

Retail Distribution Review - Problems & Solutions

The Problem

The Retail Distribution Review (RDR) appears to offer solutions to matters which the FSA has identified as problematic within the industry.

The FSA believes that the measures set out in the RDR proposals will provide for greater consumer confidence and engagement with the industry.

What is planned?

1. That all advisers attain the QCF4 qualification level by 31st December 2012.
2. That commission be removed from all investment and pension products by 31st December 2012.
3. That the industry continues to absorb stale complaints by virtue of the 15-year longstop defence being denied them..
4. That the definition of 'independent' be altered from the current workable and well understood version to one of dire complexity.

What will be the outcome?

Consumers will suffer substantial and unprecedented detriment due to the unintended consequences.

A substantial portion of the adviser population will leave the industry. Various surveys have been conducted and whilst there is no consensus on the figures it is obvious that adviser numbers will fall drastically.

- Robin Stoakley, Head of Intermediary Business at Schroders said,
"I do see up to 30 per cent of the IFA market leaving".
- AVIVA Life marketing director David Barral has said the firm predicts by 2013 IFA numbers will fall to 10,000 in total as advisers fail to comply with RDR changes, leaving middle-market consumers unserved.
- Shaun Crawford, head of insurance advisory at Ernst & Young;
"The FSA's Retail Distribution Review will have the following effect: Of a population of over 30,000 advisers, many industry commentators are expecting at least a third to leave by 2012".
- Figures provided by Matrix-Data Solutions (in June 2010) showed there were 32,000 advisers in 2008. However, this plunged to 30,198 in 2009 and currently stands at 28,714
- A study by Oxera during May 2010 showed that a quarter of advisory firms could leave the market.
- Deutsche Bank commented;
"Dwindling IFA numbers in the lead up to the implementation of the RDR will have a dramatic effect on the UK life industry. It will have a negative effect on new business volumes for insurers. There has been industry talk of 30% or even 50% of IFAs exiting the industry post 2012, which is not impossible."

- David Cox at Suuqea stated;

"Two million clients could be left without an IFA after RDR – 40% could leave the industry."

If the adviser population falls by around 1/3 this will leave millions of consumers without an adviser. Some will migrate to other advisers but many will be left without a trusted source of advice. Please note that the advisers who deal with the smaller investments of the typical everyday client are the ones who are most impacted by the proposed changes.

The UK currently suffers from the largest savings, retirement and protection gaps in its history. It is essential that these gaps, and the current over-reliance on the state, are reduced. The UK can ill afford to lose 10,000 advisers, a catastrophe that will intensify the existing problems.

Why are advisers leaving the industry in droves?

EXAMINATIONS

Existing authorised and qualified practitioners are being forced to achieve a QCF4 qualification by 31 December 2012. Failure will result in their permissions to trade being revoked.

The FSA states that the existing base-line is set too low. The current exams were set up by the FSA back in 1997 when it was known as the Personal Investment Authority (PIA). Since then the FSA has mandated that to operate in certain advice areas, identified as higher risk, an adviser must take additional specific examinations.

Thorough research has been conducted involving every chartered body in the UK. Each body was asked whether, when it upgraded entry-level qualifications, existing practitioners were required to undertake the revised qualifications. Every one of the professional bodies confirmed that existing practitioners are exempted from any re-qualification requirements.

Each professional body was then asked whether existing practitioners were required to upgrade their skill-sets in some manner. Every body, apart from that representing the teaching profession, confirmed that a programme of continuous professional development (CPD) was mandated.

Financial advisers already operate such a system.

Perhaps, more pointedly, there is a counsel's opinion that the FSA does not possess the legal ability to remove a practitioners permission to trade purely because of moving the goalposts. This is both a restraint of trade and a clear breach of the Human Rights legislation.

COMMISSION REMOVAL

The FSA has maintained that commission creates product bias where different products pay differing rates of commission. The FSA also suggested that commission created provider bias due to providers offering different commission rates.

During 2002 the FSA commissioned Charles River Associates to undertake an in depth survey which assessed the incidence and level of such bias. The survey offered the following conclusions;

- X *"The advice market is not riddled with bias"*
- X *"There is no detectable bias on regular premium products"*
- X *"There is no evidence of any provider bias in either the Stakeholder pension or the non-Stakeholder personal pension recommendations"*
- X *"Despite anecdotal evidence that some IFAs and IFA networks do take advantage of*

their position to recommend product that yield them the greatest commission, there is little sign that this is happening on a large scale"

The report then explained why commission exists and why it is beneficial in stimulating the sale of product solutions to consumers.

"The level of commission can be seen as a margin that providers pay to intermediaries for distributing their products. On the face of it, providers have to pay this margin out of their total costs, and one would expect to find that levels of charges and commissions paid by different providers are strongly correlated. If this is the case, then higher commissions would be associated with consumer detriment. We know of no quantitative research demonstrating this to be the case, however."

"The role of commission in stimulating the sale of savings products may be socially beneficial in the current UK situation, because many customers and potential customers are thought to make insufficient savings"

During 2004 Charles River Associates was asked by the Association of British Insurers (ABI) to undertake research into adviser remuneration. The subsequent report, published in February 2005, made the following observations;

"No evidence of bias being prevalent across the advice market"

"No evidence of bias to over-sell"

"No evidence of provider bias on regular premium products"

The results therefore reinforced the conclusions from the earlier research. Charles River Associates was moved to comment on the viewpoint that commission is deleterious.

"We therefore conclude that the problems of perception are greater than the reality"

The FSA envisages a world where consumers negotiate a fee with their adviser with the option for the fee to be taken from the investment contribution. Charles River Associates offered an opinion on the fee-based approach.

"One of the models tested was a fee based model - we concluded that there was no evidence that artificially moving to such a regime, to the exclusion of commission, would lead to benefits since consumers choosing to pay on a fee basis do not receive better advice than those opting for a commission basis."

Will the removal of commission benefit consumers?

Many independent commentators have considered this. A selection of their comments is shown below.

Simon Badley, Director at Aviva stated

"If people can't pay via commission then you have to charge them fees, and the mass market aren't the customers who pay. Our research shows they want to pay less than £100."

The UK's leading consumer champion, Martyn Lewis at MoneySavingExpert, remarked;

"There's a worrying possibility that the FSA is about to kill off independent financial advice in the UK for all but the wealthy. I do hope I'm wrong. I'm not convinced most"

people will want to pay for advice. The commission route has the advantage that you don't pay a fee each and every time you want information; you can go without the worry of laying out cash."

John Chapman, ex Office of Fair Trading, opined;

"The implication that selling can be replaced by an "advice process" is misleading spin. The FSA itself comments that: "Even fee-based advisers may find it easier to collect a fee if they recommend that the consumer undertakes a transaction" (June 2009 CP 09/18). With daunting drawbacks and doubtful benefits, adviser charging should be dropped."

Otto Thoresen, CEO at Aegon, is unequivocal,

"The RDR is only helping wealthy customers"

A Financial Times survey showed that,

"64% of respondents said that the overall cost of advice will rise as a result."

Peter Hargreaves, founder of Hargreaves Lansdown suggested'

"The review is likely to be bad for the entire retail investment industry."

Even the Financial Services Consumer Panel admitted,

"Financial advice will be less-widely available post-RDR."

Lack of a 15-year longstop

The Limitation Act 1980 was debated and passed by Parliament. It was accepted that there needed to be a cut-off point, a balance between the interests of consumers and of firms. Fifteen years was decided upon, although latterly there has been discussion about reducing this period to ten years.

Financial advisers enjoyed the protection of the 15-year longstop until it was summarily removed by the FSA in December 2001. The FSA argued that as the Financial Services & Markets Act 2000 did not specifically state that a longstop defence applied then it must have been Parliament's intention to not allow it.

The FSA cannot override statute yet it has held firm to this view and denied the industry a legitimate defence against stale claims. The initial RDR consultations implied that the FSA was minded to 'officially' introduce a longstop and an overwhelming majority of respondents were in favour, however the FSA has pulled back stating that such a move would not be in the interest of consumers.

The FSA's solitary argument is that the long-term nature of financial advice precludes the reintroduction of the longstop. This argument is fatally weakened when one considers the other 'long-term' occupations which do benefit from a longstop defence - Doctors, solicitors, barristers, politicians, regulators, architects, builders, civil engineers, etc.

What is 'independent'?

The consumer has come to recognise that there are two types of financial advice – independent and everything else. They realise that 'independent' means that the adviser is legally the agent of the client whereas any other type of advice means that the adviser is legally the agent of an insurer or other institution.

The FSA undermined the foundations of this distinction when it introduced the concept of de-

polarisation. Like many such measures this was claimed to be for the benefit of consumers by offering greater choice. In reality it clouded matters to the extent that consumers became confused as to the provenance of the advice.

The new idea, espoused by the RDR, is that unless an adviser is able to advise across the whole of the advice/product market then he cannot use the 'independent' title. However, an adviser who works for or who is contracted to one or more insurers, can use the 'independent' label as long as he/she offers advice across the spectrum of products. Many advisers specialise in one area, such as pensions or estate planning and will therefore lose the status of independent financial adviser even though they are able to use every provider in the marketplace.

A survey by services provider threesixty found that 48% of their members would consider losing their 'independent' tag in order to continue providing their current range of services. Threesixty director David Ingram declared,

"I think it is a great shame the FSA has put them in a position where to do that they are going to lose the brand they have built up over the years as IFAs."

The confusion that is sure to abound will serve to weaken the confidence of the consumer and further reduce the scope for resolution of the savings, retirement and protection gaps. A fatal reversal of the RDR's intended outcomes.

What is the cost of all this?

The FSA's original cost benefit analysis suggested a figure of £500m.

Janet Walford OBE, respected editor of Money Management magazine for over twenty years, stated'

"I am not paranoid enough to believe that the FSA has a hidden agenda to do away with small IFAs, but the law of unintended consequences may well mean that this will be the result. This is especially the case when set alongside the myriad of other proposals that are costing some £430 million to set up, with ongoing fees of £40 million pa thereafter, a mind boggling amount of cash."

Ernst & Young was moved to comment;

"The ban on commission and its replacement with adviser charging alone will be hugely expensive and disruptive for the industry. It is our view that the costs to the industry (£400 million one off and £43m p.a. ongoing) of shifting to an adviser charging model have been grossly underestimated. It estimates that an investment of close to £500m will be shared across the industry by 2012 – staggering."

Ernst & Young has been proved correct because since then the FSA has published a revised cost benefit analysis where the cost has vaulted to an astonishing £1.7 billion. As with any increase in costs it will be passed on to consumers.

What are the alternatives?

Qualifications

Simple logic, and an awareness of the impact on both consumers and financial advisers, dictates that the FSA should adopt a strategy similar to all other professional bodies. This would involve upgrading the entry-level requirements but allowing existing practitioners to continue using focused CPD. This relatively simple adjustment will avoid a large number of existing practitioners with, in many cases, thirty years experience, from retiring early or otherwise being railroaded out

of the industry. This will also save an indeterminate but considerable sum of money.

Commission

The Charles River Associates research has removed the FSA's ability to claim that commission caused bias so now they admit that they are combating perception as much as reality. During November 2009 the FSA's Sheila Nicoll commented

"We want to remove the influence of product providers over the remuneration of advisers and ensure that the perception, and indeed reality, of bias is removed."

The FSA's Peter Smith subsequently admitted,

"Product bias will still be possible within the market but I do not think it is a feature of the restricted channel, I think it is a fact of life."

Facts: Charles River Associates state that 'perception of bias' is the problem. The FSA believes that the seismic RDR proposals will combat 'perception of bias' and then admit that 'bias' is a fact of life.

When asked whether the RDR proposals would work, Peter Smith confessed that the FSA has no contingency plan if customers refuse to pay for advice after the Retail Distribution Review is implemented.

"We are trying to achieve a market which allows more consumers to have their needs and wants addressed. If consumers still do not want to engage with it then we probably will have to do something else."

It can be seen that the FSA is experimenting. Unlike laboratory experiments this one impacts on millions of consumers lives and on the 30,000 or so IFAs who service these consumers.

Consumers should be allowed to choose whichever method of paying for advice and products they deem most appropriate. Reducing consumer freedom whilst pretending to empower them is brazen.

15-year longstop

No civilised society singles out a group of citizens for special treatment. The fact is, the FSA has denied advisers the right to a legitimate defence without the sanction of parliament or consultation with the industry.

Advisers rights should be restored forthwith

Independent

The FSA has already weakened the independent brand by deploying its 'depolarisation' initiative. The latest proposals will effectively kill off the meaning of independent leaving the consumer so confused that he will reduce even his current level of interaction. Confusing the consumer is never a good way of persuading him to engage with the industry and the FSA should leave matters alone.

Ideally they should reverse the travesty that is depolarisation, but one step at a time.