probabilities of dying on a plane.

However, because airplane accidents are rare and, therefore, notable events, they are widely disseminated in the press. The result is that, in our minds, plane crashes are much more relevant than car crashes, which is why more people tend to worry more about getting on a plane.

Finally, it is important to highlight that behavioral economics not only challenges traditional economics theories but also seeks to validate hypotheses through an exhaustive methodology with several immediate and easy applications in real environments.

2 The importance of behavioral economics

The effectiveness of behavioral economics has been proven both in market experiments and in real environments. In fact, many financial institutions have already established disciplines around this science.

Marketing and commercial teams use it to design better ways to reach customers. It informs talent teams creating training programs for employees — to increase their well-being and motivation. And even governments use it to launch effective civil policies.

Behavioral economics has been on the rise for the past few years primarily due to two reasons, its effectiveness and its reach.

A strong example of the effectiveness of behavioral economics was evidenced at General Electric. They used the techniques of behavioral economics to triple the success rate of their smoking policies – more than 150,000 employees[1] quit smoking. Another clear example of its effectiveness is found in relation to organ donation. In countries where people are born as "default donors," the donor rate averages 90%, whereas in countries where being a donor is a proactive decision for each citizen, the average rate is just over 10%.

Secondly, we have the extensive reach of behavioral economics. Experts in companies and even in government areas use these behavioral levers on topics as diverse as public health, education, savings, financial literacy, employee talent and business strategy.

We can distinguish two major areas where behavioral economics is applied:

- Public sector
- Private sector

Behavioral economics in the public sector

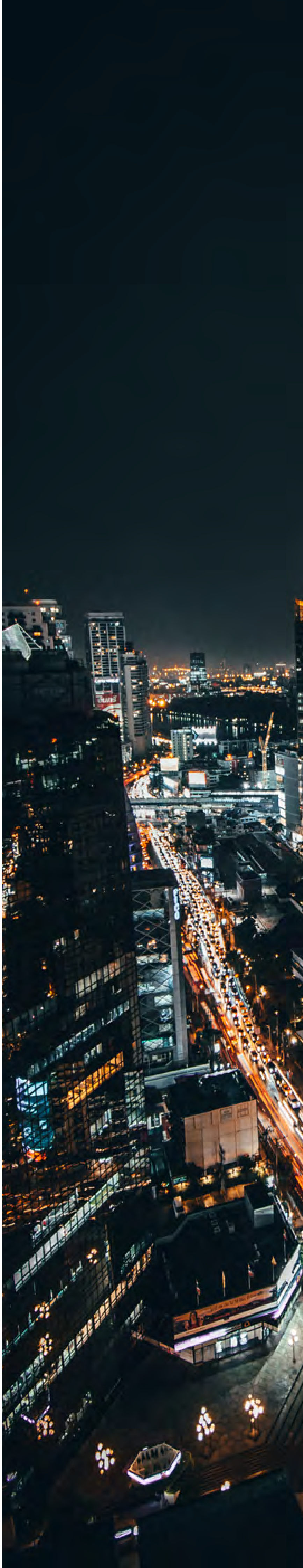
In the public sector, behavioral science has a clear vocation to help citizens and the community. Its main task is to raise social awareness and make health or civil policies more effective. There are two particularly interesting cases in this area:

The Behavioral Science Unit (BSU), created within the FBI Training Division in Quantico, Virginia, was established in 1972 in response to a sharp increase in sexually aggravated homicides. Its purpose was to develop a criminal profile of the killers. By investigating their behavior, it sought to understand the motivations and cognitive processes that led them to commit such crimes, and to therefore identify patterns or trends that would help them arrest other murderers.

The second case is the Behavioral Insights Team (BIT), also known as the "Nudge Unit." It was created by the British Government with the aim of improving its policies and achieving a more successful collection of tax dues. Among its most outstanding projects is the increased success of tax collection. This was achieved by employing what's known as the social effect, in this case, simply reminding people in a letter that on-time tax payment is the social norm. Another success was the reduction of errors in medical prescriptions. This was achieved through redesigning prescriptions that helped distinguish for better readability between micrograms and milligrams.

The BIT model was formally exported to the US in 2015 and many of its lessons are used by several countries.

[1]General Electric: Financial incentives to quit smoking - Volpp, Troxel, Pauly, Glick, Puig, Asch, Galvin, Zhu, Wan, DeGuzman, Corbett, Weiner and Audrain-McGovern, (2009). "A Randomized, Controlled Trial of Financial Incentives for Smoking Cessation." The New England Journal of Medicine.



2 | The importance of behavioral economics

Behavioral economics in the private sector

In the private sector, the application of behavioral economics is mainly within the scope of business strategy, i.e., on driving sales growth and improving customer satisfaction.

In this regard, it is key to understand the decision-making process of clients when acquiring a product or service. According to traditional economic theory, consumers, when deciding which product to buy, will analyze all the information on that product and its alternatives. They perform a cost-benefit analysis of each of them and end up choosing the one that gives them best value for money.

However, when it comes to making a decision, there are several other elements related to human psychology that influence the evaluation of a purchase.

For example, research has shown that context influences our willingness to pay as much as the product or the shopping experience itself. Several years ago, Adrian C. North conducted an experiment that sought to demonstrate that the type of music played in a store can have a significant influence on the products that customers choose to buy.

Over a two-week period, scientists observed the consumers´ behavior in the wine section of a supermarket, where they occasionally altered the type of music played.

French wines' sales tripled when the classic tunes of a French accordionist were played. However, consumers were more inclined to buy German wines when well-known traditional German music were played.

This experiment is another demonstration that customer preferences are not stable and can therefore be influenced.

In addition, scientists believe that the influence of music on purchasing decisions is not a conscious one. When asked if the tunes they heard determined their wine selection, almost all of the people who participated in the experiment strongly denied that music had anything to do with their choices.

This denial also shows the importance of understanding consumer behavior based on their actions and not just their statements.

The scenario we have just presented is one of the many applications that behavioral economics has in the definition of marketing and sales strategies. However, it is a science that is successfully applied in other areas within corporations.

Many companies have designed behavioral economics initiatives to increase employee satisfaction, improve communication with them, optimize career plans or define retention programs.

In the following chapters, we will focus on how to apply behavioral economics when defining marketing strategies for different products and services in the financial sector: savings, loans, insurance and investment products. Specifically, we will present project examples and best practices that show how the identification and removal of barriers to buying are as important as the implementation of triggers to promote purchasing behavior.

Increasing employee satisfaction, optimizing employee communication, refining career plans or defining retention programs are some of the activities that EY-Parthenon's team of experts has significantly influenced through the application of behavioral economics.

3

Behavioral economics and savings

Saving for the future can sometimes feel as a big effort. “I’ll start next month” is a common attitude.

The difficulty of visualizing the future, coupled with overconfidence in ourselves, complicates the perception of the need to save.

We prefer the satisfaction of spending today rather than saving for the future, even though we know the latter is a greater benefit.

The lack of tangible references in our daily lives related to savings prevents us from seeing it as a priority.

We tend to put off savings because we tend to postpone efforts in the intro, and "I'll start next month" is a common attitude here.

We know that saving is beneficial for our future, but we still don't do it. Savings, as a percentage of gross domestic product (GDP), does not exceed 20% in most countries. This is a clear indication of a lack of forward thinking.

From the behavioral economics point of view, there are several cognitive biases that hold us back in this important task.

Present bias

- Present bias refers to the tendency of people to prefer a smaller immediate reward rather than a greater one in the future. We might, for example, prefer to receive US$10 today rather than US$15 tomorrow. However, if the choice was to receive US$10 in one year or fifteen in one year and one day, we would not mind waiting one more day. This is a bias that is closely related to impatience or immediate gratification in decision-making.
- In a survey conducted by LendEDU, it was found that approximately half of the millenials prioritize eating in good restaurants over saving for their future. In fact, 49% spend more on eating out than they do on their retirement. Moreover, 27% spend more money each month on coffee than what they are able to save.

Projection bias

- It refers to people's erroneous belief that their preferences will remain the same over time. Both short-term transitory preferences and long-term changes in preferences can give rise to this bias. Underestimating one's own consumption habits, and how these increase over time, can lead to a projection bias in planning for the future, in particular for retirement savings. This lack of projection is closely linked to our overconfidence and the fact that we think our situation, both personally and professionally, will hardly change over the years, and if it does, it will probably be for the better.

Attentional bias

- Attentional bias refers to our lack of ability to consider all possibilities when making an important decision. Although we would like to think that we take into account all alternatives, the reality is that we often overlook some options, and some possible outcomes.
- Many times our attention is focused only on certain elements, ignoring the rest. That is a big problem when it comes to saving, an activity that doesn't have immediate rewards.
- The lack of tangible references in our daily life related to saving prevents us from seeing it as a priority. We don't have a financial advisor calling us every day to tell us that our savings are inadequate, we don't often compare our financial status with friends or family, and even less our income, debts, age, professional level and future thinking (or retirement plans), etc. Firstly because socially it is not something normal, secondly, because we would have to consider too many variables to have an ideal reference. In most cases, we apply simple rules of saving such as setting aside a percentage of our income.

We will now see how we can overcome cognitive biases by showing solutions from financial institutions around the world.

Three main solutions based on behavioral economics developed in the financial sector to remove barriers to savings:

1 Make benefits tangible

One of the most common practices in banking or savings apps is to create short-term goals. Instead of saving for retirement, which may seem like a too faraway goal, sub-accounts can be created with more tangible goals such as a vacation or the purchase of a new guitar.

When goals are closer and more feasible, we are more likely to reach them. Think, for example, of having to run a marathon in six months. It may seem like a titanic task, but if the goal is to run one kilometer tomorrow, two the next day and so on, the challenge is suddenly perceived as easier.

When communicating the benefits of savings, it is also important to use objective data that conveys possible future needs. We have seen that it is difficult to project the future, so let's bring it into the present. Indicators, such as what it may cost to live in twenty years due to inflation, may be a good way to do it. For example, if we want to make customers be aware of the importance of investing some of their money, it would be good to make them think about how much some commodities, such as gasoline or the shopping basket, would go up compared with their salary. That way they will understand their problem and the tangible benefit that saving brings.

2 Ease the action

We have seen that saving is an effort for many reasons, including the overweighting of the present, our overconfidence in the future and the lack of tangible references. The solution to these problems seems obvious, although it is rarely implemented in the digital channels of the main financial institutions: ease the action.

To encourage the action of saving, banks can employ gamification, use action reminders and reward customers with additional benefits. These rewards do not have to be monetary; recognition in the form of a message or in the form of status levels can be a sufficient incentive.

Tripadvisor or Google, for example, reward users who write reviews by providing them with different status levels that do not infer any economic benefit. They are though enough for millions of people around the world to give their opinion about restaurants, hotels or tourist sites on a daily basis.

3 Provide references

Continuous feedback, remembering past achievements or using social references with peers is a very powerful tool when it comes to achieving systematic savings from customers.

Status Money, a company created by two "data scientists" in New York, uses these levers very well. It reinforces savings behavior with positive messages highlighting customers' achievements, and compares their spending and savings levels to their peers.

Impact obtained by applying behavioral economics in saving products:

+41%
average balance

"

Half of the millennials prioritize eating at good restaurants over saving for their future.

4 Behavioral Economics and loans

Uncertainty, perceived risk or the idea of indebtedness all may negatively influence customers in the evaluation of different financing options.

More specifically, customers have uncertainty related to the amount of borrowing and how it will impact their personal cash flow. They also have concerns regarding the loan purchasing process, often assuming that it is more complex and tedious than it really is.

> A loan is a way to realize a specific ambition, whether it is a vacation, a car or a home renovation; it satisfies specific wishes.

Customer desires may be big, but small barriers, such as insecurity, risk perception or the idea of indebtedness, cause customers to delay making a decision; or to even abandon the idea altogether.

These barriers are often strengthened by the lack of references and knowledge about the amount that should be requested. Customers are usually not well-informed about the ideal loan configuration considering their personal financial situation, for example, whether it is better to use a part of their savings to complement a loan, and, if that is the case, how big that part has to be.

All this is added to the fact that a large number of customers are unaware of the specific characteristics of the product and the details of the process. They often assume that it is more complex and tedious than it really is, increasing distrust and slowing down consumption.

Behavioral economics has an explanation to understand two of the main cognitive aspects that block customers in these types of processes:

Loss aversion

Loss aversion is a cognitive bias that is well illustrated by the following example (Kahneman D. Tversky A., 1979):

> Imagine that you can choose from one of the following options. Which one do you prefer?
>
> A. 50% chance of going on a three-week vacation
>
> B. A guaranteed week's holiday
>
> C. You have no preference

In this decision, many of us would choose option (b), despite the fact that option (a) represents the potential of a more favorable outcome, the 50% probability of going on a three-week vacation which would be 1.5 weeks, therefore having more time to enjoy a paradise beach than the safe week of option (b).

However, the fear of completely losing the holiday is psychologically twice as painful as the pleasure of winning a little more time.

People are therefore more willing to make decisions to avoid a loss than to make a gain.

Availability heuristics

Among the mental shortcuts we described in chapter 1, the availability heuristics is undoubtedly one of the most relevant. It describes how we judge the probability of an event happening in relation to the ease of coming up with an example or recalling an experience about it. If we think of a dangerous animal, the shark immediately comes to our mind, and dangerous shark movies or news are the cause of it.

In 2019, there were 4 deaths from shark attacks.

However, the cow is the most deadly animal, with 22 victims a year in the US. This makes sense when you consider all the interactions that take place between a cow and a human. But we do not recall this information easily.

What is required is right timing and increasing value perception in digital channels.

Customer transactional data can provide us with the required insights to communicate at the right moment. And by behaviorally designing the digital choice architecture, we can minimize attrition.

Behavioral communication

Customers do not want the loan, they need it to satisfy a specific desire.

Banks can complement propensity segmentation with behavioral segmentation to find out customer desires and focus communications on those. This hyper-personalization is key to activating the mental shortcut described previously: availability heuristics.

And how can banks do that? They can anticipate customer desires by identifying their financial footprints. If, for example, spending patterns, such as paying for driving lessons, buying a parking space or taking out a new car insurance, are very concrete clues that a customer may want to buy a car, the communication can be adapted or personalized accordingly.

Let's look at a more detailed example of a real project in which several spending patterns were identified and used to detect that a customer might go on vacation:

Choose a date

- We can assume that a customer will travel in the same season, so we will look for expenses abroad in the previous year.
- We can also identify expense peaks during vacation months.

Select destination

- Payment of at least a certain amount for plane or train tickets, or car reservations.

Book the stay

- Credit card hold or transfer of at least a certain amount with specific subjects such as "reservation," "hotel," "cruise" or similar.

Pay for tourist activities

- Transfer to a tourist or cruise agency.
- Purchase of tickets outside the country of residence.

Decision-making architecture

Customer preferences are not stable or preset; they are created at the time of the decision depending on how the options are presented.

There are many types of frames that can be designed in order to influence the decision in a loan purchasing process. Some examples:

- Simulate the product with more focus on the instalment when the total amount is low
- Offer predefined loan recommendations with the most requested configurations
- Include value-added products, such as payment protection insurance in order to create a premium loan

When creating digital journeys, it is more important to reduce cognitive friction than to try to shorten the process by reducing the number of steps.

Impact obtained by EYP applying behavioral economics to loans

+36%

digital conversion

5

Behavioral economics and insurance

We tend to overestimate the probability that everything will go well and therefore protection policies are not perceived as necessary.

Due to the lack of differentiation between insurance products, the product is often perceived as a commodity and price becomes the main driver of the decision.

The complexity of certain insurances and the technical language often used to explain the cover has a negative impact on how the product is understood and valued.

Overconfidence

Overconfidence is responsible for the fact that, according to surveys, 93% of people believe they are a better than average driver. It also accounts for 68% of university teachers believing they are among the top 25% best teachers. Regardless of the fact that these statistics are obviously impossible, they highlight the barrier that overconfidence causes when getting customers to protect their homes, their belongings or even their family.

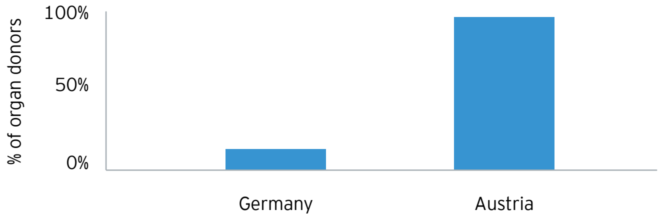
Insurance is the only product for which the customer pays for, but never expects to use, making it difficult to market.

Status quo

Status quo bias means preferring to keep things the same as they are by doing nothing or by sticking with a decision made previously. This can happen even when only small transition costs are involved and the importance of the decision is big.

The following chart shows the percentage of organ donors in two very similar countries, Germany, where being an organ donor is not set by default, and Austria, where it is when you are born.

Despite the similarity in both countries in terms of culture, very low percentage of Germans challenge the status quo and proactively volunteer for organ donation. Uncertainty about the process, the paperwork or just laziness are important barriers that prevent this action.



There are two fundamental cognitive biases to understand why many people remain underinsured.

Is insurance a commodity?

Customers tend to select more cover when it is offered in bundles and as good or better, or best cover – as opposed to highly customizable offerings where customers need to select every single type of cover on their own. The perfect scenario to satisfy all customer segments is to offer high personalization, but with proper guidance and advice which are critical to insurance sold via online channels.

Providing personalized recommendations to the most hesitant clients is key to eliminating overconfidence.

1. Enhancing value perception

To increase value perception, it is important to eliminate overconfidence by providing objective data, references and tangible examples. This information has an even greater impact if it is related to the customer's peers or their home area, or if it uses concrete examples related to the customer's day-to-day life.

In addition, it is necessary to offer advice for customers with doubts but also direct paths for informed customers. In other words, personalization and advice, yes, but only for those who want it. The advice must be capable of generating personalized recommendations for customers, something that is key in bank branches, where managers do not necessarily have to know about insurance but rather know how to sell insurance.

One way to enhance value perception and guide customers on digital channels to the most suitable life insurance is to include an intuitive profiling tool to identify their personal situation, assess their preferences through trade-offs and make a final recommendation. One of the outputs of this online advisory can be the recommended insured amount in the form of a monthly salary to make it more tangible.

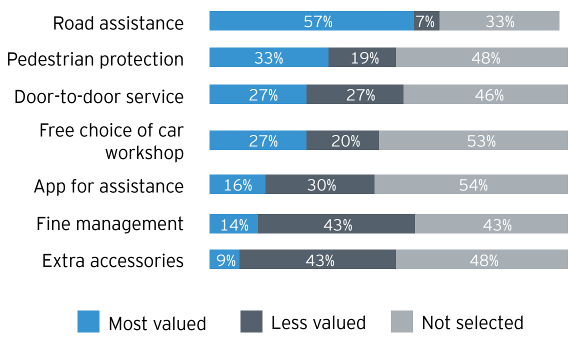
> "The most important cover that is offered is not always the most attractive feature. In car insurance, civil liability in case of an accident is very important, but road assistance is more attractive as it is perceived as something that is more frequently needed.

Adding value to the product means communicating the most valued and realized features, and leveraging on the servicing.

2. Adding value to the product

Differentiating insurance products on the basis of the most valued and realized characteristics means identifying why and how much the customer would be willing to pay for such products. This information can later be used in campaigns across all channels. There may be policies to cover far more serious scenarios, such as natural disasters, but which are perceived as less relevant and probable in everyday life. On the other hand, being protected against minor accidents, such as your child breaking a vase at home or spoiling the sofa, may seem more useful. This can be shown using a MaxDiff analysis as shown in the below chart:

Preferred features for car insurance customers:



Impact obtained by EY-Parthenon applying behavioral economics in insurance

+36%
sales

6

Behavioral economics and investments

When it comes to investing, there are many cognitive barriers that customers encounter. For example, there may be a misalignment between the investment profile and the reality of the market, which may cause a dissonance between the expectations and the final outcome of the investment.

Customers also tend to postpone taking action when there is a large and complex range of investment products to choose from. This is called paradox of choice.

Recommendations, news or success stories often guide investment choices as customers tend to perceive investments closer to home as safer, for example, stocks in their country of residence.

Finally, customers tend to disinvest when the stock market falls, even though the initial plan was a long-term investment.

If you had to decide where to invest, which of the following two options would be more appealing?

Will it be an affordable leather shoe producer founded in Leon, Guanajuato or a Silicon Valley company founded by Peter Thiel (ex-PayPal) and Hugo Barra (ex-Google) with a US$300m rating that creates sleep-tracking sensors?

We would probably associate the latter with higher profitability; however, it went bankrupt and the former is still expanding. The point is that the news and success stories of technology companies with high valuations tend to guide investor emotions when making decisions. This can even be to the extent that they feel they know those types of companies better, and so feel safer purchasing their stocks.

However, not only where we invest plays a key role here, how we do it is also relevant. And mental accounting is the key bias in this regards.

Mental accounting

Let's look at an example that illustrates this concept very well (Kahneman D., Tversky A.; 1979):

Imagine you're at the door of the cinema.
In what situation would you be most likely to walk in and see the movie?

You've lost the ticket you bought and have to go back to the box office.

A. You've lost the $10 you had on you for the ticket.

B. You have to buy it with your card.

C. You wouldn't mind one or the other.

For a perfectly rational person, the answer should be (c). However, the way in which we create mental compartments to organize our money and therefore our income and expenses makes us, in many cases, inclined to (b).

The reason is that we find it difficult to understand money as money and separate it from its origin or destination.

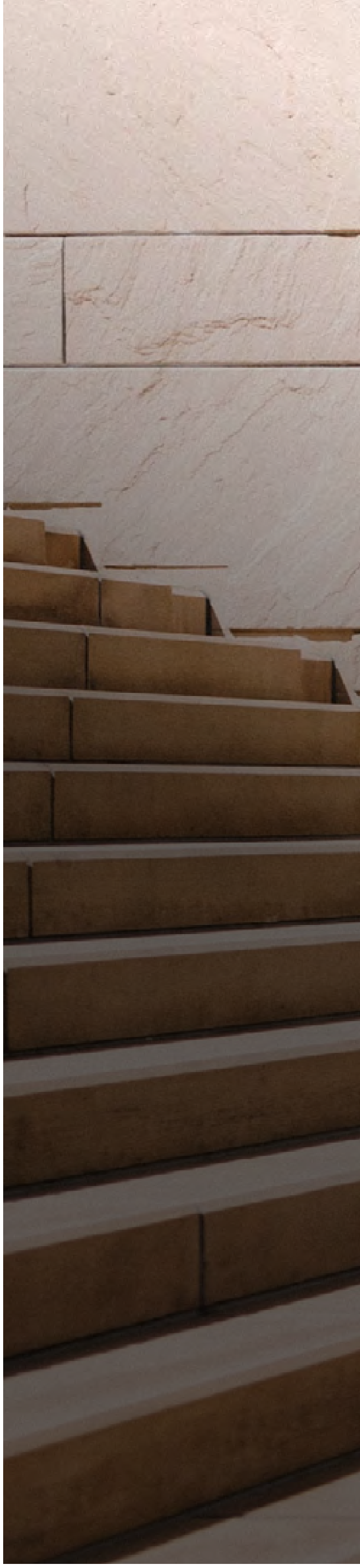
In the case of (a), we might be tempted to think that having already bought the ticket, the expenditure on seeing a film was already made and therefore buying the ticket again would be like paying double the price for it.

Would you spend your monthly salary and an extra bonus the same way? If the answer is no, why? It's money in both the cases.

In the case of investments, it often happens that customers tend to invest using these mental compartments, which can be translated into asset classes: the money we really need is placed on deposit, some other monies are invested in funds, hoping to get a higher return while assuming a bit of risk. And another small amount is invested in shares to "play" around with.

Next, we will see some practices to improve and boost investment behavior.

6 | Behavioral economics and investments



1 Facilitating choice, providing confidence

The way in which we present an offer can greatly influence preferences.

Redesigning the way investment products are presented to make them easier to understand and compare is imperative.

Showing limited options that reduce analysis paralysis or creating profiles that reduce search time are some of the initiatives that can be developed in this area. Limiting the options was, for example, a successful way to increase enrollment. of employees in the American 401(k) Pension Plan Program, as proved by an experiment conducted by Iyengar, 2003.

The gamification where the client accumulates points and status levels also helps clients who are not very familiar with investments to overcome the knowledge barrier.

All of these initiatives also have a significant impact on building customer confidence, especially in the retail sector, where interaction is often through digital channels and no specialized banker is available.

Invest-related Fintech constantly innovates in customer experience, trying to simulate human interaction in digital channels so as to overcome the ''loneliness'' of these environments. They also seek to incorporate the social component by showing where the most successful users are investing.

Other state-of-the-art apps perfectly combine these actions to facilitate choice and provide confidence through a gamified environment. In addition, the options are presented in a very clear way so that customers can immediately recognize the potential and value.

> “
> **Following up on investment purchases is key to encouraging repeat purchases and winning loyal investors.**

2 Follow-up after the investment

A timely and friendly follow-up after an investment purchase is necessary to win repeat business and loyal customers.

This can be achieved by, for example, developing monitoring systems, such as intelligent alarms or alerts that mitigate risk aversion and increase confidence, or by providing visual and easy-to-understand reports that clearly describe a customer's financial history.

7 Where to start

Applying behavioral economics does not only mean understanding the behavioral mechanisms but also adopting a way of employing them effectively. Each identification and validation of a mechanism starts from a hypothesis of human behavior that takes place right before a decision. It is followed by the setup of a study in the form of market surveys or other types of controlled tests. Numerous iterations are carried out until the results are statistically significant.

Finally, once the behavioral hypotheses are validated, they can be incorporated into product design or the definition of a customer strategy.

The role of behavioral economics has increased its relevance in large financial institutions, insurance companies, Fintech and Insurtech. In some cases with the hiring of well-known authors to lead this area.

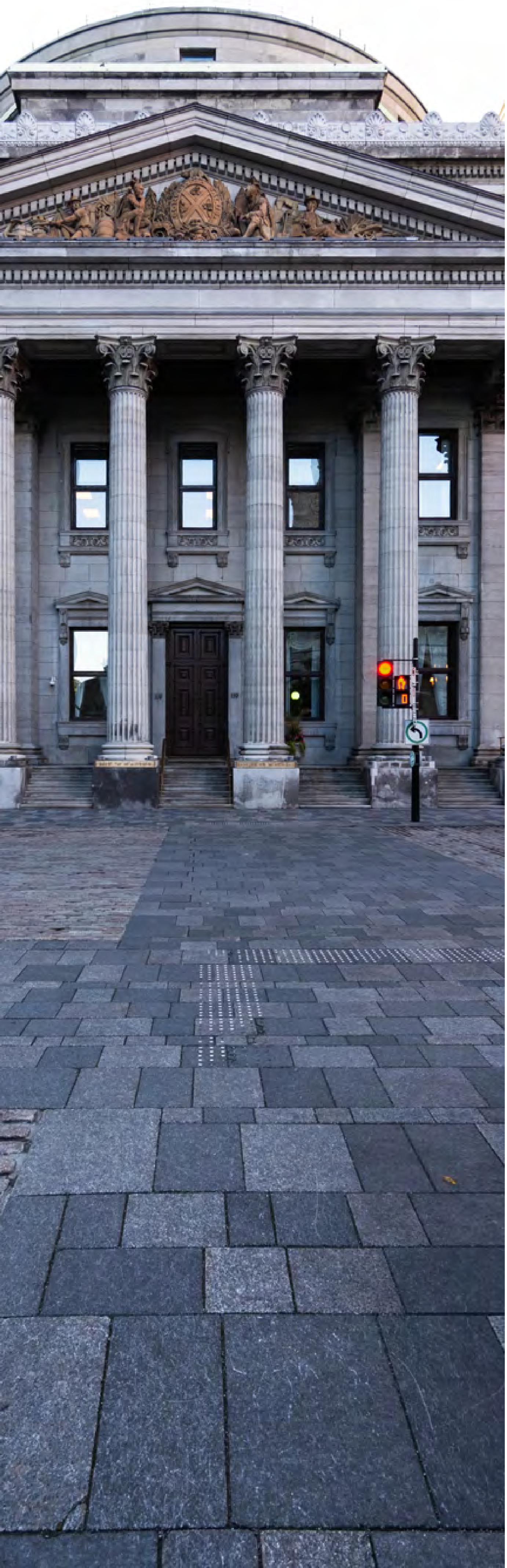
One of the main questions that large organizations face is where to start, which basically translates into where shall the financial institution allocate such a discipline or knowledge center. We have seen that the applications of behavioral economics range from pure commercial strategy to digitalization, product development or employee motivation.

The easiest way to answer this question is by understanding what the company's goals are. After the COVID-19 pandemic, several institutions are appointing a Chief Behavioral Officer to be responsible for the well-being of the employees, which is obviously a very ambitious goal. Other companies, however, may see the use of these techniques more as a completely customer-related topic and may want to start testing the approach and results in more agile ways, for example, setting up a specific team or scrum, to optimize the commercial impact of a specific product. This shall generate quick wins that can be used to create momentum or traction.

The following five success factor do not have to be taken literally by all organizations. Self-assessment plays an important role in determining whether these success factors will apply. This self-assessment needs to include the previously mentioned alignment of objectives, but also the available resources, the capacity to scale, the commitment of the top management team and the market dynamics.

Its five factors that make a difference when initially incorporating and expanding behavioral economics within an organization are the following:

- Involving the top management team from the beginning.
- Starting gradually.
- Understanding that not all employees have to be experts.
- Creating a structure that fosters collaboration across teams.
- Involving key people in the most important projects.



7 | Where to start

1. **Involve the top management team**

   It is crucial to have awareness at the top management level of the importance of behavioral economics, as well as sufficient support for its implementation. First of all, it is necessary that the top management team commits itself to focusing regularly on the importance of developing high-impact projects, training programs or even isolated initiatives in different areas. Secondly, they must set the direction and clearly define the positioning and goals of the initiative, such as how many employees need to be trained, what results are expected from its application or how many projects should be implementing the methodology in depth.

2. **Start gradually**

   A bank does not transform itself overnight, and the projects that are carried out by behavioral economics at the beginning do not necessarily have to be conducted with that aspiration. The ideal is to find an adequate balance between generating significant impact and not consuming too many resources. It is an initial stage in which it is essential to gain credibility internally. In EY-Parthenon's experience, high-income impacts can be obtained with projects lasting between two and three months.

3. **Understand that not everyone has to be an expert**

   While it is important for the entire organization to have notions of behavioral economics, not everyone needs to be an expert; its day-to-day application varies greatly from one business area to another — from accounting to risk, for example. For this reason, training courses of different levels can be designed, some of them can be for more than one day, others could be online. Also, depending on the area, not all teams will be equally involved in the projects, something we will discuss in the fifth point.

4. **Create a defined structure**

   After the agile restructuring of many banks, it is easier to expand behavioral economics to the different teams. Here, the key is to have a knowledge center and expert staff running the different projects within the multidisciplinary teams. Banks will need to identify how these experts engage with, for example, other scrum members such as the product owner or the user experience (UX) specialist.

5. **Involve key teams as much as possible**

   As we indicated earlier, not all the employees have to be experts, but those who carry out relevant projects do. Identifying the key people in the business, such as the Digital Transformation or Marketing Director, is fundamental. The same goes for the human resources area, where the training coordinator could be a major player in the rollout.

8 Conclusions

As we have seen throughout this document, behavioral economics has a place in almost every industry. However, it is in the world of financial services where employing the discipline has most potential.

Why? Because unlike other industries, financial products are unattractive, complex and sometimes difficult to purchase. In short, they are boring and therefore clients take shortcuts to make their decisions and reduce their cognitive effort.

Behavioral economics is the tool that can help financial institutions understand how clients behave and how they make decisions. Digitalization, boosting savings, facilitating credit access or eliminating cash — whatever the challenge banks have ahead, behavioral economics is more relevant than ever.

8 | Conclusions

> Nowadays, there is no doubt about the importance of behavioral economics. Several Nobel Prize winners endorse the theories and numerous empirical tests verify its results.

In the financial sector, the applications of behavioral economics are extensive, both for internal customers (employees) and external customers (clients). Applications range from creating more attractive career paths to improving business effectiveness across all channels.

Financial products are needed but not necessarily desired, as they are mostly unattractive and complex. There are numerous cognitive barriers that slow down customers' decision-making. In most cases, eliminating these barriers is more important than generating incentives to buy. Dan Ariely, one of the leading Behavioral Economists, uses the metaphor of a rocket. A rocket needs enough fuel to fly (incentives) but also not too much friction (barriers).

Behavioral economics knowledge and methodologies allow companies to rapidly investigate the cause of those barriers or frictions, and design effective triggers or incentives.

This will create a virtual circle in which customers are positively influenced to make better financial decisions, which has a consequent impact on their satisfaction, loyalty and, finally, to the organization's bottom line.

> "A rocket cannot fly without enough fuel (incentives), but neither can it fly with too much friction (barriers).
>
> **Dan Ariely**

Contacts

Manuel Pingarrón Díaz

EMEIA EY-Parthenon Financial Services Behavioral Economics & Commercial Strategy Solution Leader

Manuel.Pingarron.Diaz@parthenon.ey.com

Pedro Donoso Armada

Senior Manager

Pedro.Donoso.Armada@parthenon.ey.com

EY | Building a better working world

EY exists to build a better working world, helping to create long-term value for clients, people and society and build trust in the capital markets.

Enabled by data and technology, diverse EY teams in over 150 countries provide trust through assurance and help clients grow, transform and operate.

Working across assurance, consulting, law, strategy, tax and transactions, EY teams ask better questions to find new answers for the complex issues facing our world today.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation are available via ey.com/privacy. EY member firms do not practice law where prohibited by local laws. For more information about our organization, please visit ey.com.

About EY-Parthenon

EY-Parthenon teams work with clients to navigate complexity by helping them to reimagine their eco-systems, reshape their portfolios and reinvent themselves for a better future. With global connectivity and scale, EY-Parthenon teams focus on Strategy Realized – helping CEOs design and deliver strategies to better manage challenges while maximizing opportunities as they look to transform their businesses. From idea to implementation, EY-Parthenon teams help organizations to build a better working world by fostering long-term value. EY-Parthenon is a brand under which a number of EY member firms across the globe provide strategy consulting services. For more information, please visit ey.com/parthenon.

ED None
SCORE No. 001535-21Gbl

www.ey.com/en_gl/strategy