

170 newsletter



Financial Services Authority Informing consumers: product disclosure at the point of sale

February 2003

About this newsletter

This newsletter provides a summary of FSA Consultation Paper 170

This paper is particularly relevant to consumers and their representatives, and all firms who sell packaged products.

- You can download CP170 from our website – see details below

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- Phone our helpline on 0845 608 2372, quoting reference CP170
- Copies are available at £20 each
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Executive summary

Consumers in the market for retail investment products are at a particular disadvantage: the products are widely marketed, but they do not buy them often. The products themselves are often complex and opaque in the way they work. And while the returns on an investment can exceed those available from alternatives, there are also material risks that consumers need to understand and accept before they buy. So we set rules on the delivery of information about products – a disclosure regime – in response to this ‘information imbalance’ between customers and providers of financial services.

This Consultation Paper (CP) explains the measures we propose to introduce to improve the effectiveness of product disclosure for packaged products¹. This will help consumers make more informed decisions about what they are buying and the consequences of their purchase.

The current regime

The current regime was introduced in 1995 (1998 for non-life products²). At its core is the Key Features Document (KFD) which firms must give to consumers to help them make informed decisions and compare products before they buy.

The content of all KFDs is split into a number of sections. However, the detailed information disclosed will vary depending on the different type of product, and the quality of production and language used can also vary considerably from firm to firm.

KFDs also contain an illustration of how product charges affect what the consumer might get back. In many cases, mainly for life products, the illustration must reflect the particular consumer's circumstances. Firms may produce these illustrations in a document separate from the main text of the KFD.

The review

KFDs have had some success at a high level because their transparency about charges appears to have acted as a catalyst for firms to reduce the cost of their products. However, as a consumer information document, the KFD has been less successful.

1 Packaged products are: life policies with an investment element; personal pensions, including stakeholder pension schemes; units or shares in collective investment schemes; investment trust savings schemes.

2 Non-life products are collective investment schemes and investment trust savings schemes.

One of the key problems in the current regime is the fact that consumers do not read the KFDs they are given. Many rely on what they are told by advisers, or they confuse the KFD with marketing material and dismiss it.

Our November 2000 Discussion Paper (DP) *Informing consumers: a review of product information at the point of sale* signalled our intention to review the KFD regime, and offered ideas for discussion about what improvements could be made.

So, the main focus of our work has been to develop a document that consumers will recognise and be better motivated to read, and which, when read, is well understood. In addition, a significant aspect of making an informed choice is understanding what factors influence the suitability of a product. This issue is also central to our design of the new regime. We have sought to reduce the overall volume of information to be provided in the core document, and to focus on suitability and product costs.

In this CP, we give detailed feedback on the responses to '*Informing Consumers*'. In general, these were broadly supportive of our approach, although many respondents were concerned about the cost and upheaval of revising the regime when the industry faces other significant changes.

The paper also explains how the proposed new regime will act as the vehicle for the UK's implementation of the simplified prospectus requirements of the UCITS III Directive.³

We then examine the policy issues underlying the revisions to the regime, and set out the scope and detailed content of the new regime. Lastly, we explain our analysis of the costs and benefits of the proposals, and set out our reasons for believing our proposals to be compatible with our statutory objectives.

Summary of key proposals

Scope of the regime

The overall scope of the regime – in terms of the products to which it relates - will be largely unchanged, although we have slightly extended the circumstances in which product information has to be given (largely to comply with EU directive requirements). In this paper we also explain

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A UCITS is an undertaking for collective investment in transferable securities – broadly, a collective investment scheme or OEIC.

that we are still considering whether suitably tailored disclosure requirements for some classes of complex product not currently caught by the regime could help address the risks to consumers.

Changes to Key Features

The new regime will replace 'KFDs' and 'illustrations' with 'key facts documents' and 'examples':

- We will prescribe the front cover of the key facts document, and permit only limited provider branding (and very limited co-branding). We will also require the FSA logo to be shown with a 'regulatory message' explaining that firms are required to deliver the document.
- The structure and content of the key facts document will be prescribed and will differ in some respects between those for non-life products and those for life and pension products.
- Most of the information in the key facts document will follow a Question and Answer format in plain, direct language, using no jargon and simple sentence construction. For life and pension products, there will also be a checklist-style 'Quick Guide' designed to encourage the consumer to understand key product features relevant to their needs.
- The current illustration for life and pension products and the charges table in non-life key facts documents will be simplified to focus more clearly on comparability of cost information. This new set of information will be known as the 'example'. Firms will no longer have to give 'what you might get back' projections (except for pension products, to illustrate the 'buying power' of an accumulated fund). Pension examples will also include a 'today's money' income equivalent.
- We have also proposed a standardised way to disclose the 'critical yield' in relation to income withdrawal products. And we have proposed a new method for disclosing charges for derivative-backed 'guaranteed' products.

Product information vs full disclosure

The new rules make clear that we do not expect the new document to include all possible information about a product that a firm should

disclose to consumers. Full, clear, fair and not misleading product disclosure, with guidance on the matters to be covered and the timing of their disclosure, is still a fundamental element of the regime. But we recognise that less is more. Where necessary, firms should signpost where more can be found on topics not covered in the key facts text.

Consistency of approach

Ideally, we would have applied broadly the same approach to life and non-life products. But the requirements of the UCITS III directive have limited our ability to deliver a single set of changes.

So, we have designed the key facts document for unit trusts and OEICs to fulfil the SP requirements of the directive. This has meant that, while we could make sure that the SP information is provided in a consumer-friendly way, the key facts documents may still be longer than we might prefer. We are also unable to require the inclusion of material not prescribed by the directive.

Branding

We have developed a wider 'brand identity' for FSA-mandated material, based around the 'key facts' brand and logo. This is central to the identity of the product information document, but the logo can also be used in a wider range of contexts. This approach should make our consumer awareness messages about important information more consistent and effective.

Use of Reduction in Yield and its calculation

We have not changed the basis for price disclosure from the current 'Reduction in Yield' measure, although we propose a number of measures to improve consumer understanding of the message behind the figure.

We also propose a small change to the rules defining how RIY is calculated. The rationale for this is that the RIY should be a fair and consistent reflection of the effect of all the charges on a product's growth, to allow consumers to compare between product providers on a like-for-like basis.

Presentation of past performance information within UCITS documents

Our proposed rules and guidance will require a standardised presentation of a fund's past performance in key facts documents for schemes.

Suitability letters

Our research has shown that the 'suitability letter' is read and used effectively by consumers. So we intend to continue to require its delivery, but we will give guidance stating that it should be provided as soon as possible after the recommendation and with some minor additions.

Post-sale confirmation

In contrast with our experience on suitability letters, we have found no evidence that confirmatory post-sale product information improves consumer use, understanding or likely retention of the information. So we intend to remove the requirement to provide duplicate information post-sale.

The costs and benefits of change

The initial costs to firms arising from these proposals will be substantial: we have estimated them conservatively to be in the region of £100m for life product providers and £10m for non-life product providers. But the continuing costs of compliance with the new regime are unlikely to differ significantly from the current costs.

The system changes required to produce the new example will be particularly significant for life product providers. The one-off costs may also impact more on smaller firms. However, we do consider that these changes are proportionate. In contrast, we rejected options such as greater personalisation because they were felt to be too expensive.

We have estimated the cost of unsuitable sales, which improved disclosure is designed to reduce. We found that for life products, benefits would exceed costs if as few as 36,000 unsuitable purchases a year were avoided over ten years from the start of the full regime. This is around 0.6% of the six million such products purchased a year. A similar proportion of non-life sales would bring benefits off-setting costs for those products.

We will propose substantial transitional relief to reduce some of the initial costs. This will be phased over three years by product type, beginning with non-life products and personal pensions. This approach delivers some of the benefits of the new regime early. It also promotes consistency within product type, so consumers will be able to compare like with like.

We consider these proposals to be compatible with our statutory objectives and the principles of good regulation. We expect the benefits

to be substantial and in the longer term to outweigh the costs. There is general recognition that current product information is not effective and we have good evidence to show that many consumers do not have an adequate understanding of products they have bought.

By improving consumers' awareness of factors affecting suitability, and the absolute and relative cost of products, we should reduce the number of unsuitable or poor value products bought. This will increase consumer satisfaction and confidence in the system (encouraging growth in the market for investment products).

Next steps - non-life products: further detail on the simplified prospectus/key facts document

The European Commission is currently facilitating discussions between Member States to agree a common approach to implementation of the simplified prospectus. This work is focusing on the description of the objectives and risk profile of a fund; the costs of a fund; and its past performance, and should be concluded by mid-February.

Therefore, while we set out in this paper our intention to apply a comparable regime to life and non-life products, we will need to publish a supplement to this CP on the detailed content of key facts for UCITS products in February/March 2003. This will have a shorter, eight-week consultation period, to reflect the outcome of the EU discussions.

Delivery of the final rules

Based on the responses to the CP, we expect to make our final rules in July this year, with a transitional period of one year for non-life products, and phased transition over three years for life products.

Consumers

This paper will be of interest to consumers. The issues it discusses relate mainly to the consumer protection and public awareness objectives.

In the paper, we set out the measures we propose to introduce to improve the quality of information firms provide to consumers about life policies, personal pensions including stakeholder pensions, unit trusts, investment trust savings schemes and other retail investments.

We, the Financial Services Authority (FSA) invite comments on this consultation paper. Please send them by 2 May 2003 by electronic submission using the form on our website at:

www.fsa.gov.uk/pubs/cp/cp170_response.html

Alternatively, please send comments in writing to cp170@fsa.gov.uk or to:

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It is our policy to make all responses to formal consultation available for public inspection unless the respondent requests otherwise. The names of all non-confidential respondents will be published.

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