

PUTTING FINANCIAL REGULATION TO WORK: USING SIMPLIFICATION AND VISUALIZATION FOR CONSUMER-FRIENDLY INFORMATION

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Abstract: *Financial regulation and investment products have become more and more complex. Information disclosures tend to be off-puttingly long and densely texted documents. Investor behavior studies indicate that investors often skip and skim information – and even worse, sometimes they do not read it at all. Investors' abilities to comprehend and use financial information give no reason to cheer, either. Fortunately, we have tools to overcome complexity. Building on our previous work where we have applied simplification and visualization to improve the communication of contracts, this paper explores the use of these approaches to financial communication.*

1. The Challenges of Financial Regulation

In the end of the 2000s the world economy faced its worst financial crisis since 1929. Failures of corporate governance in the financial sector were one significant reason for the crisis. Risk assessment efforts failed for all market participants: investors, financial firms as well as their supervisors. The characteristics of the new highly complex financial products were not properly understood by financial firms' management or their owners.¹ The EU reacted to the crisis by creating a mass of new financial markets regulation. During the past few years approximately 80 new statutes concerning financial markets have been enacted. This creates major challenges especially for small and medium-size actors.² New fundamental regulation will still be issued concerning, for example, investment advice. The renewed Directive on Markets in Financial Instruments (MiFID), Market Abuse Regulation, Insurance Distribution Directive and new regulation on Key Information Documents for packaged retail and insurance-based products (PRIIPs) are going to be applied in the near future, as shown in Figure 1 below.

¹ The de LAROSIÈRE GROUP 2009, p. 6, 8, 10.

² See, e.g., FEDERATION OF FINNISH FINANCIAL SERVICES 18 September 2015, p. 1–2.

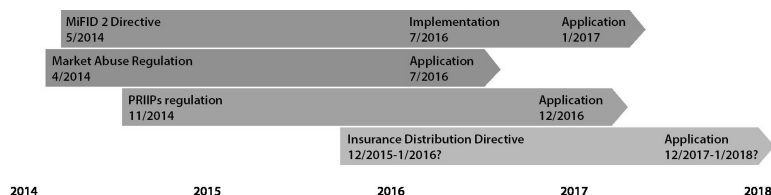


Figure 1: New EU Regulation on the Investment Sector

1.1. Complexity Caused by the Quantity and Quality of Regulation

The implicit assumption behind the ever-growing EU-regulation on financial markets seems to have been: *the more information the better*. However, information is only effective when it is understood and used. For those who are regulated, additional compliance costs and comprehension challenges are caused by the complexity of the information. This stems not only from the quantity but also from the quality and understandability of the information.

The EU has recently paid attention to the overwhelming EU legislation through its Regulatory Fitness and Performance (REFIT) program. According to the European Commission's Better Regulation Guidelines, the Commission should prepare «*well-drafted, high quality legal texts that are easy to understand and implement*».³ The European Economic and Social Committee (EESC) has noted that a *proactive approach*⁴ should be applied in order to achieve better lawmaking. Instead of focusing on failures, EU legislation should aim at securing future success. Better regulation, simplification and communication have been promoted by different EU instances as main policy objectives in completing the Single Market.⁵ A Joint Practical Guide is intended to provide assistance for those who are involved in drafting. The Guide states that legal acts should be drafted *clearly, simply and precisely*,⁶ which includes avoiding unnecessary elements, uncertainty and ambiguity. Good drafting is extremely important in Union level regulation, which must fit to the complex, multicultural and multilingual system. The persons to whom the regulations are intended to apply as well as the persons responsible for putting the regulations into effect should be taken into account in drafting.⁷

1.2. Struggling with Complexity – Investors' Perspective

From the perspective of investor protection, the main response to the financial crisis has been the introduction of new disclosure mandates. Disclosures are intended to prepare people for complex decisions which can be unfamiliar to them. Disclosure mandates have good aims, yet investors⁸ do not always benefit from them. Investors can be lazy decision-makers and overlook and skip prospectuses and other information:⁹ the British Financial Services Authority (*now* Financial Conduct Authority) has observed that the core problem concerning disclosure regulation is that people do not read the material.¹⁰ Even when people read the information, they do not always understand it. A research area called *behavioral finance* has focused on the cognitive limi-

³ EUROPEAN COMMISSION 2015, Better Regulation Guidelines Guidelines on preparing proposals, implementation, and transposition, available at http://ec.europa.eu/smart-regulation/guidelines/toc_guide_en.htm.

⁴ For Proactive Law and its origins in Proactive Contracting and the Nordic School of Proactive Law, *see, e.g.*, SIEDEL/HAAPIO 2010, MAGNUSSON SJÖBERG 2008, p. 43–56.

⁵ EESC OPINION 2009, 4.2. Especially the European Commission, the European Parliament and the EESC have argued for these goals.

⁶ EUROPEAN PARLIAMENT, THE COUNCIL AND THE COMMISSION 2014, Joint Practical Guide 2014, p. 7.

⁷ *Id.* p. 7, 9.

⁸ In this paper, «investors» refers to «retail clients» as defined in MiFID 2 (Art 4).

⁹ BEN-SHAHAR/SCHNEIDER 2014, p. 4, 8–10.

¹⁰ FSA 2003, 6.

tations of financial actors.¹¹ Investors as well as other actors of the financial markets are affected by cognitive biases in their decision making. They can be overly optimistic about what they know, or stress information that confirms their intrinsic choices.¹²

European Insurance and Occupational Pensions Authority, EIOPA, has noted that lengthy disclosures are being superseded by an approach which takes into account the presentation of information based on insights into consumer behavior and cognition. Certain styles of presenting information may help to counter cognitive biases that distort decision making.¹³ EIOPA lists among its strategic goals *preventive consumer protection* which aims at anticipating future problems rather than merely reacting to the past.¹⁴ In this paper, we take this approach one step further and focus on an approach that might be called *proactive investor protection*. Instead of problems, our perspective is positively oriented towards making information more usable and useful. As the EESC put it, «A piece of legislation is not the goal; its successful implementation is». Implementation should be understood broadly, not just as enforcement by institutions but also as acceptance and resulting change of behaviors.¹⁵

2. Overcoming Complexity by Visualization and Simplification

Recent research points to the direction that merging Proactive Law with a new, user-centred approach to information design can enable overcoming many of the complexity challenges. Research and case studies carried out in the context of legislation¹⁶ and contracts¹⁷ demonstrate how changing their design and the ways in which they are communicated can lead to better comprehension and enhanced usability. Contracting is an essential element of financial markets. Obtaining financial products actually means contracting. According to PRIIPs Regulation (Art. 6), a key information document is a *pre-contractual* document. In a broad sense, investment products *are* contracts, some even by name.¹⁸

There are several proactive suggestions for reducing the current complexity. In the following we focus on simplification and visualization. These approaches can reduce the readers' cognitive load and thus the barriers to effective communication.¹⁹ Together, they are important parts of a broader move toward improved decision making and better investors' choices. Section 3 will offer examples where these approaches have been implemented.

2.1. The Possibilities of Simplification and Visualization

The proponents of plain language²⁰, simplification²¹, minimalism²² and lean contracting²³ have suggested major changes in document design and drafting along the way, but until now, not much seems to have happened in the fields of legislation, information disclosure, or contracting. Instead, the trend seems to have been towards

¹¹ BEN-SHAHAR/SCHNEIDER 2014, p. 55.

¹² See, e.g., GARCÍA 2013, p. 1–7.

¹³ EIOPA, What will change with the Key Information Document, <https://eiopa.europa.eu/consumer-protection/consumer-lounge/what-will-change-with-the-key-information-document>.

¹⁴ EIOPA 2015, p. 6.

¹⁵ EESC OPINION 2009, 2.5.

¹⁶ See, e.g., WALLER 2015.

¹⁷ See, e.g., PASSERA 2015. See also HAAPIO/BARTON (forthcoming).

¹⁸ For example, capital redemption contracts. See, e.g., FINNISH FINANCIAL SUPERVISORY AUTHORITY 2014.

¹⁹ See, e.g., PASSERA 2015, PASSERA/HAAPIO 2013.

²⁰ FELSENFELD/SIEGEL 1981, KIMBLE 2006 and 2012.

²¹ WALLER 2011a and 2011b.

²² HETRICK 2008.

²³ WEATHERLEY 2005 and SIEDEL/HAAPIO 2010.

more complex information.

In recent years, new user-centered design approaches have started to change the picture. In the field of consumer contracts, experiments have proven how loan documents and credit card agreements can benefit from a new, more user-friendly approach.²⁴ Several projects have looked into the simplification of online Terms & Conditions, end-user licenses, and privacy policies through the use of a preview including icons highlighting the most important terms.²⁵

Information design scholarship recognizes two main approaches to the simplification of complex information: *optimization*, which includes plain language and clear typography that improve but may not fundamentally change a given document; and *transformation*, which includes a range of more radical strategies such as distillation, abstraction, layering and visualization.²⁶ Visualization employs images to supplement text. Graphs, charts, timelines, diagrams, flowcharts, decision trees - all of these and more can depict information into more easily digestible formats. In the context of contracts, the aims of visualization have been summarized to include, for example:

- Clarifying what written language does not manage to fully explain;
- Making the logic and structure of the documents more visible;
- Giving both overview and insight into complex terms and processes;
- Supporting evidence, analysis, explanation, and reasoning in complex settings;
- Providing an alternative access structure to the contents, especially to the non-experts working with the document;
- Engaging stakeholders who have been alienated by the conventional look and feel.²⁷

2.2. SPs and KIIDs as First Steps toward More Usable Investor Information

The need for simplified investor information has not gone unnoticed by the EU. In 2001, the EU introduced simplified prospectuses (SPs) intended to provide investors with *key information* on transferable funds. However, SPs were still found to be too long and not understood by investors.²⁸ In 2012, key investor information documents (KIIDs) replaced SPs within UCITS (Undertakings for the Collective Investment in Transferable Securities). KIIDs are intended to be shorter and more illustrative than SPs. The KIID template by CESR²⁹ contains two pages, including core information of the central characteristics of the fund as well as visuals of risk and profit. Hence, simplification and visualization efforts are utilized.³⁰

The use of simplified documents is going to be extended to packaged retail and insurance-based investment products (PRIIPs). The regulation on Key Information Documents (KIDs) will be applied from the end of 2016 (PRIIPs regulation). KIDs are intended to be simple and standardized documents which give key facts of the product. According to the regulation, the format, presentation and content of the information of KIDs must be carefully calibrated in order to maximise the understanding and usage of information. Under Art 6 of PRIIPs regulation, a KID should be a short document, maximum three A4 pages. The layout must be constructed in

²⁴ US CONSUMER FINANCIAL PROTECTION BUREAU (CFPB) 2011 and SIEGEL/ETZKORN 2013.

²⁵ For a summary, see LANNERÖ 2013; for updates, see Related Work, <http://commonterms.org/Related.aspx>.

²⁶ WALLER 2011b.

²⁷ PASSERA/HAAPIO/BARTON 2013.

²⁸ EUROPEAN COMMISSION 2007, Exposure Draft, 5.

²⁹ Committee of European Securities Regulators, *now* ESMA.

³⁰ CESR's template for the Key Investor Information document 2010.

a way that is easy to read, and the language used should be clear and comprehensible, with a focus on key information that retail investors need. Draft regulatory technical standards and a preliminary KID template were published in November 2015. The European Supervisory Authorities (ESAs) are expected to submit finalized standards to the EU Commission by the end of March 2016.³¹

3. Toward More Usable Financial Information

EU requirements regarding simple documents giving key facts to investors in a clear and understandable manner and representing risks and return in simple, meaningful ways are a welcome step to the direction of simplification and visualization. The high degree of standardization makes it possible to automate document production. In fact, several companies already offer document production services concerning investor information documents.³² Standardization, templates and models provide valuable assistance in implementing the legislation.³³ In addition to helping implementation, such tools aid document producers in their work, especially when the templates, icons and materials are easy to copy and to use.

The standardization of KIDs enables easier comparison between products, both online and offline, and also between products offered in different EU countries. While the languages may differ, the core details are recognizable at a glance due to the documents' highly standardized layout and graphics. Search engines could be created where investors can stress the qualities they prefer and choose the best «match» among the products. Possibilities of cognitive computing and AI-powered apps might be utilized in this area. Of course, the divergence of the products brings challenges to effective comparison and analysis.

The emergence of KIIDS and KIDS deserves notion as a landmark process within the EU financial markets law.³⁴ Both were preceded by extensive consumer testing, the studies indicating clearly that consumers prefer simpler documents: bullet points are preferred to full paragraphs and dense texting. Simpler documents were also associated with better understanding of the content and visuals were much appreciated.³⁵

The current prospectuses on complex financial products are often far from consumer-friendly with their long and extremely dense text. After 2016, these products are mandated to follow the new KID format. The Figure below (Figure 2) shows a prototype of the layout of a KID document produced following the draft regulatory technical standards by ESAs. Figure 3, in turn, illustrates a crucial part of the template, a summary risk indicator, which is intended to help investors in choosing and comparing products.³⁶ Visualization and simplification efforts are prevalent in the draft template.³⁷

³¹ EBA 2015, Joint Committee launches discussion on PRIIPs key information documents. UCITS are coming under the same regulation after a transition period of five years.

³² See, e.g., FundConnect, <http://fundconnect.com/products-services/kiid-services.html> and Kii Hub, <http://www.kiihub.com/>.

³³ In addition to KIDs, the EU has paid attention to helping implementation within its recent Directive on Consumer Rights. The Guidance created includes an optional model for presenting information on digital products. The model includes a collection of illustrative icons. DG JUSTICE GUIDANCE DOCUMENT 2014, p. 70–72.

³⁴ See, e.g., MOLONEY 2014, p. 250–253.

³⁵ LONDON ECONOMICS 2015, xii, p. 193–194, 196. See also IFF RESEARCH AND YOUGov 2009.

³⁶ Draft regulatory technical standards by ESAs, 2015, p. 49.

³⁷ The official template is expected to be published in the Spring of 2016.

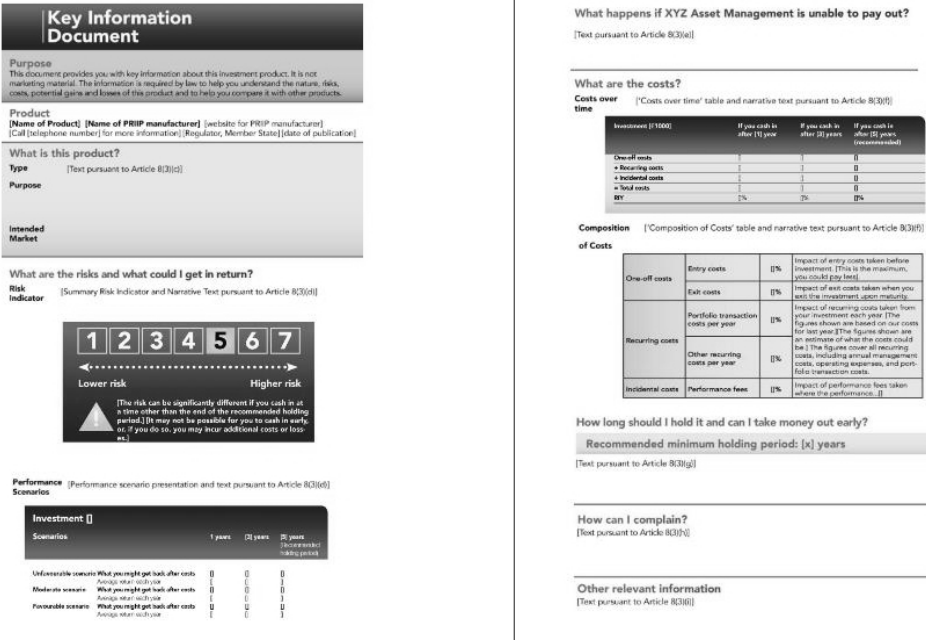


Figure 2: A Prototype Key Information Document³⁸



Figure 3: The Format for Presenting a Summary Risk Indicator³⁹

Our example concerns investor information. Visualization and simplification can be used in a similar manner for example for internal guidance and even regulation.⁴⁰ Simplified briefings of regulations would be welcome among the users of the financial markets regulation. Some signs of this kind of progression can be seen in MiFID II technical standards composed by ESMA (European Securities and Markets Authority). The technical standards themselves and documents related to them are exhaustingly long. However, ESMA has created short briefings for some central stakeholder groups.⁴¹

4. Conclusion

Investors, compliance officers, and other users of financial regulation are struggling with complicated and lengthy texts. Instead of asking for *more* information disclosure in the finance industry, this paper proposes to improve decision making and enable better investors' choices through simplification and visualization. Investor information documents, KIIDs and KIDS, are important steps toward more user-friendly information.

³⁸ The layout example is based on the Draft regulatory technical standards by ESAs. See ESAs 2015.

³⁹ Excerpt from the format for the presentation of a Summary Risk Indicator shown in *Id.*, p. 49.

⁴⁰ See, e.g., MARGARET HAGAN's Illustrated Law Flow Charts.

⁴¹ See, <https://www.esma.europa.eu/news/ESMA-readies-MiFID-II-MAR-and-CSDR>.

Visualization and simplification could be expanded even more widely to financial markets regulation.

Visualization is not about decorating documents. Instead, it is about helping them function and be effective. The content is still in the center, maybe *even more*, as the aim of the simplification efforts is to aid important information to stand out. The documents are not «less legal», if they are user-friendly. Quite the opposite: too lengthy and dense documents can lead to unintended non-compliance, while effectively designed documents can help keeping up with the requirements. The users of financial documents and regulation differ widely on their knowledge and skills. For example, studies on financial literacy indicate that investors have in general quite moderate abilities to read financial documents and these abilities are not evenly divided.⁴² The diversity of users forces us to think about the design of these documents.⁴³

New EU requirements have already inspired several companies to develop tools and technologies for producing KIIDs. These developments could expand to internal guidelines and regulation to help financial market actors comply and work with the regulation. Document assembly engines that incorporate visualizations in the text they generate can significantly reduce the challenges for future document producers who want to make their core message easier to find, understand and act upon. The benefits can be great for the entire finance industry and beyond.

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⁴² See, e.g., ATKINSON/MESSY 2012, p. 7-8.

⁴³ MITCHELL 2015, p. 13, 23, 21.

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