Investor Protection and Education Going Forward

What does it take to change behaviour?

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ECONOMIC PSYCHOLOGY AND INVESTOR EDUCATION

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[some of] THE CHALLENGING PROBLEMS
1. We don’t have stable preferences – rather, we’re context dependent
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higher life satisfaction!

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2. We’re **BLIND**
2. We’re **BLIND** to our OWN **blindness**
3. We want to be fooled!
3. We want to be fooled!

If you don’t fool me...
...I’ll do it myself!

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4. THERE IS A LARGE GAP BETWEEN INTENTIONS... AND ACTIONS!
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TROUBLE!!!
On one hand,

Financial markets are rough...

- a complex world where complex choices must be made
On the other hand,

human abilities are limited
ECONOMIC PSYCHOLOGY / BEHAVIOURAL ECONOMICS + FINANCIAL EDUCATION = COMPLEMENTARY WITH GREATER EFFICACY
ECONOMIC PSYCHOLOGY – 1881
[more recently Behavioural Economics, Behavioural Finance, Neuroeconomics, Applied Behavioural Science]

- interdisciplinary field – economic behaviour and decision-making
  → anomalies, distortions in perception, memory and judgment of data

- 3 Nobel Prizes in Economics:
  - 1978 – H. Simon → bounded rationality
  - 2002 – D. Kahneman → prospect theory
  - 2013 – R. Shiller → financial markets and bubbles

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EMOTIONS and IMPULSES are VERY powerful
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Not only GREED and FEAR...
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EMOTIONS and IMPULSES are FAR MORE powerful than REASON is

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THINKING IS A RECENT ACHIEVEMENT!
AND STILL RATHER UNSTABLE!
IT MAY ‘COLLAPSE’ ANY TIME...

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It is as if there were 2 of us in our mind!

hot self

impulses – fast

automatic

action

doer

short range

PSYCHOLOGY

cold self

ponderation – slow

reflexive

intention

planner

long range

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THIS IS WHY IT IS RELEVANT TO UNDERSTAND THE INVESTORS’ MIND

THUS, DESIGN [MORE] EFFICIENT FINANCIAL EDUCATION PROGRAMS FOR THEM

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btw, that includes protecting the investor against HIM/HERSELF as well!!!

fraud, scams, Ponzi schemes are not the only threats to be addressed...
The Homer Simpson* living [more or less] secretly inside us is always lurking...

* [or the chimp, or the baby – unfortunately, less often the Einstein... ]
It’s a tough struggle!
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we need all the help we can get!

the fantastic quartet

psychological insights +

financial education +

consumer protection +

regulation

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- investors are driven by major psychological forces

- and there are several implications resulting from these tendencies...
- investors are driven by some major **psychological forces**: 

- constant **search for comfort** and **relief** [from tension, distress, anxiety]
- investors are driven by some major psychological forces

IMPLICATIONS

- constant search for comfort and relief
  [from tension, distress, anxiety]

- If no immediate solution is to be found in reality → resort to illusions
- investors are driven by some major **psychological forces**:

- enormous **loss** and frustration **aversion**
- investors are driven by some major psychological forces

IMPLICATIONS

- enormous loss and frustration aversion

- In order to try and avoid losses → run more risks in the name of ‘attempting to recover what’s been lost’ [or is in danger of being lost] – while unaware of it...
- investors are driven by some major psychological forces:

- **uncertainty** and ambiguity are equally **hated**

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- investors are driven by some major psychological forces

IMPLICATIONS

- uncertainty and ambiguity are equally hated

- so simple perspectives and alternatives will be preferred – even when what they may yield does not amount to much – or worse, when they involve risk
- investors are driven by some major *psychological forces*:

- also **hated** → the very act of **making decisions**!
investors are driven by some major **psychological forces**

**IMPLICATIONS**

- also **hated** → the very act of making decisions!

- then **procrastinate, do nothing, push** the final decision to others [later on, to be blamed if it doesn’t work out...], or choose just about anything, **only to get rid of** [the distress caused by] the situation
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AS A RESULT...

bounded rationality
AS A RESULT...

and emotions riding again!
human abilities are limited

we’re VERY suggestible
...and gullible
...and vulnerable
human abilities are limited

**selective attention**
human abilities are limited

social pressure / herding behaviour
human abilities are limited

EXCESSIVE

pessimism...
human abilities are limited

EXCESSIVE

pessimism...

optimism...
human abilities are limited

EXCESSIVE

pessimism...
optimism...
self-confidence...

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human abilities are limited

EXCESSIVE

pessimism...

optimism...

self-confidence...

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human abilities are limited

euphoria
human abilities are limited

panic
human abilities are limited

problems **perceiving**
and **assessing** data
And we don’t have only optical illusions!

We also have **cognitive** and **emotional** illusions → they interfere with the ability to **judge** data
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HOW DO INVESTORS HANDLE ALL THAT?
HOW DO INVESTORS HANDLE ALL THAT?

- they simplify – all they can – and some more too, while perceiving and assessing data, perspectives, options

→ but... over the process of simplifying, precision is lost!

→ and inadequate choices may follow...

though their single wish is to always have everything work out as fine as possible!
And the root of all simplification is... emotional!
because this is the **first step** to judge all kinds of data: an **EMOTIONAL stoplight**!

- if seems **unpleasant** = good-bye! [disregarding consequences]
- if seems **pleasant** = welcome! [even when only an illusion...]

And this **automatic**, unconscious and rudimentary ‘**assessment**’ considers only the **short range**!
So, all these actual features of the investor’s mind ought to be considered when the goal is to change behaviour towards enhanced decision-making skills and better choices.
AND HOW CAN EFFECTIVE BEHAVIOURAL CHANGE BE ACHIEVED?

√ psychological limitations must be considered

√ accuracy in mental operations can’t be taken for granted
  - but emotions should, because they’re always present!
  - preferences are not consistent

√ the hot self and groups [herding is powerful!] are the targets
  - since they’re the actual doers most of the time
  - however, they’re not too good as far as learning goes…

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FINANCIAL EDUCATION + ECONOMIC PSYCHOLOGY: ‘DO’S’

1. clear language ✓
2. examples and narratives ✓
3. different delivery channels ✓
4. relevant, tailor-made and timely info on the psychology of economic behaviour and decision-making ✓
5. warnings against fraud ✓
6. careful maintenance and constant updating ✓
7. checklists ✓
8. multidisciplinary approach ✓
9. exchange experience ✓
10. specific formatting for different segments ✓
11. good timing – learning opportunities ✓
12. coherence ✓
13. crowdsourcing – investors ✓
14. internet and social media ✓
15. choice architecture ✓
16. ‘MANTRA’: KEEP IT SIMPLE ✓
   [a.k.a., the HUGE challenge here...]

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FINANCIAL EDUCATION + ECONOMIC PSYCHOLOGY: ‘DON’T’S’

1. getting carried away with jargons and abstractions

2. too much information

3. too many options

4. excessive complexity → HUGE challenge here...

5. ‘loose’ – i.e., out of context – recommendations & warnings

6. solely logical explanations

7. ‘one size fits all’

8. obsolescence

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BUT ONE THING IS FOR SURE:
IN ORDER TO ACHIEVE EFFECTIVE BEHAVIOURAL CHANGE...

...different strategies must be devised to move beyond the simple presentation of technical information and advice
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CHOICE ARCHITECTURE → NUDGE

- recent research line
- designing policies to help make those choices more successful → NUDGES → fool proof contexts

- strategies to encourage better decision-making by turning limitations into advantages – not compulsory! – with opt-out

- to qualify as NUDGE
  - low cost
  - simple
  - mass scale

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famous **NUDGE** to keep male public bathrooms more decent...

[Schiphol airport, Amsterdam]
What would your meal be like if it started like this?
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CHOICE ARCHITECTURE  →  NUDGE

And what if it started this way?
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CHOICE ARCHITECTURE → NUDGE

Or this??

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If the goal is to stay healthy and/or lose weight...

the *nudge*, here, has been to start with healthy options – though one could always skip them, and go straight to the greasy fattening stuff!

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Choice architecture is everywhere – and has been around forever...

- novelty:

CAN IT BE USED TO BENEFIT THE DECISION-MAKER?

i.e., investors

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For instance:

- In light of behavioural findings, start by analyzing the current choice architecture used by the industry and regulators.
  - what have investors been ‘nudged’ towards doing regarding practices, norms etc.?

- then, afterwards, discuss, test and consider what and how things could be changed wherever necessary.
CVM – Behavioural Studies Center – new! [NEC-Núcleo de Estudos Comportamentais]
- team of **behaviour** specialists: **economic psychology**, **behavioural economics**, **neuroscience**, **cognitive** and **social psychology**, **education**
- in light of **behavioural** studies, provide insights, suggestions, criticism, recommendations and technical support towards **enhancing efficiency and efficacy of educational policies**, as well as information and guidance for **investors**

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VERA RITA DE MELLO FERREIRA

VÉRTICE PSI  Psicologia Econômica – um vértice psicológico para pensar perspectivas, decisões, arquitetura de escolha e políticas

VERTICE PSI  Economic Psychology – a psychological outlook for perspectives, decision-making, choice architecture and policy

THANK YOU!

• Ph.D. in social psychology (PUC-SP), Economic Psychology independent consultant (policy-making: Behavioural Studies Center-NEC, at CVM, ENEF-National Strategy for Financial Education, NUMIP-Economic Psychology and Financial Education Interactive Center at the Brazilian Central Bank Money Museum, and other organizations), Lecturer (FIPECAFI), Psychoanalyst (Inst. Sedes Sapientiae)
• Speaker; Coordinator of economic psychology study and work groups
• Member of ICABEEP- The International Confederation for the Advancement of Behavioral Economics and Economic Psychology Executive Committee and IAREP-International Association for Research in Economic Psychology Representative in Brazil
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