Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

Telephone: 020 7066 9346
Email: enquiries@fs-cp.org.uk

15 March 2023

By email: dp22-06@fca.org.uk

Dear Sir / Madam,

Financial Services Consumer Panel response to FCA consultation on Future Disclosure Framework – DP22/6

We welcome the opportunity to respond to this consultation on the future disclosure framework. We consider that the Discussion Paper contains a helpful overview of the range of issues that will need to be addressed, in order to develop a new disclosure regime. There are three key themes that underpin our response to the more detailed questions within this consultation, namely the importance of:

- ensuring that the disclosure regime that is introduced for packaged retail investment and insurance-based investment products (PRIIPs) is designed in a way that will allow it to be easily extended to cover other consumer investment products such as undertakings for collective investment in transferable securities (UCITS). Developing a coherent approach to retail investment disclosure that will easily allow consumer to compare potential options is likely to allow them to make more effective decisions on the suitability of different options;
- prescribing a standardised approach to both key parts of disclosure (such as risk and costs and charges) and key processes for providing information (such as options for layering), where it can be shown that this will improve consumer decision-making; and
- using consumer testing to determine which approaches are most effective in supporting consumers in making decisions about their investment options. To be assured that disclosures are genuinely effective, testing needs to be done in environments that reflect the real buying journey including after people have been exposed to realistic promotions, and in advised, non-advised, physical, virtual and digital environments. Particular attention should be given to the effectiveness of disclosure in a non-advised context, as this will be when consumers receive the least support and will have to rely most heavily on the regulatory disclosure process in order to make a decision.

In general the Panel considers it important that the overarching regulatory regime governing retail investments, including disclosure requirements, provides a coherent approach to setting regulation that meets consumers' needs. Our response should be considered in the context of our vision for how the market should function, which is set out in our response to the FCA's call for input on consumer investments. The foundation of this vision is a correctly implemented and supervised Consumer Duty[1]. This would make the firm responsible for consumers' overall suitability for and understanding of the products which they invest in. This would create a market where:

- more of the population with investible assets, and where the decision is right for them, make an active and informed choice to invest, so maximising their own returns and supporting the real economy;
- the information disclosed to potential investors is designed in a way that will allow them to make effective decisions, and to compare the risks, rewards and sustainability not only of different options for a given product type, but also of different products;
- it is not possible to use regulatory arbitrage to circumvent rules designed to protect consumers;
- information, education, guidance and advice is readily available and tailored to the consumer to ensure they are supported in taking decisions both pre-investment and on an ongoing basis. This will require the re-engineering of current thinking to better integrate these aspects and blend them throughout the customer's investment life-cycle. Only in this way will trust be established;
- the use of guidance or advice should be the gateway to anything other than a range of default-based, simple, tax-efficient investments;
- products must be better designed, labelled and described to enable consumers to better understand fully the opportunities, risks and costs involved and easily compare these across options; and
- when harm does occur, there must be easily accessible and efficient redress and compensation solutions.

Our responses to the questions posed in the consultation are included at Annex A below.

Yours sincerely,

Helen Charlton

Chair, Financial Services Consumer Panel

[1] For our comments on the FCA's proposed new Consumer Duty, please see here: https://www.fs-cp.org.uk/sites/default/files/final_fscp_response_cp21-36_a_new_consumer_duty_20220214.pdf

Annex A – responses to questions

Q1: What are the benefits or drawbacks of the timing of disclosure being prescribed by the FCA? Or should it be left to firms to find the right time for their target consumer?

The Panel considers that there will be benefits to the FCA in prescribing the timing of when consumers receive key pieces of information. As the FCA has identified, anchoring plays an important role in consumer decision-making. This means it is important that key pieces of information are received early in the process, in order to ensure they are properly considered. In addition, having some key information easily accessible will help consumers compare products, which will be beneficial in allowing consumers to narrow down their choices.

In order to ensure that it is easy for consumers to compare products, the Panel considers that it is likely to be helpful if they receive a risk indicator and costs and charges information early in the process.

The Panel notes that in FCA's recent proposals on ESG disclosure (CP22-20), the FCA identified that it helped consumers to have the sustainability labels available as part of the first layer of information. This allowed consumers to more easily identify which products matched their preferences. The Panel considers that it will be important to conduct similar consumer testing, in order to identify what other information (such as risk) is crucial at an early stage, in order to ensure that consumers can make effective decisions that reflect their preferences. To ensure that disclosures are genuinely effective, testing needs to be done in environments that reflect the real buying journey including after people have been exposed to realistic promotions, and in advised, non-advised, physical, virtual and digital environments. Particular attention should be given to the effectiveness of disclosure in a non-advised context, as this will be when consumers receive the least support and will have to rely most heavily on the regulatory disclosure process in order to make a decision.

Q2: Will a durable medium requirement constrain your ability to deliver innovative disclosure? Are there any other rules that may constrain the medium in which information can be provided?

The Panel considers that it is important that consumers receive a record of the information they received on a product during the purchase process. This will enable them to demonstrate their entitlement to redress, if necessary.

Q3: Do you agree that we should future proof the disclosure requirements? How else can we do this? Do you have any views or evidence on the merits and drawbacks of different approaches to future-proofing?

The Panel is supportive of creating rules that will help future proof disclosure requirements.

As part of this process, the Panel considers that it would be extremely helpful for the FCA to consider how other consumer investment products (such as UCITS) will fit within the new PRIIPs regime once it is developed. The Panel considers that the FCA's aim should be to produce a coherent regime that will eventually cover all consumer investment products, rather than taking a siloed approach and developing different disclosure rules for different products. This makes it important that the FCA considers the implications of adding additional products to the PRIIPs regime up front. Otherwise additional changes to the regime are likely to be needed as the disclosure rules for different product types come under review.

The Panel notes that taking a siloed approach to disclosure rules can create significant confusion for consumers. For example, the synthetic risk indicators used for PRIIPs and

UCITS are visually very similar, but are calculated in completely different ways, meaning they cannot be used to compare products, even though some UCITS are also PRIIPs.

The Panel notes that having a standardised synthetic risk indicator can considerably improve the suitability of consumers' choices. For example, research for the Associate of British Insurers in 2010 demonstrated that providing consumers with disclosure documents using a single risk indicator design led to an improvement of over 20% in the likelihood of participants being able to identify the most suitable funds compared to text-based disclosures. In contrast, when participants were shown disclosure documents that used different risk indicator designs, the likelihood of them being able to identify the most suitable funds fell by 3% compared to participants seeing text-based risk disclosures.[2]

The Panel therefore considers that part of the FCA's future proofing should be to develop a risk indicator methodology that can be used to compare risk across all investment products. Such an indicator should:

- deliver consistent risk scores over time. A consumer does not want to buy what they think is a low risk product today, only to discover that tomorrow the methodology used would indicate that it is a high risk product;
- produce intuitive results that a consumer will understand; and
- allow the consumer to differentiate between products with different risks. In other words to avoid creating risk buckets that will cause bunching, with the majority of products in only a few buckets.

The Panel notes that the calculation methodology currently used as part of the PRIIPs regulation is particularly poor. Testing of different risk metrics conducted for the ABI and IMA in 2010 suggested that the most effective methodology from a consumer perspective would be to use a standard deviation measure based on ten years of data, as this delivered the most consistent (and intuitive) risk rankings. The benefits of this methodology could be enhanced further by adjusting where the boundaries between different risk buckets are drawn in the UCITS current regulations.

The reason why this research suggested that a standard deviation based methodology would be preferable to the Sortino ratio is illustrated by the consistency of the risk rankings produced by the two methodologies over time. Calculations using three years of monthly data for twenty three asset classes showed that recalculating the resulting risk rankings each month over the period 1990 to 2008 produced much more consistent rankings in the case of the standard deviation methodology. In particular, the average correlation in the risk rankings of the 23 asset classes over time was over 83% when a standard deviation methodology was used, but less than 14% in the case of the Sortino ratio.[3] Given consumers care about how stable risk indicators are, because they do not want to buy what they think will be a low risk product only for it to change into a high risk product, the low correlation in the rankings for the Sortino Ratio is problematic.

Q4: How do you envision the distribution of retail disclosure changing over the next 5-10 years?

No comment.

Q5: Who should have responsibility for producing retail disclosure?

[2] R Driver, N Chater, B Cheung, M Latham, R Lewis and H Scott (2010) "Helping consumers understand investment risk: Experimental research into the benefits of standardising risk disclosure", ABI Research Paper No 25.

[3] See A Clare (2010) "Developing a risk rating methodology", Joint ABI and IMA Research Paper.

It is important that the information consumers receive is accurate. On balance this would suggest that the manufacturer is best placed to produce the information required. However, there may be exceptions, for example where platforms add additional charges.

Q6: How should it be determined that a product is suitable for the retail market and therefore that regulated disclosure should be produced? Does this need to be balanced with choice for retail investors?

The issue of which organisation should determine the suitability of a product for the retail market (as opposed to its suitability for an individual investor) is important, because it determines who will pay redress in the case that the product does not perform as advertised. The Panel considers that the manufacturer would be best placed to make this determination.

Retail investors are typically at a significant informational disadvantage compared to institutions. If the manufacturer (or distributor) is unwilling or unable to produce the relevant retail disclosure to allow consumers to compare investment options, then the Panel considers that on balance it would be preferable to restrict access to the product, even if that means limiting consumer choice.

Q7: Do you agree with these principles for effective disclosure design? Are there any other principles we should assess?

The Panel agrees that the use of plain language and prominent display of key information are helpful principles for retail disclosure.

The Panel also considers that the use of images and graphics can help consumer understanding and engagement. In addition, for some types of information, such as risk disclosure, using a standardised risk indicator can help improve consumers' ability to make effective decisions around the most suitable products.

Q8: Do respondents have any evidence or consumer testing results on the merits or drawbacks of different forms of presentation?

The Panel is aware of research undertaken for the Association of British Insurers (ABI) in 2010 on the potential benefits of standardising risk disclosure.[4] The ABI research was done in two phases, with 29 different disclosure options being tested in Phase I and 23 in Phase II.

The research showed that, for the top three risk disclosure designs, compared to text-based disclosures providing consumers with disclosure documents using a single risk indicator design for all funds led to an improvement of 23% in the likelihood of participants being able to identify the most suitable funds. This improvement was equivalent to raising financial literacy by over 25%.

In terms of the improvement in people's ability to pick the most suitable funds, the top three risk indicators tested were all thermometers, and included the thermometer design proposed by CESR for use in the UCITS disclosure regime. These top three designs were roughly twice as effective as the worst three designs. However, providing a consumer saw only one risk indicator design used for all funds, then even the worst three performing designs led to an improvement of 13% in the likelihood of participants being able to identify the most suitable funds compared to text-based disclosures.

---

[4] R Driver, N Chater, B Cheung, M Latham, R Lewis and H Scott (2010) "Helping consumers understand investment risk: Experimental research into the benefits of standardising risk disclosure", ABI Research Paper No 25.

In contrast, when participants were shown disclosure documents that used different risk indicator designs, the likelihood of them being able to identify the most suitable funds fell by 3% compared to participants seeing text-based risk disclosures. People who see the same presentation of risk are on average 16% more likely to pick the right funds than those who saw mixed designs.

The research also demonstrated that although consumers often say that they prefer information to be presented in charts rather than tables, doing this can undermine their ability to understand the information. For example, in the case of investment performance, using bar charts rather than a table to present the information reduced people's ability to answer questions correctly by 50-75%. This emphasizes the importance of not just asking whether people like a particular disclosure presentation, but of actually testing what impact it has on their decision making.

Another piece of research the Panel would like the FCA to consider is research undertaken by Plain Numbers[5] in 2021 which revealed a stark contrast between perceived and actual understanding. The findings from this research support the need for consumer testing.

One additional insight was that grids covering likely return, chance of beating cash, volatility and risk to initial investment performed poorly in consumer testing. This included cases where RAG (red-amber-green) rankings were used. One possible explanation for this may be, for example, that red can be used to indicate either high or bad. Depending on the question which boxes are red under those two approaches will differ, but people may instinctively assume one or the other ranking without checking the details, leading to confusion.

Q9: Evidence suggests that layering in retail disclosure can improve consumer understanding. Do you agree with this and can layering also reduce the burden on firms? Are there any challenges we should consider?

The Panel notes that the consumer testing that was done on the FCA's ESG disclosure proposals showed that layering information could help consumers. The Panel is therefore supportive of the idea of using layering to ensure that key information is presented upfront, and not lost in long and very detailed disclosure.

In addition to ESG labels, the Panel considers that information on risk and costs and charges are particularly important for comparing products and should therefore be available as part of the top layer of information. Based on existing research, the Panel considers that it is likely to be helpful for the top layer of information on risk to be in the form of a standardised risk indicator.

However, the Panel considers that the chosen approach should be subject to consumer research to determine the impact of different options on the ability of consumers to make effective decisions. To ensure that disclosures are genuinely effective, testing needs to be done in environments that reflect the real buying journey including after people have been exposed to realistic promotions, and in advised, non-advised, physical, virtual and digital environments. Particular attention should be given to the effectiveness of disclosure in a non-advised context, as this will be when consumers receive the least support and will have to rely most heavily on the regulatory disclosure process in order to make a decision.

Q10: Are there other interactive disclosure approaches we should evaluate?

Subject to consumer testing, the Panel can see potential value in interactive disclosure options, providing the risks that the FCA has identified are addressed.

[5] https://plainnumbers.org.uk/research-key-findings

Q11: How can disclosure requirements facilitate firms to use plain language to further consumer understanding while balancing accuracy, particularly with complex products?

The Panel is supportive of allowing firms to move away from the use of jargon and instead to use plain language.

However, the Panel notes that there are key areas where standardisation will help consumers make decisions. Therefore, the Panel considers that any moves by firms to abandon the standardised approach should be subject to rigorous consumer testing. This testing should not only consider consumers' reaction to a firm's proposed option, but also what impact different approaches will have on decision making. Where decision making deteriorates relative to the standardised option when a consumer sees multiple different approaches used, then, even if the firm's preferred approach tested well, the standardised approach should be retained.

Q12: What do you consider the appropriate balance between flexibility and prescription in disclosure? Does comparison feature in this balance?

The Panel considers that answering the question about the degree of prescription needed and the importance of standardisation rests on answering the question "does standardisation help consumers make better decisions?". Where flexibility can be shown to enhance decision making, for example because it enables consumers to gain a better understanding of differences in product types, then it should be allowed.

However, where it can be shown standardisation benefits consumers, then this should be the approach taken. It is then up to regulators and the industry to devise the most effective methodology possible to underpin this standardisation.

In addition to considering the need for prescription about what is disclosed, it will also be important to consider whether prescription is needed around when and how in the process it is disclosed.

Q13: What information, if any, should be comparable? Do you have evidence to support or refute comparability between similar product types?

The Panel supports standardisation where it will help improve consumer decision-making. It considers that establishing where standardisation will help improve outcomes should be the subject of consumer testing.

However, a priori, it considers that the most important areas to focus on standardisation will be those where the answers should be known upfront, and where it will help consumers match the options available to their preferences, namely:

- costs and charges;
- risk; and
- ESG profile.

The FCA will need to develop methodologies to underpin these types of disclosure to ensure that the information provided is both meaningful and consistent across providers (including intermediaries, where relevant).

In addition to disclosure requirements that are designed around the use of a consistent methodology, the FCA may also want to prescribe certain elements of disclosure, without prescribing the exact form of what is disclosed.

The Panel considers that being able to compare different types of consumer investment products will help consumers. It also notes that products often overlap, as is the case with

PRIIPs and UCITS. This is one reason why the Panel is keen to see a coherent approach to disclosure that will cover all consumer investment products, rather than a siloed approach. A siloed approach is particularly unhelpful for consumers if the resulting regimes produce contradictory reporting requirements that superficially appear similar. This is the case, for example, for the synthetic risk indicators used for PRIIPs and UCITS, which are both based on a thermometer design, but currently use very different calculation methodologies. As some PRIIPs are also UCITS, not only can these methodological differences potentially distort comparisons between products, they will also potentially yield very different results for the same product. This will not help consumer decision-making.

Q14: What level of prescription should be involved in the calculation of costs to ensure clarity and consistency for consumers while also prioritising the need for accuracy?

The Panel considers that costs and charges represent important information that consumers need to understand in order to make the right investment decisions. The information needs to be presented in a comparable fashion that allows consumers to compare products.

The Panel considers that the exact presentation of costs and charges should be subject to consumer testing, in order to understand how different options will influence understanding and decision making. Once the most effective presentation of the material has been identified, work will then need to be undertaken to develop a methodology that is both compatible with the chosen presentation and will allow costs to be accurately compared across product types.

Q15: What are the pros and cons of presenting cost as single figure, with more detailed information layered in disclosure?

Having a fixed comparison option (i.e. for £X and time y) readily available will make it easier for consumers to compare product options. Ideally this type of information should be available as part of the top layer of information available to consumers.

However, the Panel notes that the mixed of fixed versus variable costs, and upfront versus ongoing charges will influence the actual costs consumers pay both in total and as a proportion of their investment, with the outcome depending on factors such as the investment time horizon and the size of the investment. Having a single comparison point eliminates the possibility that comparisons are distorted by consumers inputting different parameters to different websites. However, the Panel recognises that having additional information that is more tailored to a consumer's actual likely investment could also be beneficial. Again the Panel considers that how this is presented and at what stage should be subject to consumer testing to identify which options are best from a consumer perspective.

Q16: What level of flexibility should there be in the calculation and presentation of risks?

The Panel considers that the evidence on the benefits of having a standardised risk indicator set out in its answer to Question 8 strongly suggests that a standardised approach would benefit consumers. It therefore considers that the FCA should introduce a standardised risk metric as part of its reforms to the PRIIPs regime, and that the chosen metric should be one that will also work for other consumer investment products such as UCITS.

The Panel notes that the problems identified with the current approach are primarily linked to the calculation methodology (i.e. that the calculated risk rating did not make sense), rather than whether in principle a standardised approach to risk reporting would not help consumers. The Panel considers that it should be easy to move to a different calculation methodology that will be both more robust and more intuitive, and that doing so would help consumers.

In designing a risk indicator, the Panel considers that from a consumer perspective the three main criteria should be to:

- deliver consistent risk scores over time. A consumer does not want to buy what they think is a low risk product today, only to discover that tomorrow the methodology used would indicate that it is a high risk product;
- produce intuitive results that a consumer will understand; and
- allow the consumer to differentiate between products with different risks. In other words to avoid creating risk buckets that will cause bunching, with the majority of products in only a few buckets.

In addition, however, the metric will also need to:

- be simple to calculate and replicate (to avoid inconsistencies between providers); and
- have the potential to be applied to a wide range of investment funds and products.

As set out in its response to Question 3, the Panel notes that the calculation methodology currently used as part of the PRIIPs regulation performs particularly poorly against these criteria. It is therefore likely to be helpful for the FCA's approach to the regulation of risk disclosure to use a different methodology. Which calculation methodology is likely to best meet consumer needs will be an empirical question.

Joint ABI and IMA research in 2010 compared the performance of eight different risk calculation methodologies - Standard Deviation, Range, Sharpe Ratio, Beta, Downside Deviation, Maximum Drawdown, Sortino ratio, and Value at Risk.[6] The aim was to assess which methodology is likely to be most robust and best match consumer needs. One of the tests the research used was to calculate the risk for twenty three asset classes using the eight different methodologies and three years of monthly data, ranking the asset classes from most to least risky and then redoing these calculated risk rankings each month over the period 1990 to 2008. The aim was to see which of the metrics produced the most consistent rankings over time. This proved to be the standard deviation methodology, which had an average correlation in the risk rankings for the 23 asset classes over time of over 83%. In comparison, the correlation in the risk rankings using the Sortino ratio was less than 14%. Given consumers care about how stable risk indicators are, because they do not want to buy what they think will be a low risk product only for it to change into having a high risk ranking, the low correlation in the rankings for the Sortino Ratio is problematic.

Follow up research by the ABI and IMA also assessed whether the amount of data used to calculate outcomes matters in the context of CESR's proposed risk buckets.[7] It found that using CESR's proposed boundaries between risk categories and the standard deviation methodology, after just one year (ie between the end of 2006 and the end of 2007), 43% of asset classes had changed their risk category if five years of data was used, compared to just 4% changing their category if ten years of data was used to the assessed risk. Similarly, after three years (ie between 2006 and 2009) using ten years of data meant that only 30% of asset classes had changed categories, while 70% changed their risk category if only five years of data was used. Similar results were found using data for 435

[6] See A Clare (2010) "Developing a risk rating methodology", Joint ABI and IMA Research Paper.

[7] See R Driver and J Patterson (2010) "Note on CESR's recommendations for the calculation of a synthetic risk reward indicator" ABI and IMA Briefing Note.

funds. This strongly suggests that it would be beneficial to increase the length of data used in any risk calculation.

Q17: What is the purpose of performance disclosure?

The Panel agrees with the FCA that past performance is not a good indicator of future performance, and that there is a risk that consumers will place too much weight on performance indicators relative to other factors such as costs.

However, some description of potential performance is likely to be needed, if the FCA wants to achieve its objective of encouraging consumers with significant savings to move away from cash. As part of encouraging that switch, one option for presenting performance might be to include the likelihood of beating cash for investments over different time horizons. This would allow consumers to assess likely risks and rewards.

However, ultimately decisions on how performance is described to consumers and the degree of standardisation needed should be assessed based on the impact on consumer decision-making.

Q18: To what extent should the FCA prescribe the performance information to be provided to retail investors? Should the FCA categorise products for the purpose of performance disclosure?

The Panel considers that the best way to assess this would be to use consumer testing to determine if standardisation is helpful.

Q19: Would tailoring or flexibility promote accuracy and enhance consumer engagement?

The Panel considers that some key information should be disclosed in a standardised way regardless of the product or consumer segment, namely costs and charges, risk and ESG information. The standardising of key information will allow consumers to compare across products and ensure they choose the best product given their circumstances and preferences.

Just because a given product only targets a particular type of consumer does not mean that those types of consumer only consider that type of product. This makes the comparability of core information important. However, beyond that some flexibility may be desirable, and again the Panel considers that this should be subject to consumer testing.

Q20: Are there other content requirements that should be included in regulated disclosure? Should this content be disclosed alongside product information?

The Panel agrees with the issues that the FCA has identified form an important part of the information consumers need to make effective decisions. For example, recommended holding periods and penalties for early withdrawal are both issues that a consumer needs to understand in order to compare options and make an informed decision.

Similarly, redress options and complaints procedures are also important, although particularly in the case of complaints procedures these might not need to be provided as part of the initial layer of information. Ultimately deciding on the rules governing what information is needed and how it is presented to provide consumers with the best chance of making effective decisions should be subject to consumer testing.