Financial Services Authority

Financial Promotions: taking stock and moving forward

February 2005

Contents

1 Introduction

Financial promotions have always been a particular risk area for consumers – they play an important and influential role in how consumers make decisions. But because consumers may not have a sufficiently complete understanding of products, and of the risks associated with them, consumers may be misled by financial promotions.

Recognition of these risks to consumer protection, combined with instances of mis-selling in which financial promotions have played a part, led to our decision to increase our resources and focus on financial promotions, as announced in our 2004/05 Business Plan.

We have seen some improvements in financial promotions over the last few years, and we recognise the considerable efforts that many firms have put into complying with our rules. However, there is still more to do to encourage compliance with our requirements, and our responsibilities now extend to new areas such as mortgages and general insurance.

We are aiming for a financial promotions regime that balances consumer protection with firms' need to promote their products effectively. We do not want to stifle innovation or restrict competition and we are aware that consumers are bombarded daily with thousands of advertising messages, so financial services firms have to differentiate themselves to attract consumers' attention and encourage them to buy their products.

We want to avoid introducing more detailed rules, for example for specific products or media. This is particularly important in the area of financial promotions as products, marketing techniques and media are constantly evolving. We also do not want to constrain the ability of firms to innovate and to remain competitive.

Our financial promotions work forms part of our overarching theme of Treating Customers Fairly (TCF). Our work here puts emphasis on firms treating customers fairly throughout the whole lifecycle of a product, from design and marketing through to the end of the product life. Our work on financial promotions is concerned with the early stages of this process. We want firms to consider, when preparing promotions:

- whether the material is clear, fair and not misleading;
- whether it provides a balanced picture of the product or service;
- whether the marketing matches what the product or service delivers;
- whether they have identified and understood their target audience; and
- whether the promotions will be easily understood by their customers.

This paper sets out:

- how we have progressed against the objectives set out in our 2004/05 Business Plan, and our approach to regulating financial promotions (Chapter 2);
- some of our major concerns about promotions and systems and controls. We also describe the initial outcomes of some of our theme work (Chapter 3); and
- how we will continue to build on our work reviewing promotions, visiting firms and communicating with the industry. Challenges we face in 2005 include mortgage regulation, the new general insurance regime, and preparation for the implementation of the Markets in Financial Instruments Directive (Chapter 4).

This paper builds on and adds to our April 2002 paper – *The FSA's regulatory approach to financial promotions*. We plan to keep our stakeholders – the industry, trade associations and consumers – updated on our work in these and other areas by regularly updating the forthcoming financial promotion pages on our website and by issuing regular bulletins.

CONSUMERS

This paper may be of interest to consumers as it sets out how we are seeking to improve the quality of information provided to them at the beginning of the buying process. Any improvements to financial promotions will increase consumers' ability to make decisions that are right for them.

All firms and others must have regard to the requirements that apply to them in the Financial Services and Markets Act 2000 (FSMA), the secondary legislation made under that Act and the rules in the FSA Handbook. Under FSMA, we are given the power to give guidance – and we do so extensively in the Handbook. We call this 'general guidance'. We also give guidance to particular firms in their particular circumstances – 'individual guidance'.

The information given in this paper is for information purposes only, and is not intended to be guidance in either of these two senses.

We hope that the material in this publication will be of general interest to firms in preparing their financial promotions. While the paper uses illustrations and provides information on only a limited number of promotions and products or services, this is not the limit of our focus. All firms should be aware of the requirements for their financial promotions in the Handbook.

2 Progress and Approach

This chapter sets out our progress since April 2004. This includes:

- how we have progressed against our Business Plan objectives; and
- our preparation for the new mortgage and general insurance regimes.

Business Plan 2004/05

In last year's Business Plan, we said we would aim to take several actions relating to financial promotions. These were:

- setting up a new department to:
  - – expand our monitoring activities to include television commercials;
  - – have a general focus on direct offer materials;
  - – visit firms to assess their systems and controls over financial promotions;
  - – improve communications with all stakeholders;
- building on previous 'theme' work, including regional newspapers and television commercials and carrying out further work;
- setting up a Hotline so consumers and regulated firms can report misleading financial promotions to us; and
- working with the industry to explain and prepare for the new mortgage regime.

Below, we report on our progress on each of these.

The approach of the new Financial Promotions department

The new department was created in April 2004. We recruited heavily from April to August, and we now have a department of around 30 staff.

We regulate financial promotions by:

- regularly **reviewing** promotions in the press, on television and on the internet;
- **investigating** complaints made to us by members of the public and firms concerning material that they feel is not compliant;
- **assessing** firms' systems and controls through visits;
- **communicating** with the industry and consumers about the work we are doing and what they can do to help themselves and us; and
- taking appropriate **regulatory action** where firms do not comply with our rules, either with regard to the content of the financial promotions, and/or with regard to the firms' systems and controls.

To achieve our aims effectively, we work collaboratively with other relevant areas of the FSA. For instance, we are in close contact with the supervisory areas: they can consult us on financial promotions issues and we approach them before contacting a firm. This means that, from a firm's perspective, any approach by the Financial Promotions Department has been coordinated through that firm's supervisor.

We work predominantly in a thematic and risk-based manner: we examine particular areas in depth, and then use a range of tools to resolve any issues.

Themes might relate to:

- specific products – for example, products that are new to regulation, or that are particularly complex or risky, sold in large volumes or that have recently generated large numbers of consumer complaints;
- a particular sector of the market – for example, one that has recently undergone changes, has begun marketing to the public, uses a particular method of distribution or has generated public concern; or
- a particular medium – for example, sales through websites, or on television.

Some of our past thematic work, such as that on baby bonds, pension unlocking and spread-betting has resulted in us issuing a 'Dear CEO' letter to the relevant firms. In each case, the Dear CEO letters highlight our concerns and issues that firms should address. For more information on these, please refer to the Dear CEO letters on our website. You can find the outcomes from some of our more recent thematic work in the next chapter. We expect to be able to report on more of this thematic work on our website and through other communications on a regular basis.

Reviewing promotions

We monitor financial promotions through a combination of proactive and reactive work.

We recognise the need to ensure the increased resources are used effectively and efficiently, and are directed where most required. In light of this, we follow a proactive risk-based approach to our review of financial promotions. We focus our resources on areas with the highest risk to consumers, with the greatest potential or actual impact. We use a variety of sources to analyse the areas we should focus on. As well as the risk-based work, we also maintain proportionate coverage of the whole market.

The intelligence through which we determine where to focus our resources includes our own assessments of the market; our own monitoring; and information from elsewhere in the FSA as well as from firms, consumers, and other interested external parties.

We regularly review various sections of the press, industry publications, television promotions and internet sites.

Reactively, we also follow up any information provided to us by firms or consumers about material they consider to be misleading. We look at every case that comes to us in this way so long as it relates to a promotion that falls within our remit. If the promotion is not within our remit, we will pass it on for consideration by one of the other regulators, such as the Advertising Standards Authority or the Office of Fair Trading.

If we find a promotion that we believe does not comply with our rules, we will decide whether to take action based on the seriousness of the breach and the likely risk to consumers. If we decide to pursue the case further, our first action is to communicate with the firm involved to set out why we consider there has been a breach. Following this, there are a number of possible outcomes; we may use one or a number of these. We may:

- accept the firm's position on why it believes the promotion is compliant;
- ask the firm not to issue the promotion again;
- ask the firm to amend the promotion, or withdraw it (if a firm does not agree to withdraw the promotion, we can vary the firm's permission or seek an injunction to require it to withdraw the promotion);
- if we believe there has been actual consumer detriment, or that consumers have bought the product or service on the basis of a non-compliant promotion, we may ask the firm to offer remediation to these consumers possibly by allowing consumers to withdraw from the product without penalty, or by offering compensation;
- refer the case to our Enforcement Division to issue a 'private warning' or for further investigation and possible disciplinary action – which could result in a number of outcomes, including public censure or a financial penalty.

This work has resulted in a number of enforcement actions, including private warnings or the imposition of a financial penalty. The most recent include:

Axa Sun Life was fined £500,000 for producing misleading promotions which did not provide customers with sufficient information about how the product worked or the risks involved. The design, content and format of the promotions focused attention on the benefits of the products including the offer of free promotional gifts, but gave less prominence to key information about the risks. Some of the advertisements also included comparative data that was inaccurate.

Cantor Index was fined £70,000 for running a misleading campaign promoting spread-betting. The company's senior management failed to ensure there were adequate systems and controls in place to ensure that its promotions were systematically monitored, which led to some promotions being issued without adequate risk warnings.

Hemscott Investment Analysis was fined £50,000 for the production and distribution of misleading financial promotions. A promotion using the slogan 'We even make a bear market all soft & cuddly' had completely by-passed Hemscott's approval procedures and selectively quoted past recommendations by the firm, using only the best performing recommendations rather than a cross section of all recommendations. This provided a distorted picture of the firm's service.

Assessing systems and controls

We visit firms to examine their strategies, policies and processes for producing promotions, from product development to marketing, and to establish how effective these processes actually are. We also identify examples of good and bad practice, which we intend to share with the rest of the industry.

While at the firm, members of our team interview staff in various areas – from marketing to compliance – as well as senior management. The team might also review the operation of the firm's processes to see whether they are adequate by carrying out 'walk through tests' and/or by reviewing a firm's records. This gives us a clear understanding of the systems and controls in place and how they are implemented. In Chapter 3, we set out some areas of specific concern and questions that senior management should consider. Of course, as with all areas of our regulatory regime, it is the responsibility of senior management to ensure that their firm has compliant systems and controls in place and that they are being properly implemented and operated.

We identify which firms to visit through theme work, the supervisor's risk mitigation programme analysis, or when problems with published promotions suggest there may be systems and controls issues at a firm.

Communicating

We aim to increase our stakeholders' understanding of our expectations; to increase our understanding of firms' and consumers' interaction with the regime and to ensure we apply it effectively.

We are achieving these objectives through a variety of means: for example, by meeting with firms, trade associations and other regulators to discuss the issues they are having with the regime, and to see how we can respond to those issues and what help we can give firms to enable them to comply with our rules. We want to use the information gained from our risk-based work to provide examples of good and bad practice for firms. One outcome of that is us providing more information on our industry website. The new financial promotions pages on our industry website will be available when the FSA re-launches its website shortly and we will continue to develop it as new issues and questions arise. We are also keen to increase our communications with consumers. We are improving our consumer webpages and our bulletins, which we issue periodically – we published the latest edition in December 2004.

We aim to help firms help themselves and to provide as much information as we are able. However, at no time will we provide a pre-vetting service for firms, nor will we provide comments on individual promotions sent to us.

Financial Promotions Hotline (08457 300 168)

We launched the Financial Promotions Hotline on 6 July 2004. It is a dedicated phone number to encourage both consumers and firms to report promotions they believe to be unfair, unclear or misleading. Consumers and firms can also report promotions through our website. From the launch until the end of 2004, we received 164 reports to the Hotline or through the website on financial promotions.

The calls have covered a variety of products and issues. When the mortgage regime was introduced, we experienced a significant increase in the number of calls to the Hotline, suggesting there is a good level of awareness of it. We are currently looking at ways to maintain and increase this level of awareness.

The new mortgage regime

We began regulating mortgage promotions on 31 October 2004, which brought new challenges. In comparison to our existing work on the promotion of investment products and services, the promotion of mortgages takes place across a much wider range of media and has an impact upon a much greater number of consumers. For instance, mortgage lenders and intermediaries make much greater use of television advertising than investment companies do. Press advertising is also much more widely used, including in national tabloids and in regional and local newspapers.

As many of the newly authorised and approved firms are new to FSA regulation, we put considerable effort into communicating requirements and expectations in the run up to October 2004.

The new general insurance regime

The promotion of general insurance products poses some different risks from those associated with the promotion of investments and mortgages. We have taken this into consideration when deciding on our overall priorities.

We have been doing some initial work on looking at the type and style of advertising that takes place in the general insurance market, and the types of products and sales volumes – with a particular focus on the role of intermediaries. From this, we will gauge the relative risk to consumers of the promotional activity of one product over others. All of this will inform the theme work that we will carry out during 2005.

Some facts and figures (April 2004 to December 2004)

Cases

We have reviewed many promotions across a wide range of media during this period. Of the cases we have looked at, we are pursuing **162** of them with the firm involved. In addition, in **44** of the cases we have concluded, we asked the firm concerned to amend the publication. In a further **8** cases, we asked the firm to contact customers who had bought the product, offering them the opportunity to withdraw at no cost if they thought that they had been misled. We decided to take no further action in **64** cases.

Other thematic work

As well as our general monitoring, we concentrated on some specific areas, which resulted in follow up casework, including:

– websites – **30** reviewed, resulting in **6** cases;

– television and radio promotions – **20** reviewed, resulting in **5** cases;

– direct mail promotions – over **50** reviewed, resulting in **14** cases;

– branch leaflets – **30** reviewed, resulting in **2** cases; and

– promotions for Guaranteed Equity Bonds – **20** reviewed, resulting in **4** cases.

The cases arising from theme work are included in the overall figures.

Visits

We have carried out a total of **16** visits. Of these, **3** were general fact-finds or were conducted as part of our usual supervisory visits. We visited **7** firms as part of our thematic work on spread-betting and equity contracts for differences; **6** firms were visited as part of our thematic work on Child Trust Fund providers.

3 A summary of key issues

The rules on financial promotions are contained in our Conduct of Business Sourcebook, Chapter 3 (commonly referred to as COB 3). On 31 October 2004, the mortgage regime came into force with a new distinct set of rules for all authorised firms who wish to promote mortgage products. These are contained in the Mortgage Conduct of Business Sourcebook, Chapter 3 (MCOB 3). As these differ, some of the sections of this chapter will distinguish between issues relating to COB 3 and MCOB 3. We will cover our approach to general insurance promotions, as set out in the Insurance Conduct of Business Sourcebook, Chapter 3 (or ICOB 3), in force from 14 January 2005, on our website and in forthcoming bulletins.

None of what is contained in this chapter is new. The rules and guidance for investment products have been in place for some time and therefore firms should have been complying with these rules. However, as we have developed and undertaken the activities described in the previous chapter, we have collected a significant amount of information on promotions and on systems and controls that we consider to be non-compliant. Our aim in sharing this with the industry – through this publication, our website, Dear CEO letters and other communication initiatives – is to help rectify this situation and help the industry comply with our rules. However, none of these initiatives provide safe harbours for firms – as products, services and the material that promotes them are too varied. It is always the responsibility of the firm's senior management to ensure that promotions are compliant.

As part of our commitment to inform the industry, in this chapter we provide an overview of the key areas. More detail will be available shortly on our website. First, we set out our recent concerns relating to promotions falling under the COB 3 rules, some of them general to all promotions and some arising from our thematic work. We then set out some of our initial concerns relating to promotions falling under the MCOB 3 rules. Finally we set out some of our concerns with firms' systems and controls, which apply to both sets of rules.

These concerns should be seen as a selection of our views. As we move forward, there are likely to be further areas of concern that we identify, which we will then communicate to industry.

In this chapter, we also present some questions for firms that senior management ought to focus on when considering financial promotions. We hope this will help firms comply with our rules. In the boxes there are some high-level questions that all firms can ask themselves. These are suggestions that are intended to help, and the lists are not exhaustive.

We have included some mocked-up examples in this chapter. Please note our discussion of issues regarding these examples may not cover all the potential problems in the examples, and complying with any positive suggestions set out in this paper and on our website will not in itself necessarily ensure compliance with the rules.

Not all of the financial promotions rules apply to all promotions. It is for firms to identify and apply rules in the Handbook which are relevant to any particular promotion.

Treating Customers Fairly – COB 3 and MCOB 3 – questions to consider

- Are your products and services designed for a particular market?
- Does your marketing match what your products/services deliver?
- Do you believe your target customers understand your marketing and other communications?
- Does your marketing development involve the right people outside the marketing department?
- Can your senior management monitor all of this, and does it do so?

Promotions – COB 3

General concerns

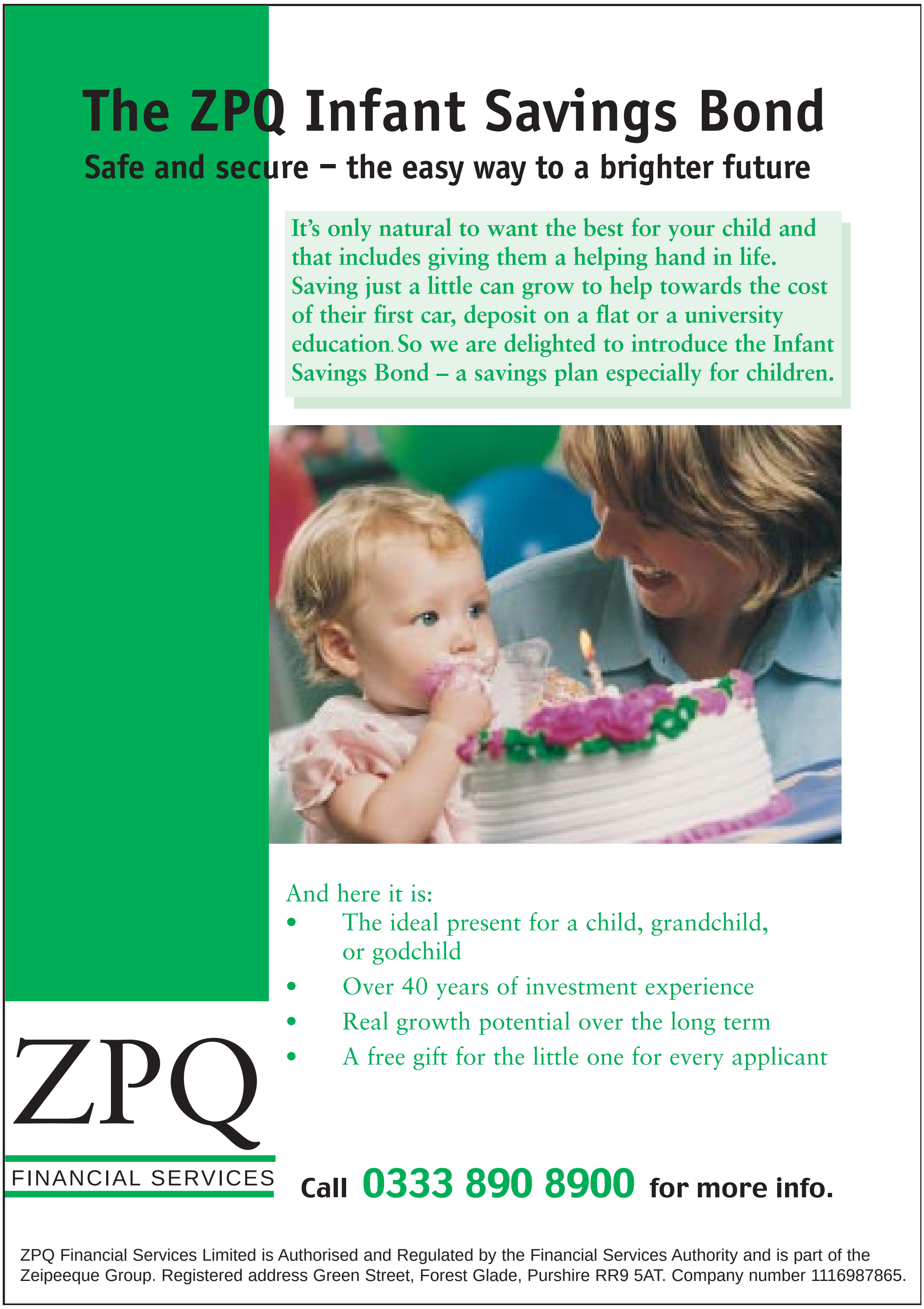
There have been issues that recur in many promotions we review, across sectors and media. These are the five most common ones. We have included two mocked-up example promotions that illustrate some of the points. More mocked-up examples will be available on our website at www.fsa.gov.uk, which we will be regularly updating with new information. These mocked-up examples are based on the results of our monitoring and thematic work, but are not intended to bear any relation to any individual promotion.

The points outlined below illustrate that we do not necessarily advocate long, detailed promotions. But our rules require – and we expect – products and services to be presented in a balanced and appropriate way.

1. **Clarity of product –** A financial promotion should clearly indicate what the product or service is. This may seem to be a basic and obvious point, but in many cases it is simply not clear. Firms should produce material that describes products and services in a way that is relevant and meaningful to their intended customers. It is not necessary, however, and in some cases not helpful, to describe the product in technical terms, as many customers will not understand such a description.

   Where firms are exposing the general public, as opposed to a limited class of investor, to a particular promotion they should not assume that the inherent risks of a product or service will be understood by all.

In the first example below, the product is described as a ‘savings bond’, and ‘safe and secure’. In some examples we have seen, there was no indication that the product would invest in the stock market and that any return would therefore depend on the performance of a market or markets, that returns would not be guaranteed and that capital would not be secure.



2. **Risk warnings –** Financial promotions should include a description of the risks associated with the product. We are often asked how much information on risks a firm is expected to include in a promotion. We require that financial promotions present a balanced indication of the product, but they do not necessarily need to be all encompassing – we do not expect every possible risk to be described in a short advert. The risk warnings should have sufficient prominence within the promotion and should not be buried in the small print or on the back page of a brochure, for example.

   Again, in the first example there is no indication of any risks, such as the fact that customers might get back less than they have invested, either during the term of the product, or at the end of it.

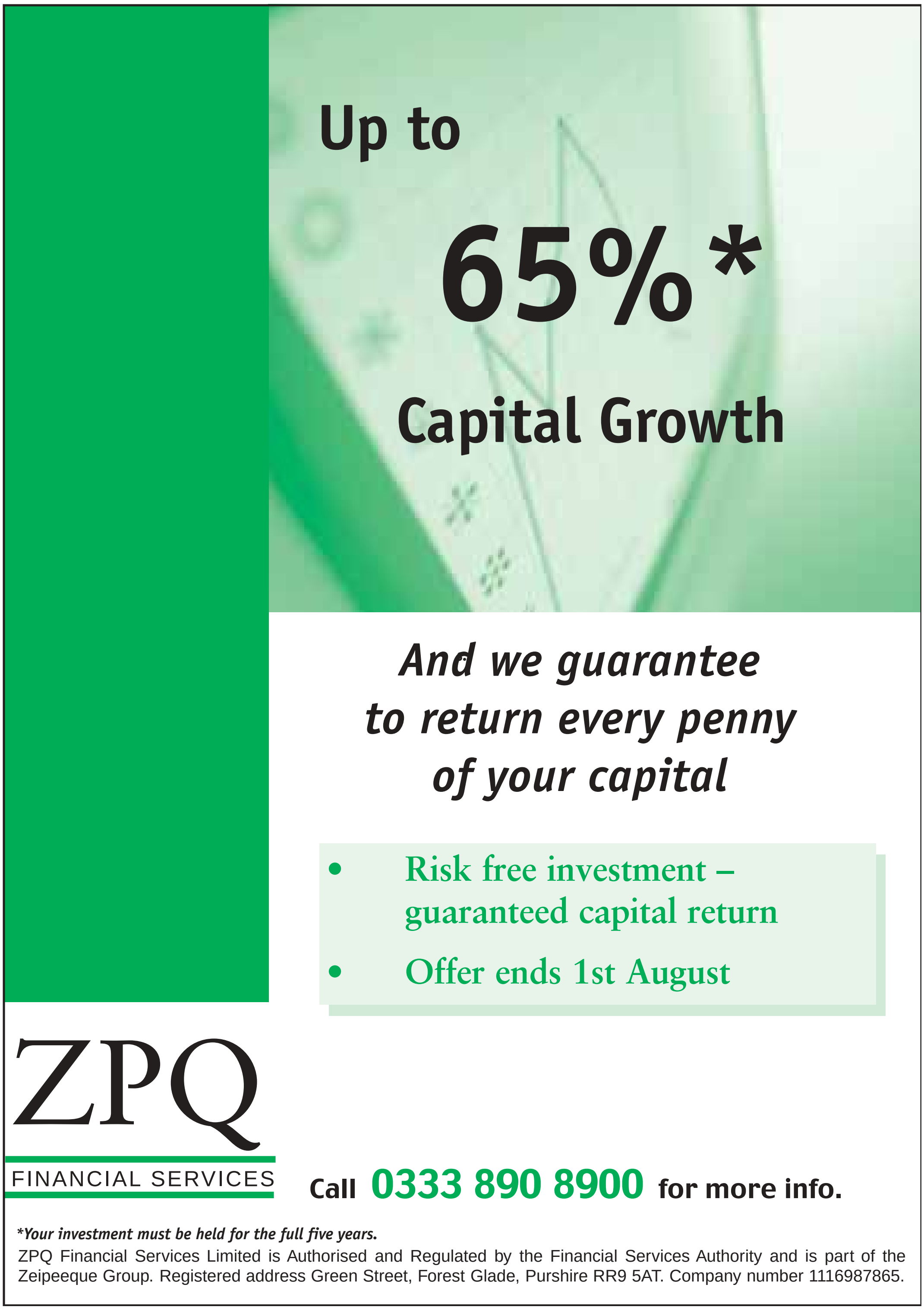
   Firms should also be aware that just because they may consider a particular risk warning to be the industry standard and we have not taken action against it in the past, this does not automatically mean it is compliant or that we will not take action in the future. Each firm should strive to comply with our rules, regardless of the actions of its competitors.

3. **Percentages and headline claims –** Unrealistic and misleading headline figures should be avoided. For example, headlines showing percentage rates that are only obtained if certain unrealistic criteria are met. In addition, headlines showing a prominent possible return should, where it is the case, clearly identify that this is a possible return that could be achieved over the period of the investment rather than annually. Consumers are more familiar with annual percentage rates when borrowing money or when saving in standard deposit accounts.

   In the second example, we consider that the headline claim of 'up to 65% Capital Growth' to be misleading if, as we have seen in some examples:

   - it is not made clear that the return quoted is over a period of five years, rather than annually (in the example below, it is explained in very small type towards the bottom of the promotion);
   - it is unrealistic, as it was based on a series of unrealistic assumptions, which are not mentioned in the promotion.

   We consider that the claim 'And we guarantee to return every penny of your capital' would also be misleading if, as in examples we have seen, access charges apply if the customer wanted to withdraw the money before the end of the five-year term.



4. **Misleading statements** – Statements should not mislead the customer into believing something that is not true, or highly unlikely. We acknowledge that headlines and statements are an essential part of the marketing message, but sometimes they play to customer misconceptions. For example, bearing in mind the nature of financial markets, it would usually be misleading to suggest that it is possible to take no risk and still

receive a high return or that it is realistic to receive a very high growth rate (as shown in the example above). Once established, these misconceptions are hard to dispel.

5. **Charges and early redemption penalties –** Firms' promotions must provide a balanced, fair and adequate description of the investment, the commitment and the risks. To ensure that firms meet this standard, they should consider the extent to which information about charges and early redemption penalties should be described, and with what degree of prominence. For example, suggesting that no charges apply where deductions are in fact made would be misleading.

   Further information on all of this, including further illustrations demonstrating the key points, will be available on our website.

Issues arising from thematic work to date

In the previous chapter we mentioned our thematic work, which involves looking at particular products, industry sectors or media in depth, finding out what the deficiencies may be in that area, and taking appropriate action as a result. Previous examples include pensions unlocking, spread-betting and investments for children, which all culminated in us issuing Dear CEO letters to the relevant industry sectors.

By way of further example, we set out below our findings for four of our recent themes.

As noted above, we are not advocating that balanced promotions should be long and detailed. So in a short advertisement, we would only expect there to be an indication of the key risks and drawbacks (to reflect the benefits being promoted); in a larger advertisement/brochure containing more detail about the benefits, we would expect to see commensurately more detail about the risks and drawbacks.

i) Website promotions

We have been reviewing regulated firms' websites for compliance with our rules. Websites may themselves be financial promotions, so should comply with our rules and contain the information required in any stand-alone promotion. Websites that allow consumers to buy straight from them may also constitute 'direct offer financial promotions' and so need to comply with the relevant rules in this area (see the next section on direct offer promotions). As well as exhibiting many of the general concerns set out in the previous section, we found other concerns relating specifically to websites. These included:

- **non-compliant past performance warnings –** we noted that some sites contain inadequate past performance warnings, and that some do not contain the warning on every page mentioning past performance; and
- **use of the FSA logo on sites –** some firms are using the FSA logo on their websites. Just as firms cannot use the FSA logo on paper promotions, they are not allowed to use it on a promotion in any other media. Firms are only permitted to use the FSA logo on letters or their electronic equivalent, which does not include websites.

Further details on this will be available on our website.

ii) Direct offer material

We have specific rules for direct offer promotions: the underlying reason for this is to ensure that consumers are provided with sufficient information to enable them to make an informed decision about engaging in an 'investment activity' (it is important to remember that 'investment activity' can range from investing in a product, to simply opening an account to trade at a later date). The direct offer financial promotion may be the only information the consumer receives before investing in a product or service, or it might be part of a chain of information.

Specific deficiencies we noted in some direct offer promotions included:

- **Balance –** some direct offer packs were not balanced. Direct offer packs may be treated as a single promotion, but that does not mean that information about the risks or the nature of the product or service can be put anywhere in the pack. We have seen a number of cases where significant risks are only explained in the key features document but the key benefits are outlined in the cover letter. Where this is the case, we would expect to see a balance of risks and benefits in the cover letter instead. As with all promotions, firms should ensure that messages about risks or drawbacks are not diminished or obscured by their placement in the pack. Firms will know which risks or drawbacks will be of greatest importance to their target market and should ensure that they are presented appropriately.

- **Target audience –** some direct offer promotions did not take account of the target audience and did not give explanations sufficient for their audience, or in terms their audience would understand. The more complex the product, the more difficult it may be to provide the information required in a way that allows the consumer to make an informed decision. The more financially sophisticated the target audience, the more reasonable it is to assume a level of knowledge.

- **Media –** communications should be adjusted accordingly, but some promotions did not appear tailored to the medium used. For example, because of the structure of websites, consumers do not interact with them in the same way as they do with paper promotions. While customers may flick through a brochure and read sections out of order, there is nonetheless a clear 'route' through the material and if customers follow this, reading the brochure from start to finish, they should receive all the necessary information in a coherent way. However, with websites, there is often no clear single route through the site and consumers explore it in a different way. Firms need to take this into consideration when developing their websites.

iii) Investments for children

Some firms are promoting investment products as a way of providing for the future financial security of children or grandchildren (for example, to help towards a first car, education fees, or for a deposit to buy a property). A number of firms are also promoting their Child Trust Fund products and many of the issues described below will also be relevant for those promotions.

Our key concern is that some promotions emphasise the benefits of the product without identifying, or giving a fair and adequate explanation of the nature of the investment, the commitment required, and the risks and potential drawbacks involved. Specific concerns we had with some promotions included:

- **Product description –** we noted that some promotions described the product as a 'savings plan', without also describing the nature of the product, for example, whether and how the investment is linked to stock market performance.
- **Risks to capital –** some promotions asserted that the product will provide a 'nest egg' or 'windfall' without making it clear that customers may get back less than they put in. Also, some promotions described the products as 'safe' or 'secure' when in fact there were risks to capital and/or no guaranteed return on investment, as these were investments in the stock market.
- **Comparisons with savings accounts –** some promotions compared the returns of the advertised product with those of a bank or building society savings account. Where such comparisons are allowed under the rules, they must refer to the relevant differences – including risks to capital, opportunity for greater certainty about growth and access to savings.
- **Tax claims –** some products were stated as being 'tax-free' or mentioned tax benefits, without being clear how tax is incurred on such a product or that the benefits may change in future.

iv) Capital secure structured products

We have reviewed a number of financial promotions for these products (sometimes called 'guaranteed equity bonds' or 'secure equity bonds'). As well as displaying some of the characteristics set out above, promotions for these products also had the following specific issues:

- **Access to capital –** some promotions did not indicate the existence of early encashment penalties or that the cash is locked up with no access for the whole period.
- **Explanations of product features –** we noted that some promotions did not adequately explain some of the features of the product. Firms should also consider what the implications of these features are for the customer. This includes explanations of: averaging, use of baskets of indices, capping of upside performance and the format of the starting and finishing indices. This is an important area because consumers may not appreciate that any return they receive (in five years, for example) may not be as high as they expected, or that they will only be able to access the money before the end of the period if they pay a charge. As with the other comments above, we are not advocating long, detailed communications – but we do expect promotions to present a balanced picture of a product in a proportionate way. So, for example, in a short 'teaser' advertisement in a newspaper, we would expect to see an indication of some of the potential drawbacks, with a much fuller and comprehensive explanation in the main text of the brochure/key features.

Producing a compliant COB 3 promotion – questions to consider

When producing a promotion, we expect all firms to take a step back and look at it from the perspective of the audience who will be exposed to it. As we have said previously in this paper, we acknowledge that different products have different risks and diverse groups of consumers have different understandings. With this in mind, firms should consider each promotion carefully in its own context.

- If the promotion is for a specific product or service, is it clear what the product actually is? For instance, is it clear what a consumer's money will be invested in? Is it in shares or a deposit? Is it clear what the product would do for the consumer and what need is being met?
- Does the promotion suggest the product or service is free of charge, when in fact there are charges?
- Are the returns quoted in the headline realistic? Or are those returns only available under strictly limited circumstances?
- Is the required commitment made clear? For instance, is the quoted return only available if the customer keeps their money invested for six years and any withdrawals before then will result in a lower return?
- What drawbacks need to be mentioned – for example, should it be clear what the penalties are for withdrawing the investment early?
- Are there any other drawbacks in the small print that should be in the main body of the promotion?
- Is it clear whether there is risk to capital? Will the customer get their original investment back, plus some income? Or is there a risk that they will get back less than they put in?
- Does the promotion mention any kind of guarantee? If so, is it easy to understand precisely what it is that is guaranteed? Is it actually fair to say that it is 'guaranteed'? Is it really a 'guarantee' in the sense that the customer audience might understand?
- Taking an overall view, is the promotion clear, fair and not misleading?

Promotions – MCOB 3

We have only recently taken on regulation for mortgage promotions – on 31 October 2004. The financial promotions regime has a wider scope than that for the rest of MCOB. Promotions provided by FSA authorised lenders for loans secured on land count as qualifying credit promotions and come under our remit. This includes second charge loans used, for example, for debt consolidation purposes.

It is still early days, and, bearing in mind many promotions were subject to transitional arrangements until the end of January 2005, we highlight below some of our initial areas of concern:

- **Use of the FSA logo –** unless your firm has an individual licence our rules only allow the FSA logo to be used in letters or the electronic equivalent. It should not be used in other promotional material.
- **Incorrect authorisation status disclosure –** some firms used a non-compliant description of their authorisation status in the qualifying credit promotion. The correct disclosure statements are prescribed in our rules.
- **APR –** some promotions did not contain the APR when one was required. Also, some promotions did not state the APR using the correct wording as prescribed in the rules ('The overall cost for comparison is X% APR'). In other promotions, firms did not make the APR prominent enough.

Which regime?

It is important to note that those promotions for loans that are not covered by MCOB 3 fall under the Consumer Credit (Advertising) Regulations 2004, which are enforced by the Office of Fair Trading and Local Authority Trading Standards Officers. Some promotions may cover products that are under both regimes – if so, the promotion needs to comply with both regimes. We will shortly be providing more information for firms on this.

Systems and controls – COB 3 and MCOB 3

Through our visits to firms, we have identified some common areas where firms' systems and controls relating to financial promotions are not of sufficient quality. Below are the areas which we see most often:

- **Procedures –** Some firms do not have robust procedures outlining how they ensure their financial promotions are compliant with FSA requirements. Where firms do have good procedures, sometimes in practice these procedures are not followed by staff.
- **Monitoring –** Monitoring by compliance and audit of the firm's adherence to the procedures can be irregular.
- **Senior management –** Some senior management require little or the wrong kind of management information about financial promotions. In accordance with SYSC (Senior management arrangements, Systems and Controls), we expect senior management to have a good understanding of the types of risks that can arise from the failures in systems and controls over financial promotions and how these can occur. We would expect senior management to be proactive in this area and ensure that procedures are adequate and effective and their staff adhere to them. We also expect them to have appropriate mitigation policies and processes including how they can factor back into the financial promotion design process any information they receive from complaints about their financial promotions.

- **Audit trails** – Some firms do not have good audit trails of how financial promotions are approved. The faults range from a lack of clarity on who approved the promotion, when it was approved, what corrections were to be done – to whether they were done at all and whether what is recorded on the file is the final document used. In addition, where a financial promotion includes comparison tables or quoted data from a particular day, sometimes there is no – or little – good evidence supporting the accuracy of the data on file.

Systems and controls – COB 3 and MCOB 3 – questions to consider

- Have senior management established clear strategies for marketing and the relevant systems and controls? Do they require and obtain good management information that alerts them to the effectiveness of their systems and controls and, conversely, risks?
- Are there procedures that are accessible, clear and are used in practice by those designing/approving financial promotions, in line with SYSC?
- Do these systems and controls adequately apply to electronic, as well as paper, financial promotions?
- Are there adequate controls to ensure that only appropriate staff issue a financial promotion or that a financial promotion is only issued after confirmation that it complies?
- Are there clear accountabilities for design/approval of financial promotions?
- Is the shelf life of financial promotions managed regularly?
- In the case of a promotion used over a period of time, can you be sure that it remains clear, fair and not misleading over the whole period?
- Are records adequate and complete?
- Are complaints analysed, looking for systemic or common failures from financial promotion related complaints and is this information factored back into your financial promotions processes?
- Is adequate training provided on the rules and processes for staff involved in designing and approving financial promotions?
- What positive steps are being taken to ensure that the financial promotion approval system is operating properly?

In this chapter, we touched on the areas of concern to us. We will go into more detail on all these subjects and more on our forthcoming webpages on the FSA website at: www.fsa.gov.uk. You will also find more example promotions and frequently asked questions.

4 Next steps

As part of our risk-based approach we have identified a number of areas which we will be examining in detail through thematic work in the coming months.

For COB 3, we are undertaking an initial review of firms' preparatory work for Child Trust Funds.

On mortgages, we are undertaking thematic projects on the promotions produced by the following:

- mainstream lenders;
- equity release providers and brokers;
- sub prime lenders and brokers; and
- debt consolidation lenders and brokers.

We are also conducting a review of mortgage networks' systems and controls.

Our early work on general insurance will focus on the promotion of those products that we believe might pose a relatively high risk to consumers – for instance, those targeted at the vulnerable, or where unnecessary cover may be being sold using inaccurate or false claims.

We aim to have information for stakeholders on the outcomes of these themes in the first half of 2005.

Our priorities for the second half of 2005 will be identified through our continuing analysis of risks in the market, to ensure our resources are focused on the most important areas.

To keep all our stakeholders informed of our progress and the outcomes of our work, we will be publishing a series of bulletins, including:

- a quarterly bulletin for firms that have to comply with COB 3;
- a quarterly bulletin for firms that have to comply with MCOB 3 and/or ICOB 3; and
- a quarterly bulletin for consumers.

We will also continue to update and develop our industry webpages, and we hope these will be a significant and informative tool for communicating with firms.

In 2006, the regulation of COB 3 financial promotions will be significantly affected by the implementation of the Markets in Financial Instruments Directive (MiFID). We are therefore conducting a review of our regulatory requirements in COB 3. For this, we will build on our experience in assessing the ability of firms to deliver promotions that are clear, fair and not misleading; our research into consumer understanding of communications about financial matters; and the approach to these issues taken in MiFID. We intend to re-examine the highly detailed and prescriptive approach we have followed in the past. We will aim for a new regime that is in line with our general preference for principles-based requirements that place responsibility securely on firms' senior management to treat their customers fairly. We will be working with our many stakeholders on this review.

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