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Improving the Financial Disclosure Documentation Process

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Abstract

While it is to be applauded that every customer taking out or indeed considering a financial product is provided with considerable relevant information, warnings and conditions, the format and delivery of this information is generally suboptimal from a decision and understanding perspective. Consumers, faced with pages of terms and conditions, tend toward not reading or not digesting the material and vital facts are lost amongst the mundane but required information.

This report considers the existing evidence and supplements it with extensive investigations into the documentation and delivery process. As expected, all documentation reviewed contains the relevant and required information, but it is not delivered in a way that enables (in general) the consumer to engage and digest it. We suggest various technological and behavioural solutions to this issue, but also note the mandate for universal customer receipt, we suggest a beyond compliance approach with the existing minimum complemented by a behaviourally targeted approach.

Introduction

Defined simply, product disclosure is any information that is provided to the consumer concerning the features, costs or other attributes of a product. Typically, information can be accessed by consumers before, during or after a transaction. The aim of good product disclosure is to ensure that consumers can access and assess the information relevant to a purchasing decision and continued use of the product.

The regulation of product disclosure takes many forms across a wide spectrum, with stated general principles right through to specific standards of communication. In particular there are stringent rules on the format of documents, to the standardization of calculations to allow customers to compare products. A number of these more stringent rules have been introduced as part of the MiFID II regulations, effective from January 2018. Moreover, advances in technology have meant that the way in which consumers interact with product disclosure is changing.

The Role of the Regulator

While the introduction of MiFID II has returned the issue of product disclosure to the fore, the debates surrounding product disclosure have been addressed previously by the regulator. The FCA have responded to representations surrounding product disclosure from the industry in a number of positive ways. The 'Smarter Consumer Communications Initiative' was first formally launched in 2015. Publications under this initiative chronical the main issues faced by the industry, the regulator and consumers in relation to product disclosure and communications, some of which will be discussed further below.[1] [2] [3]

One of the main features of the 'Smarter Consumer Communication Initiative' is that it combines both the FCA's own commissioned research and the results of industry focus group and uses this to comprehensively summarise the main issues to be faced in relation to product disclosure. The main finding from the research is that the financial services sector is in a position to improve communications with customers and provides some signposts on how this

[1] Oxera research https://www.fca.org.uk/publication/research/review-of-literature-on-product-disclosure.pdf
[2] Financial Conduct Authority – Discussion Paper DP15/5 June 2015
[3] Financial Conduct Authority – Feedback Document FS16/1 October 2016

may be achieved. Importantly, the regulator recognised its own role in this process, and began by simplifying disclosure requirements, with the repeal of a number of ineffective disclosure requirements from its handbook.[4]

Published in March 2016, the HM Treasury commissioned the 'Financial Advice Market Review,' [5] which also visits issues surrounding product disclosure. In particular, Recommendation (8) details how firms can use advances in technology to find new ways to engage customers. While face-to-face advice is seen as the main way consumers seek advice, the increase in the use of mass-marketed, automated advice models (often referred to as Roboadvice) is increasing.

The publication of the FCA Mission statement in 2018 reiterates the regulators commitment to helping both the industry and consumers navigate the product disclosure space and promises further research in the area.[6]

Behavioural Biases and Heuristics Affecting Financial Decision Making

Product disclosure can be an integral part of a firm's advertising and marketing strategy, and as such commercial considerations about how much best practice to share is likely to be a barrier to improvement for the industry overall. It is acknowledged by the FCA that much of the research into product disclosure is carried out behind closed doors by firms operating in the industry. However, as mentioned above, some publicly available research has been carried out by the FCA directly or commissioned from third parties. The following section describes in more detail some of the more specific research carried out in relation to product disclosure, and the application of behavioural economics in this area.

Behavioural Economics and Product Disclosure

[4] Removal of a number of ineffective disclosure requirements. https://www.fca.org.uk/publication/policy/ps16-23.pdf
[5] Financial Advice Market Review – Final Report http://www.fca.org.uk/publication/corporate/famr-final-report.pdf
[6] FCA Mission statement, https://www.fca.org.uk/publication/corporate/our-future-approach-consumers.pdf

The first report into the use of behavioural economics by the FCA was published in April 2013;[7] 'Applying behavioural economics at the Financial Conduct Authority' explicitly states the regulator's intention to focus on understanding consumer behaviour, and how it can affect decision making in relation to the use of financial products. The report covers in-depth the ways in which consumers may be affected by behavioural biases and suggests a number of ways the FCA can intervene to help consumers make better decisions. Specifically, with regard to product information, the main areas seen as suitable for further investigation were stated to be a requirement for firms to provide information in a specific way or the prohibition of specific marketing materials or practice. In particular, the provision of better or 'smarter,' information, which reflects how consumers actually process information – for example, providing actual cash costs of an investment rather than percentages.

The 2013 report was first in a series of Occasional Papers produced by the FCA, and many of the subsequent Occasional Papers draw upon and expand the issues raised in the initial report, reiterating the regulator's continued commitment to the use of behavioural economics.

In October 2014, 'The Review of Literature on Product Disclosure,' was published by Oxera Consulting, on behalf of the FCA. This report draws together a number of different strands of both academic and commercial research. While primarily focused on the financial services industry, it also highlights examples from other industries where product disclosure has been improved, using different communication methods such as SMS text messages. The report also describes the many methods that have been used to inform improvements, such as targeted market research through to more experimental and randomized trials.

Published by the FCA is March 2017, 'Rules of Thumb and Nudges: Improving the Financial Well-Being of UK Consumers,' draws together all the previous strands of research, and suggests five financial rules of thumb for consumers to follow. In particular, recommendations from this report highlight that behaviour change is most likely to occur when information is received at the right time for the investor, and in the right way.

The next step in the research process is to now provide a framework to ensure consumers engage in the Disclosure Documentation Process.

[7] FCA (2013) 'Applying behavioural economics at the Financial Conduct Authority' Occasional Paper 1

Biases in the Disclosure Documentation Process

There is evidence of a lack of engagement by consumers: research carried out by the FCA attempts to quantify the scale of the problem in the UK. The Financial Lives Survey, first conducted in 2017, is the first wave of a new tracking study commissioned by the FCA.

The survey asks a number of specific questions in three areas, relevant to product disclosure: (1) Understanding of financial products; (2) Engagement with financial products; and (3) Product information. Key findings from the survey show that:

Understanding of financial products

- Of those with a residential mortgage, 2% disagreed that documentation is clear and understandable
- Of those making investments, 30% said they understood the information they were presented with very well, with 64% saying they understood it fairly well. 5% did not understand the product well.
- 4% of those receiving a pension statement did not understand it.

Engagement with financial products

- Of those with credit cards, only 22% of respondents said they had read the documents carefully, 60% only briefly looked at the credit agreement and pre-contract information, 13% did not read it at all and 5% did not know whether they had read the information.
- When respondents were asked about investment documentation, 33% stated they read it carefully, with only 43% stating they looked at it briefly. The numbers not reading the documentation at all were 9%, and a further 9% of respondents did not recall receiving any information. 6% did not know if they had read the documentation.
- 4% of respondents taking out, renewing or switching motor insurance policy in the last three years did not look at policy documents at all.

Product Information

- The quantity of information received when respondents took out their products was deemed to be too much by 8% of respondents, with 76% stating it was about right. 3% felt the information was too little, with 13% not knowing whether the quantity of material was sufficient.

- 5% of respondents who made a significant change to their mortgage in the last three years agreed that there was too much information to deal with during the mortgage application process.

While the data collected in the survey may have value in itself, it is clear that there are a number of contradictions in the way respondents report their own understanding of their financial products. For example, by comparing some of the responses described above, of those making investments over 94% stated they understood their product very well or fairly well, however, with only 33% reading the documentation thoroughly, this could be viewed with some scepticism. Likewise, as consumers may not understand their product fully, it is difficult to know how respondents conclude they have sufficient information.

A greater understanding of the disclosure documentation process would add insight and understanding of these behavioural contradictions.

Disclosure Documentation

Both advice and the financial documentation given by financial advisers to clients is in theory designed to provide the individual with the necessary information required to make an informed decision. This paper explores the influence of such advice and, in particular, the influence of financial documentation on investment decisions. Moreover, to what extent do investors understand and make use of the information they receive? This paper finds that the answer to this question depends on the characteristics of the documents, including readability of the document and the behavioural biases readers may be influenced by.

We consider the influence of financial documentation provided by an individual's financial adviser on investment decisions. From an economics perspective, additional information in the form of financial documentation would be significantly useful in terms of ensuring one makes an informed decision. As such, we would expect a rational investor to read such a document and use it to aid their decision-making process. However, comparable research on the subject carried out by (Alexander et al., 1998), in an analysis of 2,000 randomly selected mutual fund investors, find 40% of those surveyed state they have never read the mutual fund prospectus. Moreover, the likelihood of an investor both reading and comprehending the documentation is likely to be influenced by several factors. Firstly, one must consider the readability of such documents, in terms of comprehension and clarity. Complexity, in terms of readability, may

also lead to confusion or the client disregarding the information because they simply do not understand it. Secondly, one must consider that investors may not be able to objectively read the documentation, and instead may be influenced by the biases they exhibit when they are reading it, reducing the impact of the additional information.

Readability:

Analysis of the relevant literature has highlighted that the readability of financial documents has a significant influence on investor decision making. For example, in a study of financial documentation containing 12,771 observations from 1994 to 2006, (Miller, 2010) find the more complex the wording and structure, in terms of length and readability, the less the trading activity of smaller investors, as a result of investors experiencing difficulty processing the information. However, larger investors are less affected by readability. Moreover, in an experiment analysing the effects of the Security and Exchange Commission (SEC) emphasis on the use of 'plain English,' in documentation, (Rennekamp, 2012) finds more readable disclosures leads to a stronger reaction from small investors. With a positive change in value for good news, and a negative change in value for bad news. Moreover, the easy processing method of a more readable disclosure acts as a heuristic cue and encourages trust in the disclosure.

Furthermore, investors who have disclosures that are more readable revise valuations to be less extreme when made aware of variations in readability. The positive influence of readability is further illustrated by (Barron et al., 2004) in an experiment assessing the effect of readability of financial documents for both professional and non-professional investors. The authors find that while a higher level of disclosure did not influence the information generated from the documentation by professional investors, it led to more information inferred by a non-professional investor. This is further illustrated by (Bloomfield, 2002), who proposed that the costs of extracting useful information from data keeps people from understanding the true meaning of the statistics, and therefore are not reflected in the market. This has implications for the presentation of statistical information.

(Hirshleifer and Teoh, 2003) provide an explanation for the influence of readability. As investors have limited attention and processing power, disclosures which have the same information but are presented differently have a different effect on investor perceptions. Lower readability reduces the amount of relevant information they are willing and able to extract. The influence of the presentation of information is further illustrated by (Sedor, 2002), who find

that when a manger's future plan is framed as a scenario rather than a list, analysts have a more optimistic view. This has implications for the provision of financial documentation, as information presented in a scenario may encourage optimism, which may in-turn be a double-edged sword from a behavioural perspective.

This section has highlighted the importance of ensuring the information in financial documentation is depicted in a clear and readable manner. This is simply to increase the chances of the document being read, and important information being comprehended. This would aid informed decision making and encourage the most optimum method of information provision.

Objectivity of Comprehension

This section considers that even if investors were able to adequately read and comprehend financial documentation, they may not be able to do so objectively. This subject considers basic behavioural economic theory, and the biases investors exhibit when making financial decisions. This introduces the idea that though investors may be seeing the additional information, it may be having an inefficient influence on their decisions.

Firstly, as illustrated by (Kent Baker and Nofsinger, 2002), when making an investment decision, in order to decrease the complexity and scale of the information, the brain filters some of the information and creates short cuts. This process is known as heuristic simplification and leads to the existence of several biases. Furthermore, as a consequence of the effects of cognitive dissonance, investors reject information which conflicts with their beliefs and unconsciously ignore memories which suggest otherwise. This implies any information contained in financial documentation which contradicts the investor's belief will be disregarded. The effects of cognitive dissonance are illustrated by (Goetzmann and Peles, 1997), who measure the recollection of mutual fund investors by asking both architects and members of the American Association of Individual Investors what their return was last year, and by how much they beat the market. The architects recalled investment performance of 6.22% higher than actual, and reported they beat the market by 4.26% more than they did. This compares to member investors, who overestimated past returns by 3.40% and overestimated performance relative to the market of 5.11%. This behaviour is similar to the self-attribution bias identified by (Griffin and Tversky, 1992), which suggests investors are more prone to attributing success to their own abilities, but losses to bad luck.

As individuals wants to believe their investment decisions are the right ones, their brains may filter out contradictory evidence, including the information contained in financial documentation.

An alternative effect of additional information is related to the overconfidence bias. As explained by (Kent Baker and Nofsinger, 2002), the 'illusion of information,' concept suggest that new information makes investors feel more informed and knowledgeable, and investors tend to interpret this new information as a confirmation of prior beliefs. This leads to individuals exhibiting overconfidence. Furthermore, Barber and Odean (2008) state investors overestimate the precision of the information they have and exhibit bias when interpreting new information. Similarly, (Slovic et al., 2004) find overconfidence will have an influence on the processing of information, with investors tending to be overconfident with regards to their own judgements.

There is significant evidence of the effect of overconfidence on investment behaviour. In an experiment calculating the effect of an increase in confidence, measured using calibrated confidence and the illusion of control, (Slovic et al., 2004) find increased confidence led to an increase in trading activity. The influence of overconfidence on investors is also illustrated by (Barber and Odean, 1999), who in a study using data from over 35,000 households from a discount brokerage – from 1991 to 1997 – find overconfidence. In particular, they find men exhibit higher levels of overconfidence than women, with women showing a 1.72% reduction in overconfidence. The existence of overconfidence is further illustrated by (Bhandari and Deaves, 2006) who, in a survey of 2,000 defined pension plan members, find evidence for overconfidence in investors. The demographic factors, which seem to explain higher levels of overconfidence, are higher education, gender, proximity to retirement, ability to receive investment advice and experience of investing.

Furthermore, it's apparent that investment decisions are likely to be influenced by the way information is framed in financial documentation. For example, in an asset market experiment in which 64 subjects traded two assets, (Kirchler et al., 2005) find that objectively irrelevant information has an effect on trading behaviour, with positively and negatively framed information leading to particular patterns. The authors also find evidence of the disposition effect, as investors who experienced a gain sold the asset more rapidly compared to those who had experienced a loss. This is similar to the risk-taking behaviour found in subjects by (Kahneman and Tversky, 1979).

This section highlights the importance of ensuring that financial documentation is designed in the most appropriate way to encourage optimum investor decision making. Documents need to be clear and concise, while ensuring important information is not unconsciously filtered. Language and presentation that minimises or eliminates framing effects should be used, with a simple and concise format coupled with appropriate warnings.

It is apparent there is a significant lack of research, which assess the likelihood of investors reading the financial documentation provided to them by their financial advisers. However, one can use insights from behavioural economic theory to develop an understanding of how additional information may influence investor decision making. An important implication of this paper is the variety of factors which influence the likelihood of an investor reading the relevant financial documentation. Firstly, a lack of readability is likely to discourage investors from reading the documentation and may even increase the complexity of the decision-making process, leading to decisions that are more difficult. Therefore, information should be presented in a clear and understandable manner. Secondly, a lack of consideration of the features of financial documents, such as the way in which information is framed and presented, may encourage or increase the effects of behavioural biases. As a result, in order to encourage optimal behaviour, one should ensure information is presented in a clear and unbiased way to limit the influence of behavioural biases on investors. Overall, the analysis has outlined the importance of appropriate advice and documentation to ensure investors are making the most optimal choice, based on their objectives.

Behavioural Biases in Disclosure Documentation Delivery

While the previous section describes potential issues with documents themselves, an often overlooked but vital component of this customer journey is the timing and method of delivery and receipt of the disclosure documentation. Crucially, there is a considerable scope for behaviourally targeted interventions in this process.

The timing and method of delivery are vital in the understanding and digestion of disclosure documentation. Ultimately, those taking financial advice have decided to behaviourally defer responsibility to their adviser which provides a closing of receptiveness in the process. Furthermore, the final documentation received post-purchase is given in a behaviourally closed mind-space.

Understanding the Disclosure Documentation Process

In order to suggest behavioural improvements to the disclosure documentation process, we undertook a comprehensive review of industry-wide documentation, subjecting documents to a behavioural audit[8] and a participant driven examination of the delivery process.[9]

Review of Disclosure Documentation

A random sample of financial product terms and conditions for products available in the UK (N = 176) were analysed first for readability. After, a behavioural audit (BA) was performed, analysing the documents for behavioural biases, heuristics and framing effects that may impact a user's comprehension of the document. Of the 176 documents, 37% were for non-ISA savings products (current accounts, etc.), 30% were insurance products (largely home insurance products with various degrees of contents cover, and travel insurance with various optional cover), 11% were for ISA products, 9% for pension products (including SIPP products), 7% for credit card and 6% classified as other products (these include wealth management services, personal loans, bonds and so on, and only account for 10 of 176 observations). This breakdown is summarised in the table below:

TABLE 1: Product Type Breakdown

Product Type	No. of Observations	Percentage
Non-ISA Savings	65	37%
Insurance	52	30%
ISAs	20	11%
Pensions	16	9%
Credit Cards	13	7%
Other	10	6%
Total	**176**	**100%**

Determining a Behavioural Audit Score

While a degree of subjectivity will persist in any behavioural audit, a BA framework was established against which all documents were analysed to ensure consistent basis for analysis. The purpose of the BA was to identify opportunities where a behavioural bias, heuristic or

[8] A screening process for behavioural biases and heuristic drivers.
[9] The final report due on the 28th February 2019 also includes a focus group of participants to further examine this point.

other effect could impede a customer's understanding of the content of the document, even though all legally required disclosure material was present.

For example, research finds people often evaluate prospects differently depending on whether they are framed as gains or losses (Tversky and Kahneman, 1992). When considering an investment product, therefore, the framing of risks and returns (for example, discussing returns before discussing risks) is a potential behavioural deficiency, which in turn may impact an investor's understanding of their product.

The behavioural audit framework utilised is set out below:

TABLE 2: Behavioural Audit Framework

Behavioural Deficiency	Overview and Example
Framing or gains/losses	Giving emphasis to one outcome over the other, for example discussing gains more than losses.
Default positions	Setting defaults without explanation of why a default is set, or without emphasis on the act of default setting, for example defaulting to a different rate after a period.
Salience (text)	Choosing to emphasise certain aspects of a document with creates greater salience, for example a large, bold title for one aspect of the document vs. a smaller title for another part.
Salience (graphics)	Using colours and graphics with suggest positive/negative outcomes, for example the use of the colour green may minimise an appreciation of risk; the use of a tick bullet point may imply a positive statement.
Complexity	Using overly complex tables/figures/appendices to explain crucial information, for example referring to paragraph numbers (e.g. 1.2.a) rather than subheadings. Alternatively, overly simple constructions may also be ineffective.
Information Overload	Providing too much information/too disparate information within a short section of text, for example referring to multiple parties/departments involved in providing a product.
Embedded Heuristics	Referring to or establishing rules of thumb, heuristics and other mental short-cuts which reduce reader engagement with relevant material or misrepresent important ideas. For example, "investments can go up or down," acknowledges risk but does not inform of risk level.

Data Descriptions

In conjunction with the behavioural audit score described above, a readability score was calculated for each document in the sample. These scores are summarised below, by product type and as a single sample (N = 176):

TABLE 3: Readability and BA Scores

	Readability		BA	
Product Type	Mean	Range	Mean	Range
Insurance	51.6	27.7	7.5	4.7
Credit Cards	54.6	8.8	7.8	2.2
Non-ISA Savings	54.5	43.9	7.6	5.7
ISAs	52.4	28.0	7.9	5.1
Pensions	48.2	25.9	7.6	4.5
Other	47.6	26.0	8.6	3.5
ALL	**52.1**	**26.7***	**7.7**	**4.3***

*** = average of ranges**

Readability Score

As seen above, where a readability score of 100 is perfectly readable and 0 is impenetrable to the average reader, all reviewed documents performed poorly, with an average score of 52.1. Pension documents performed particularly badly on the readability measure, while non-ISA saving products and credit card products performed the best. However, with average scores of 54.5 and 54.6 respectively, these were by no means notably accessible to the average reader. However, the range, which is the greatest recorded score less the smallest recorded score, is also a worthwhile indicator to consider.

The remarkably small range for credit cards of 8.8 suggests credit card documentation was very consistent in its readability, whereas the large range of 43.9 found for non-ISA savings documentation suggests a large amount of variability in the readability in the documentation for these products. All other products were in line with the average readability score and range (around 52 and 27, respectively).

BA Score

For the BA score, a score of 10 represents no behavioural deficiencies, while a score of 0 represents a significantly behaviourally deficient document, where each identified deficiency

reduces the score by 0.1. The average BA score was 7.7, demonstrating that the average document had 23 behavioural deficiencies that could inhibit a reader's understanding of the content of the document. While 'Other,' documents appeared to perform the best for the BA, this group was undefined and therefore likely anomalous. ISAs followed by credit cards were subsequently the best performing document type for bias, however all document types were relatively similar with a behavioural bias count around the mid-20s.

As with the readability score, credit cards had a remarkably small range (2.2) compared to all other document types and the average range of 4.3. This suggests the number of behavioural biases for credit card documents was more consistent, and taken with the readability score findings, highlights a potential future avenue of exploration.[10] Non-ISA savings were the second most biased document type, but there was also a lot of variability in this result, with the best and worst performing non-ISA savings documents differing by 57 behavioural biases.

Initial Conclusions

We noted significant (but expected) readability issues and a considerable number of behavioural biases, heuristics, complexity and framing issues. We would note that technical documentation generally averages around a score of 50 and industry-wide we found that documentation clustered around technical readability. With greater availability and drive toward private pension provision we would suggest a broader average readability target of 60-70. We also subjected each document to a behavioural audit, with a score of 0 indicative of significant behavioural issues in the document and a score of 10 indicative of a behaviourally neutral document. Here the industry saw significant variability with numerous areas for potential improvement.

This reveals an interesting, but expected, picture of industry-wide documentation being relatively difficult to understand and digest with the potential for behavioural biases, heuristics and complexity to further add to the difficulties with comprehension.

Addressing Behavioural Issues

[10] It should be noted that a small range is most likely due to the small sample size for credit card documents (N = 13). However, this does not explain everything. For example, the 'Other,' grouping and Pension product type have small samples too (N = 10 and 16, respectively), but relatively average FRE ranges (28 and 26). If a small sample was entirely responsible for the small range, it would be expected that the ranges for FRE and BB for Other and Pensions would be much smaller than they are.

As noted, even using a comprehensive behavioural framework to analyse documents for potential issues, there is a subjective element that cannot easily be eliminated. While it should remain an aim of the industry to embed behavioural insights into the document design process, a customer orientated approach should therefore be prioritised.

Delivery Mechanism: Tier 1 – Understanding Literature and The Client Journey

When considering our criticisms of the existing documentation, an often-overlooked aspect is the actual delivery of this information to the customer. A typical customer journey could look like:

1. **Initial Decision to Purchase a Financial Product and Seek Advice**
   The initial decision both to purchase a financial product and to choose an adviser has considerable implications for the customer's behavioural profile. For example, choosing to seek advice and actively participating in longer-term financial planning may be indicative of particular personality types which have implications for the use, understanding and digestion of disclosure documentation.[11]

2. **The Client Meeting**
   While the customer may feel that the adviser is significantly more important during the meeting than the literature, the literature could be of vital importance for the client to refer to at a later stage, or to refresh some of the information previously discussed in the meeting. As such, the role of the adviser is key in terms of ensuring the client understands the literature. Generally, a customer will receive a Terms of Business Document, a Fees Document, complete a Risk Tolerance questionnaire and receive technical details (for example, past performance) about their product type.

3. **Follow-up communication**
   After the meeting, generally financial advisers send the client a document detailing various recommendations designed to help achieve the client's long-term financial objectives. The recommendations outline the optimum composition of assets for the client based on the risk tolerance suggested Risk Tolerance questionnaire and any other psychometric tests which

[11] More research is required here to refine any suggestion for intervention or improvement.

may have been performed. This may help to ensure that the client knows the types of funds that their investments could be invested in.

4. Longer Term Processes

Generally, the customer will receive an annual statement detailing product performance, fees and projections, however there is considerable evidence (FCA, 2017) of limited readership and digestion of this material:

"2 million UK adults say they have a defined contribution pension, have received and read their annual statement in the last year and did not understand it very well or at all."[12]

This finding highlights the importance of ensuring clients leave the meeting with their financial adviser feeling adequately knowledgeable about their product, and with accessible supplementary material, to continue engaging fully and productively with their financial products.

Throughout the client journey, there are areas where an enhanced readability strategy could improve the understanding of clients, benefiting both the client and the product provider.

As potential customers search out products and perform initial enquiries, ensuring materials are sufficiently informative as well as welcoming and understandable can ensure a positive start to the client/adviser relationship.

An Industry-standard readability score

Prior to, during and after any client meetings, the adviser and the product provider needs to take steps to ensure that the client understands all the documentation, so it may be referred to by the client at a later time. These meetings will vary in the quality of communication between the adviser and client and the amount of time available for both parties. This parallels patient/doctor and client/lawyer meetings in the medical and legal industries, both of which have or are encouraging set standards for document readability using industry-specific readability scores. Establishing a financial industry-specific readability standard would afford

[12] FCA (2017) – The Financial Lives of Consumers Across the UK: Findings from the FCA's Financial Lives Survey 2017.

an adviser and the product provider greater confidence that the client is in a position to make an informed decision.

An industry-standard readability score would also enhance any follow-up communication and improve the conditions for future decision making. The adviser may not always be physically present to explain a product's recent performance, future recommendations or required decisions. Ensuring that key documentation complies with an industry-standard readability score would rectify this communicative shortfall.

An evidence-based, industry-standard readability score could be developed by considering documentation relating to a wide-variety of products aimed at a spectrum of financial profiles and would also integrate other industry and regulatory standards such as fiduciary responsibility and consumer protection from predatory practice, to name but two. Additional findings such as biases identified by behavioural economics could also be integrated.

Further, while not captured by general-readability scores, an industry-standard score could be built to appreciate the specific lexicon of financial language and the specific features of financial products. For example, compound-interest is a phrase commonly used in the financial sector, and the effects of compound interest are often explained to clients using an example calculation. Where a general-readability score renders these aspects of financial documentation difficult to read, an industry-specific readability score could be adjusted to reflect these aspects appropriately.

Until such a score is developed, however, financial disclosure material should aspire to meet a standard of readability that is acceptable for most people. Ensuring documents have a readability score of above 60 would enable a financial product provider to begin to see some of the benefits identified in our client journey framework.

Delivery Mechanism: Tier 2 – A behaviourally targeted disclosure documentation process

A considerable amount of personality data and propensity for various behavioural biases and heuristics is collected in the established customer journey process, mostly through the Risk Tolerance questionnaire but also potentially through web tracking data and customer contact.

We would suggest using this data to provide a beyond compliance approach, supplementing the established disclosure documentation process with an automated but bespoke intelligent content creation and delivery system. For example, by understanding individual client cashflows and spending habits, inappropriate financial products/recommendations could be automatically filtered, cutting down on the level of work and potential confusion experienced by the client, and allowing the financial adviser to target their recommendations for the maximum client benefit.

Further, while the existing delivery system has several advantages such as providing a safety net of compliance and entire customer coverage, we believe these advantages can not only be maintained but extended by using behavioural economics and data science approaches. For instance, the Risk Tolerance questionnaire (where it does not already) could be modified to include discovery questions concerning myopia, status quo bias, confirmation bias, overconfidence and a variety of relevant biases. Coupled with a customer's activity on the adviser's website, this could be used to design reasonably accurate, 'disclosure document reader types,' which in turn would suggest (automated) strategies to increase the likelihood of understanding and digestion of the disclosure documentation.

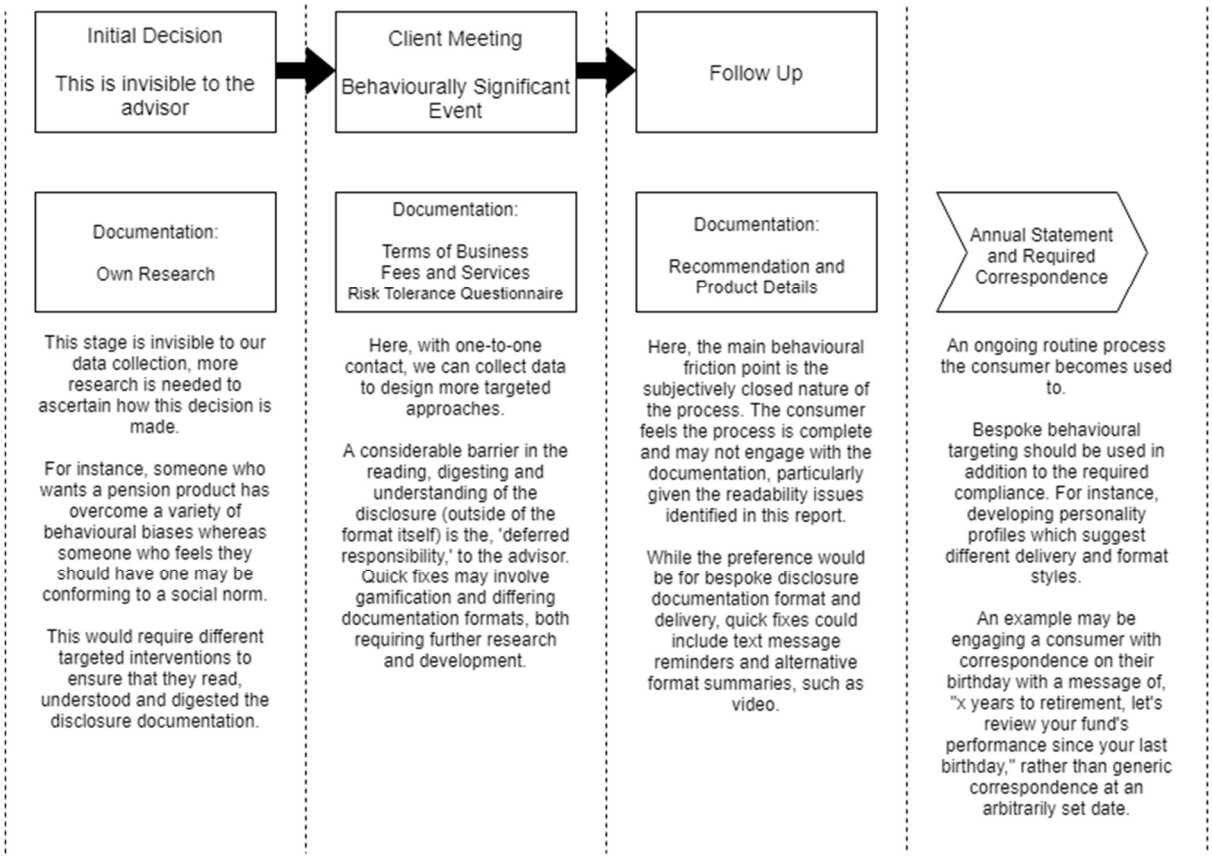
Overconfidence, for example, is pervasive within the consumer finance sector. In 2017, the FCA published, 'The Financial Lives of Consumers Across the UK: Findings from the FCA's Financial Lives Survey 2017,' within which the authors noted that a significant number of people fail to read their documentation but believe their funds are generally doing well. This is a simple example of how overconfidence can manifest and the consequences it can have on financial decision making. Fortunately, most standard risk profiling questionnaires can indicate overconfidence (and where a questionnaire is inadequate, this adjustment is reasonably easy to implement). This data could form part of a customer's behavioural profile, which would be used to design personalised interventions (Sunstein, 2014). For example, an overconfident customer could be automatically sent a text message reminder, nudging them to read their documentation in more depth (Cadena and Antoinette, 2011; Altmann and Traxler, 2012).

Existing, potentially under-utilised customer data could also be incorporated too. Recent research has found sending reminder text messages around important dates, for example a birthday, can have a compelling impact on customer behaviour (Beshears et al. 2016). This, 'fresh start,' nudge could be used to schedule reminder nudges and annual performance documentation.

We would suggest a trial of various interventions in order to fully build a personality profile database and thus subsequent bespoke (automated) content and delivery processes. This would allow for far greater precision in targeting while ensuring the whole customer coverage by incorporating the established processes.

In addition to client-focused behavioural interventions, we would encourage the integration of behavioural auditing into a best-practice approach. Frequent behavioural audits of documentation would identify and minimise, 'behavioural traps,' which might harm customers' understanding and performance.

Delivery Mechanism: Small Change, Big Results



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Notes

The contents of this report concern the behavioural economic analysis of literature and website and processes. The Authors, The Future Economies University Research Centre and The Manchester Metropolitan University have made suggestions and potential recommendations based solely on the application of Behavioural Economics theory. Prior to any action being taken from this report, the

regulatory, financial and business operation aspects should be fully considered, checked and approved by an appropriately qualified individual.

Furthermore, The Authors, The Future Economies University Research Centre and The Manchester Metropolitan University, whilst completing the report in good faith and with the appropriate expertise wish to state the subjective nature of Behavioural Economics and thus that the recommendations are built on general principles which may not be applicable to individual consumers.

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