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RDR: increased transparency or added confusion? Lessons learned from overseas

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Overview

1. Introduction to the RDR
2. Lessons learned from overseas
3. Initial trends in the UK
4. An advisor perspective
5. So what's next?

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Introduction to the RDR

What were the drivers for change?

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FSA Concerns and Objectives

Concerns

The FSA was specifically concerned with:

- Existing **commission structures** and the likely effect on **product provider bias and churn**
- Measuring a firm's success based on business volumes rather than quality of offerings
- **Poor persistency** for life and pensions products and consequently **low profitability**.

Objectives of RDR

Through the RDR, the FSA aimed to:

- Develop an industry that engages with consumers to deliver more **clarity on products and services**
- Provide a market that allows more consumers to have their needs and wants addressed
- Enforce remuneration arrangements that allow competitive forces to work in favour of consumers
- **Increase the professional standards of advisers** to inspire consumer confidence and build trust
- Deliver an industry where firms can deliver on their longer-term commitments and treat their customers fairly
- Provide a regulatory framework that supports delivery of these aspirations without inhibiting future innovation.

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A customer walks into a bar…

Perspective	Pre-RDR	Post-RDR
Customer	• Example commission: upfront commission of 5% and 1% p.a. for duration of investment	• Range of fees offered by Adviser • Example fees: one-off up-front fee of £1500; £75 per month ongoing…
Adviser	• Could receive commission from product providers upon securing a sale • Some implicit charges allowed	• Must disclose charging structure upfront • Can only receive on-going charge for on-going service
Life Company	• Scope to use aligned FAs to sell its products directly • Scope to pay advisers product profitability bonuses	• Re-pricing products to remove or change commission • Fees must link to service directly • Consider impacts on reserving/modelling

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Industry Changes from the RDR

Key Industry Changes

- Greater transparency of **adviser charges**
- Removal of **commission bias**
- Improved clarity of **disclosure** of services provided
- **Enforced independent status** for financial advisers, or disclosure of any restrictions
- Introduction of **required qualification** for advisers, equivalent to first year degree-level.

Product provider requirements under the RDR

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

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Lessons Learned from Overseas:
Australia

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Lessons from Down Under
The market context

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Lessons from Down Under

The market context

Australian Market Fundamentals	UK Indicator?
Average Retirement Savings	○
Cost of living	○
Compulsory Pensions Contributions for working life	○
Tax regime	○
Specific tax incentives for advice	○

● strong ○ weak

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Lessons from Down Under

Initial findings show positive effects

- **Average cost of advice expected to halve (to £750),** driven by clients:
  - Negotiating a lower fee once they realise how much they are paying
  - Shopping around to obtain a lower price
  - Seeking advice only when required (i.e. paying for ongoing service only)
- **The number of Aussies seeking financial advice expected to double**, driven by:
  - Increased personal pension savings driven by compulsory contributions (12% p.a.)
  - The reduction in the cost of advice
  - Ongoing tax benefits associated with advice
- **No expected change to the number of advisors**
- **Increase in private savings under advice** by $144bn (£96bn)

… over the next 15 years

- **Rumours that Risk advice will be the next target for FOFA**

Source: Rice Warner Actuaries

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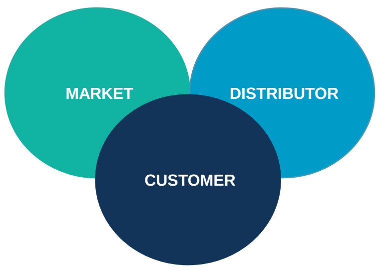
Lessons Learned from Overseas:
Denmark

An Introduction to the Danish Market
What were the key characteristics?

The market consists of life and non-life products, but few companies sell both

64% of non life market is private insurance and 36% is business insurance*

State support exists, but is limited



Tied agents used in individual pension and private non-life

Independent intermediaries used in non-life business and company agreed pension schemes

Brokers only active in the business-to-business market

Close to 90% of the workforce in Denmark are mandatory members of an occupational pension scheme*

Most insurance employer-led where the reward and pension package contains a variety of products including protection products

*Source:Danish-Insurers-MEP-Seminar-20th-of-march

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The Drivers for Change in the Market

Lack of transparency led to negative press for the insurance industry

Drivers for Change

High Commission

Brokers were circulating company agreed pension schemes every three years earning a commission on 15-20% of the premium of the scheme.

Lack of incentive to negotiate

Fees are not paid by the employer but the scheme and so there is no incentive to negotiate costs down.

Hidden fees

No transparency in fees which were often hidden in products meaning the policyholder didn't know they were paying commission.

- Ineffective competition in the marketplace
- Lack of transparency in total fees paid and by who
- Customers interests not at the heart of the product

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Forsikringsformidling

Driving competition, increasing transparency, protecting the customer

Key Features

- Introduced in 2008 and has been iterated in subsequent years
- Covers independent intermediaries on both life and non-life market
- Brokers are no longer allowed to receive payments directly from insurance companies
- All fees charged must be disclosed

Driving Competition

Comparison website for pension products

Fixed fee for transaction

Increasing Transparency

Transparent fees paid by consumers

Information shared on total cost of scheme

Protecting the Customer

Products realigned to customer needs

Hidden costs removed

The Impact

- No shortfall in insurance supply
- No significant decline in brokers
- Consolidation of pension schemes

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So what has the impact been in the UK?

Early indication of trends

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FCA's responses: generally positive…

"Firms have made a lot of progress" – FCA's Thematic Review of RDR six months after implementation.

Progress

- Firms have generally acted to implement the RDR requirements, and are open to feedback from the FCA
- Many firms' propositions were in line with the new RDR rules
- Some firms have tried to make their disclosure material clear and engaging.

Areas for improvement

- Some firms were not providing clients with some or all adviser charges in cash terms, only as percentages
- Some firms were not clear what on-going services would be provided, particularly with regard to regular reviews
- Some firms did not provide their generic charges in good time before making personal recommendations
- Some firms were not offering a truly independent service, despite describing themselves as independent
- Firms providing restricted advice were not adequately describing the nature of their restrictions, in some cases.

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… but sweeping improvements required?

"Serious concerns and a poor management culture… undermining the objectives of the RDR" – FCA guidance consultation three months later.

Comments

- Much more critical of industry, both financial advisers and insurers.
- Sought to clarify existing rules rather than introducing new rules – exemplified arrangements that would not be accepted in future.
- "Significant increase" in support services spending before and after implementation – but large proportion of spending did not add value for customers.
- Questioned the independence of adviser and provider "joint-ventures" to secure distribution and profits.

Breaches of conflict of interest commission rules

- Over half of firms sampled had arrangements in breach of the conflict of interest principles.
- Firms getting around commission rules by offering non-financial incentives to IFAs to promote their products, such as purchasing support services, overseas hospitality events and paying for training or IT development.
- Two most seriously offending firms under investigation over suspected breaches .
- Regulator plans to visit advisers and insurers in future to review their arrangements.

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Impact on HY13 results – good and bad

20% increase in group profits

"the RDR has fundamentally changed the adviser landscape for savings and investment business"

28% increase in UK operating profit

"the RDR has played to the strengths of the advisers we do business with and we have also been able to open our doors to a broader range of advisers"

46% fall in pre-tax profits

"largely due to the impact of the RDR"

14% fall in life sales and 23% fall in operating profit

"affected by the RDR and the Gender Directive"

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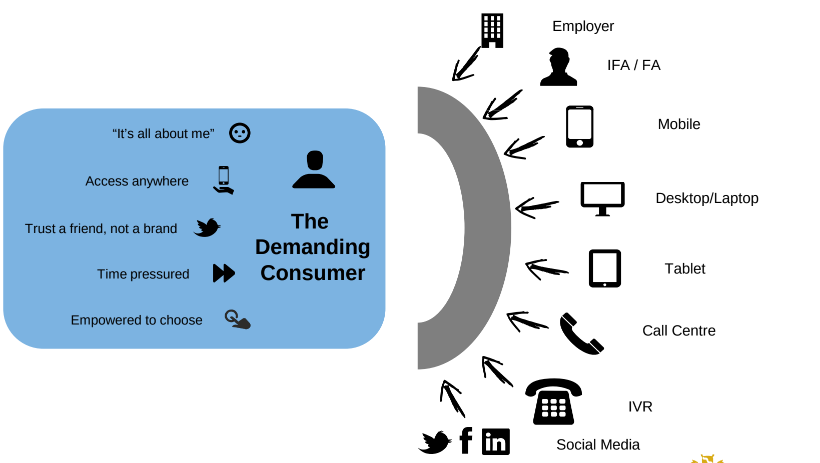
An adviser’s perspective

Rosemary Hunter, UK Financial Adviser

So What’s Next?



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Questions Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenters.

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