



**The Actuarial Profession**

making financial sense of the future

## Retail Distribution Review Gary Warman & Andrew Power



Impacts on operating models  
for product providers

November 2010

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# Agenda

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- 1 Retail Distribution Review and product providers
- 2 Publications timetable
- 3 RDR response options
- 4 Operating model impacts from RDR
- 5 Areas of actuarial involvement in RDR
- 6 Conclusions and next steps
- 7 Partnering for successful implementation

# 1. Retail Distribution Review and product providers

## Direct impact on product providers

The Retail Distribution Review is an FSA regulation which must be implemented by all retail investment providers and distributors by the end of 2012.

### Overview of RDR

The Retail Distribution Review (RDR) was established in June 2006 to look at how retail investments are distributed to consumers in the UK. The overall purpose of RDR is to:

- Improve the clarity with which firms describe their services to consumers
- Address the potential for adviser remuneration to distort consumer outcomes
- Increase the professional standards of advisers

This aim is to restore consumer confidence in the investment market at a time when more people are in need of professional financial advice.

### Objectives of RDR

- Develop an industry that engages with consumers in a way that delivers more clarity for them on products and services
- Provide a market which allows more consumers to have their needs and wants addressed
- Enforce remuneration arrangements that allow competitive forces to work in favour of consumers
- Ensure standards of professionalism that inspire consumer confidence and build trust
- Deliver an industry where firms are sufficiently viable to deliver on their longer-term commitments and where they treat their customers fairly
- Provide a regulatory framework that supports delivery of these aspirations without inhibiting future innovation

### Impact on product providers

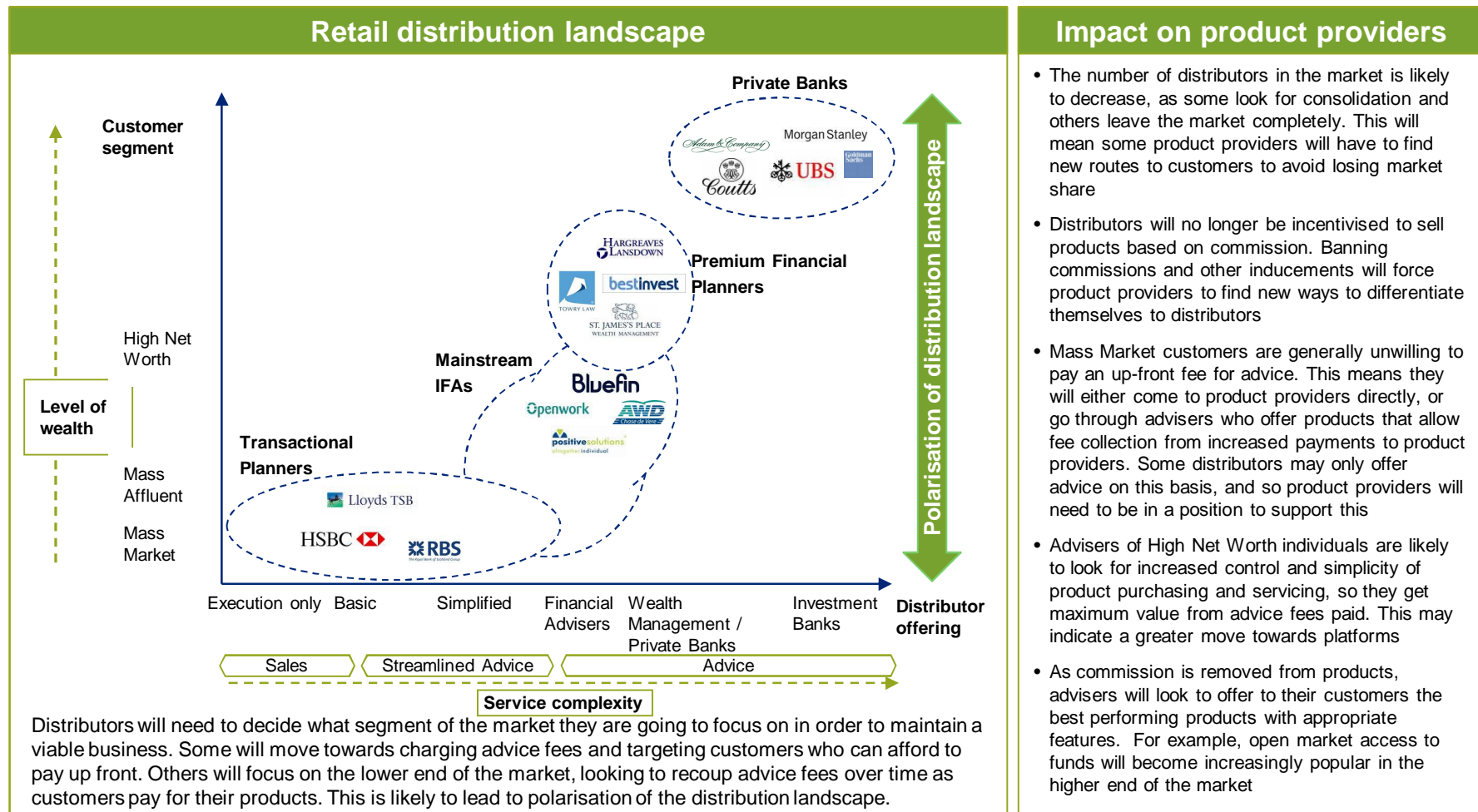
By 31 December 2012 all product providers must:

- Remove commission/factoring from all retail investment products available for sale
- Review all contracts and remove any preferential deals with distributors
- If any additional services are offered, offer these to the whole of the market
- Separate product charges from adviser charges
- Implement new reporting standards to meet FSA requirements
- Train any customer-facing adviser staff to new standards, and label all advice types appropriately
- Develop salesforce remuneration policies that are not based on commission

# 1. Retail Distribution Review and product providers

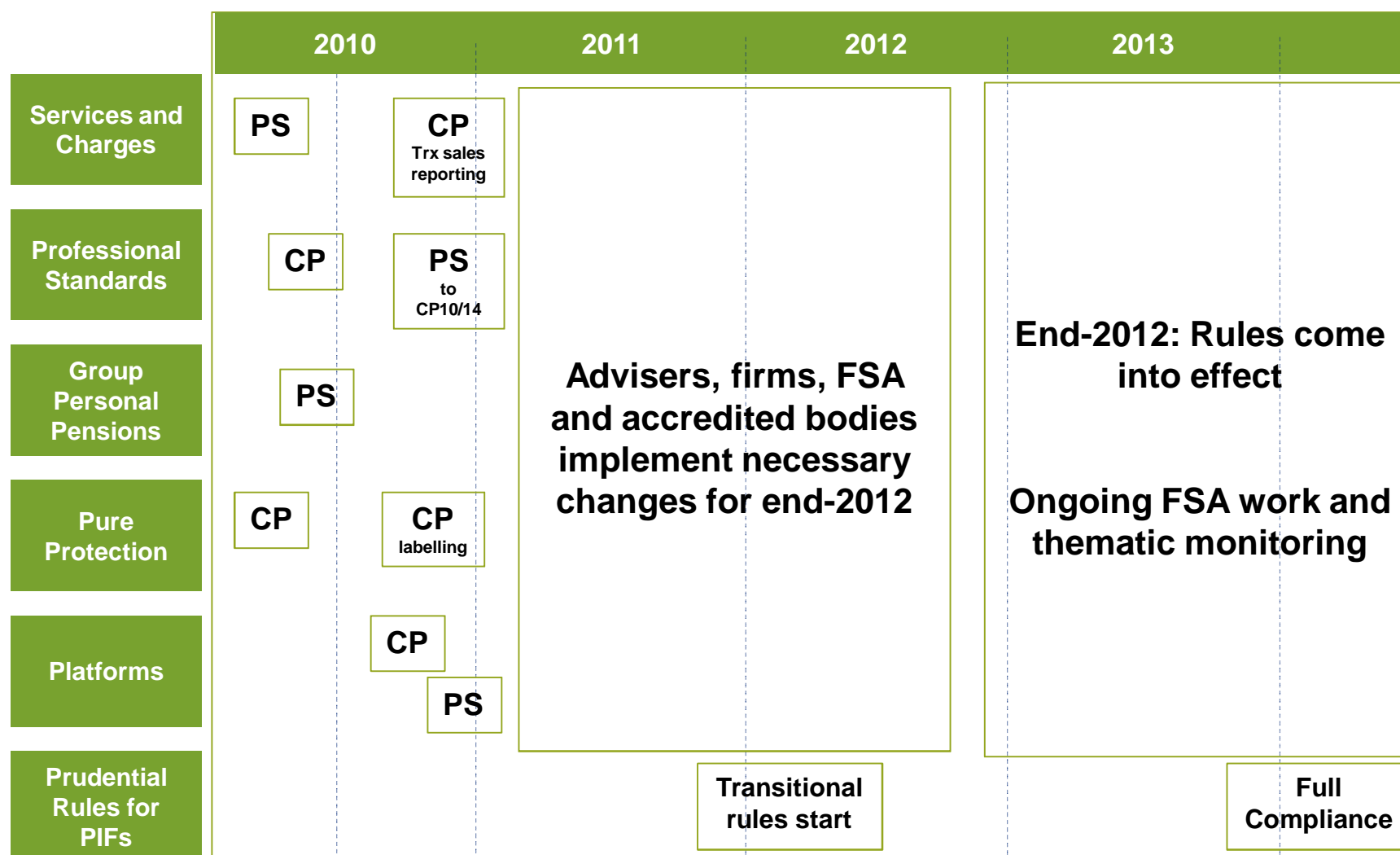
## Indirect impact on product providers

RDR will change the retail distribution landscape. Distributors will need to establish what services they are going to provide and how they are going to charge for any advice services they offer.



## 2. RDR publications timetable

FSA publications and compliance



### 3. RDR response options

#### Defining the strategy for compliance

There are three options an organisation can take when defining their response to RDR. The decisions as to which one to follow must be made in full knowledge of the impacts the decision will have on the business.

Option	Description	Opportunities	Risks
Compliance only	Base post RDR proposition on existing factory gate priced products and associated distributor services	<ul style="list-style-type: none"> <li>• Limited amount of work required</li> <li>• Low cost to implement</li> <li>• Minimal disruption to BAU</li> <li>• Minimal impact on operating model</li> <li>• Can be quickly implemented</li> </ul>	<ul style="list-style-type: none"> <li>• Current product set may not be competitive post RDR</li> <li>• Other providers may find new differentiators and ways of working with IFAs</li> </ul>
Refresh proposition	Modify the product proposition to offer factory gating pricing and adviser charge / payment facilities	<ul style="list-style-type: none"> <li>• Favourable product proposition for advisers and customers leads to increased sales</li> <li>• Opportunity to refresh products and remove non-profitable business</li> </ul>	<ul style="list-style-type: none"> <li>• Refresh activities have a relatively high cost</li> <li>• Significant disruption to BAU as new products are launched</li> <li>• May still not keep pace with market leaders</li> </ul>
Radical transformation	Develop a radically new distribution operating model to gain significant market share post- RDR.	<ul style="list-style-type: none"> <li>• Channels, products and propositions re-aligned to lead the market</li> <li>• Increased market share</li> <li>• Market leading profitability through lower costs per policy</li> </ul>	<ul style="list-style-type: none"> <li>• Costs and timescales</li> <li>• Market may not move as fast or in the direction foreseen</li> <li>• Board level buy-in required</li> </ul>

## 4. Operating model impacts from RDR

### Typical product provider impacts from RDR.

The operating model of product providers will be affected by RDR in a number of different areas. The level of impact will depend on the product provider's current business model and planned approach to RDR.

Business functions impacted by RDR		
<b>Customer</b>	Mass Market Mass Affluent High Net Worth	The aim of RDR is to improve the way the retail investment market operates, giving an improved customer experience and a greater level of trust in the industry.
<b>Channel</b>	Execution Only Bancassurance Direct Sales Force Self Service IFA	The way customers buy products will change, as will the economics of each channel. Distributors must provide suitable terms to customers.
<b>Distributor Proposition</b>	Adviser Payments Broker Consultants Platform Business Support	To stay competitive post RDR, product providers need to offer distributors a new proposition, suitable for customer needs. The focus will be on services offered, rather than product characteristics alone.
<b>Product Proposition</b>	Fund Access Portfolio Admin. Product Design and Marketing Product Pricing	Products will need to change to comply with RDR regulation. Factory gate pricing will promote competition based on product performance. Product offerings will differ at each end of the market.
<b>Servicing - Distributor</b>	Advice Fee Servicing Commission Statements Distributor Relationship Management	The relationship between product providers and distributors will change. Product providers may provide advice fee processing, but this will have knock-on impacts for the rest of the operating model.
<b>Servicing - Customer</b>	New Business Processing Existing Business Servicing Annual Statement Production	Processes will change to match new product and distributor offerings. RDR will therefore require changes through all layers of customer service, especially those facing off to distributors.
<b>Technology</b>	Direct Platform Salesforce Remuneration Sales Platform Sales MI Product Engines Outputs Quotations and Illustrations CRM Distributor MI IFA Extranet Fund Supermarket Commission Box Mgt. Distributor RM	RDR enforces changes to the product and distributor proposition which will require changes to product and channel related systems.  If the product provider offers additional services to distributors or customers, there will be further implications throughout core applications, and potentially infrastructure. One example would be the development of adviser fee payment capabilities.
<b>Information</b>	Sales Reporting Regulatory Reporting	Additional mandatory reporting will be required as part of RDR. Product providers should also be developing MI which will aid the transition through to 2012, and help monitor progress in the future.
<b>Shared Services</b>	Remuneration Training and Competency of Workforce	All areas of shared services are impacted to some extent by RDR. The major impact will be vertically integrated firms training their sales forces.

## 4. Operating model impacts from RDR

### Providers using intermediated sales

Product providers are revising their product and distributor propositions to compete in the RDR compliant world. Associated strategies vary from incremental, based on today's capabilities to radical and transformational

#### Operating model impacts for providers using intermediated sales

<b>Customer</b>	Mass Market
	Mass Affluent
	High Net Worth
<b>Channel</b>	Execution Only
	IFA
	Self Service
<b>Distributor Proposition</b>	1 Adviser Payments
	Broker Consultants
	Platform
	Business Support
	Fund Access
	Portfolio Admin.
<b>Product Proposition</b>	2 Product Design and Marketing
	Product Pricing
<b>Servicing - Distributor</b>	3 Advice Fee Servicing
	Commission Statements
	Distributor RM
<b>Servicing - Customer</b>	4 New Business Process
	Existing Business Servicing
	Annual Statement Production
<b>Technology</b>	5 Direct Platform
	IFA Extranet
	Box Mgt.
	Fund Supermarket
	Distributor RM
	Commission
	Product Engines
	Outputs
	Quotations and Illustrations
	CRM
<b>Information</b>	6 Distributor MI
	Sales Reporting
	Regulatory Reporting
<b>Shared Services</b>	7 Remuneration
	Training & Competency

Intermediated sales will focus on mass affluent and higher net worth customers, though the way and amount customers pay for this service is likely to vary significantly. Execution only and self-service channels are likely to see increased usage from customers unwilling to pay for advice.

Key impacts on the product providers operating model:

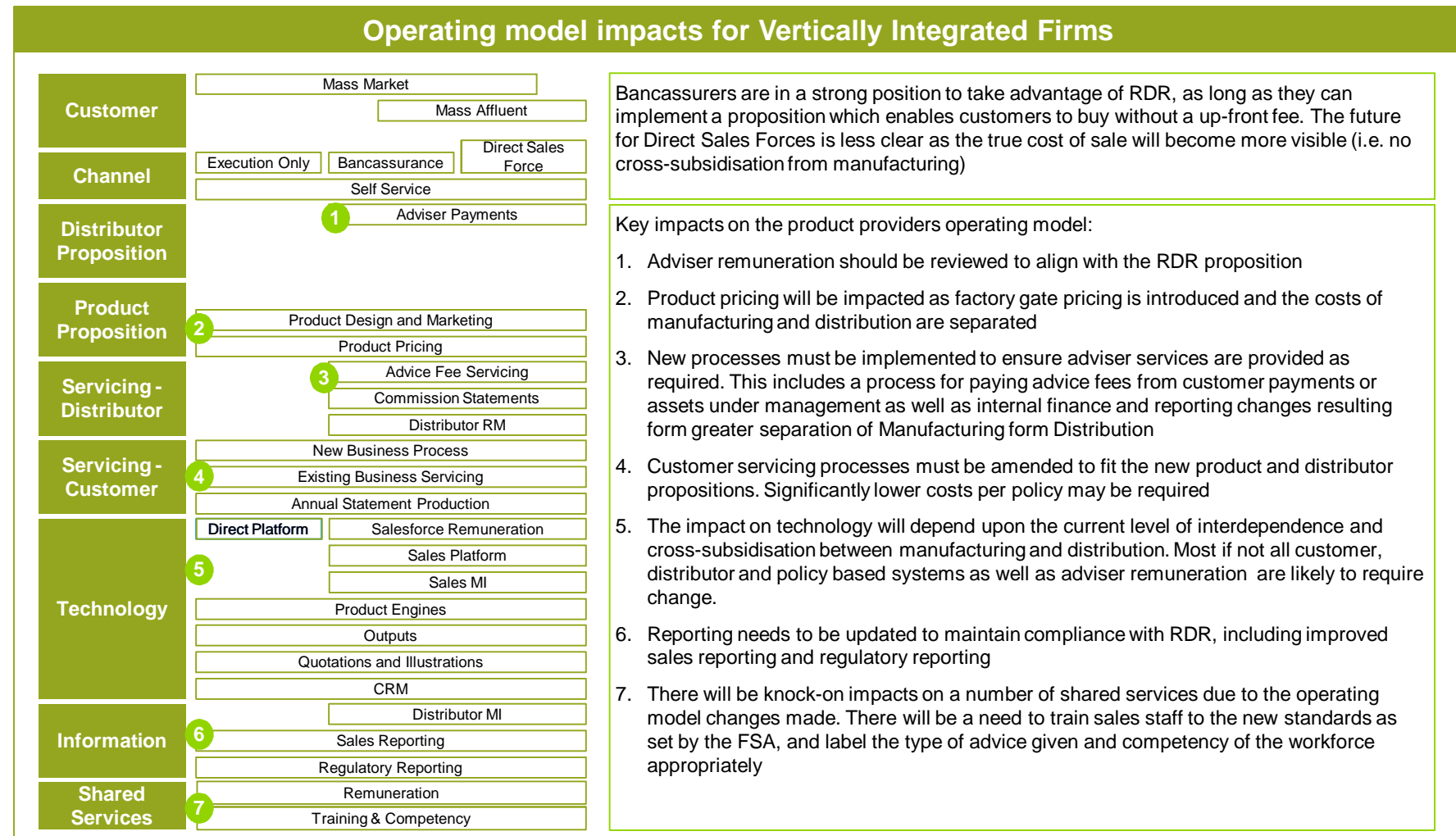
1. The proposition offered to distributors will change as commission is removed. Product providers will increasingly compete on distributor service, and the role of the Broker Consultant is likely to change significantly. Higher end IFAs will start to require portfolio administration capabilities and will make increased use of Wrap platforms. Distributor propositions must address this shift.
2. Product Providers will launch a new range of factory gate priced products. Existing products will continue in run-off (with associated commission)
3. New processes must be implemented to ensure adviser services are provided as required. Commission processing will reduce significantly but this may be replaced by processes for paying advisers advice fees from customer payments (if offered)
4. Customer servicing processes must be amended to fit the new product and distributor propositions. Significantly lower costs per policy may be required
5. The impact on technology will be significant just to comply with the new regulation. Enhanced distributor service will only increase the impact. Most if not all customer, distributor and policy based systems will require significant change and new systems may be required for enhanced distributor service (advice fee payments etc.)
6. In order to manage the impact of RDR pre- and post-implementation, enhanced MI is likely to be required, especially sales and persistency reporting by distributor. Regulatory reporting should also be enhanced.
7. Remuneration and Training & Competency of sales forces will be affected, including Broker Consultants



## 4. Operating model impacts from RDR

### Vertically integrated providers

RDR represents a significant opportunity for vertically integrated providers, but they will have to more clearly separate manufacturing from distribution.



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## 5. Areas of actuarial involvement relating to the RDR

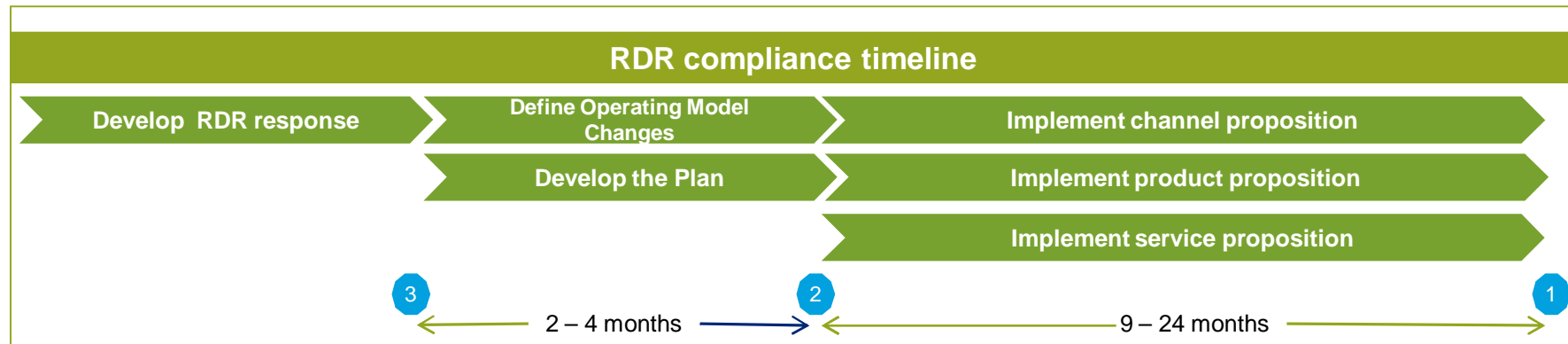
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- **Product Design and Pricing:**
  - Beyond compliance operating models will require innovative propositions - e.g. capital efficient structures, flexibility and offerings that may be suitable to various distribution models
  - A need for simplicity in product design, whilst offering a range of investment approaches for the more sophisticated investor, to promote access (no advice/simplified advice)
- **Product Management:**
  - Monitoring profitability of existing book – lapses, switching activity, take-up volumes, product mix (protection vs. investment where latter is more capital intensive),
  - Actuaries will need to ‘bring together’ the impacts of the RDR on product performance whilst communicating performance metrics in the new Solvency II world.
  - Likely to be an enhanced focus on expense analysis/attribution.
  - Monitor and understand the financial and reputational implications of any transfers from closed book to new generation products
  - Maintaining funds on open-architecture products/platforms (treatment of rebates/volume impacts etc)
- **Marketing Actuarial:**
  - Managing the competition- life products vs. unit trusts vs. platforms
  - Unbundled pricing – transparency vs. complexity of charging structures → competitor comparisons
  - Focus on relationship building – education of sales force
- **Distribution:**
  - Channel economics including adviser productivity & assistance for advisers
  - Adviser proposition (product only an element)
  - Advice fee processing

## 6. Conclusions and next steps

### The clock is ticking

RDR will radically change the distribution landscape for all involved in the retail investment market. As a minimum, firms must comply with the new regulation, but a compliance-only approach may not sustain current market share, and certainly won't deliver competitive advantage. If a more radical approach is required, the clock has already started ticking



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- RDR has to be implemented by the end of 2012, but the market is already moving towards the RDR models and the pace will increase gradually as the deadline approaches.
- Providers must time the release of RDR compliant products and services to achieve the optimal balance of sales volumes and associated cost and risk.
- This means implementation dates well before the end of 2012.

2

- Assuming delivery of at least some RDR compliant products and services will be required well before the end of 2012, IT lead times for anything more complex than a "Compliance Only" approach would suggest that providers should have their RDR Implementation plans well advanced already.
- Achieving this requires a thorough understanding of the changes required to Operating Models across the business, typically a 2-4 month process once the strategic response is agreed

3

- Most providers are now in the position where their strategic response to RDR is agreed
- For IFA providers this includes a position on "platforms" and "wrap"
- Those providers not yet in this position are beginning to constrain their options, especially if a more radical approach is required

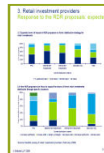
# 7. Partnering for successful implementation

## Deloitte credentials relevant to RDR

Deloitte is the industry leader in delivering regulation-driven change in the Insurance industry (e.g. Solvency II), due to our unique combination of consulting capabilities which span business strategy, operations, technology, actuarial and regulatory domains

Policy setting and regulatory change implementation	Life Insurance Sales and Service	Technology implementation
 <ul style="list-style-type: none"> <li>FSA: The Cost of RDR, Conduct of Business rules affecting regulatory controls for sales, review of prudential funding requirements for personal investment firms (IFAs)</li> <li>ABI: Indemnity Commission, Pension Reform</li> <li>Treasury/DWP: Stakeholder pricing, Pension Reform</li> <li>Solvency II: Gap analysis and implementation</li> </ul>	 <ul style="list-style-type: none"> <li>Market and competitor analysis and scenario testing</li> <li>Distribution strategies, segmentation, remuneration design, commission structure, propositions</li> <li>Wrap / service platform strategies</li> <li>Target Operating Model</li> </ul>	 <ul style="list-style-type: none"> <li>IT Operating Model design</li> <li>IT Sourcing and cost reduction</li> <li>Product platforms, agent and commission systems transformation</li> <li>Enterprise-wide solution for insurance reporting</li> </ul>

### Deloitte research and publications



#### Firm behaviour and incremental compliance costs, 2009

Research for the Financial Services Authority on the total incremental compliance costs of RDR proposals

#### Insurance Market Update, 2008

Customer Agreed Remuneration and the Retail Distribution Review – Will CAR deliver to its objectives?



#### Solvency II reporting and disclosure requirements, January 2010

Final advice on implementing measures ("Level 2") for the reporting and disclosure aspects of Solvency II

#### Making the case for Solvency II technology, February 2010

Our point of view article looking at the role that technology will play in delivering Solvency II



#### Insurance Market Update, February 2010

The Deloitte view for life insurers

In this February edition, we look at the concept of risk appetite in the context of a life insurance company. We also consider the impact Solvency II requirements will have on an insurer's risk appetite framework



#### The right combination, November 2009

Rethinking business operating models in insurance

Our latest thought leadership research for the Insurance sector offers a detailed view of the approaches currently taken across organisations and the key steps that both global and regional players should be taking to ensure their business operating models are best serving their needs.

