

FINANCIAL PROMOTION - FSA EXPECTATIONS

During the course of this year the FSA has made it clear that firms must prioritise fair treatment for customers in developing their strategy for product and business development and in the marketing, selling and after-sales service provided for their products. Its Plan and Budget draws attention to the fact that it is strengthening its focus on firms' management controls in this area and expressly says that it has decided to sharpen the focus of, and significantly increase the resources committed to, its regulation of financial promotions in 2004/2005.

As a result, the FSA has established a new department to work on issues related to financial promotions, it will be involved in communications with industry, focused visits to firms to assess their procedures and financial promotions and, as appropriate, will be involved in remedial and enforcement action. In particular, it expects to be even more proactive than it has been to date - actively reviewing financial promotions wherever they appear, particularly those targeted at the retail consumer - for example, those on the television, on websites, in the press, in taxis and on the underground. As is noted below, recent enforcement action in this area has been as a result of such proactive efforts on the part of the FSA.

It is therefore essential that the senior management of firms ensure that their firm has considered and reviewed its strategy and culture in the light of the emphasis on fair treatment of customers. The FSA is particularly interested to ensure that firms have taken steps to mitigate the risks to consumers that can arise in product development and design, that they have addressed their use of jargon and selling practices as well as dealing with consumers after the point of sale and handling their complaints.

Firms should ensure, in this respect, that they have looked at the FSA Consumer Bulletins and read the Consumer Research that the FSA has published entitled Consumer Research 21 - Standardisation of Past Performance.

Recent financial promotion enforcement cases have shown the issues which concern the FSA. DBS Financial Management plc was fined £100,000 and had to return its customers money. It is noteworthy that the enforcement action concerned a single direct offer that was proactively identified by the FSA after a brochure appeared in newspapers. It illustrated issues that arise when judging whether a financial promotion is clear, fair and not misleading, in particular:

- it was a complex product with unusual features unlikely to be familiar to the target audience - nevertheless, it was not clearly described;

- there was a lack of clarity about the nature and limits of the capital guarantee and the early surrender penalty - bold statements in the brochure were contradicted by the small print;
- there were misleading claims about charges - with full detail at the end in small print;
- the projections and returns information was misleading.

In addition to the failings in the advertisement itself, the FSA was particularly concerned that these arose because of the inadequacies in internal procedures. Firms need to ensure that their procedures require a re-assessment of the entire advertisement prior to final approval and that, once compliance sign-off has been obtained, no changes are made. Too often, marketing departments and printers change formats or print size for reasons which seem good to them, but which may affect the compliance of the advertisement. Ideally, firms would check a printer's proof. It is also essential that firms keep a record of the grounds on which they consider an advertisement to be fair, clear and not misleading - particularly in relation to any aspects which are known to raise difficulties with consumers - again, understanding the FSA Consumer Research is key to this. Firms must also ensure that the persons responsible for approving financial promotions have proper training - they need to know not only the FSA Rules but also the issues that surround any particular product, legal, tax and commercial, so that they can form an overall assessment of what is being said.

Firms should also note that the enforcement action taken in relation to financial promotions has immediate commercial consequences - the FSA will often insist that customers are offered a refund and compensation.

If your marketing department appreciates this immediate detrimental commercial effect, it will be more likely to understand and co-operate with the approval process.

Chase de Vere plc have also been fined £165,000 for a misleading financial promotion and again, the case showed many aspects similar to that in the DBS case. (It is noteworthy that, as with the anti-money laundering fines, the level of fines seems to increase with successive cases on the same subject.) Another feature of Chase de Vere was that their financial promotion had been signed off by a compliance consultant. This illustrates that firms cannot delegate responsibility and that they use third parties to sign off on financial promotions at their own risk. Firms should consider if someone who is not intimately involved with the development of the product can really give a proper sign-off on a financial promotion.

The third and most recent fine has been issued to Berkeley Jacobs Financial Services Limited - of £175,000.

All three cases to date followed proactive identification of the advertisement by the FSA - in the case of Berkeley Jacobs, from a focus visit looking at business resulting from TV advertising campaigns.

Whilst no individuals have yet suffered enforcement action, this seems likely, in particular at a senior management level, if a firm has had previous warnings about inadequate procedures, if there is no evidence that the firm has recently reviewed systems and controls - if "unfairness" to the customer is institutionalised. In such cases the FSA will increasingly be expected to look to the senior management.

A particular concern of the FSA, on which specific rules have now been made, relates to the use of past performance information. Since 1st June firms have been subject to specific rules. In particular:

- past performance data must not be the single or most significant message being used to promote a product. You have to look at the effect and message of the promotion as a whole - the FSA have deliberately made this a subjective test - firms which use past performance information should therefore document their reasons for being satisfied that the information is not predominant;
- the information must not be presented so as to suggest it constitutes projection of possible future value, or that similar returns will be achieved in future;
- a past performance wording must be given legibly and in the main text. Again, it is for the firm to decide what is the "main text". The FSA's guidance suggests that where past performance information covers a number of pages, the warning should be on each relevant page - firms which ignore this guidance will do so at some peril, as the FSA is on record as saying it is not confident that sign-posting is an adequate measure to ensure delivery of the warning;
- the warning wording is not prescribed - this is deliberate - firms are meant to design wording appropriate for the type of promotion and target audience. Firms might like to look at paragraph 3.23 in Consultation Paper 132 which sets out some examples of possible wording.

There are additional rules on the use of hypothetical past performance information and firms which use it need to be very careful as it can only be used in extremely limited circumstances.

The FSA has also attacked the use of jargon. In guidance to the Financial Promotion Rules it specifically says that the use of terms that are ambiguous, or that the target audience is unlikely to understand, is not clear, fair and not misleading. Consultation Paper 132 gave examples of terms such as "quartile" and "decile" as being unclear and noted that consumer understanding of numerical information generally, such as percentages, is limited.

Firms should also be conscious of the extent to which information in a promotion is current. The FSA originally wanted to have guidance requiring firms expressly to state in a promotion that past performance information is out of date, if the period to which it relates expired more than three months before the date on which it is being read. This proposal was not adopted in the end - but be aware of the FSA's attitude. Firms should keep a record of why they are satisfied that any particular time period used by them does not produce a result that is unfair or misleading.

The FSA has had particular concerns about the use of past performance information in packaged products and the new rules require that, if past performance information is used in such financial promotions, then, whilst a firm may use its own presentation, it must also provide past performance information in a standardised format set by the FSA. Thus for regulated collective investment schemes and unit-linked life policies and stakeholder pensions, firms must show discrete annual returns for the five complete 12 month periods ending with the last full quarter preceding the date on which the firm confirms compliance. It must show the annual returns as percentages. The FSA like this approach because it shows volatility and when presented as a bar chart or table, is found by consumers to be easier to understand. For other packaged products, including conventional and unitised with-profits policies, the previous five years' information is required unless it is a fixed-term product, in which case, the performance over the whole period. It should be noted that past performance information, including hypothetical past performance information, cannot be used at all for a product in respect of which there is less than 12 months actual information and firms must indicate where actual performance information does not exist for a relevant period. The standard information must be no less prominent than any other past performance information.

Firms should also note that the FSA has emphasised that consumers are particularly likely to be misled by the use of monetary terms - although they have decided not to make formal guidance on this topic, they reminded firms to look at Consumer Research 21 - Standardisation of Past Performance - to determine whether it has any implications for their financial promotions.

Given the FSA's views, if a firm uses past performance information or benchmarks to compare deposits and equities, then it must make sure it makes it clear that, in risk terms, the

comparison is of "apples and pears". If you use monetary information then you should document the reason for being satisfied it is not misleading, showing an awareness of the Consumer Research on this point.

In the light of the FSA's proactive, high profile approach to financial promotions, all firms who are in the business of issuing financial promotions, particularly to retail customers, should consider carrying out a review of their activities. In particular, they should assess their prospective client base, the type of promotions they are likely to make and their systems and controls - identifying the higher risk products and forms of advertising (of which direct offer is clearly one).

Firms should consider whether their procedures need any improvement, particularly in relation to the liaison between marketing and compliance, ensuring that compliance has adequate time to give approval - timetables for product launches need to build in proper time for compliance to do its job. Compliance, marketing and possibly others should be trained both on the FSA's current approach, the likely enforcement consequences of a breach and compliance needs to be trained on the products with which it will be concerned.

The FSA's recent actions and announcements should leave firms in no doubt that a failure to be compliant, in relation to retail financial promotions, will be severely dealt with.