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Strategic Obfuscation and Consumer Protection Policy in Financial Markets: Theory and Experimental Evidence

CCP Policy Briefing

Strategic Obfuscation and Consumer Protection Policy in Financial Markets: Theory and Experimental Evidence

BACKGROUND

- There has been a surge of interest in recent years in the behaviour of retail financial markets and how to improve market outcomes given consumers' incomplete understanding of these markets.
- There is evidence that firms may deploy strategies designed to take advantage of consumers' limitations: firms may choose to obfuscate, where 'obfuscation' refers to strategic actions designed to prevent some consumers from recognising the best offer.
- Possible consumer protection policies include education programmes designed to improve the financial literacy of consumers, a disclosure policy that forces firms to disclose all possible fees, and a cap on obfuscation possibilities such as limiting the length of the footer section of a credit card contract.

METHODOLOGY

- The authors investigate the question of whether policies to promote market transparency and to protect consumers are effective given that firms may choose to obfuscate.
- The focus of the investigation is on the impact of policies when the firms competing for retail customers differ with respect to their level of prominence in the market.
- The authors develop a theoretical model of the behaviour of firms and consumers and then empirically assess the validity of arguments by means of a laboratory experiment.

KEY FINDINGS

- The model reveals that more prominent firms have larger incentives to obfuscate.
- While prominent firms always choose maximum obfuscation, the obfuscation by less prominent firms depends on the degree of asymmetry in prominence and on the consumer protection policy: a lower level of asymmetry in prominence and a stricter consumer protection policy increase the less prominent firms' incentives to obfuscate.
- A consumer protection policy that limits the scope of obfuscation may be less effective than expected: the policy may have the intended effect on a prominent firm leading it to obfuscate less, but it may have the unintended effect on a less prominent firm of encouraging it to obfuscate *more*.
- The main implications of the model are confirmed in the laboratory experiment:
    - prominent firms obfuscate more frequently than less prominent firms; and
    - there is confirmation of the adverse effect of introducing the protection policy on the obfuscation strategy of the less prominent firm.

POLICY ISSUES

- Because more prominent financial institutions are more likely to obfuscate than less prominent ones, policy makers should design policies that target those firms when they are considering how to promote transparency in financial markets.
- Policy makers should be aware that consumer protection policies designed to promote transparency may backfire in the sense that they may increase the incentives of less prominent firms to engage in obfuscation strategies.

W: www.competitionpolicy.ac.uk
T: +44 (0)1603 593715
A: UEA, Norwich, NR4 7TJ

University of East Anglia

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- The authors' findings may also be applied to telecommunications markets and insurance markets where the complexity of decision-making is high.

THE CCP

The ESRC Centre for Competition Policy (CCP), at the University of East Anglia, undertakes competition policy research, incorporating economic, legal, management and political science perspectives, that has real-world policy relevance without compromising academic rigour.

FOR MORE INFORMATION

The full working paper (Number) and more information about CCP and its research is available from our website: www.competitionpolicy.ac.uk

ABOUT THE AUTHORS

- Yiquan Gu, University of Liverpool, yiquan.gu@liv.ac.uk
- Tobias Wenzel, Düsseldorf Institute for Competition Economics (DICE), Universität Düsseldorf, tobias.wenzel@dice.uni-duesseldorf.de