Harry Taylor Consulting

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Does your firm need a Retail Distribution Review Health Check?

Introduction

The next big thing to hit financial services will be the Retail Distribution Review (RDR) and all firms in this sector should be doing a 'Health Check' now on how well placed (or not) they are to cope with the sweeping regulatory changes to be fully implemented by 2012.

The RDR is gaining momentum and profile following the publication in November 2008 of Feedback Statement 08/6 containing wide ranging proposals from the UK regulator, the Financial Services Authority (FSA). Much more detail on the proposals became available in the most recent Consultative Paper 09/18 released at the end of June 2009. Now is a good time to summarise where this initiative currently stands.

What firms will be impacted by the review?

RDR will fundamentally change the way retail investment products are distributed in the UK and this will impact Advisers (particularly Independent Financial Advisers), Life & Pension firms, Banks, Building Societies and Investment firms. All this will result in different 'business models', changes to distribution channels, products and services. There will be many high profile/high budget 'RDR change programmes' across the financial services sector to deliver what is required. Inevitably the impact on IT systems and business processes will be very significant for both firms and any business partners who provide outsourced services to them. An estimate for the one off IT/Systems change costs commissioned by the FSA is £220m for Product Provider firms and £71m for Intermediary firms. Other industry estimates pitch the change costs at a much higher level.

Why do a 'Health Check'?

The 'Health Check' is important because historically, financial services firms in the UK have a patchy track record of delivering this type of major regulatory change. It is true that most major players 'get there' by the deadline but for some this is only at the last minute with de-scoped delivery, huge effort, risk and post deadline essential follow-ups. All of these programme delivery problems can be avoided.

When and why did this review start?

These are proposals for major change in UK retail financial services being driven by the FSA. The extensive consultation process with all stakeholders started back in 2006 in response to well publicised problems in the retail investment market such as mis-selling of pensions and mortgage endowments. There was also a general view that the market was not working effectively for consumers or product providers because of

- Too many complex products with performance hard to measure
- Opaque charges which are difficult to understand
- Providers and Distributors at a huge advantage over consumers who generally lack the 'know-how' to select the best product or provider and rely heavily on financial advisers.

The FSA view is that the quality of professional financial advice has been variable and remuneration by means of commission created some dangers leading to high costs with

- Consumers sold products which are not suitable, best value or even needed
- Business models dogged by excessive churn, with low persistency giving poor benefits to consumers and high cost to providers

The original aims of RDR were set out in 2006 as six joined-up outcomes

- An industry that engages with consumers in a way that delivers more clarity for them on products and services
- A market which allows more consumers to have their needs and wants addressed
- Standards of professionalism that inspire consumer confidence and build trust
- Remuneration arrangements that allow competitive forces to work in favour of consumers
- An industry where firms are sufficiently viable to deliver on their longer term commitments and where they treat their customers fairly

- A regulatory framework that can support delivery of all these aspirations and which does not inhibit future innovation which would benefit consumers

The success of RDR is also tied in with other FSA initiatives for increased financial capability such as Money Guidance, Treating Customers Fairly (TCF) and the supervision of wholesale and retail firms.

What is the RDR proposing to change?

The FSA have set out four measures they view as key to delivery calling them the desired market outcomes. These should really change and improve the way consumers engage with distributors and providers.

- Providing greater clarity for consumers about the advice service being offered
- Modernising the way advice is paid for
- Introducing a new standard for independent advice
- Raising the professional standards of all advisers

It is worthwhile saying just a bit more about these target outcomes

Clarity of service to consumers

- Clear distinction between Independent and Restricted advice
- Independent advice will be truly independent with advisers providing recommendations that consider all the products and providers that could potentially meet a customer's needs. All independent advisers will need to provide unbiased and unrestricted advice that targets the best outcome for each customer, based on a comprehensive and fair analysis of all relevant markets.
- Restricted advice describes the service where firms recommend the products of one or a limited range of providers and must make this clear to customers
- Firms will build the broad characteristics of the 'Money Guidance' service into their advice and sales processes where relevant. Money Guidance itself will make clear where consumers should go if they need help

Remuneration for advice

- Advisers will have to clearly agree the cost of advice up front with customers without any involvement of the product provider. This will be called 'Adviser Charging'. Provided the client makes the request, it will be allowable for Adviser Charges to be deducted from the product but only as and when they are due to be paid. The current system of commission will cease by end 2012, including 'factoring'.
- Separate disclosure of the cost of advice from any product costs for both 'independent' and 'restricted' advice. This aims to help consumers understand the real value of advice and different types of service being offered

Professional standards

- The FSA want financial advice to work like other professions with a 'Professional Standards Board' improving quality and setting competency levels for the same investment advice roles whether independent or not
- A benchmark minimum qualification for all investment advisers of QCA level 4 (which in Scotland is SCQF level 8) and possibly higher levels for specialists
- The FSA have drawn together an independent group from the existing financial services professional bodies, the FSSC, main trade associations and FSA own panels to advise on how to take this forward

What is the RDR implementation timetable?

- Q1 2010 – policy statement: new FSA rules made
- 2011 – new rules start to come into force
- End 2012 – deadline for full implementation

It is generally acknowledged that the reforms are wide ranging and challenging for the sector but the FSA believes it provides an opportunity to rebuild consumer trust and confidence. The changes are to be implemented over a period ending at latest on 31 December 2012, but the FSA would like to see early adoption of the new practices as soon as possible. The end 2012 implementation completion date coincides with the introduction of Personal Accounts for pensions and getting the national Money Guidance service fully established (this is not providing advice but an unbiased information service available to everyone in the UK to improve understanding of personal finance). It does impose a very tight deadline on individuals who give investment advice to complete the necessary examinations so they can continue in business.

How will this affect financial services firms and what should they be doing about it now?

Every firm affected directly or indirectly by the proposals should by now have a formal RDR programme established and reporting back at board level with an appropriate executive sponsor. The **'9S' framework** (developed by Harry Taylor Consulting Ltd) provides the starting point for a programme 'Health Check'. This obviously has to be tailored to the business context for any particular firm. In addition there are sets of key questions which the business should be considering to develop strategy and tactics (see RDR White Paper June 2009 by Harry Taylor Consulting Ltd). The **'9S' framework** is:

- **Study** the detail of what is being proposed in the FSA documents and what people are saying about it in the press, at conferences, to the FSA, to analysts and investors etc
- **Strategy** impact assessed and clearly understood as RDR will fundamentally change the distribution landscape. It will produce opportunities and threats while exposing weaknesses and strengths. Porter's five forces analysis is a good starting point considering customers, suppliers, new entrants, substitutes and competitors in the market
- **Scenarios** should be developed to understand the range of possible business outcomes which could emerge short, medium and long term
- **Simplification** of products, services and process from a customer perspective is essential, but it is much easier in business to complicate things than to simplify
- **Segmentation** of customers and the various distribution channels to access them is crucial. Particular attention to the IFA channel as significant change in numbers of advisers, firms and type of business written is likely
- **Selection** of target segments for business focus to ensure profitable customers and efficient routes to market can be maintained or developed during the transition and post 2012
- **Scan** constantly for new information and market insight to incorporate in the development process
- **Specify** plans priority and resource to manage the change and adapt as the 'real world' impact emerges different from the scenarios investigated
- **Sell** the changes with an ongoing communication programme for all internal and external stakeholders at all levels. This is fundamental to any major change programme

What are the main points of controversy?

- Views differ on the extent to which RDR will actually deliver the FSA's desired market outcomes
- The extent to which the IFA sector will shrink post RDR. Current views range from 'a small reduction' to estimating the sector will reduce by over 50%.
- Impact of RDR on the Bank and Building Society channel
- The length of time for advisers to achieve the necessary minimum qualifications and the set up of the new professional body
- Achievability of end 2012 for all aspects of RDR given the scale of change proposed and other economic recession related challenges faced by customers and all firms in the financial services sector
- Impact of any change in government on the regulatory framework and initiatives following a 2010 general election
- How willing customers will be to pay fees for independent advice
- Degree of success achieved by the Money Guidance initiative
- Scale of growth in 'direct to customer' channels and new channels such as Supermarkets
- How likely that RDR opens up a 'gap' in the advice market driven by a reduction in the number of IFAs
- 'Read across' impact of RDR if it is applied in some ways to mortgage, general insurance, PPI, protection or corporate/group pensions markets
- Indirect impact of RDR changes to the IFA sector on the overall distribution capacity for other products such as protection

- Possible cross border regulatory arbitrage if advisor firms establish elsewhere in Europe such as Dublin and 'passport' services back into the UK
- Possible delay or complication to implementation from any overriding EU legislation on financial supervision

For more information or to discuss this White Paper please contact Harry Taylor.

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About HARRY TAYLOR BSc (Hons) FFA FSAI

Harry Taylor is an independent actuary and business consultant with extensive commercial experience of insurance, pensions, investment and banking. He has been director at several of the UK's major financial services companies leading proposition development, marketing and operations (including outsource). He specialises in creating and delivering innovative solutions for financial services firms to solve complex problems and develop new opportunities. Consulting specialist areas are Innovation, Strategy, Proposition Development & Marketing, DC Pensions, Workplace Savings, Platforms, Auto Enrolment, Default Funds, Segmentation and RDR.