The Actuarial Profession
making financial sense of the future

Highlights of the 2009 life conference

Presentation by Towers Watson and the Association of British Insurers

Retail Distribution Review: The Where, What and Why

23 February 2010

Purpose of the presentation

- The purpose of this session is:
  - To outline the main changes that are being implemented by the FSA and its Retail Distribution Review (RDR)
  - To discuss the implications of the changes on the investment and savings industry
  - To articulate some of the responses from the industry

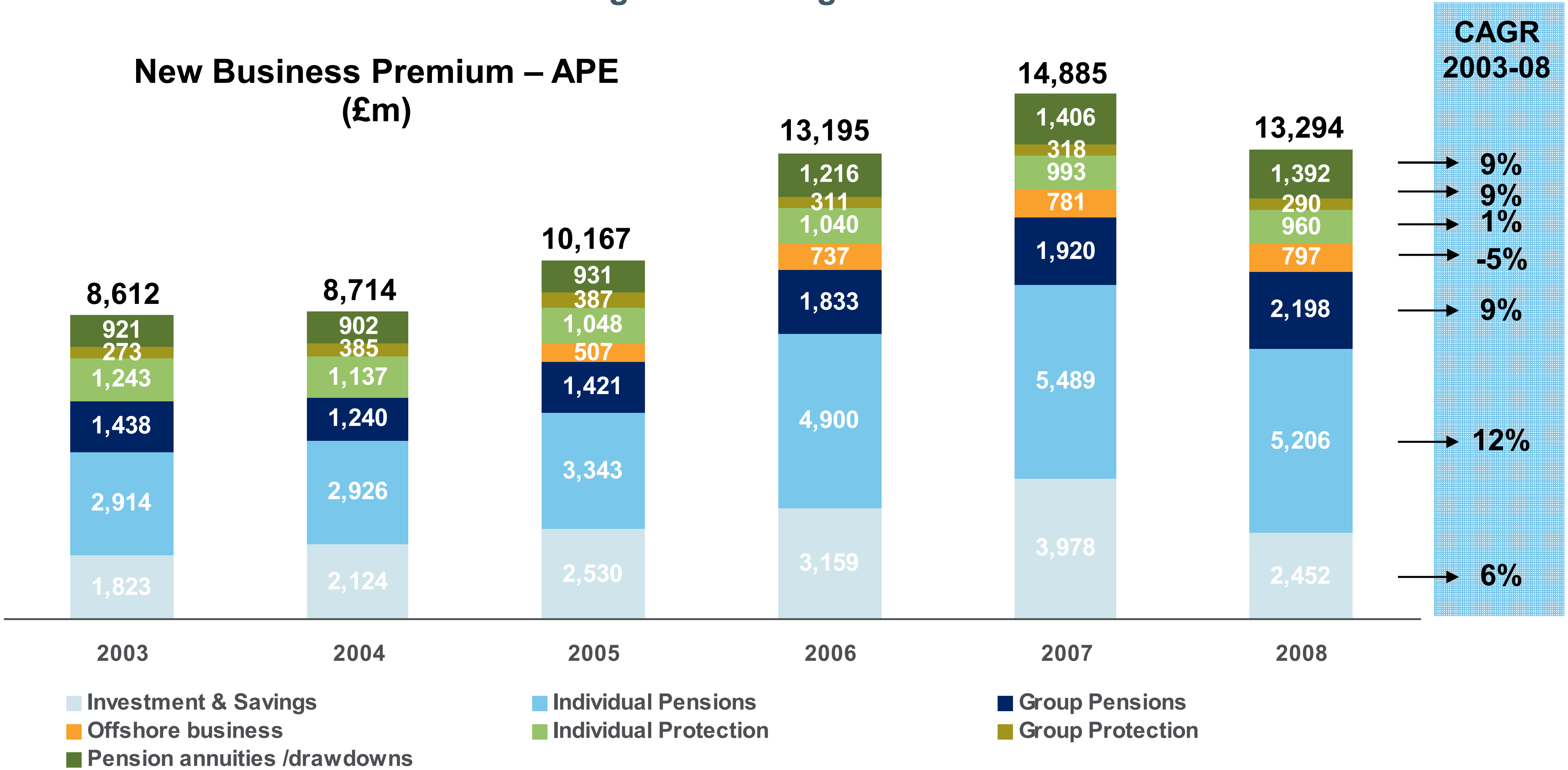
Contents

TOWERS WATSON

ABI Association of British Insurers

UK life and pensions market

In 2008, the Life & Pension new business premium reached £13bn, with Individual Pensions and Investment & Savings accounting for over half the total



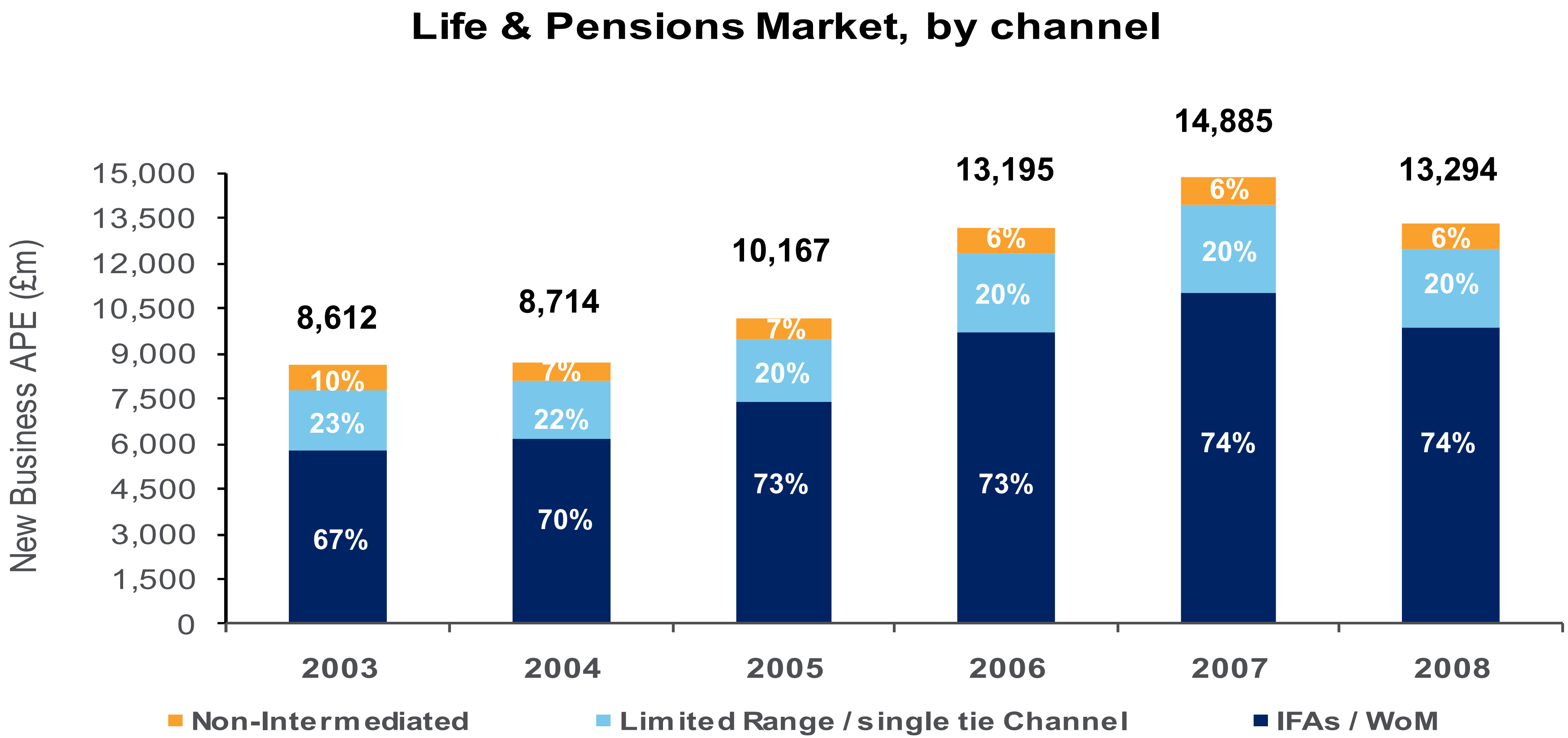
TOWERS WATSON

ABI Association of British Insurers

Source: ABI; Note: CAGR – Compound annual growth rate; **Note**: does not include collective investments

UK Distribution

There has been little change over the last six years to the dominance of the IFA channel



TOWERS WATSON

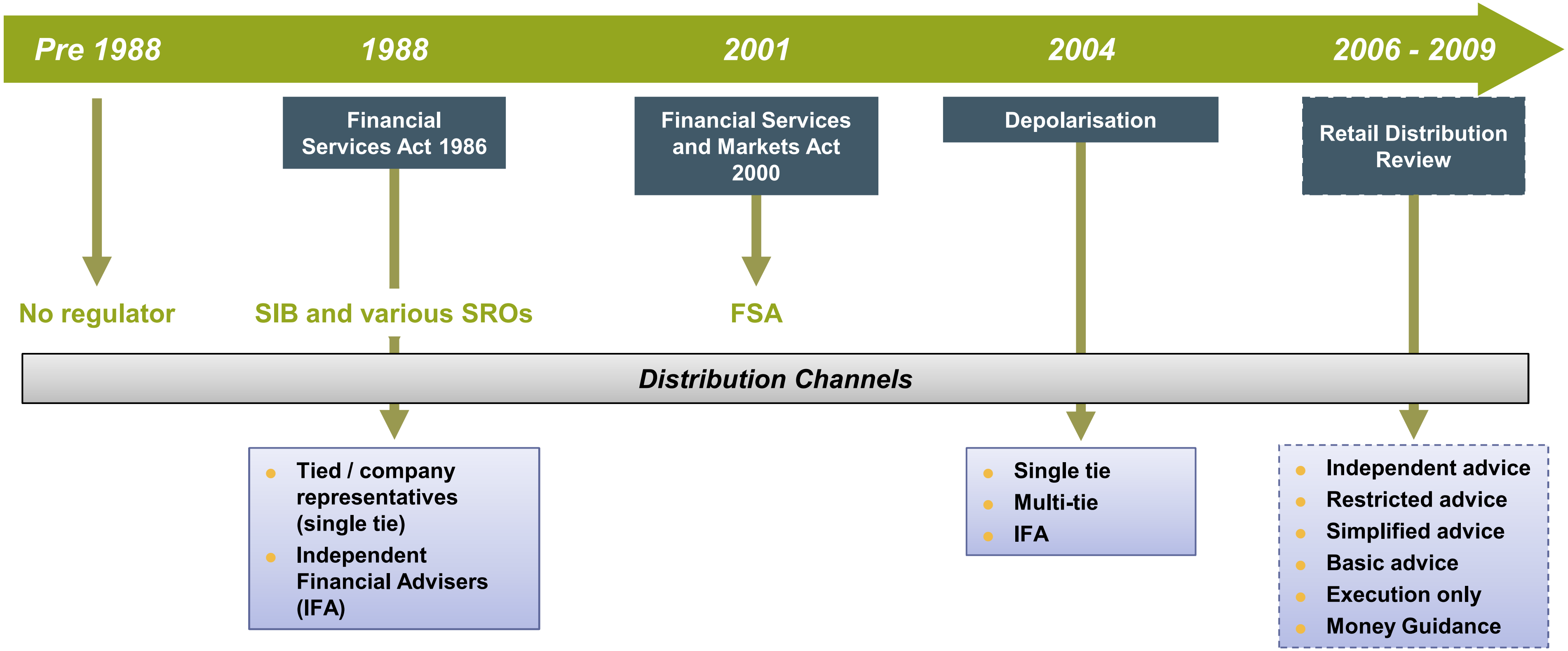
ABI Association of British Insurers

Source: ABI; Note: does not include collective investments

History of Regulation

The regulation of retail distribution of investment and saving products in the UK is fairly recent and under review again

History of regulation / distribution in the UK – timeline



TOWERS WATSON

Association of British Insurers

Source: ABI, FSA, Internet

Contents

Principles behind RDR

The RDR is one strand of the FSA's retail market strategy, ensuring that consumers have the necessary confidence through improved advice, products and services

- RDR is an important component of the overall retail market strategy, complementing Treating Customers Fairly and Financial Capability initiatives

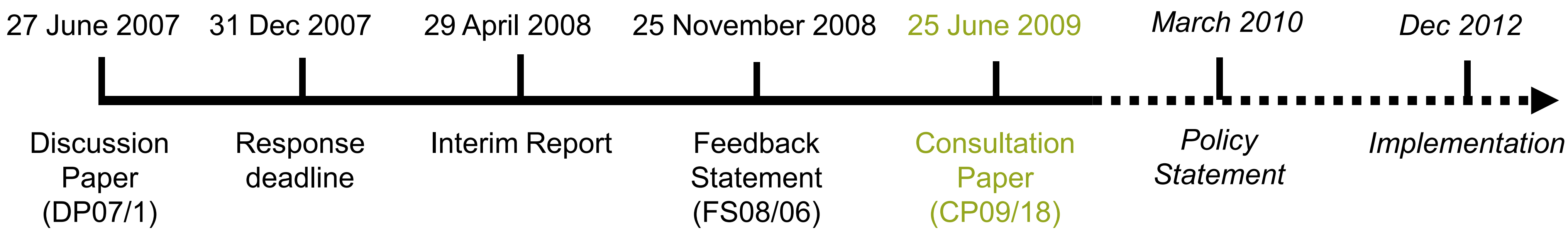
- The aim of it is:

  "for more consumers to have sufficient confidence in the market to want to use its products and services more often"

- The intention is for this to be achieved through:
  - Clarity of products and services
  - More consumers to have needs and wants addressed
  - Improved standards of professionalism
  - Remuneration that allows competitive forces to work in favour of the consumer
  - Viable firms able to deliver on long-term commitments who treat customers fairly
  - A regulatory framework which supports these aims and does not inhibit future innovation

Timeline of RDR

CP 09/18 is the latest step towards the FSA's new distribution landscape, due to be implemented in full by December 2012



The consultation paper landscape

Distribution will range from independent and restricted advice through to services such as execution only (Sales) and Money Guidance

Advice		Streamlined advice		Sales
1. Independent	**2. Restricted**	**3. Simplified**	**4. Basic**	**5. Execution only**
• Fair analysis of the market • Written and oral disclosure of independent status • Adviser charging will apply • Professionalism QCF level 4*, CDP	• Limited to part of the market • Written and oral disclosure of restrictions • Adviser charging will apply • Professionalism QCF level 4*, CDP	• Can be either independent or restricted • Adviser charging will apply • Likely to require QCF level 4*	• Scripted questions, but full assessment not carried out • Advice on stakeholder savings and investment products only • No qualification requirements • No adviser charging requirements	• No major changes from existing rules

Money Guidance
6. 'Moneymadeclear'
• Not under the remit of the FSA, • Included for completeness • Will be a 'gateway' for some individuals, from which they will engage with the financial services industry through one of the other distribution channels

TOWERS WATSON

Association of British Insurers

* Scottish qualification equivalent: SQCF level 8

Advice - 1. Independent

The fundamentals of independent advice are adviser charging, independence and professional standards

- Independent remuneration – 'Adviser Charging'
  - Set charges, make clients aware of what their advice and services will cost
  - Product providers cannot determine how much commission is paid to an adviser or include adviser commission in their product prices
  - Product providers may offer facilities for customers to have adviser charges deducted from their investments but from 2012 factoring (including indemnity commission) will no longer be allowed

- Independent advice process
  - Provide unbiased, unrestricted advice
  - Give comprehensive and fair analysis of their relevant markets
  - Wider definition of 'retail investment products'
  - Use of panels and portals still allowed subject to meeting specific criteria
  - Ownership of Independent advisory firms by product providers is still allowed

- Professional Standards
  - All will need to have a minimum qualification of QCF level 4*

*** Scottish qualification equivalent: SQCF level 8**

Advice - 2. Restricted

The traditional ‘single’ and ‘multi-tie’ advisers are likely to fall within ‘restricted advice’, so long as they meet adviser charging and professionalism standards

- These services meet the definition of advice but not the new definition of independent
- This category allows full advice services to clients based on a comprehensive review of their needs; can be limited to:
  - Specific needs or the full range
  - A single or multi-tie arrangement
- Same professionalism and adviser charging standards as for independent advice
- Tied and multi-tied services in the current market may (subject to professionalism and charging) fit here
- IFA firms who no longer meet the independent criteria may also sit within this category

Streamlined advice – 3. Simplified

Streamlined advice process (which used to be called ‘advised guided sales’) will still require the same professional standards and adviser charging

- Simplified advice processes involve a firm providing a personal recommendation to a client
- As a recommendation is involved, adviser charging and how firms describe their services are applicable
- As investment advice is being given, the same professional standards are likely to apply, but this is an area that is being consulted upon
- Non-advised ‘guided sales’ (introduced in April 2008 Interim Report) is no longer an option

Streamlined advice - 4. Basic

Re-introduced in the CP paper (having been removed as a concept in the feedback statement)

- Basic advice was introduced in 2005 as a new form of regulated advice
  - Charge-capped stakeholder savings and investment products with a streamlined sales and advice process
  - Pre-scripted questions about income, savings and circumstances to identify the financial priorities and suitability for a stakeholder product
  - Full assessment not conducted nor is advice offered on whether a non-stakeholder product may be more suitable
- In FS08/6, the FSA set out plans to consult on removing the basic advice regime. It now proposes to retain the basic advice regime to support the wider stakeholder regime
- Need to articulate whether independent or restricted
- No intention to apply the professional standards or adviser charging to this category

Sales - 5. Execution only

A channel for individuals who know exactly what it is they require and are happy to purchase with limited or no intermediary involvement

- Under execution only the customer knows precisely what they want to buy and does so
- The FSA believes that the proposed 'Moneymadeclear' service may boost demand for execution only
- The FSA is consulting on whether the principles of adviser charging need to apply

Sales - 6. Moneymadeclear

Moneymadeclear is a separate piece of work which the FSA is co-leading with the Treasury

- Thoresen Review led to Money Guidance; Moneymadeclear is the resulting ‘pathfinder’ service set up in the North West and North East
- Accessed through FSA Moneymadeclear website, by telephone, and face-to-face through regional partner organisations and charities
- Staff are trained to provide consumers with clear, impartial and personalised information and guidance on money matters, such as avoiding debt problems
- Ambition for Moneymadeclear to become a national service
- Moneymadeclear is not a FSA regulated activity nor is it a commercial service
- The proposal includes opportunities for consumers to ‘self serve’ through non-advised services

Advice

In order to help consumers distinguish between the different forms of advice on offer to them the FSA has put forward definitions and requirements

- Disclosure of independent / restricted status:
  - All firms will need to disclose whether they are independent or restricted
  - Restricted firms will need to use a specific form of words

- All advice must be made in the client's best interests, including not to buy a product, if appropriate

- Firms who are independent will not be able to exclusively offer just their own funds or model investment portfolios

- The FSA has set a new definition for retail investment products
  - In addition to packaged products 'retail investment products' includes integrated collective investment schemes, investment trusts, structured products, exchange traded funds etc. which offer exposure to underlying financial assets, but in a packaged form

Adviser charging - principles

Adviser charging reflects the services being provided, without reference to the product or provider being recommended

- The high level principles behind adviser charging are:
  - The client and adviser agree the services to be provided and the explicit charges to be levied
  - Adviser firms should only be paid for the advice and related services that they provide through 'adviser charges' rather than by commissions set by product providers
  - Regardless of whether adviser charges are paid directly by a client as a fee or are paid as deductions from their investments, these charges should reflect the services being provided to the client, not the particular product provider, or product, being recommended

- As a result of this, the FSA states that adviser charges should not:
  - Vary inappropriately according to product provider
  - Vary inappropriately according to the type of product offered, where different types are substitutable
  - Be influenced by the existence of terms or facilities offered by product providers to collect adviser charges

Adviser charging – vertically integrated firms

Vertically integrated organisations are likely to be required to adopt adviser charging, but the details as to how have yet to be finalised

- The FSA seeks to apply adviser charging to 'vertically integrated' organisations, where the product provider (or a firm in the same group) gives advice to the consumer
- Vertically-integrated firms are likely to be required:
  - To separate their adviser charges from their product charges
  - To allocate expenses fairly, in a way that represents the cost and services provided, to minimise any form of cross-subsidy
- The emphasis for such organisations may need to be different, i.e., on internal incentives and remuneration systems and whether they influence advice to consumers
- The FSA is not convinced the current disclosure of 'equivalent' adviser charges should continue to be allowed, and are consulting on applying Adviser Charging to all firms, including vertically integrated ones

Adviser charging – product providers

Product providers will need to ensure that they offer a reasonable level of flexibility for advisers using the product to deduct the charge, on a matched basis

- The obligations on manufacturers are to have:
  - ‘Reasonable’ flexibility of charges
  - Validation and monitoring of adviser charges
  - Match adviser charging payments
- Adviser firms are expected to decide on their own charging structures, realigning the services they offer and applying them consistently to consumers
- The FSA will not prescribe the basis on how a firm will charge

Professional standards and qualifications

All advisers to have minimum of QCF level 4* (subject to confirmation for simplified advice processes)

- Professional Standards Board: will be part of the FSA rather than a separate entity

- Benchmark Qualification:
  - Will be raised to QCF level 4*, all advisers must reach this by 2012
  - New entrants will be required to reach the new benchmark once this is finalised in 2010
  - FSSC is consulting on the details
  - Would apply to all those giving “independent”, “restricted” and “simplified” advice, but not “basic advice” or execution only

- Alternative Assessments:
  - To be developed involving oral assessments in place of (and as robust as) QCF level 4* exams
  - Applies to current advisers and will be withdrawn by end 2012
  - Awarding bodies conduct assessments through independent assessors

*** Scottish qualification equivalent: SQCF level 8**

Next steps

The FSA has laid out a timetable for implementation of its distribution landscape by December 2012

- The FSA will issue a policy statement and transition timetable during Q1 2010, expected to be March
- Full implementation expected to happen before 31 December 2012

Contents

- Background to the retail distribution review
- Retail distribution review
- **Implications of the retail distribution review**
- Industry response

Independent Financial Advice operations

IFAs have much to consider under the proposed changes by the FSA despite potentially being best placed to benefit from the proposals

- Satisfying the new independence standards
  - Training and retaining suitably qualified advisers
  - Fundamentally reviewing their remuneration model
  - Extending their offering beyond Packaged Products

- Assessing the value of truly independent financial advice
  - How this is perceived by their clients
  - What their ‘value proposition’ is
  - How they will charge for this under ‘Adviser Charging’

- Managing the impact of changing income patterns on cash flow
  - Maintaining or sourcing adequate capital

Single and multi-tie operations

Single-tie and multi-tie operations appear to be caught in the middle of the proposed changes by the FSA

- At present, there is no obvious automatic 'home' for such arrangements as they do not:
  - Satisfy the new independence standards
  - Typically have suitably qualified advisers
- The options for such organisations are:
  - Restricted advice
  - Simplified advice (restricted)
  - Basic advice
  - Execution only
- If an option other than basic advice or execution only is chosen some organisations may struggle to justify the costs associated with:
  - Getting the advisers qualified to QCF level 4*
  - Applying adviser charging

*** Scottish qualification equivalent: SQCF level 8**

Wealth managers

Wealth managers (e.g. private client investment managers) may have to consider describing themselves as restricted, especially those who use in-house funds

- If a firm wants to describe its advice as independent it will need to consider whether it provides advice that is based on a comprehensive and fair analysis of the relevant market; and is unbiased and unrestricted

- If a wealth manager does not meet the new independence standards, it will need to disclose to clients that it will provide restricted advice

- Where a wealth manager designs or operates products such as in-house collective investment schemes, basing its advice on such products would not meet the requirements for providing unrestricted advice, even where the products invest in a wide range of underlying investments. Such firms could therefore either:
  - Disclose to clients that it will provide restricted advice; or
  - Consider its in-house products impartially, as part of its comprehensive and fair analysis

Product providers and fund managers

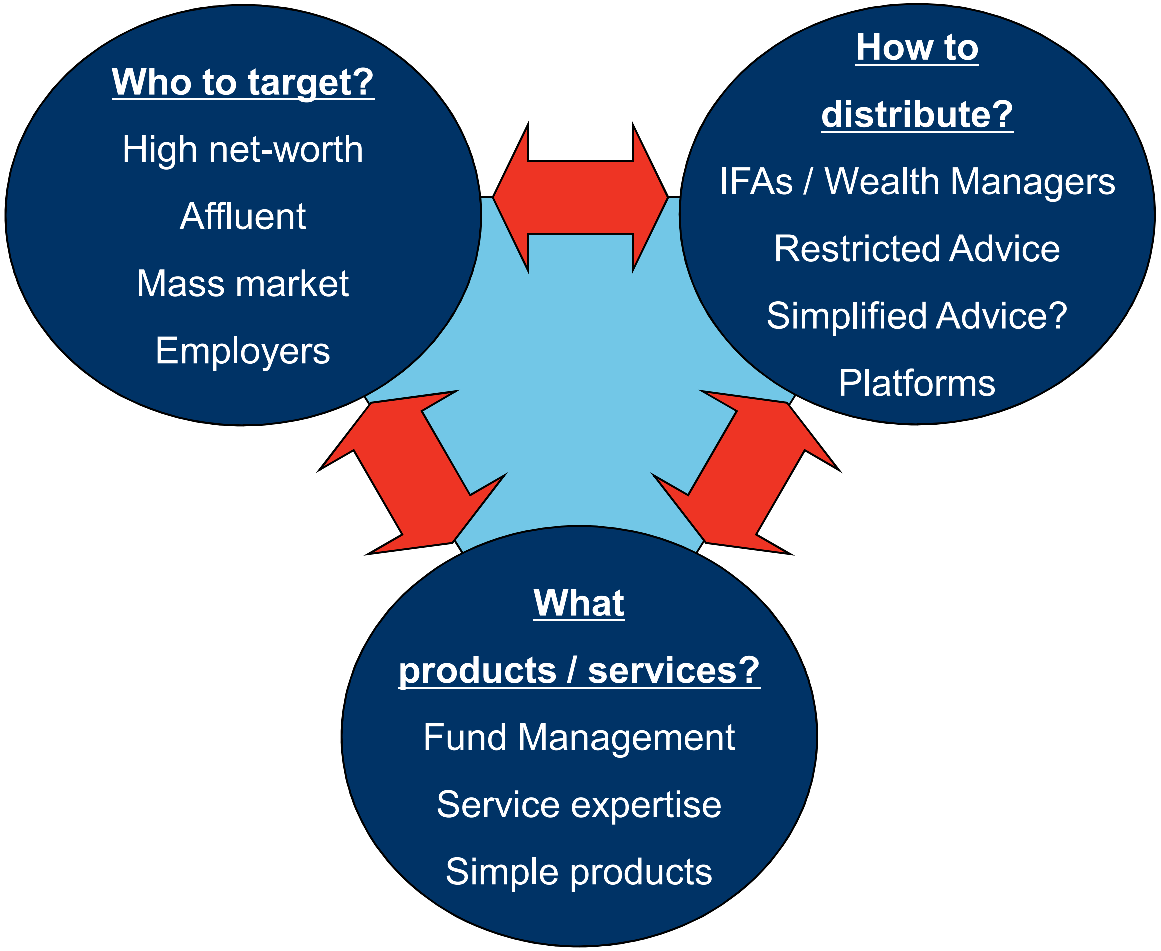
Product providers have some changes to make to ensure that they can accommodate adviser charging

- Product providers will be expected to have 'reasonable' flexibility of charges:
  - The implication of this is that systems will need to be adapted, but the question for many is how flexible is 'flexible'
  - Fund Managers have complex issues to resolve – multiple share classes, product design or outsourcing to platforms – in order to accommodate the flexibility required
- Product providers will have to match payments made to advisers against charges made to customers
- All products and accompanying literature (intermediary or consumer focused) will have to separate out the provider and adviser charges
- Product providers with distribution channels and third party arrangements will need to consider how they can operate within the new rules

Contents

Firms face a strategic challenge

The RDR is causing product providers to review their strategy; consumer, distribution and products / services



The new post RDR world will look very different

We have started the journey to the 'new world' but there is still a long way to go

Customer = end client

Product = Designed to meet specific need

New business levers = service and cost

Outstanding Questions

- QCF level 4* for Simplified Advice?
- Factoring ban?
- Change of Government
- Disclosure rules
- Definition of PRIPs?
- Tax treatment of Adviser Charging?

Certainties

- End of commission
- Advice will continue to move up-market
- Take-up of platforms will continue
- Price competition will increase

Clear need for change

Strategic choices are difficult to call

TOWERS WATSON

ABI Association of British Insurers

*** Scottish qualification equivalent: SQCF level 8**

Product provider responses

Product providers have some key questions requiring clarification before fine-tuning individual strategies

- The details surrounding post RDR advice:
  - Independence, the scope of products / investments and the role of platforms?
  - The value of Independence vs. Restricted Advice efficiencies
  - Adviser charging – how much flexibility? How to assess in vertically integrated firms?
  - Tax treatment – clarity of VAT position?

- The impact upon consumer access to advice:
  - Raising the bar for Advice – ‘Mind the Advice Gap’
  - Basic Advice? Simplified Advice?
  - Direct mail, internet or telephone based offerings

Close

- Any questions?

- For further information please contact:
  - Sarah Luheshi, Senior Consultant, Towers Watson
    sarah.luheshi@towerswatson.com / 07506 723477
  - Alexander Smith, Policy Advisor, Consumers and Distribution, Association of British Insurers
    alex.smith@abi.org.uk / 07889 642 036

TOWERS WATSON

ABI Association of British Insurers