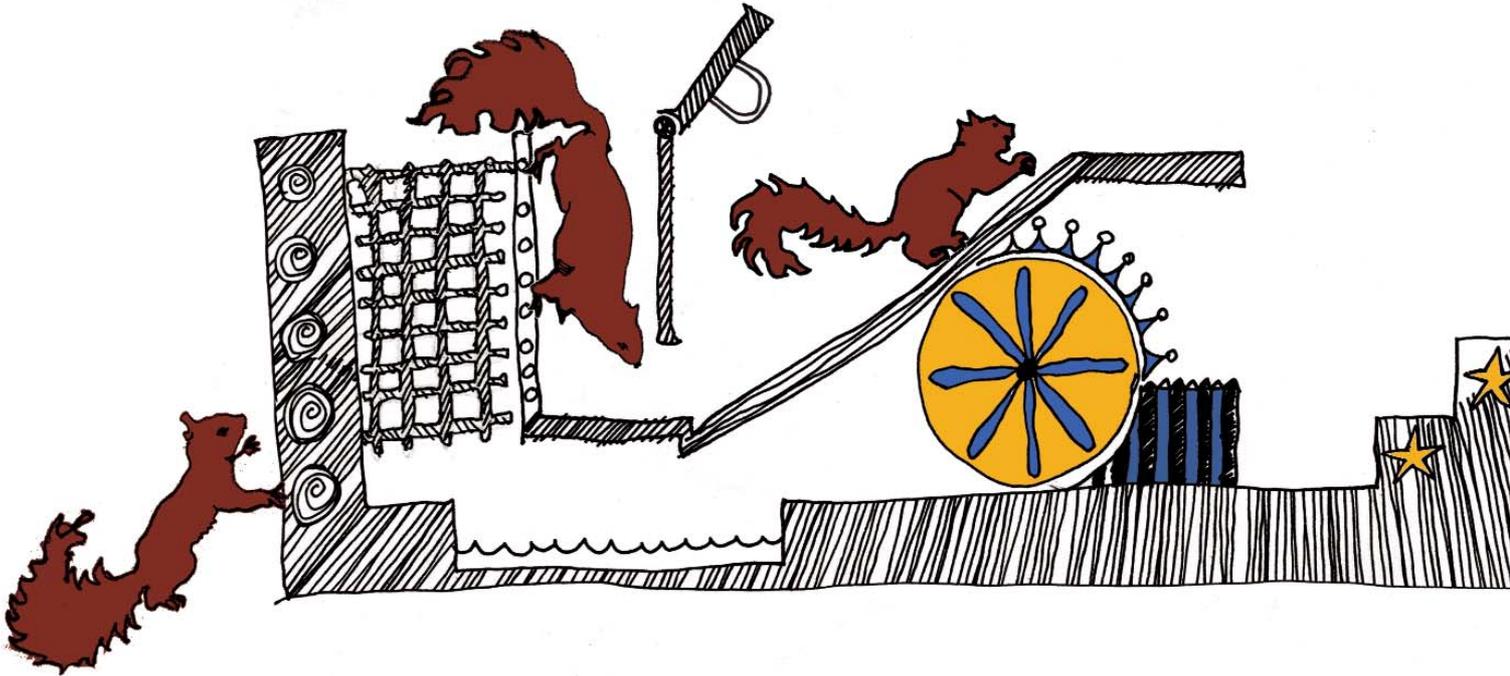


Regulation



Financial promotions in a more principles-based regime

Sarah Wilson, director responsible for the FSA's TCF initiative, spoke at the recent FSA Financial Promotions conference on 20th June 2007, giving an important insight into the regulator's approach to financial advertising and promotions.

It is our view that an exciting and challenging time lies ahead for everyone involved in designing and developing financial promotions. The new COBS rules for investment promotions, published on 31st May 2007, reflect our commitment to more principles based regulation and present a fantastic opportunity for the industry as a whole to see how the focus on principles and high level rules will apply in practice.

Gone are the detailed rules that prescribed the processes for producing such promotions. Instead a series of high level rules refocuses regulation on the outcome we are seeking to achieve – advertising and promotions that are fair, clear and not misleading.

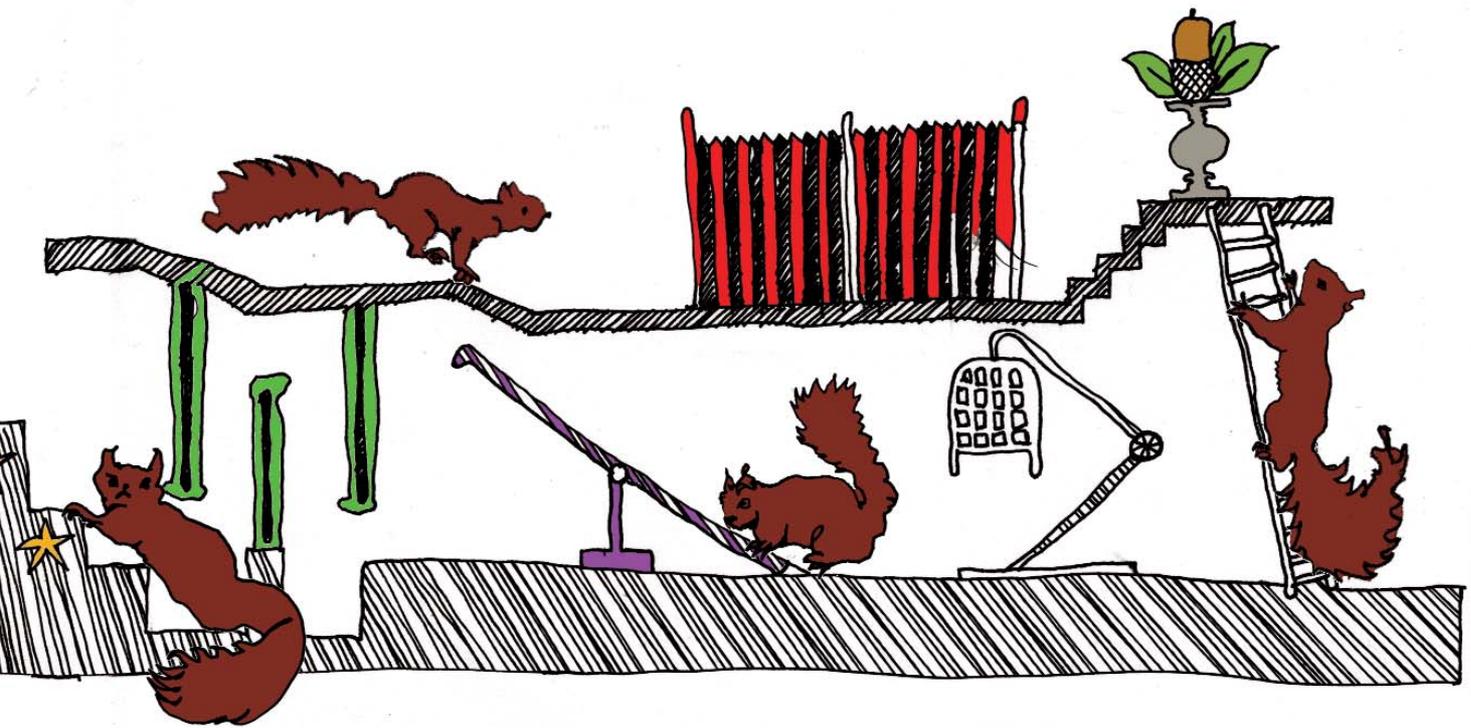
I'd like to bring to your attention a number of initiatives that reflect how our approach to financial promotions is changing under more principles-based regulation, and to reinforce some recurrent but important messages about the challenge this presents for firms. I hope that my comments will give you a clearer idea of how

financial promotions fit into the wider agendas of more principles-based regulation, and the Treating Customers Fairly initiative, and of what we expect from you, what you need to do and what we are doing to help you get there.

Why do financial promotions matter?

First it is useful to remind ourselves why it is so important that firms get their financial advertising right. We take the view that advertising is important because it can influence consumers to act in one of two ways: it might prompt them to find out more about a particular firm's products, or it might prompt a consumer actually to buy a product. And, for consumers that don't obtain advice, the information presented to them by firms is their *sole* reference point when working out which is the right product for them.

Given the low level of financial capability in the UK it is very important therefore that advertising is fair, clear and not misleading – in particular, that it adequately



describes the nature of the product and the risks involved. Poor promotions can lead consumers to buy the wrong product, ultimately with unhappy outcomes for them and for firms. On the other hand, good promotions can help consumers make the right choices, and play a part in increasing consumer engagement and trust in financial services and thereby enhance their willingness to take greater responsibility for their financial decisions. There are benefits all round if firms get it right.

Wider context

How then does our approach to this important aspect of firms' consumer-facing activities fit in the wider regulatory context? To help achieve a fair deal for consumers, we find it helpful to think in terms of the four pillars essential to delivering a more effective and efficient market in retail financial services:

- Helping consumers to become more capable and confident in the decisions they are required to make
- Ensuring that consumers receive, and use, clear, simple and understandable information
- Ensuring that firms are soundly managed, well capitalised and that they treat their customers fairly
- Delivering a regulatory regime that is proportionate and risk-based

Our approach to financial advertising is relevant to the delivery of all four of these pillars - each of which articulate the outcome to be achieved rather than prescribing how we or firms should get there. And, as you will know, it is this outcome-focused approach that is at the heart of our move as a regulator towards more principles based regulation.

Treating Customers Fairly is an FSA principle in itself, but it is also one of our over-arching retail objectives, and our more outcome-focused approach to financial

promotions is a core element of our TCF initiative in practice. Indeed, the requirement to produce promotions that are fair, clear and not misleading is directly linked to the achievement of three of the TCF outcomes we articulated in July 2006, namely:

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- Products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly
- Consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale
- Consumers are provided with products that perform as firms have led them to expect

We recognise that it is our job to help you understand our expectations of what this means in practice. It is, of course, your job to deliver the desired outcomes on the ground.

Principles-based regulation

It is important to note that a focus on outcomes and a move away from detailed rules is not about lowering standards. Instead, the move away from process driven rules will allow both us and firms to focus on

what matters, and the result should be a raising in standards actually achieved. In the past, detailed rules with self evident guidance have not always produced the desired outcomes and, in particular in the area of financial promotions, have resulted in too much tick-box compliance where firms have complied with the letter of the rule but not the spirit.

Detailed rules are also inflexible. They cannot cover all types of business and all types of firm. Nor, as we

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have seen, do prescriptive standards prevent misconduct. Most importantly perhaps, we believe that detailed and complex rules are more likely to result in disengagement of senior management from compliance issues. By contrast, a reliance instead on principles and high level rules will increase the ability of senior management to focus on the necessary judgments that they need to make in order to comply with the spirit rather than the letter; and will offer them more flexibility of approach in response to market changes and innovation.

Such a level of engagement by senior management is in our view key to the success of more principles based regulation generally and the TCF initiative specifically. Senior management needs to take responsibility and be accountable for delivering our overarching regulatory principles at the coal face. This applies equally in the area

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of financial promotions - senior management needs to ensure that marketing processes produce a fair outcome for consumers. This means driving and embedding the focus on principles and high level rules throughout their firms; and measuring, through appropriate management information, that this is delivering the right outcomes.

We are not saying that we expect everyone involved in the marketing process to be experts in our rules. It is up to every firm to work out for themselves what this means in terms of processes, systems, controls, training etc. However, we do believe that it is necessary for the relationship between marketing and compliance

to be governed satisfactorily and that all those involved in promoting a product have familiarity with the desired regulatory outcome - fair, clear and not misleading communications. This does not seem to us to be onerous. Be honest about what you have to offer and clear in the way you express it and you go a long way to meeting our rules.

The challenge for the regulator

It is fair to note that more principles-based regulation presents challenges for our industry, for the firms we supervise *and* for us as regulator. Let me turn for a moment to the FSA – and the initiatives that we are embarking upon to help firms raise and maintain standards in a more principles-based world. A key challenge will be in the way we deal with firms. We must be prepared for more challenging discussions with firms and be prepared to adapt our strategies as necessary.

An excellent example of principles-based regulation working effectively in a financial promotions context relates to a widespread issue we identified in the general insurance sector. This related to the misuse of savings claims which induce consumers into contacting companies on the basis of misleading information. This can cumulatively distort the market by making it harder for consumers to compare deals and pushing other advertisers to test the boundaries of what is acceptable.

In December we set out in clear terms our expectations and what we wanted to achieve. Following this communication, we adopted a new approach and over the next three months picked up the phone – speaking directly with the relevant senior management at the firms where we had concerns. We also engaged closely with the ABI so that together we could help firms raise their standards. As a result we were able to announce a remarkable turnaround in the number of deficient promotions, reducing them from 45% to just 6% in a three-month period.

What we can do to help

We have also given a good deal of thought to how, in a principles-based world, we can assist firms in understanding the principles, such that the increased flexibility given by the new regime does not expose consumers to unacceptable risk. For firms, we will be making more material available. This will not always be in the form of guidance text in our handbook but there will be greater focus on case studies, 'Dear CEO' letters, industry guidance that we confirm as reliable for compliance, and in our regular communications such as our bulletins or press releases.

Of course, materials such as these do not create obligations on firms; but where firms choose to apply them to a relevant business process, they will be able to rely on them in deciding how to satisfy their regulatory obligations.

But while we already put a great deal of our work in the public domain, firms have asked us to make available to the industry more details of our specific concerns.

Firms tell us that this would help them to understand better and contextualise our expectations. They have told us that they could learn from the mistakes of others.

We will therefore continue to look at ways in which to make our expectations more explicit and details of our actions clearer – to assist industry to raise its standards further.

Priorities for the next period

Our main focus over the coming months will be a smooth transition and helping firms get to grips with the new regime. We will be publishing cases studies; offering industry training and using speeches to reinforce our messages. Proactive monitoring is and will continue to form a vital part of our work in preventing consumer detriment. In particular, we will be focusing on promotions on the Internet and the risks they pose. Our efforts to raise standards in the mortgage arena will continue – especially in the sub-prime area and of newly regulated home reversion plans. We will ensure that the messages we have recently published on GI press promotions are carried across all media and all aspects of insurance promotions will also be a focus.

Collaboration with other regulators

We will also continue to collaborate with other regulators. At a time when there has been a plethora of proposals and directives coming out of Europe that impact on the way that financial services are sold and marketed, it is vital that we implement these requirements in a way that avoids overlap not only with our own rules, but also those of other regulators.

At a macro level, we ensure that as an organisation we are involved in discussions about new legislation at an early stage. This way we can seek to influence outcomes and ensure that they are articulated in a way that is consistent with our own regulatory objectives.

At a micro level, from a financial promotions point of view, we have been, for example, working closely with the OFT to identify actual and perceived overlaps between our respective regimes under the CCA and FSMA. As part of a more strategic approach we and the OFT are working together:

- To assess the impact and extent of the burden of dual regulation
- To consider how our rules can be changed or clarified to reduce the regulatory burden for dual-regulated firms and to increase the clarity and fairness of mortgage advertising
- To achieve greater co-ordination of our respective work, through, for example, joint thematic work

and an alignment of messages to firms to achieve coherence and clarity of approach.

We and the OFT will regularly publish the progress of our joint work.

Conclusions

We believe that the financial promotion regime delivers significant benefits for consumers. However, it is right that we as regulator should be constantly challenged about how we are meeting our aims. I've touched on the key areas where we are looking to meet the

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challenge. We need to produce and enforce rules that allow firms to take responsibility for how they achieve the desired outcomes. We need to explore ways of being more transparent about what we do. And we need to produce materials where necessary to help firms deliver fair, clear and not misleading communications that meet our TCF objectives.

For your part, I hope very much that you will carry the message back to your senior management that a more principles-based regime for financial promotions will provide an opportunity for you to focus more closely on the needs of the consumers to whom your financial promotions are directed and to produce advertisements designed to achieve a fair deal for consumers as a result. □

Sarah Wilson, director responsible for the TCF initiative, FSA

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