Improving Fee Disclosure Through Behavioural Insights

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Note: Slides are incomplete without accompanying oral commentary.
AGENDA

1. Who we are

2. Research overview

3. How we carried out our research

4. Research findings:
   a. Ideas for solutions developed based on interviews and literature review
   b. Putting our ideas to the test

5. How our research approach and results could be applied in other contexts
WHO WE ARE
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• On October 30, 2015, the Ontario Securities Commission (OSC) launched its new Investor Office.

• The Investor Office sets the strategic direction and leads the OSC’s efforts in investor:
  • engagement
  • education
  • outreach
  • research

• The Office also has a policy function, plays a key role in the oversight of the Ombudsman for Banking Services and Investments (OBSI), and provides leadership in the area of behavioural insights at the OSC.
INVESTOR RESEARCH

• The Investor Office conducts investor research using a variety of methods, including surveys, qualitative interviews, and randomized experiments as part of our evidence-based approach to policy and program development.
RESEARCH OVERVIEW
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• Starting in 2016, securities regulators in Canada have required firms to provide clearer information to clients about the cost and performance of their investments.

• Investment firms must send their clients an annual report summarizing all charges that clients paid to them and all other compensation received by the registered firm that relates to the client’s account.

• During this presentation we will refer to this report as the annual fee report.

• The Annual Fee Report benefits investors because it requires disclosure of charges paid directly by those investors and indirect charges, like trailing commissions paid by fund managers to investment firms.
RESEARCH OVERVIEW

- Studies have been published suggesting that there is room for improvement with respect to how these reports are designed delivered to clients.

- The goal of this project was to identify practical applications of behavioural insights that make annual fee reports more engaging, easier to understand and more useful for investors.
RESEARCH OVERVIEW

• Disclosure requirements are a well-established regulatory approach to supporting the needs of consumers and helping them make better decisions.

• The underlying rationale is that consumers will review and understand the disclosed information and then use it to make decisions (e.g. when selecting an investment firm or choosing which securities to purchase).

• In practice, many consumers fail to read the disclosure documents, do not understand them, or cannot use the information to make decisions.

• Behavioural insights research can help improve consumer disclosures and make for a better investor experience.
HOW WE DID OUR RESEARCH
HOW WE DID OUR RESEARCH

• The primary goal of this research was to uncover insights that were feasible to implement and impactful for investors.

• Given budget, time and internal resource constraints, we opted to conduct this project in partnership with an external vendor who could do methodologically rigorous behavioural science research.

• The OSC worked directly with the vendor throughout the project to ensure that recommendations were in keeping with securities regulation and our mandate.

• We opted to use mixed methods for this project because qualitative research provided nuanced insights into investor interactions with disclosures and quantitative research allowed us to test the effectiveness of disclosures with statistical certainty.
HOW WE DID OUR RESEARCH

• We partnered with a service provider to carry out research on barriers to engagement with and comprehension of disclosure documents.

• The service provider was selected in a competitive procurement process. In our invitation to potential partners, we outlined the problem we wanted to solve—improve the effectiveness of disclosures—and stated that we wanted to apply a behavioural lens to this problem.

• Vendors responded by developing high-level research plans to examine this problem, which included descriptions of the research techniques they planned to apply.

• At the close of this process, we selected the Behavioral Insights Team (BIT) as our partner.
HOW WE DID OUR RESEARCH

• BIT was originally part of the UK Cabinet Office (often called the “Nudge Unit”).

• It now operates as a social purpose company, part-owned by the UK Government, an innovation charity, and its employees.

• BIT carries out research primarily for public sector clients, operating from offices in London, Toronto, Manchester, New York, Singapore and Sydney.

• BIT staff played an important role in designing our research methodology and ensuring the rigour of our research results.
HOW WE DID OUR RESEARCH

• BIT started by conducting a scan of academic literature on behavioural insights and information disclosure (especially in complex financial settings).

• Because of the accelerated timing of our project, a full review of the literature was not feasible.

• A review of current and leading practices (in both industry and regulatory oversight) on information disclosure.
HOW WE DID OUR RESEARCH

• OSC and BIT also conducted interviews with investors who live in Ontario.

  • These interviews added nuance to our understanding of how Ontarians engage with the disclosures that they receive and the challenges they experience understanding and acting on this information.

  • Interviewees were recruited through “convenience sampling”—OSC and BIT staff recruited participants by promoting the research on social media and through personal networks.
HOW WE DID OUR RESEARCH

• OSC and BIT collaborated to develop interview guides as a structure for the interviews.

• The guides included questions on:
  
  • individuals’ experiences working with advisors or brokers,
  • if they remember receiving specific disclosure documents,
  • if they understand the information in a sample disclosure,
  • their knowledge of the fees that they pay as investors,
  • their knowledge of the performance of their investments, and
  • basic demographic questions

• Interviews were audio recorded so that the research team could refer back to them after the interviews ended.
HOW WE DID OUR RESEARCH

• The qualitative research was used to identify 11 key barriers individuals face in engaging with, understanding and acting on disclosure information.

• BIT and OSC staff collaborated to develop a list of 24 tactics that could help individuals mitigate these barriers. BIT staff ensured the tactics proposed aligned with behavioural principles and research findings.

• BIT and OSC staff prioritized a few of the tactics for quantitative testing, based on:
  • feasibility (ability of OSC and BIT to test the tactic given limited resources), and
  • potential impact (potential to improve disclosure effectiveness).
HOW WE DID OUR RESEARCH

• Our quantitative testing was carried out using an online platform that enabled us to present sample fee disclosure documents to Canadian investors and evaluate their comprehension of the information.

• The methodology used for this phase of the research is described later in this presentation, but in summary:
  
  • We carried out a randomized experiment to test investor comprehension of different versions of a fee report that investors receive from their dealer or adviser.
  
  • BIT staff designed the testing methodology and reviewed results to ensure the research was robust and to determine to what extent the results received were statistically significant.
RESEARCH FINDINGS

• We used the literature review and interviews as a basis for proposing 24 different ways that firms and other stakeholders can mitigate the following key barriers to investors’ using fee reports as intended.

• These tactics are grouped around the following barriers:
  • Barriers to engagement
  • Barriers to comprehension
  • Barriers to action.

• Examples of these opportunities are outlined in the slides that follow.
BARRIERS TO ENGAGEMENT

• Investors may not notice or recognize the importance of their annual fee report amid the various other disclosures provided to them.
BARRIERS TO ENGAGEMENT

• **Barrier:** Investors may not see the report.
• **Tactic:** If the report is sent by mail, use language or visuals on the envelope itself to call out its importance.
• **Tactic:** If the report is provided electronically, send investors an alert or notification that grabs their attention.

• **Barrier:** Investors may open the fee report but not really read it.
• **Tactic:** Make it clear that the information in the report is important by using eye catching visuals, such as a stamp, that says “Important Annual Fees Report – Please Read – Fees Impact the Value of Your Investments.”
BARRIERS TO COMPREHENSION

• Investors may be confused by the terminology and information included in their annual fee report. They may not understand which fees are included (and which are excluded) from the report, and lack reference points to determine whether their fees are higher or lower than the norm.
BARRIERS TO COMPREHENSION

• **Barrier**: Certain critical but complex terms may limit investor comprehension.
  • **Tactic**: Where complex language is unavoidable, include a plain language explanation of the term in the fee report.

• **Barrier**: The volume and format of the content may overwhelm the reader, leading to poorer comprehension.
  • **Tactic**: Put important information at the top of documents because it will get more attention and is more likely to be remembered.

• **Barrier**: Third-party compensation is not well understood and investors may be underestimating its significance.
  • **Tactic**: Use flow diagrams to depict the flow of services and payment between investment firms and their representatives, fund managers, and investors.
BARRIERS TO COMPREHENSION

• **Barrier:** Investors may underestimate the impact of fees over time.
• **Tactic:** Create an interactive online tool that shows a projection of how investment firm fees impact returns over time.

• **Barrier:** Without a reference point, it may be difficult for investors to know whether their fees are appropriate or not.
• **Tactic:** Establish a series of benchmarks (i.e. guidelines) that investors could use to gauge the appropriateness of their fees and charges.
BARRIERS TO ACTION

• Even if investors see and understand the report, they may not know how to act on the information it provides. The gap between understanding and action is a core focus of behavioural science.
BARRIERS TO ACTION

- **Barrier:** Investors may be unaware of their options for reducing fees.
- **Tactic:** Provide a list of actions in the report that investors can take to reduce their investment firm fees or increase the level of service they receive for those fees.

**Talk to us** about whether lower-fee investment options might be right for you. Call us at (555) 123-4567, or reach us by email at advisor@investmentdealerabc.com

**Go to our website** to learn more. For example, learn what questions you might want to ask us to start a conversation about our charges.

If it is right for you, consider making fewer transactions in your account.
BARRIERS TO ACTION

- **Barrier**: Investors may be unaware of their options for reducing fees.
- **Tactic**: Explicitly link charges to the choices that investors have made or services that they have received.

<table>
<thead>
<tr>
<th>Transaction Charges</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trading Fees</td>
<td>$29</td>
</tr>
<tr>
<td>Sales Charges</td>
<td>$204</td>
</tr>
</tbody>
</table>

Charged for three mutual fund transactions.

Charged for purchasing ABC Mutual Fund, which has a front-load sales charge.
PUTTING OUR IDEAS TO THE TEST

• Several of the tactics identified in above were tested in a random experiment with 1,900 Canadian investors.

• Each participant reviewed one of four versions of an annual fee report and then were asked seven comprehension questions to test how well they understood the information.

  1. Control: This version was based on a fee reports that are currently used.
  2. Simple: This version addressed “information overload” by minimizing the volume and complexity of the information provided.
  3. Summary + Detail: This version took the Simple version and added a second page with a more thorough breakdown of the fees.
  4. Action: This version took the Simple version and added a list of three actions that investors might want to take to reduce their fees.
PUTTING OUR IDEAS TO THE TEST

- We tested four fee reports in total. Three of the four reports included tactics from behavioural science to increase investor comprehension.

- We tested the impact of these Annual Fee Report versions through a randomized controlled trial (RCT).
PUTTING OUR IDEAS TO THE TEST

- Investors who saw the Summary + Detail version of the Annual Fee Report had the highest comprehension scores, answering 4.4 out of 7 questions correctly on average.
- This was a “statistically significant” increase over the Control version. This means that it is unlikely that the difference in score was the result of chance.
PUTTING OUR IDEAS TO THE TEST

• The results of our experiment indicate that investors could benefit from fee disclosure reports that:
  • Have a simple summary page with the most critical information and a subsequent page with additional information.
  • Provide descriptions of why each type of fee was incurred.
APPLYING RESEARCH IN OTHER CONTEXTS
HOW RESEARCH APPROACH AND FINDINGS COULD BE APPLIED IN OTHER CONTEXTS

• Our research approach can be applied in other contexts:

  • Investor surveys can inform the design of behavioural research by highlighting key problems faced by investors.

  • Third party service providers can assist with research design and ensuring rigorous, decision-useful results.

  • Often, a mix of qualitative (e.g., interviews) and quantitative (e.g., testing) research techniques can provide helpful results.
HOW RESEARCH APPROACH AND FINDINGS COULD BE APPLIED IN OTHER CONTEXTS

• The research findings may be applied in other contexts in several ways:

• To the extent the qualitative research reveals similar challenges, the opportunities for intervention described in our report could be applicable (either as described in the report, or modified to reflect the local context).

• This research focused on fee disclosure reports, however the behavioural science principle can be used to enhance any kind of disclosure.

• Testing the opportunities for intervention suggested in the report.

• The opportunities uncovered through our qualitative research are just hypotheses—testing will help determine whether and to what extent they make disclosure documents easier to understand and use.
QUESTIONS?