

# Financial Promotions: The next evolution?

There has been a rapidly increasing number of enforcement actions relating to financial promotions over the last few months. In some respects, this should not have come as a surprise as the FSA made it clear in their 2004/05 Business Plan that it had 'decided to sharpen the focus of, and significantly increase the resources committed to regulation of financial promotions in 2004/05'. This is exactly what it has done and this approach has been reiterated with vigour in its 2005/06 Business Plan and its recent publication 'Financial Promotions: Taking stock and moving forward'. These publications give a clear warning to firms that the FSA is prepared to take action where it finds deficiencies in their promotions or controls.



This level of activity and focus raises a number of questions:

- Why did the FSA decide to focus on promotions and will this focus continue?
- What impact will the Treating Customers Fairly ('TCF') agenda have on this area?
- What happens next?

This article considers what has changed in recent times to lead to this intense focus on promotions, and gives a practical perspective on the issues that now face firms in this area.

## What has changed? The FSA's approach

In terms of confirming that a promotion complies with regulatory rules, it is arguable that very little has actually changed. The key principle that communications with customers must be 'clear, fair and not misleading' has been a consistent theme in regulation for more than ten years. However, what has changed is the focus and interpretation applied to the promotions rules by the FSA. This evolution has taken a number of forms, both conceptual and practical.

### Conceptual evolution

Conceptually, the FSA has built much of its recent regulatory approach under the TCF banner with the aim of ensuring the fair treatment of customers. Compliant promotions are perceived as central to this concept as they are often the first and most influential communication with customers. There is an increased emphasis on how 'balanced' a promotion should be in terms of how the benefits and risks associated with a product or service are portrayed. Emphasis, realism and transparency are increasingly important, whilst bold, headline claims and small print are now considered inappropriate.

Moreover, the existence of a misleading promotion brings into question the adequacy of internal controls within a firm. It not only raises concerns about the approval process, but raises questions about the adequacy of product development processes and the firm's Product Risk Framework; in particular, the process for identifying the target market and determining how appropriate distribution channels are for that target audience. Recent enforcement action has demonstrated that whilst an investigation may begin with the issue of a non-compliant promotion, enforcement will also assess the adequacy of the systems, controls and record-keeping as part of its investigations.

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### Practical evolution

In practical terms, the FSA has set up a department dedicated to financial promotions. This department is now 30 strong and is a clear example of the focus and importance with which the FSA is treating this area. The department regularly reviews promotions in all media and has undertaken themed visits to firms looking at systems and controls and record-keeping standards. The department also continues to encourage all parties (not just customers but firms as well) to report potentially misleading promotions to it. The results of all this activity are discussed in its recent publication 'Financial Promotions: Taking stock and moving forward' (available on the FSA's website).

The recent publication cites five areas of concern in the promotions it has reviewed:

- Lack of clarity of product
- Placement and type of risk warnings
- Unrealistic and misleading percentages and headline claims
- Inclusion of misleading statements
- Exclusion of information on charges and early redemption penalties

The actual FSA rules in chapter three of the Conduct of Business Source Book (COB 3) have not changed substantially. However the FSA has:

- strengthened the COB 3 rules amid concerns over the presentation of structured products and the use of past performance in promotions;
- expanded the rules in the wake of EU legislation
- added mortgage and general insurance promotions to the portfolio of products covered by the rules.

Looking to the future, the FSA has stated that it is looking at the impact of the MiFID directive on the COB 3 rules and said that this is likely to move the regime further towards principles-based rather than detailed requirements.

### What has changed? The industry's approach

Firms have recently been expressing concerns over whether the increasing focus on promotions has led to a change in the advertising strategy - with a shift away from advertising specific products to more generic 'life-style' focused promotions and brand awareness campaigns. Anecdotal feedback suggests that this is something the FSA would encourage. However, by adopting this route firms will lose the differentiation that exists between the products and services that they offer, which could simply add to consumer confusion over what is actually being offered. This approach also denies firms the opportunity to highlight the individual features of their products. What is clear is that a "balanced" approach is key when advertising specific products and services.

On the whole, the financial services industry seems very aware of the FSA's increased focus on promotions. However, it is not clear to what extent the industry has acted to understand how this increased focus translates into improved internal controls and

review processes. Like the pot of gold at the end of the rainbow, some feel that "compliance", in this instance, is a moving target due to the subjectivity that the assessment of promotions inevitably includes. If this is the case, then the only protection is a robust and transparent approval process for new product development and the subsequent promotions, a clear mechanism for identifying failures and learning from them, and an ability to take a "step back" in order to review the promotion away from the marketing/design team and through the eyes of the customer.

### What are the likely issues and how can they be addressed?

There are a number of issues firms need to consider and address in order to ensure that they remain compliant in this evolving environment. These can be broadly broken down into the following areas:

#### 1) Interpretation of the COB 3 financial promotions rules:

This remains a subjective issue. What is fair and balanced to one person may not be to another. Firms need to make sure that they have sufficient guidelines and procedures in place to ensure they can provide a clear and consistent approach to the approval and monitoring of promotions. They must also ensure that they have the necessary rationale and records to be able to justify their position in the event of specific criticism from the FSA.

#### 2) Systems and controls:

Linked to the point above, a firm must have sufficient procedures and standards in place for the assessment and approval of promotions by suitably competent staff. Monitoring of this process and the ongoing competency of staff is also important. Management information and reporting lines should be in place to allow senior management to be aware of any issues, including the monitoring of sales and volumes by product and region to identify unusual variations, and enable it to take timely action should errors be discovered;

#### 3) Treating Customers Fairly:

This concept primarily focuses on building trust with the customer. Financial promotions are an integral part of TCF and an area where firms can add real value to their operations by taking the time to get it right and produce well-balanced, targeted promotions. As the elements of TCF interlink within the product life-cycle, it is important that firms take advantage of this to improve their overall approach to customers. Complaints handling may, for example, raise concerns about certain promotions. By monitoring these complaints, the concerns can be fed back into the promotions approval process and learnt from in the future. Equally, by testing promotions with a sample of customers in advance of large campaigns, a firm could demonstrate the steps it has taken to confirm that the promotion is generally appropriate for a target market.

The tailored nature of promotions approved within a TCF environment has the potential to be more successful at building relationships with customers than the mass-marketing campaigns that have often been developed in the past.



#### 4) Remedial Action:

If a non-compliant promotion is subsequently identified, a firm needs to act decisively to assess and address any potential disadvantage caused by the promotion to its customers. It will also need to consider any impact on the effectiveness of its internal controls and how to manage its relationship with the FSA.

#### 5) Compliance of specific promotions:

- The ISA selling season is underway and therefore firms should ensure that any promotions in circulation are compliant with the standardised past performance rules which came into force last summer.
- Recent enforcement actions have centred around particular products such as spread betting, guaranteed and with profits products. Firms should ensure that promotions include sufficient information on the product and its risks and that the promotion is tailored to the experience and knowledge of the specific target customers. This would also include consideration of the media channel and publication which is being used to communicate the message to the target market.
- The General Insurance and Mortgage sectors now fall within the scope of the promotions rules and therefore firms in these sectors should ensure that the procedures, internal controls and promotions meet the relevant FSA standards.

#### 6) Future themes to be covered by the FSA:

The Financial Promotions Department has stated that it will focus on the following areas in the coming months:

- Firms' preparatory work on Child Trust Funds;
- Mortgages Conduct of Business source book – promotions (specifically mainstream, equity release, sub prime and debt

consolidation lenders and systems and controls); and

- General insurance promotions (specifically promotions targeted at the vulnerable or where the cover provided could be seen as “unnecessary”).

Firms which have activity in these areas should ensure they are satisfied with their procedures and promotions.

#### 7) Keeping up to date:

We have touched on a number of points raised by the FSA in its recent publication, all of which should be taken into account in each firm's financial promotions strategy. This publication and the imminent special section on financial promotions announced on the FSA website should be read by firms to ensure that they are up to date on this area.

### Conclusion

With TCF continuing to develop as a concept and the FSA's focus on financial promotions sharpening, the production, content and monitoring of promotions has never been more important.

Firms need to be confident that they have considered carefully their approach to the promotions rules and have developed sufficient procedures and controls to manage the approval of promotions effectively. By doing so, not only will they be able to remain compliant within an evolving environment, but they will have the opportunity to validate a key element of their activity associated with the fair treatment of customers.

Responsibility for this area must be shouldered by senior management within firms and cannot be delegated to the Compliance department alone as it has significant ramifications for other operational areas of the firm. It should always be borne in mind that a proactive, robust approach could have a significantly positive revenue effect for a firm by improving its reputation, sales and customer relationships, whilst not taking the consistent approval of promotions seriously could adversely affect a firm's reputation, profitability and relationship with the regulator.

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