



# Newsletter – The Retail Distribution Review

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Subject: COBS Newsletter 10

## The Retail Distribution Review

The Retail Distribution Review will have a fundamental impact on the UK insurance and savings market.

### The scope for the new rules

The new rules will apply after 31<sup>st</sup> December 2012 to all advised sales for investment products. Advice will include any statement of suitability for the individual customer and investment products include all those policies normally subject to COBS rules. This includes any insurance policy with a surrender value or maturity value.

Out of scope are any investments sold as execution only and any pure protection contracts sold subject to advice. Execution only would include any sales made by introducers (including the major retailers). Pure protection contracts include whole life

insurances if there is no surrender value attached to the policy.

### The requirements for advisers

Advisers need to pass the new qualifications which have been set at QCF4 level – roughly equivalent to the first year examinations at University. There is no “grand fathering in” rule and existing advisers need to pass the examinations.

Advisers need to decide whether they will be fully independent or offer restricted advice. Restricted advice may be by type of product or by provider firm or both. Quite large firms of advisers have decided to provide restricted advice. These firms have decided that it would be impossible to meet the requirements for fully independent advice and that they can only thoroughly research a limited number of providers and product types. Fully independent firms need to be able to give advice on all products and on all providers. Restricted advisers need to tell their customers of this at the initial part of the advice process and explain what it means.

The aim of these changes is to make adviser more professional and avoid any mis-selling due to ignorance or under training.

Advisers also need to undergo regular Continuing Professional Development of a structured form.

### Commission and fees

Commission is banned under the new regime. Advisers will be paid by fees from clients and not by commission from providers. Providers cannot influence the type or amount of fee payment.

Providers can facilitate the fee payment by deducting fees from investment value and paying the fees to the adviser firm. There

must be clear instructions provided by the client on the amount of fee.

Fees cannot be paid without a service being provided. This means that any renewal fees will need to be justified by continuing advice and may be stopped by the client if they feel that the advice is not worthwhile. Providers will need systems to capture this.

Providers are not allowed to give fees in advance of receiving funds from clients. This is the “no factoring” rule and will outlaw “indemnity fees”.

### Integrated firms

Firms with their own in-house advisers will end up in a real “dog’s breakfast”.

The firm will need to charge a separate advice fee from product charges and will have to get agreement to this advice fee from the client. They can, though, continue to pay salaries and bonuses or initial indemnity commission to their advisers. They will need to show that they can make a profit from their advice fees to cover their outlay in commission or adviser costs plus on-costs. There will be interesting times on proving this as any cost allocation could prove contentious.

Trying to explain the separate advice fee (why should I not buy the product from your web site rather than take your advice) may prove tricky.

### Providers and allocation

Providers cannot provide investments that appear to give more value than the contributions received from the client. This is a ban on over 100% allocations. The aim is to avoid providers hiding charges in complex charging structures. Examples of the latter would include a single premium personal pension with 110% allocation and a 1.5% annual management charge allied to

surrender penalties of 15% on day 1 reducing to 1.5% after 10 years and then nil. Equally, a 102% allocation with a 5% bid / offer spread will be banned.

### HMRC Rules

HMRC have stated that they want the RDR to be “revenue neutral”. However, the changes above will have a knock on effect on policy taxation.

For pensions, the fee is treated as an expense of the pension scheme for advice. This is no change from now.

For life assurance and for ISAs, HMRC are currently saying they will treat fee payments made by providers to IFAs as withdrawals made to the client. The provider is just acting under instruction from the client to make his withdrawal over to his adviser.

This will lead to adviser fees creating chargeable events for non-qualifying policies and could lead to qualifying policies becoming non-qualifying. Obviously, the fee payment for the latter could be made from the amount remitted to the provider by the client before the premium is set. The client pays £50 and £10 is paid to the adviser and the premium is £40 to the policy. This would need careful controls to avoid breaking HMRC rules on premium fluctuations.

### Likely consequences (1) market for advice

It is very likely that the market for advice will decline quite sharply after RDR goes live. Very up-market individuals (the top 10% by income for example) will accept paying advisers fees for service. Some others may accept signing advice fee agreements for providers to deduct fees from their investments. The wrap provider experience shows that this becomes the norm for medium income clients.

However, we think that the bulk market will move to execution only. We also think that there will be growth in “introducer” sales forces. Introducers are outside RDR and we can see that, as they will not have the overheads of completing time expensive fact finds, many old salesman types will find this route extremely attractive.

Introducers will need to avoid giving any statement of suitability. They can provide compliant literature and answer any factual questions the client has (for example, can I pay monthly) but cannot imply or state that the plan is “suitable” for the client.

Introducer sales forces will need to be carefully controlled by their management.

The market for advice may become concentrated on “restricted advisers”. If you are not on the list of products to be provided, you do not get any sales.

We see a vast increase in direct sales possibly via the internet.

### **Likely consequences – product providers**

We see product providers needing to decide their sales strategy.

If sticking to the IFA market, the firm will need to:

1. Ensure they get on lists for key advisers or concentrate on independent advisers;
2. Provide clean products with no distribution margin built into the prices. A clean 100% allocation and 0.7% annual management charge may become the norm.
3. Concentrate on single premium investment products rather than regular savings.

4. Provide a high quality of service.
5. Ensure products are on wrap platforms.

For some providers, they may concentrate on the direct market. The web site would need to be of a high quality and easy to use. Search engine optimisation and concentration on products seen by clients as being a “good thing” rather than necessarily what they need.

For some providers, introducer sales forces with distribution margins in the price will be the solution. Again, simple products that can be sold without advice will be the nature of the day.

Some product providers will pull out of the investment market and only provide protection contracts. Some IFAs have said that this is the way they are going.

Product providers will need to concentrate on niches. Trying to be all things to all people and distributing by all methods will not work.

### **Likely consequences – customers**

We think the likely consequences for customers will be two fold:

- Much more limited access to full financial advice on savings and investment. It will only be clients with lump sums to invest who will have access to investment advisers. We have met IFAs who are looking at their client bank in a new way – are these clients going to be profitable to me after RDR. Financial advice on protection policies will be still wide spread.
- More sales from “introducers” and direct from web sites will become the norm. Introducer sales forces being targeted on sales volume will be the normal way regular savings plans will

be sold. They may even have the odd adviser scattered in the field force to deal with “complex cases”. We think there will be mass confusion on the level of advice that clients are receiving. We can see mis-selling scandals arising due to the boundary between forceful introduction and advice being quite narrow. It will be interesting to see how the Ombudsman deals with complaints where the client has signed a statement that no advice has been given.

The web site sales will become the norm on some easily sold products – notably ISAs. Good web sites will become important. It is hard to see how comparison web sites can cope when prices will be all much of a muchness- maybe, by concentrating on past performance.

### **The European dimension**

At the same time as RDR, the EU is taking more of an interest in marketing of investments. The FSA are firmly of the opinion that RDR fits into MiFID2 and PRIPS well.

This is a short summary of RDR and its likely consequences. We see RDR as more fundamental to IFA sales based investment providers than Solvency 2. Preparation will be everything.

S. Dixon

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