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Strategic Implications for Life Insurers in a Post-RDR World

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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
- 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

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RDR strategic response options

Defining the response strategy for product providers

There are three approaches organisations are adopting when defining their response to RDR. The decisions have been driven by their strategic intent wrt distribution, impacts on the business and cost.

Option	Description	Business impacts	Implications
Compliance only	Base post RDR proposition on existing factory gate priced products and associated distributor services	• Limited amount of work required • Lower cost to implement • Minimal disruption to BAU • Minimal impact on operating model • Can be quickly implemented	• Current product set may not be competitive post RDR • Other providers may find new differentiators and ways of working with IFAs
Refresh proposition	Modify the product proposition to offer factory gating pricing and adviser charge / payment facilities	• Favourable product and servicing proposition for advisers and customers should lead to increased sales (although note "hygiene factor" requirement".) • Opportunity to refresh products and remove non-profitable business	• Refresh activities have a relatively high cost. • Significant disruption to BAU as new products are launched • May still not keep pace with market leaders
Radical transformation	Develop a radically new distribution operating model to gain significant market share post RDR.	• Potentially significant cost to implement with long lead times. • Resource constraints and impact on BAU (and SII programmes?) need to be managed. • Board level buy-in required	• Channels, products and propositions re-aligned to lead the market leading to (hopefully) increased market share. • Market may not move as fast or in the direction foreseen • Market leading profitability through lower costs per policy

Operating model impacts from RDR

Typical product provider impacts from RDR

The operating model of product providers will be affected by the 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

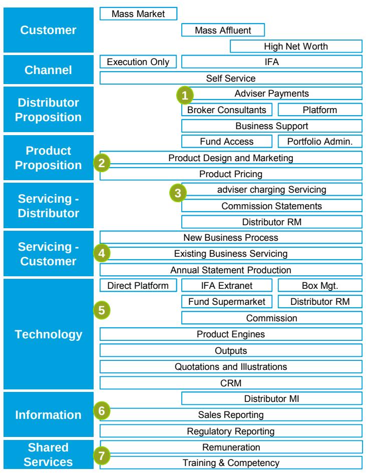
Customer	Clearer strategic targeting of customer groups and alignment of products to their requirements
Channel	The way customers buy products will change, as will the economics of each channel. Distributors must provide suitable terms to customers.
Distributor Proposition	To stay competitive post RDR, 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.
Product Proposition	Factory gate pricing will promote competition based on product performance. Product offerings will differ at each end of the market.
Servicing - Distributor	Product providers may provide adviser charging processing, but this will have knock-on impacts for the rest of the operating model and is likely to become no more than a hygiene factor anyway.
Servicing - Customer	Processes will change to match new product and distributor offerings. – For example statement consolidation and illustrations etc.
Technology	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, • Development of adviser fee payment capabilities. • Management of 'pre' and 'post' RDR remuneration systems
Information	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.

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



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:

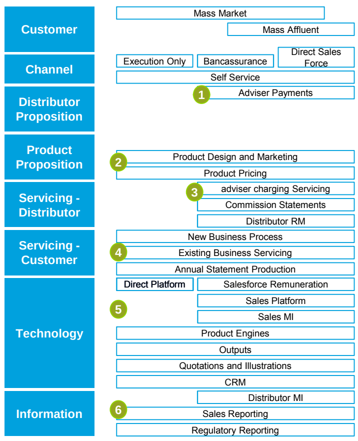
1. The proposition offered to distributors will change as commission is removed. Product providers will increasingly compete on distributor service, and the role of the Broker Consultant is likely to change significantly. Higher end IFAs will start to require portfolio administration capabilities and 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 adviser charging 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 (adviser charging 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

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.

Operating model impacts for Vertically Integrated Firms



Bancassurers are in a strong position to take advantage of RDR, as long as they can implement a proposition which enables customers to buy without a up-front fee. The future for Direct Sales Forces is less clear as the true cost of sale will become more visible (i.e. no cross-subsidisation from manufacturing)

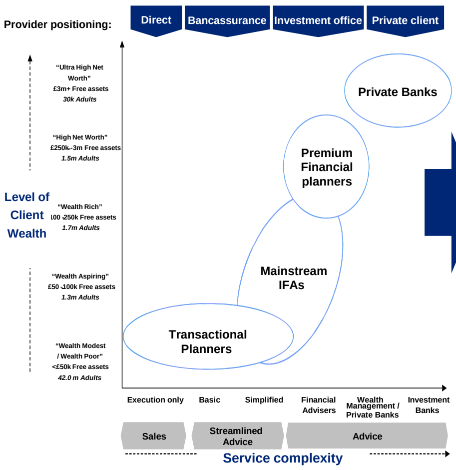
Key impacts on the product providers operating model:

1. Adviser remuneration should be reviewed to align with the RDR proposition
2. Product pricing will be impacted as factory gate pricing is introduced and the costs of manufacturing and distribution are separated
3. New processes must be implemented to ensure adviser services are provided as required. This includes a process for paying adviser charging from customer payments or assets under management as well as internal finance and reporting changes resulting form greater separation of Manufacturing form Distribution
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 depend upon the current level of interdependence and cross-subsidisation between manufacturing and distribution. Most if not all customer, distributor and policy based systems as well as adviser remuneration are likely to require change.
6. Reporting needs to be updated to maintain compliance with RDR, including improved sales reporting and regulatory reporting

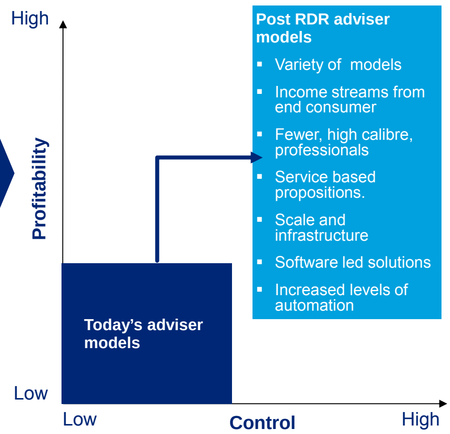
RDR impact on distributors - Polarisation

Some distributors are moving towards adviser charging, targeting customers who can afford to pay up front. Others will focus on the lower end of the market, recouping advice charges over time as customers pay for their services. This is likely to lead to polarisation of the distribution landscape.

Potential Future Distribution Segments

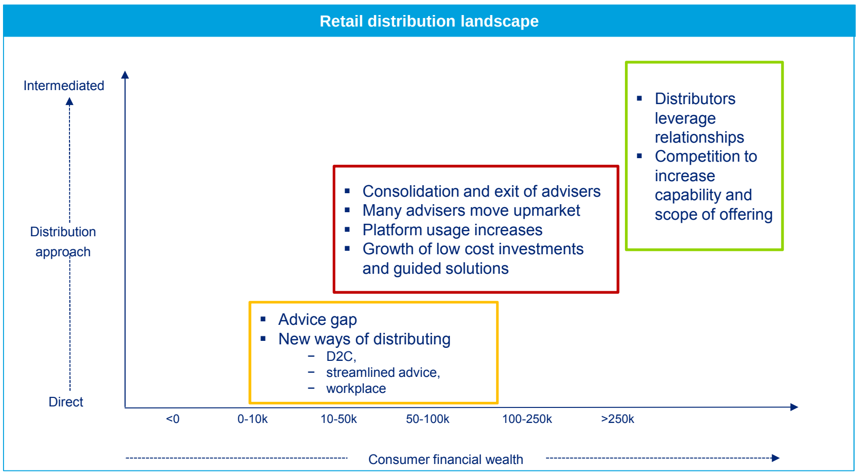


Expected impact of RDR on Advisers



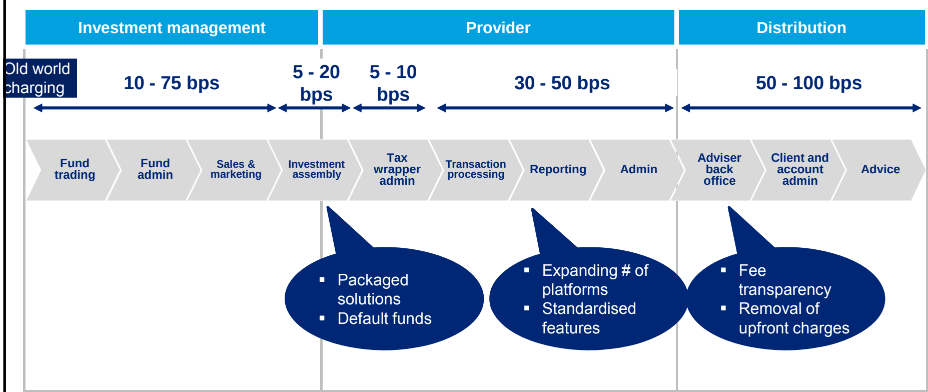
Market impacts and changes required

Having decided 'where they want to play' distributors need to develop core capability specific to their target market



Impact on the value chain

RDR is expected to lead to a squeeze in margins due to increased fee transparency and removal of upfront charges.
Will we see a shift in the balance of power away from distributors to investment managers?



Post RDR strategic considerations

Changing financial dynamics

- Margins squeezed
- Volume or niche play
- More crowded in mass affluent and above
- Churning plunges
- Gulf in consumer willingness to pay & advice costs
- Cross-subsidies eliminated

Leading to opportunities

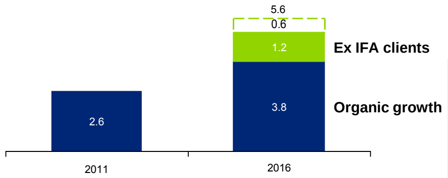
- D2C
- Focused IFA
- Workplace
- Platforms
- Investment Solutions

Critical strategic choices

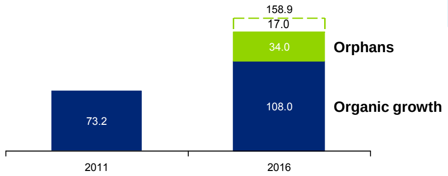
- Channels
  - D2C
  - Intermediary segments
- Propositions
  - Low cost vs. High service
  - Differentiation
- Product
  - Breadth
  - Packaging
- Value Chain
  - Participation
  - Make vs. Buy

Success in D2C requires overcoming barriers

Forecast growth in D2C clients (mn)



Forecast growth in D2C assets-under-administration (£bn)



More D2C customers

- IFA clients deterred by the upfront cost of advice
- Fewer IFAs
- IFAs focusing on mass affluent & above

1. Require education and convincing of D2C benefits

Increased growth in existing D2C base

- Mistrust of financial institutions
- Growing use of the internet
- Increased knowledge of and access to product information

2. Effectively serve and attract more like-minded clients

Workplace offers interesting, but challenging potential

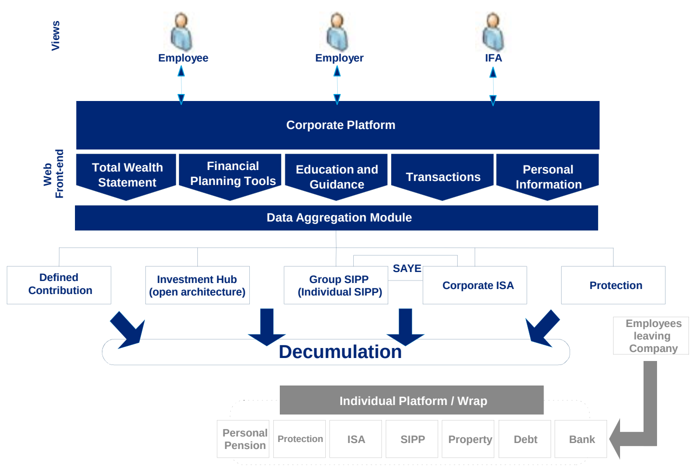
UK group pension market is undergoing significant change...

1. DB closure and scheme restructures
2. Increased employee mobility and desire for portability
3. Desire to retain and recruit employees with more flexible package
4. Auto enrolment & NEST
5. Changes to pensions tax relief
6. Greater 'e' availability in the workplace

...creating a growing Workplace market opportunity

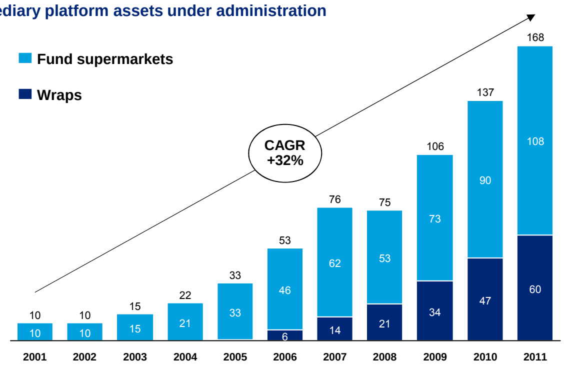
1. Employees more in control ; need advice both in accumulation and decumulation
2. Advice can be provided on a more economic mass basis in the workplace
3. Employers becoming facilitators of employee wealth
4. Life companies and EBCs want to future-proof their businesses – lock in volumes
5. Proof of concept exists internationally

Corporate Platforms are being explored by all the larger players



Growth in retail platform market has escalated and will continue

Intermediary platform assets under administration
£bn



	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Number of intermediary platforms	6	6	7	8	9	13	15	18	20	22	25

Source: Platforum data; Deloitte analysis

Future growth

- Varied predictions; > £500bn by 2016 including D2C
- Continued demand from advisers
  - RDR compliant business model
  - Creation of long term value in their business

Consolidation expected, but still large number of platforms

Future platform market

- ***Fund supermarket***
  - Fund supermarkets have critical mass, still need to develop profitability
  - Transforming their business with multiple wrappers and investment instruments
- ***Life & bank oriented platform***
  - Yet to reach scale, still investing in functionality
  - Likely to transform into a business solution proposition
- ***Independents***
  - Most unlikely to survive due to investment requirements
  - Acquisition by larger institutional players

Implications

- Continued land grab for assets
- Pricing pressure exacerbated, similarity of underlying technology makes differentiation hard
- Back end likely to be industrialised with focus on front end innovation
- Consolidation will be facilitated by convergence of functionality, mandatory re-registration and standardisation of technology