

# OAC

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## Key Features Documents

### Good and poor practices, part 2

The FSA has recently fired its latest salvo in its ongoing campaign to make Key Features Documents (KFDs) and - by extension - all promotional material, more understandable. Its latest document entitled "Supplementary Annex to Good and poor practices in Key Features Documents", released in April 2009, publishes the findings from the work carried out in 2008, which was promised in the original publication of September 2007.

The new document provides an update on progress made, and sets out issues that are still holding back progress in some firms. Further examples of good and poor practice are given supplementing those in the original document.

#### Work carried out by the FSA

The FSA reviewed its original sample of KFDs and noted that two thirds now showed significant improvement, with the ones not making sufficient improvement generally being those produced by asset managers. The FSA did note that some organisations outside the sample still had not updated all of their KFDs, and it will be assessing how far good practice has spread as part of the routine supervision of firms. Firms can expect the topic of KFDs (and other promotional material) to feature within any forthcoming Arrow visits, and will need to be able to explain their approach when designing KFDs and substantiate why they believe that their KFDs now deliver the required clarity and standard.

#### The Regulator's findings and our comments

The FSA notes that whilst there is now less jargon in KFDs, consistently plain and succinct language is not yet being achieved by all.

The regulator commissioned work from the Plain Language Commission (PLC), which was asked to assess four pairs of KFDs, comparing old and new versions for readability. It is interesting to note that the PLC uses an average reading

age for the UK of 12 -14, which gives an idea of how clear, straightforward and jargon-free the language used in a KFD (and other promotional material) needs to be. Perhaps surprisingly, the KFDs for a Guaranteed Equity Bond and for a Child Trust Fund were able to limbo dance under that rather low bar, whilst the Unit Trust and Investment Trust KFDs were not. However, it does show that the required standard is achievable.

According to the FSA, legalistic and technical styles were sometimes defended on the grounds that the product was sophisticated, and being marketed to sophisticated investors. Its view is that all investors are entitled to documents that are succinct and understandable. It is worth bearing in mind that the FSA is talking about language here; an adequate explanation of a complex product might be more intricate, and hence more challenging to understand, but it need not use more obscure language.

The requirements in COBS were apparently being followed with little difficulty. It follows that any documents that do not comply with COBS are likely to stand out as non-compliant, and it seems unlikely that the FSA will be receptive to any attempt at justification. In fact,

the actual rules in COBS governing the content and format of KFDs are relatively few and straightforward, with little room for misunderstanding or misinterpretation. However, there is much that is guided by principles that require careful judgement in their application.

The FSA is keen that firms should avoid jargon within promotional material. Dipping into the Supplementary Annex at paragraph 4.9 will reveal examples of terms that firms should seek to eliminate as too specialised for the average person to understand. It makes the clear point that "A consumer's main need is to understand the feature, not the name the industry gives it". Hence, an approach of defining jargon words when they are first used is not favoured. However, where jargon or technical words are unavoidable, the use of a glossary is suggested. We suggest that firms take care not to let that approach get out of hand; the glossary should be short, say six terms at most and preferably much fewer.

The KFD should communicate in language that is clear, direct and straightforward so that the reader can concentrate on the message rather than wrestling with the meaning of the language. Shorter sentences,



rather than long tortuous ones, are much preferred; the reader should not have to wade through long sentences to extract the meaning of the KFD. The FSA makes the point that consistent use of succinct language will generally lead to shorter, more approachable, documents.

The FSA also points out that reference to regulations, and statements of compliance with the demands of those regulations, may well disengage the reader as - quite legitimately - they may not know what those regulations are.

It also says that the KFD should not contain information that is not relevant to the decision to invest, and should not overload the reader with background detail (which can simply be signposted).

The risks must be described in the KFD in a way that is understandable and not misleading. The impact of each risk (if it occurs) must be clear to the reader with the effect it could have on the value of the investment. It is suggested that risks should be ordered, perhaps by their occurrence through the life of the product, or by their importance or potential impact. We would caution firms seeking to prioritise risks to take the greatest care in their presentation. Presenting a low-incidence, high impact risk below one with a higher incidence, but lower impact, might easily mislead if a reader's grasp of the risk is tenuous.

The FSA does recognise that there are difficulties where a Simplified Prospectus (SP) has to be produced. Where a combined SP and KFD is produced, which happens typically in the case of a stocks

and shares ISA, it can lead to a long and repetitive document which can be difficult for the reader to understand. The European Commission is consulting on a replacement for the simplified prospectus (to be introduced in 2012), which currently takes the form of a two page key information document for each fund or sub-fund. Whilst the FSA has received much feedback to the effect that the SP makes it difficult to produce a succinct, user-friendly document, there seems to be little appetite at the regulator to tackle the issue ahead of the introduction of the replacement document. Firms are left to tackle the problem as best they can.

Firms producing the combined KFD and SP document must make sure the purpose of the document is clearly conveyed to the reader. Where both a KFD and SP are produced separately, it is important that there is a good explanation of the relationship between them, and the reasons for the duplication that often results.

If there are multiple funds within the product, the consumer must be able to differentiate clearly between the aims and strategy of each fund, and firms are required to meet the relevant requirements of COLL. In particular, the simplified prospectus must not simply repeat the wording of the prospectus, but where it is possible it should explain the main points in simpler, clearer language.

#### What do firms need to do next?

Any firm that has not reviewed its KFDs recently should do so now, as the FSA has given warning that it will review KFDs

as part of its Arrow visits. We would recommend that all firms might look again at their KFDs in the light of the Supplementary Annex. The objective set by the FSA is quite challenging; writing this short article for a professional audience is much easier!

Firms should ensure their documents are readily understood by testing them with their target market. Testing in-house is unreliable as employees will almost always have some knowledge of the product. Only consumer testing tells a firm whether it has truly achieved its aims.

#### How can OAC help?

Firms should consider an external audit of their KFDs and related promotional material, as an outside agency reviewing their material will be in a better position to give an objective assessment of that documentation.

OAC can supply reviews of your KFDs and other material to make sure it is in line with the latest FSA thinking and such reviews can be tailored to your requirements.

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