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Consumers struggling to understand structured products as Financial Conduct Authority calls for improvements from firms

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A [behavioural economics research paper](#) published today by the Financial Conduct Authority (FCA) has found that many consumers overestimate the expected returns on structured deposits.

Consumers were asked to anticipate how the FTSE 100 would grow over time and then asked for their expectations for structured deposits linked to the FTSE 100 during the same period. While consumers' expectations for FTSE growth were in line with the FCA's assumptions, they did not match the returns they anticipated on structured products based on the same benchmark. The FCA found that, on average, returns were overestimated significantly, by almost 10 percent of the assumed investment amount over five years.

The FCA also found that consumers did not recognise that the structured products designed for the purpose of the research were unlikely to offer greater returns compared to best-buy fixed-term cash deposits. Indeed, consumers needed to be offered relatively high rates of return on risk-free cash deposits for these products to be preferred to structured deposits. However, targeted disclosure somewhat improved how consumers make these comparisons.

The research findings reinforce the importance of firms designing structured products that are a reasonable match for the financial sophistication of customers in the target market. The FCA considered this as part of its assessment of how a sample of firms designed and manufactured structured products, which is also published today.

Tracey McDermott, director of supervision and authorisations at the FCA, said:

"There is a place for structured deposits in the market. But our research shows that many consumers find it difficult to understand how these work and compare them to alternatives. That is why it is crucial that firms ensure the way they design and market these products is driven by the needs of consumers. Our work indicated that this is not always the case.

"For consumers, the message is simple – think very carefully before buying a product if you don't understand how it works and if you're unsure, ask for more information or consider seeking financial advice."

The FCA's discovery work with firms highlighted a number of areas of concern where some firms were falling short of expected standards. In particular:

1. Firms' senior management must do more to put customers at the forefront of their approach to product governance. This should begin with the identification of a clear target market during product design and then inform each subsequent part of the product development and distribution strategy.
2. Structured products should have a reasonable prospect of delivering economic value to customers in the target market. Firms must be able to determine and evidence this via robust stress testing as part of the product approval process. Products that fail this process should not be manufactured nor distributed.
3. Firms need to provide customers with clear and balanced information on each product and any risks. This is particularly important for information explaining the likelihood of potential investment returns and any risk to the customer's capital.
4. Manufacturers need to strengthen the lifecycle monitoring of their products. This includes ensuring distributors have enough information about the manufacturer's product to sell it appropriately and that each product is being distributed to its identified target market.

The FCA has asked some of the firms involved in the review to undertake more work to see whether any of the issues identified may have resulted in consumers being disadvantaged.

Previously published guidance provides firms with a clear framework to develop products in a way that allows for a good result for consumers. While the FCA believes that the current regulatory regime is clear, it has said that if on-going supervision of this market does not show firms responding to its findings further regulatory action will be considered.

Notes to editors

1. [Occasional Paper No. 9: Two plus two makes five? Survey evidence that investors overvalue structured deposits](#)
2. [TR15/2: Structured Products: Thematic Review of Product Development and Governance](#)
3. [Structured Products - Qualitative research with consumers](#)
4. [Retail Product Development and Governance – Structured Product Review](#), March 2012
5. [Responsibilities of providers and distributors for the fair treatment of customers](#), July 2007
6. On the 1 April 2013 the Financial Conduct Authority (FCA) became responsible for the conduct supervision of all regulated financial firms and the prudential supervision of those not supervised by the Prudential Regulation Authority (PRA).
7. The FCA has an overarching strategic objective of ensuring the relevant markets function well. To support this it has three operational objectives: to secure an appropriate degree of protection for consumers; to protect and enhance the integrity of the UK financial system; and to promote effective competition in the interests of consumers.
8. Find out [more information about the FCA](#).

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