

A REVIEW OF RETAIL DISTRIBUTION
THE FINANCIAL SERVICES CONSUMER PANEL
RESPONSE TO DP 07/1

December 2007

HEADLINE VIEW

Our conclusions from the Discussion Paper are as follows:

- **A consumer focused model for the purchase of financial products is needed which is intuitive and simple.**
- **In our view the FSA's proposed model does not meet these criteria.**
- **Our preferred model is for a simple three tier market place of generic financial advisors, independent financial advisors and sales staff who would be described as such.**
- **'Independent' must mean advice is fee only and based on a whole-of-market service.**
- **Customer Agreed Remuneration could provide a viable alternative to fees.**
- **Generic Advisors should be able to recommend product types upon which Independent Financial Advisors can give focused advice.**
- **Generic Advisors should also be able to issue portable fact finds, which can be used by Independent Financial Advisors or sales staff.**
- **We believe that Primary advice, as defined by the FSA, is not appropriate.**
- **The system of professional financial qualifications should be simplified to enable consumers to understand them and qualification standards should be increased over time.**
- **We believe that these changes should be mirrored in the mortgage and insurance markets.**

INTRODUCTION

The Consumer Panel congratulates the FSA on recognising the importance of reviewing retail distribution and for publishing the Retail Distribution Review Discussion Paper. The Panel looks forward to an outcome which restores consumer confidence in an industry which has been plagued by mis-selling scandals in recent years.

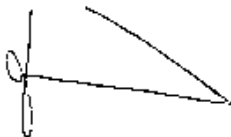
The FSA encouraged the industry to come forward with solutions to the problems experienced in the current market. There are understandable reasons why the industry should put its own house in order. However, we believe a consequence of this approach is that the suggested solutions do not sufficiently meet the needs of consumers. It is the Panel's view, supported by research it has commissioned, that consumers need arrangements for advice and purchase of investment and other products which are simple to understand and intuitively acceptable but it is in this regard that the proposals outlined in the Discussion Paper fall short.

The overall issues from the Consumer Panel's point of view are as follows:

1. The structure of retail distribution that emerges from the present review must be intuitive and simple from the perspective of consumers. If this is not achieved, consumer engagement will be inhibited.
2. The proposals in the Discussion Paper do not meet the needs of consumers to have a clearly understandable, simple system.
3. Our preferred model would have three tiers founded on a properly financed and run generic advice service. There should then be a clear distinction in the marketplace between 'advice' and 'sales'. Advice must be independent and impartial, with the advisor acting unambiguously and solely in the interests of their client. All other intermediation in the sales process should be described as selling, which would of course also continue to be regulated.
4. The Panel sees two sources of advice: generic advice and truly independent financial advice. The distinction between professional financial planners and general financial advisers outlined in the DP is not easy to understand. The Panel has serious concerns that any introduction of general financial advisers and proposals for primary advice will potentially lead to greater consumer detriment.
5. The Panel firmly believes the term 'independent' must mean that the adviser is remunerated by way of fees paid directly by the consumer, or through a suitable alternative such as Customer Agreed Remuneration – CAR. Independent advice must also be based on a whole-of-market service. It must also be clear to consumers at the outset whether the fees they are being asked to pay cover initial, one off advice or initial advice plus ongoing advice.

6. The Panel believes that the paying of advisers directly through commission must stop – provider firms should not be able to buy market share in this manner, and competition must be based on the quality of the financial product itself. Customer Agreed Remuneration, where a fee for advice is agreed with the customer, and then taken gradually from the cost of the product, is a viable alternative, although the Panel is concerned that this should not be implemented in a way which discriminates against products like National Savings or cash ISA's which do not currently pay commission.
7. Generic advice has a very important role to play in the new arrangements and should be seen as an integral part of the structure of retail distribution.
8. Generic advisers should be able to recommend product types, following which consumers may purchase particular products via focused advice from a professional financial planner or via a regulated sales process. Portable fact finds compiled by generic advisers should assist this process.
9. There needs also to be a system to ensure that the equivalent of commission does not influence sales within tied firms. So banks and insurance companies should be required to quote the price of products they supply separately from the cost of their intermediation services. Also, bonus structures within firms should demonstrate that bias is not written into procedures so they reward quantity rather than quality of sales.
10. The present system of financial qualifications is far too complex and the basic standards required are woefully low. The system should be streamlined to enable consumers to understand who is qualified to do what. This is crucial to facilitate a true market place in advice. Exam standards must be increased over time.
11. While the FSA Discussion Paper focuses on the retail market for investments, the Panel believes that the approach needs to apply to all key intermediated markets, particularly mortgages and insurance, so that again, there is simplicity and clarity in the financial services marketplace for consumers.

The Panel appreciates this is a highly complex market with entrenched working practices and established business models. However, this does not mean it should remain unchallenged, particularly when there has been proven market abuse and where the market does not necessarily work in the consumers' interests.



John Howard, Chairman, Financial Services Consumer Panel

Professional Financial Planning and Advisory Services – Full Advice

Q1: How will increased requirements and consequential higher costs of providing full professional financial planning services affect advisory firms? Could the impact be significant enough for them no longer to offer these services, and, if so why?

A: The Panel believes that increasing the level of professionalism and qualifications should not dictate the structure of the market place. The right structure should be put in place first and then improved qualifications should gradually be introduced.

The Panel does not necessarily agree that there will be significantly higher costs in providing a more professionally based independent financial advice service. This assertion does not appear to have been made on the basis of hard evidence. Bearing in mind reductions in costs coming from other regulatory changes, the Panel believes this will have the effect of balancing out any increase in costs associated with higher entry level qualifications. The issue of costs should not be looked at in isolation but examined with the potential to increase revenue. It should also be borne in mind that where IFAs develop longer-term relationships with clients, the costs associated with for example, undertaking fact-finds may over time be reduced.

In suggesting there may be higher costs associated with providing independent financial advice, the DP does not take account of the positive impact generic advice will have. If consumers enter the market armed with basic information about the broad type of product which would suit their needs and circumstances, this could reduce the routine, time consuming work done by some advisers at the moment. The ability to provide portable fact-finds will also cut down costs usually incurred during the purchasing process.

Moreover, one deficiency of the DP is that it contains no factual account of the retail market, nor of the trends that are occurring, regardless of the regulatory regime. It seems that much of the retail distribution of financial services is oriented to the one-off sale of products, hence the emphasis on front-end commission, the debate about the purpose of trail commission, the cost of the one-off fact find, the seeming reluctance of clients to pay fees, and the need to consider CAR. However, there is a trend for advisers to develop longer term relationships with clients, which is likely to be encouraged by the move away from final salary pensions. There is an expanding role here for advisers offering longer term advice who might aim to start a relationship with salary earners with reasonable earnings prospects by mid-career, and carry this through both the accumulation and decumulation phases of the life course. If the quality of advice was high with a full range on offer, clients may well be more willing to pay a fee, either based on time (say one review meeting a year plus follow up effort) or based on the value of assets under management.

Q2: Is it helpful to re-define the term 'fee-based' to mean any advisory remuneration derived in discussion with the customer, and not influenced by the product provider?

How would this work in the different market sectors?

A: We think this definition would be helpful. However the industry and FSA should avoid using terminology that does not fit with the average person's interpretation of 'fee-based'. A different consumer-friendly way needs to be found of describing customer agreed remuneration (CAR) – if this is adopted – which makes it clear that the fee charged is being added to product charges and paid for indirectly by the consumer. The Panel believes there is currently a great deal of confusion over how commission is paid for.

Q3: Do you agree with defining 'independence' in terms of freedom from bias, even if the adviser only selects products from a limited range? How far should this be taken, if at all? Would an independent label still have value, if these ideas are implemented?

A: The term 'independent' must relate to complete freedom from biased advice, so it must be linked to a whole-of-market service which is not influenced by commission payments. In this context, advisers should not be able to accept commission of any form, but must be remunerated using either a fee-based, or CAR-based service. The Panel would be interested to see if there is scope for using a different term to describe the advice, which has no association with the current system, for example, 'impartial' instead of 'independent'

Q4: Should we allow, in principle, the grandfathering of advisers to the new professional financial planner role if they do not have the necessary minimum qualifications or an equivalent? If we did allow this, what might be the consequences and how should we then encourage advisers to secure relevant qualifications? If you think we should not allow grandfathering, why not?

Our preferred model is for a simple three tier market place of generic financial advisors, independent financial advisors and sales staff who would be described as such. We see financial planners as being a subset of independent financial advice and grandfathering would not be an issue.

The Panel would not agree with any proposal to allow existing advisers to be grandfathered into the new regime described by the FSA without having to undergo a 'top-up' qualification or assessment of some description. The consequence would be that standards may not increase and the desired outcome of professionalism inspiring consumer confidence and trust may not be achieved. It also does not accord with the recommendation from the Industry Groups that minimum qualifications must be raised – this must apply to all advisers operating in this advice market.

The Panel would be happy to see grandfathering used for a specific period whilst advisers gain the necessary qualifications or undergoes an appropriate assessment. This may of course depend on the level at which any new qualification standard is set.

General Financial Advisers

Our preferred model is for a simple three tier market place of generic financial advisors, independent financial advisors and sales staff who would be described as such. The Panel does not agree with the proposals for a general financial advice service, and feels in the FSA model there is not enough clear water between primary advice and GFA. The Panel commissioned a research project to test some of the concepts being suggested in the DP. Results from this qualitative research show that having a tiered advice structure appears sensible to consumers, but fears over key aspects of this tier (and primary advice) may not encourage consumers to use this level of advice service (see answer to Q.16 below) but may in fact discourage them from doing so.

Overall reaction to the concept of a tiered approach was generally positive. A new tiered landscape would be clear and logical, and as this has common currency in many different sectors, consumers are comfortable with the idea. Consumers liked the sliding scale of expertise, payment and independence and the fact they would be able to make a choice of which service to use based on their specific needs and the amount they had to invest. However, consumers felt that primary advice and GFA represent what exists already. Consumers also felt that primary advice and GFA are closely linked which runs counter to the DP which suggests GFA and independent advice are the tiers more closely linked.

The results also show that a structure consisting of three levels of advice – basic, middle and advanced - is more intuitive. Combining primary advice and GFA was spontaneously suggested by consumers taking part in the research, with this new 'middle' tier felt to be more akin to branded sales, although there could be a split between those working for one product provider and those working for several.

Q5: Do you agree with the proposed distinction between professional financial planner and general financial adviser? If greater distinction is needed between general financial advisers and professional financial planners, how might this best be achieved?

A: The Panel does not agree with the suggestions in the DP relating to general financial advice (GFA). The Panel feels that the traditional commission-based model gives rise to bias and so this would on the face of it, be capable of continuing in this advisory context. Our preferred model is for a simple three tier market place of generic financial advisors, independent financial advisors and sales staff who would be described as such. We see financial planners as being a subset of independent financial advice.

The Panel would prefer, in any intermediated sale that CAR must be adopted. There may be scope for using GFA as a transition to help move all brokers to an independent model, but there must be a limited time-frame for doing so. This would allow time for higher standards to bed in, but there must be a strict transition and time limits if this were to be the case.

The Panel also feels that GFAs should not be permitted to work in the same firm as Independent Financial Advisers. The description 'independent' should apply at firm level, and therefore the firm would be required to operate entirely on a fee-based or CAR-based remuneration model. This would preclude operating any other structure and thus rule out employing GFAs.

The results from the Panel's research indicate that consumers feel the best approach would be to amalgamate Primary Advice and GFA rather than GFA and the independent professional planner tier as suggested in the DP. Primary Advice and GFA were felt to have more in common as they are both based on commission and are 'salesy' in nature.

Q6: Is there sufficient incentive for advisers to want to be professional financial planners? What further restrictions should we place on the permitted activities of general financial advisers, if any, and why? Should they have to offer a fee option?

A: Our preferred model is for a simple three tier market place of generic financial advisors, independent financial advisors and sales staff who would be described as such. We see financial planners as being a subset of independent financial advice. Our fee based independent advice structure would create a market place for advice which should encourage firms to offer increasingly higher standards of service.

The Panel is not in a position to judge if the FSA proposed incentives being offered to firms to move to the higher professional adviser standard are sufficient. The Panel feels the use of commission in all intermediated sales should be banned.

Q7: Do you think that this two-tiered approach is desirable and, if so, should this be a transitional feature of the market or more permanent? Should there be any other classification of adviser offering full advice services beyond professional financial planner or general financial adviser?

A: The Panel's research clearly shows consumers feel there are four tiers being proposed (including generic advice), not two. As such, the Panel feels there is significant scope for confusion in maintaining the split as outlined in the DP so we do not see it as desirable. The Panel's research would support a three tier system with generic advice forming the basic or foundation level.

Q8: What are the arguments for and against mandating the use (or preventing the use) of particular remuneration methods, for instance requiring the use of fee-based remuneration according to our wider definition

by all advisers? What might be the market consequences if we took such action? How else might we encourage firms to adopt particular remuneration methods (or discourage the use of some others, for instance traditional indemnity commission)?

A: The Panel feels that in view of the evidence of commission bias leading to a number of mis-selling scandals in the past, there should be a ban on using this remuneration model across all intermediated sales. In banning commission and adopting, for example a CAR model, the Panel believes there will be greater clarity for consumers, less scope for mis-selling, and a greater willingness for consumers to engage with the industry. Commission could be replaced by fees negotiated with consumers, with no space for providers to be able to manipulate the system by determining how much they will pay for the sale of any specific product. It will eliminate the potential for providers to buy market share. However, with many forms of CAR, there is still a cash-flow from provider to intermediary which could work against the provision of impartial advice for products which do not currently pay commission, like National Savings, cash ISA's and investment trusts. The Panel is concerned that any implementation of CAR should guard against this risk.

There must be a level playing field within the operating structures of banks, and so provider firms should also be required to move away from commission type structures designed to reward only the quantity of sales achieved. Bonus schemes operating within firms should not militate against a fair sales policy and should avoid the 'product of the month' scenario where sales targets overtake the focus on satisfying the individual consumer's needs. Provider firms must be able to demonstrate any bonus scheme they operate is fair to consumers and does not run counter to principles of TCF. Sales targets are not wrong per se, but there are issues over appropriate governance structures here. There was evidence of mis-selling of precipice bonds within banks due to higher levels of 'commission' paid to sales staff.

The Panel's research shows that terms such as 'impartial' and 'whole-of-market' were met with some cynicism until the CAR model was explained and understood when consumers felt they could believe and trust them.

Q9: Should we allow, in principle, the grandfathering of advisers to the general financial adviser role if they do not have the necessary minimum qualifications or an equivalent? If so, how should we encourage (or require) any up-skilling to the necessary standards?

A: Please see the answer to Q4 above.

Primary Advice

Our preferred model is for a simple three tier market place of generic financial advisors, independent financial advisors and sales staff who would be described as such. The Panel does not agree with the proposals outlined for primary advice as

it believes there may be significant dangers in the regulatory structure adopting an approach which permits sub-optimal outcomes for perhaps large numbers of consumers. The proposals in the review appear to suggest that a reduction in overall standards for the mass consumer market would be appropriate and the Panel does not feel this is acceptable.

Clearly, many consumers will have similar needs and these may be accommodated by providing products designed for broad categories of consumers. But to segment consumers along income lines is too simplistic. Whilst it may be feasible to suggest that 'primary products' would be suitable for large groups of consumers, segmentation along different lines – perhaps preferences and capability, and age and lifestyle – would be much more appropriate.

The Panel believes that these proposals will provide some of the larger firms with the potential to reduce costs because of reduced regulatory requirements, capture greater market share, increase charges, and at the same time reduce significantly the existing level of consumer protection. It does not agree with the contention that these proposals will increase access to financial advice, or encourage more consumers to save.

Q10: What are likely to be the characteristics of the target consumer segments for Primary advice?

A: The Panel feels it may be a mistake to suggest such services are only for consumers with less complex needs; this may be too simplistic. Consumer needs are much more sophisticated than the DP suggests and the Panel feels it is wrong to categorise actual target market by income. What may be more appropriate is to develop a categorisation driven by preferences, confidence and capability, age and lifestyle. Based on the suggestions in the DP, there is a view that this advice tier is in fact about 'primary products' and not primary advice. In addition, some of the advice suggested as being provided in this tier could be given by generic advisers.

Q12: What should be the conditions for Primary advisers to be called independent?

A: Please see the answers to Q3 and Q5 above. The term 'independent' must relate to a whole-of-market service, where remuneration is either fee-based or based on a CAR-type model. The Panel does not feel a firm should be able to mix the levels of service it offers, so the term 'independent' can only apply at firm as well as adviser level, with such firms not being able to offer any of the other advice 'tiers' unless they do so on the same basis across all tiers. Given this, the Panel is not convinced there will be a large market for intermediary firms wishing to offer primary advice based on sales of simpler products which may not provide the desired level of fee income. Such firms would be in direct competition with banks/insurance companies and may not be able to utilise economies of scale sufficient to make this a viable option. In the circumstances, the Panel is concerned

that competition in this specific sector of the market will reduce, potentially leading to consumer detriment.

The Panel also questions the premise that primary advice will reduce the cost of sales. If this is the case, the Panel feels that, with the removal of charge caps, there is the scope for firms to increase charges levied on consumers and increase profits, but with little or no benefit to their customers.

Q13: Is Primary Advice the right name? Would use of the term 'information' instead of 'advice' give consumers more confidence to use these services? What might be the implications of using the term 'information'?

A: 'Advice' needs to have a premium associated with it. If, as suggested in the answer to Q12 above, this tier is in fact focusing on *primary products*, there should be a way of providing a sales service which minimises the scope for them to be mis-sold where they are recommended by sales staff. 'Information' does not suggest 'sale' which in practice is what this will amount to being, for example sales advice based on the limited offering within a bank, or potentially tied advice where the firm's main business is e.g. mortgage broking.

The Panel would also ask the FSA to clarify what it envisages being sold through this channel, as the answer to this question may influence the responses to the DP. What does a limited range of 'savings pensions and protection products' mean?

The Panel is concerned that the suggestions in the DP would still permit the use of commission-led and therefore biased sales in this primary advice sector. Bearing in mind the segmentation outlined in the DP, commission bias could be more acutely felt in the less sophisticated – and potentially more vulnerable - consumer segment. This should be avoided. The use of defined advice processes (decision trees etc) may also be too restrictive to deal with a number of different consumer needs. The Panel is also not convinced that increasing prudential requirements will result in firms ensuring greater TCF measures are in place.

Other implications of service propositions

Q15: What are the possible implications for consumers, if the proposed market for advice is introduced?

A: There is scope for considerable confusion over the number of places to get advice and the types of advice available. There could be confusion over the different remuneration models, particularly as there may be little outward difference between PFPs and GFAs. The Panel's research shows that where all the different types of advice are explained to consumers, they can see more clearly how the structure fits together, and understand the relative merits of each advice tier. However, as the research report highlights, in the real world consumers are not likely to have this structure explained and so these benefits will not be immediately

apparent. This is one area where the Panel feels the generic advice service can provide a valuable role.

Consumers pay for the commission given to an adviser now – the only difference the new model will provide is that the amount when using a PFP will be determined in negotiation between adviser and consumer. However, the Panel's research suggests many consumers may be reluctant to negotiate a fee with their adviser.

The Panel feels that a key to the success of any new advice structure in the financial services industry is to get the generic advice model working well. The Panel's research clearly reinforces this view. Generic advice could appropriately hand over to focused advice or to any other tier of advice. The costs associated with focused advice need to be looked at by the FSA as would ways of accessing this advice by those people who have not gone to a generic adviser.

Q16: Would the ideas put forward help more consumers to access financial advice relevant to their needs? Do you have other ideas?

A: The Panel's research suggests that generic advice would encourage financial novices to seek advice as it provides an easily accessible starting point, from which this group of consumers would be able to see it is worth taking advice and that it is not just for the affluent. It would help give consumers the confidence to engage with financial services. For those consumers with a metaphorical £5000 to invest, generic advice would also enhance their propensity to seek advice. It would show this group that whatever sum of money they have to invest, there are options available that are worth considering. It would also reinforce the fact that because of the plethora of products available, it is worth/necessary to seek advice.

The research showed that financial sophisticates would value the expertise and independence of the highest tier of advice – professional financial planners – which would encourage them to seek advice. The perceptions of expertise would appear to be the key driver in changing behaviours rather than issues around independence itself. There may also be scope for consumers with smaller amounts of money to invest, to be serviced by the top tier of adviser; this has not been explored in the DP.

However, in the case of primary advice and GFA, consumers felt this was no different from the existing regime and the research suggests that a perceived lack of independence and impartiality could undermine the validity and usefulness of the advice provided and thus discourage them from seeking advice in the first place.

Conclusions on the future of retail distribution

Q17: Do you think that the view of the future distribution market for investment products set out in this DP can address the current market problems? If not, why and what could?

A: The Panel feels the changes suggested in the DP may address some issues, but will not deliver the right consumer outcomes overall. Any new model needs to be focused on consumer needs and whilst the Panel understands the FSA is seeking industry action to address the various issues with the current model, we believe the regulator will itself need to be proactive in driving through change.

The Panel does not believe the suggested model will stimulate demand – it's a provider-led model as opposed to being consumer driven. Nor does the Panel feel the proposals will help close the savings gap. The Panel is also firmly of the view that any new model introduced will fail to deliver benefits fully unless it is translated to the mortgage and insurance markets as well. If commission bias is the main culprit in driving mis-selling, then the simplest and perhaps most effective means of improving market practices would be to find an alternative remuneration model that works for consumers and firms.

Our preferred model is for a simple three tier market place of generic financial advisors, independent financial advisors, (where independent means fee based and whole of market) and sales staff who would be described as such.

Chapter 3 – Professional financial planning and advice

Higher standards of competence and behaviours

Q21: Do you agree that these qualifications are at the right level for the roles described?

A: The Panel sees the issue of higher standards of competence and behaviour as separate from the structure of the market place. Whatever the outcome of the RDR on structure, standards must be improved. The Panel's research suggests that consumers see the current level of qualifications as 'worthless' being akin to the type of qualifications required for estate agency. The general feeling was that if consumers were to be expected to pay for this tier of advice, they would expect a high level of expertise, with advisers having to pass a difficult and taxing industry standard exam, coupled with rigorous regulation and vetting. They would also expect oversight by a professional body. Ultimately, professionals like lawyers and accountants are what consumers are prepared to pay for – the term 'professional' has some rigorous implications for consumers.

Better labelling of services

Q24: Do you agree that better labelling of available services would help in building the professionalism and reputation of the sector and in making services clearer to consumers?

A: We agree but the labels must mean what they say for example 'independent' must mean unbiased, impartial and whole of market. However better labeling *alone* will not help improve professionalism; there needs to be a significant change in the underlying sales practices within the industry to make significant improvements.

The Panel's research suggested that there may be a danger in making consumers concerned about the validity and trustworthiness of advice. The conclusion drawn was that this may potentially disincentivise consumers from seeking advice in the first place. Research also indicates that labelling devoid of subjectivity and emotion will be needed and suggests highlighting the 'sales' nature of the service being offered may in fact discourage consumers from further engagement. Clearly, more research is needed here.

There are more fundamental issues that need to be addressed in order to increase the propensity to seek advice. The research suggests these to be increasing the importance and relevance of seeking advice, and enhancing accessibility and perceived expertise.

Enhanced role and focus of professional bodies

Q25: Do you agree with these proposed measures to enhance the role of professional bodies and do you think these would make a difference to the professionalism of the financial advice sector?

A: The Panel believes that external stakeholder groups and professional bodies may be helpful in an advisory capacity, but should not be relied upon in isolation to increase standards. Clearly, membership of a professional body, especially one which may have an entry level qualification, will have a role to play in raising standards of advice. Better qualifications are needed. The TCF initiative must be seen to be effective in driving up standards in many key areas of the market, including the training and competence regimes implemented within firms.

Q27: Do you have other suggestions for how the overall aim of raising professional standards and enhancing the reputation of the market could be met?

A: The Panel believes the inclusion of GFA and the continued use of commission would be detrimental to the stated aims of the project in terms of advice offering an enhancement to the reputation of the market. We believe our preferred model for a simple three tier market place of generic financial advisors, independent financial advisors (where independent means fee based and whole of market) and sales staff, who would be described as such, would be more likely to enhance the reputation of the market.

Q28: What role should we play in raising professionalism as opposed to relying on the professional bodies? Or can the industry lead the way in delivering improvements?

A: The Panel feels there are too many qualifications which can be used to comply with the current T & C regime. This we believe would benefit from being streamlined to assist consumer understanding. Consumer understanding of the qualifications held by advisors is crucial for the creation of a market in advice. Clearly the FSA must unequivocally set out its expectations of the actual standards

each adviser must reach and take swift action if it finds these standards are not being met.

Regulatory and prudential standards to manage liabilities

Q29: Do you agree with the group's view that a system of risk-based financial resource requirements for personal investment firms, with a higher minimum requirement than at present, and which includes regulatory dividends, will contribute to better outcomes for consumers and a more sustainable distribution sector?

A: The Panel believes the link between an increase in prudential requirements and the ability to reduce the potential for mis-selling is tenuous.

Q30: Do you agree that firms that give financial advice should be required to make some provision or arrangement for liabilities to customers which may come to light after they have ceased trading?

A: Yes. Run-off cover is an expectation in the legal profession for example and the Panel is firmly of the view that financial advisers should adopt a similar model.

Q32: Do you agree that we should consider changing the time limits we set for the periods within which cases can be referred to the FOS by introducing a 15-year 'long-stop', such as applies in the courts?

A: The Panel is against the FSA introducing any such long-stop restriction on a consumer's ability to refer a case to the FOS. The existing provisions of the Limitations Act would seem to be sufficient for the purpose. Firms should remain liable for at least the term of the product. It may be many years before an issue with the original advice or the product manifests itself. Sir Callum McCarthy, in his speech at the Gleneagles conference in 2006, referred to the 'extended time-span for judging the performance of a financial product'. In this case, there must be an extended time-span for judging issues around inappropriate advice or inherent problems with the product structure and performance

Q33: What do you consider to be the risks and benefits of introducing a 15-year 'long-stop'?

A: There are no benefits to consumers. There is a risk firms will see this as an opportunity to take less consideration of consumers longer-term needs when giving advice – on the basis that once the long-stop has passed they will no longer be liable for inadequacies of the original advice given or the failure of the product to perform as the consumer has been led to believe. Thus there would be no legal or regulatory risk involved. This would be a serious backwards step in consumer protection with little or no perceived benefit for consumers. This is especially a danger where commission-based pay structures (with the inherent risk of bias) are still to be applied across two out of three of the proposed advice models. It will also seriously undermine one of the six consumer outcomes of the TCF initiative.

Clearly, the consumer will be taking all the risks associated with such a policy whereas firms will reap the main benefits in reduced costs.

Q35: Do you agree that stakeholders should try to identify circumstances that may prompt valid complaints at an earlier stage, and within a 'long-stop' period?

A: The Panel feels that firms should be doing this now under TCF. This should not simply be in the context of a 'long-stop' approach to complaints.

Q36: Do you agree that stakeholders should seek ways of ensuring that measures taken by the industry to prompt valid complaints are taken into account when deciding whether a consumer was aware that he or she had grounds for complaint?

A: Nothing should fetter a consumer's right to take a complaint to FOS – who can then judge the validity of the case. Taking the example of 'red letters' required in endowment cases, Consumer Panel research on claims managements firms suggested that the quality of these letters in terms of alerting consumers to the potential for them to have a valid claim was poor.

Q37: If it is not possible to agree on consumer responsibilities, would it help to agree on a set of 'sensible consumer actions' when buying a retail investment product, which could be made available to customers and taken into account when considering complaints, even if these are not legal obligations on consumers? Do you have other suggestions?

A: The Panel is quite happy that consumers are informed of the sensible actions they should take but has serious concerns that the FSA should be consider that this should be taken into account when complaints are being considered. There is no such thing as an 'average consumer' and whilst it is always sensible for consumers to read information given to them, the FSA itself acknowledged that consumers rely more heavily on what they are told than on what they read (ICOB review CP).

There is a significant sea change needed before an ideal world can be reached where consumers read and understand all product literature they get. Added to which the FSA's own research suggests that product documentation is woefully inadequate. A complaint should not be judged on the basis of a consumer not reading information which does not adequately describe a product; recent thematic work shows that the vast majority of current disclosure documentation fails to comply with relevant rules at one level or another.

Q38: Do you agree that preparing a record of good contemporary market practice, by a group with strong industry and consumer representation and credibility, would lead to greater certainty about the standards against which advice will be judged?

A: There are too many variations of consumers and products to make best practice models useful in every circumstance. They do of course have their place but should not be relied upon too heavily. They may be useful to judge complaints in hindsight. There is of course an issue over which agency will produce these manuals.

Q40: What regulatory incentives, in addition to risk-based prudential requirements, do you think would encourage financial advisory businesses to improve the quality of their advice?

A: We believe regulation can be used to improve the quality of advice by creating a proper market place in advice. This requires the cost of advice and its quality to be made clear to consumers. We believe the model for advice services we have proposed stands a better chance of achieving this. Our model focuses advice on independent financial advisors (where independent means fee based and whole of market) if the qualifications of these advisors are made much more transparent, consumers will be encouraged to shop around for high quality advice at a price they are prepared to pay.

The Panel is firmly of the view that more robust and quicker enforcement action is a key tool to ensure firm behaviours are changed in the most appropriate and timely manner. 'Naming and shaming' is one way of making the FSA's expectation on compliance clear, and will of itself act as an incentive for firms to raise the bar on compliance performance ensuring more reach a 'right first time' standard. Regulatory incentives can only be considered when there is evidence a market is working in the best interests of the people it seeks to serve. Standards must be raised significantly first before any incentives can be offered.

Transparency of remuneration

Many consumers currently believe there is no cost associated with the financial advice they receive, either from an intermediary or from a bank. This perhaps gives the impression there is no value attached to it. If consumers become more familiar with a system which clearly labels the costs of the advice, where they understand the means by which they pay for this advice and the quality of that advice, a proper market for advice services may well develop over time.

The Panel's research clearly shows there is a degree of nervousness amongst some consumers over costs and the idea they may need to negotiate a fee with their adviser. The Panel believes that a combination of a CAR-type model of payment and a properly operating generic advice structure will help to overcome this hurdle. This may be one of the fundamental arguments supporting the view that the industry should contribute to the costs of providing a generic advice service – they will clearly reap the benefits.

Q42: Do you agree that greater clarity for consumers on what services are being supplied, how much they are paying for them, and more influence for

consumers on remuneration generally will help to address inappropriate advice risks?

A: The Panel believes many consumers do not fully understand that commission payments are taken from the value of their investment in the form of charges. In the circumstances, the Panel wants to see greater clarity around remuneration structures in terms of how payments are made, and how much an adviser is being paid for the advice given. However, whilst greater clarity will help over the longer term the Panel feels it will not provide the whole solution to the problems which exist in the current market structure. The problems inherent in the current system must be addressed at many levels to ensure the improvements needed are made.

The Panel is also of the view that clarity must be applied to branch based sales. Banks and Insurers should be able to separate the cost of the advice from the cost of the product and disclose a 'fee' associated with it. To fail to address the issue across the entire market will simply reinforce the current impression consumers have that the advice is free. In an environment where intermediated sales have moved to fee-based or a CAR-based model, unless a model based on full disclosure of the cost of advice is also adopted in branch sales, this will create a seriously misleading view.

Giving consumers greater influence over remuneration will be a good thing for the market. The extent to which consumers will engage in any negotiation with their adviser over fee levels is difficult to judge. The Panel's research suggests that paying for (top tier) financial advice is an emotional barrier that would be very difficult to overcome. Financial novices may be frightened away – only sophisticated/affluent consumers would pay for this level of advice. This may be especially so in the case of a finite fee even if it was paid over time. Clearly, more work needs to be done to fully understand whether consumers will accept the notion of paying either up-front or over time for the advice they receive. Issues around how CAR will be structured – whether it will be based on a fixed fee, or on a percentage of funds under management may also have an impact on consumers' perception and acceptance of this new model. The Panel is open-minded over what might be the best charging approach as long as the key issue of provider bias is properly addressed.

Q43: How, if at all, should we intervene on the issue of consumers' rights to switch off trail payments?

A: There is a distinction to be made here depending on the purpose of the trail payment. If it is a deferred payment for the original advice, then it is arguable that consumers should not be able to switch it off, except where the original advice is found to be defective. If the trail payment is for an on-going service, then consumers should be able to switch off the payment if this advice is inadequate or no longer required, or indeed if the consumer switches to a new adviser.

As with the true nature of commission payments, the Panel feels there is a general lack of understanding of trail payments. Where these payments are for an on-going advice service, they should be referred to as annual or periodic fees and/or be included in the CAR payments agreed at the outset with the consumer. There may be less of an issue where they are deferred payment for the original advice and where this is made clear.

Customer Agreed Remuneration

The Panel feels that the CAR model does have merit over the current heavy reliance on commission based sales. However, this alternative is still based on a product sale, and involves the same cash-flows from provider to distributor. For the benefit of a new approach to remunerations to be felt appropriately, any new model must be applied across the whole intermediated sales market. Bonus structures must also be placed under close scrutiny to ensure they comply fully with principles of TCF. The Panel's research does however suggest that it may be difficult to explain how the CAR model works to consumers who may not appreciate the difference and benefit to the new approach.

Q44: What do you think is the most appropriate approach under Customer Agreed Remuneration (CAR) to matching payments (in terms of amounts and timing) from the consumer to the provider, and payments from the provider to the intermediary, and why? What role, if any, might there be for regulation, or for guidance from other parties, to establish uniformity of approaches in the market?

A: In order for consumers to engage in the process of agreeing fees and to avoid bias, the whole process must be made as simple as possible. The Panel believes there is the potential in some cases for bias to creep back into the process where payments are not matched, and where firms are able to determine when they pay – or are paid - fees.

Q45: Do you agree with the concept of third party financing, and if so, how might this operate?

A: This is a complex area, although the Panel agrees with the general concept. However, payment streams must be the same as originally agreed with the consumer. The Panel can see that independent financing of fees may help alleviate issues over payments for advice still coming from the provider firm although this issue needs to be very carefully considered so as not to allow bias to inadvertently creep back in to the process.

Q47: Do you agree that CAR could assist advisory firms to move towards a fee-based revenue model (according to the current definition of fees)? Could this help to erode the perception that advice is a free commodity?

A: The Panel agrees that CAR could help advisory firms move towards a fee-based service, which should help erode the mis-conception that advice is currently free.

Q48: *What are the main challenges to implementing CAR, and what might be the implications for consumers, firms (of all types) and the FSA?*

A: The Panel understands some of the market has moved to a CAR model already and this should provide the FSA with useful insights into the process of changing remuneration structures. The issue for the industry would seem to be in managing the transition to a completely new model.

The Panel's research found that consumers felt that in the context of independent advice, free from any bias, a CAR model will help ensure independence is achieved. However, the majority of consumers involved in the research would not feel comfortable negotiating a price for such advice. This suggests that advisors would simply state the cost of their advice and consumers would not feel able to negotiate. The industry should therefore be encouraged to publish details of rates and charges to encourage competition.

Many of the consumers in our research did not feel happy with paying by the hour as they felt they would have 'no comeback' if they decided not to take the advice given. There is also the perception that this advice is likely to be very expensive. The report's authors point out that consumers are not rational machines weighing up equally the positives and negatives of decisions; they often make emotional decisions based on gut feel. The authors firmly believe that paying for advice is an emotional barrier that most consumers will not overcome, as consumers currently don't understand the value and importance of taking advice. Interestingly, where respondents did understand the importance not only of advice but of independent advice, there was a greater incidence of consumers saying they would be willing to pay for advice.

The Panel therefore feels there is a real need to establish a proper market for advice services in the financial services context which may help alleviate consumers' fears in this regard. The FSA should do consumer research in this area to ascertain the level of likely consumer engagement with the process.

Q49: *What market mechanisms (if any) do you envisage could contribute to reducing the risk of advisers exploiting the extra information they might possess on consumers' willingness to pay? Would the risk of price discrimination be a concern for consumers and how might this risk be mitigated?*

A: Greater transparency of pricing should help avoid this scenario. The generic advice service could also be used to inform consumers of realistic or bench-mark prices which may apply in each case.

Chapter 4 – Primary Advice

Primary Advice

The Panel does not support the proposals put forward for primary advice. There appears to be the potential for large-scale providers to increase sales, reduce the costs of sales and at the same time enjoy the removal of charge-caps and benefit from lower suitability standards. It is unacceptable that the DP should propose it would be possible to achieve sub-optimal outcomes for some consumers due to the notion of standard or simple products being suitable for large numbers of consumers with standard needs.

Our preferred model is for a simple three tier market place of generic financial advisors, independent financial advisors (where independent means fee based and whole of market) and sales staff who would be described as such.

The Panel's research highlights a number of potential problems with a Primary tier of advice. Consumers believe the proposals simply reflect the status quo – this being the service already offered in banks. This tier was unpopular with the vast majority of consumers in the groups. They saw staff as being relatively untrained in general financial matters with more of an expertise in the specific products for which they were responsible. The idea of a salesman was not attractive as it has negative connotations of an adviser who puts a high-value sale before the customer's best interests. Consumers felt there was an implication of cheapness coupled with relatively 'dodgy' advice. Communicating clearly what this tier is and actually does had the effect of putting people off using it for advice over future financial decisions. Clearly more needs to be done to fully explore the implications for consumers in introducing a new approach to lower level advice where there are limitations to the service offering, as the Panel research suggests this will have the reverse effect to that intended.

Q50: What should be our role in endorsing the criteria for segmenting consumers for Primary Advice? What role is there for the industry to provide appropriate standardisation?

A: The Panel has serious concerns over the suggestions for primary advice, covering all aspects of the proposals. The Panel does not agree with segmenting consumers along income lines as suggested in the DP. As outlined in the answer to Q10, it may be more appropriate to develop a categorisation driven by preferences, confidence and capability and age and lifestyle. The Panel believes an alternative may be to look at this as a means of delivering primary products as opposed to the focus being on primary advice. This could be an area where generic advisers could point people to an appropriate primary product, where the subsequent sale is done on an execution-only basis. More thought clearly needs to be given to the range of primary products based on learning from poor sales of stakeholder products, and with the anticipated appearance of personal accounts.

The Panel also has concerns that it will be very difficult to explain to consumers the limitations of the advice given.

Q51: To what extent is there unmet demand for some form of simple advice, bearing in mind that the wider proposals in this DP and other market developments could alter the demand in the future?

A: In its response to the Thoresen Review, the Panel stated that it saw generic financial advice as helping move people along the consumer journey of financial services – making them more effective in the choices and decisions they make. The individual should then be in a position to contact a provider, armed with the right questions to purchase a relevant, affordable and appropriate product(s). Conversely it could mean a consumer changing his portfolio of products to meet life circumstances or act as a consequence of negative or positive external factors.

Consumers find themselves in a range of complex financial situations and want advice which helps them identify their financial needs. The Panel thinks a generic financial advice service should gather information about a person including their assets and liabilities and their attitude towards risk. The service should also help consumers understand their financial needs and the rest of the structure of the market place, helping consumers to be more confident in engaging with financial services.

In the context of responding to this DP, these comments are still very relevant, and the Panel sees the provision of a properly functioning generic advice service as being the lynchpin to the success of any changed model.

The Panel's research showed that of all the proposals put forward for the new tiers of advice, the provision of a truly impartial basic or foundation level of financial advice was most welcomed by consumers. It was received extremely positively by the majority of consumers and was indeed considered to be the most important of all the proposed new tiers of advice. Consumers felt it would provide general information about financial products, the difference between them and pros and cons of each. Even those consumers who were more financially sophisticated came to the conclusion that they may use this tier as a good starting point for any advice decision and felt it was important to refresh one's knowledge of the options available. The reason for such positive attitudes was the true impartiality of the advice and information with little room for bias.

Most importantly, some consumers felt this tier would actually encourage them to seek further advice if it became the first port of call for all or most advice decisions.

Q52: Do you think that a Primary Advice service would benefit consumers and, at the same time, provide sufficient consumer protection?

A: The Panel does not believe primary advice as drawn in the DP will benefit consumers, nor are there sufficient consumer protection measures proposed. The Panel's research findings endorse the view that highlighting the limited nature of

the service being offered, and the 'sales' nature of the advice being given, will act as a disincentive for consumers to use such services.

Implications of debt for savings advice

Q53: What are your views on the extent to which people with existing debts should be encouraged or discouraged by financial advice to make investments and to save?

A: The Panel believes this issue is not as straightforward as the questions suggests. It will not always be an easy distinction to suggest consumers should be either encouraged or discouraged from investing and saving where they have existing debts. Debt clearly must be taken into account in the advice process, and the Panel sees this as a potential key function of the generic advice service.

Standardised and portable fact finds

Q56: Do you think that these standardised and portable fact finds will help with the provision of advice to a wider range of consumers and help contain costs?

A: The Panel endorses the idea of generic advisers being able to carry out a fact-find which can be passed on to other financial advisers, thereby saving some cost. There are of course issues over liability where the fact-find has not been done to a proper degree, but these issues, which are fairly complex, can be examined later in the consultation process.

Product approval

Q58: Do you agree that using product criteria would help firms deliver appropriate products to the target market for Primary Advice?

A: The Panel does not support the proposed Primary Advice tier. The Panel does not feel the proposals for Primary Advice will deliver the required benefits for consumers, but feels in a scenario where simple products are being sold to the mass market, there should be product criteria developed. However, the Panel would like further debate on this. The Panel recently conducted some research into with-profits issues, and feels these products show why more product criteria and target market suitability are needed. Clearly these products would not fit into the criteria at para 4.28 in the DP, but were sold via big firms to 'standard' consumers, and the drawbacks and potential for serious consumer detriment associated with these products is now very apparent. This issue demonstrates only too well why there would be a real need for some form of product approval, should the market move towards a structure similar to that outlined in the DP.

Q59: Do you think having FSA-endorsed products would help? If so, how would this work?

A: If primary advice includes a limitation on the type of product which can be sold via this channel, then effectively this must involve an endorsement by the FSA of what is a suitable product for this advice tier. If 'primary products' are a more suitable alternative, there must be an endorsement of the basic product criteria and appropriate target consumers. If this idea is to be progressed, then the FSA must have a clear picture of what the criteria will be as a central part of any future consultation.

Q60: Do you have any other suggestions or options for limiting risks of inappropriate products being sold via Primary Advice?

A: The Panel is not supportive of the principle of primary advice and therefore has no further suggestions based on the proposals outlined in the DP.

Suitability

The Panel does not agree with the proposal that in exchange for providing 'simple' products within a primary advice framework, firms would enjoy reduced suitability requirements. Consumers will expect – where they opt for an advised service – that the product a firm recommends is suitable for *their individual* needs. It is not acceptable to permit sub-optimal consumer outcomes for what the Panel believes will be large numbers of consumers, rather than – as the DP suggests – only some. The Panel does not accept the premise put forward in the DP that this outcome is better than consumers having no access at all. Consumers currently have wide access to a vast and confusing array of financial products on their local High Street – the issue of why consumers are not saving is much more complex than suggesting it relates solely to issues over access.

Clearly, there is scope for developing primary products which may well suit large numbers of consumers, who fall within certain easily recognisable segments. But the sale of these products must still be conducted in accordance with fair and reasonable suitability requirements which put consumers' interest first. The DP suggests that it would be important that consumers were made aware of and fully understand the limitations of the advice, but the Panel research shows that highlighting the true nature and limits on the advice service being given may be counter-productive as it will have the effect of putting consumers off using it altogether.

Q61: Do you agree that different suitability standards would encourage delivery of Primary Advice and what should these be?

A: The Panel is opposed to any reduction in requirements relating to suitability. If this were to happen, firms will simply see it as a way of lowering standards whilst at the same time increasing the number of sales.

Decision processes

Q62: Do you think that decision trees would be a useful means of ensuring that consumers had access to some type of information/advice?

A: The Panel feels decision trees may be helpful but this type of tool would be more appropriate in a generic advice scenario.

Q63: What other ways might be used to standardise the advice process for Primary Advice?

A: The Panel feels that implementing standard advice processes runs the risk of failing to meet the needs of significant numbers of consumers and is therefore sceptical it will meet the objectives of the DP proposals. There may be a role for such processes in the generic advice service.

Application of risk-based prudential requirements to Primary Advice business

Q64: How should risk-based prudential requirements and risk-based supervision for personal investment firms that give Primary Advice take account of the risk and consumer protection issues associated with it?

A: The Panel believes the link between an increase in prudential requirements and the ability to reduce the potential for mis-selling is tenuous. The Panel feels a review in this area would be beneficial but would urge caution over introducing a regime which could have a disproportionate impact on smaller firms which may force some firms out of the market. This would only serve to reduce consumer choice and access to advice.

Other ways of increasing access for more consumers

Q65: Does the boundary between advice and information need to be clarified? What other regulatory changes might help delivery of non-advised products to consumers in a clear and meaningful way?

A: The current distinction between advice and execution-only is very blurred, and many consumers who are sold to feel they have received advice. There needs to be greater clarity between advice, sales and simple information.

Q66: Do you think that an 'assisted purchase' model could work?

A: An assisted purchase/guided purchase would seem realistic in terms of what banks may do in selling the range of products they offer. However this is still regulated business and so suitability standards must apply. There is still scope for confusion over whether advice is being given or if it is a straightforward sale.

Q67: Are there any other models that you think could work?

A: Our preferred model is for a simple three tier market place of generic financial advisors, independent financial advisors (where independent means fee based and whole of market) and sales staff who would be described as such.

Clearly a number of models are capable of working effectively; the proposals in the DP outline only one option. The Panel would like to see the market move towards a situation where consumers are fully aware that true independence is based on sound principles of impartial advice, free from bias where the consumer's interests are centre stage, and where products are chosen from the whole of the market. Any intermediated sale which is not based on these principles is simply a sales process. The Panel's research showed some scepticism amongst consumers that 'whole-of-market' could be achieved by choosing products from only a handful of provider firms.

Consumers in our research were wary of calling what would be the middle tiers in the new proposals 'sales' because it has serious connotations of lack of expertise and will put people off – the term 'salesman' drives a lack of appeal and implies cheap, dodgy advice. However, there is a degree to which this is the case. Whilst the advice may not be 'dodgy', it will be based on a lower level of expertise than is being proposed for PFPs. That said, the Panel would endorse a process which makes the distinction between these two polarised situations absolutely clear for consumers.

The Panel is also firmly of the view that in order to ensure any new model adopted works in the consumer's best interests, the establishment of a generic advice service must form an integral part of the changes. Consumers will greatly benefit from a generic advice service able to provide them with impartial information- and possibly recommendations - about products types; where it is able to undertake a fact-find which is portable; which can advise them of the strengths and limitations of the next stage in the advice process, and which can then pass consumers to the most appropriate source of advice or indeed straightforward sales process.

Q68: Is there an argument for more radical approaches, such as further compulsory savings (beyond the levels envisaged by Personal Accounts)?

A: There may be scope for considering Government subsidies which could help to persuade more people to save. This could take several forms, for example, further tax incentives, or an alternative model based on child trust funds but aimed at adults. The savings gateway pilot may also help provide ideas for other alternatives.

Chapter 5 – Legal and Regulatory Considerations

Regulatory certainty

Q70: Do the proposals put forward in this DP go far enough to improving the position? If not, what other measures could we introduce?

A: As we have indicated above our preferred model is for a simple three tier market place of generic financial advisors, independent financial advisors (where independent means fee based and whole of market) and sales staff who would be described as such. This model seems to us to stand the best chance of engaging more consumers with financial services, boosting confidence and providing better outcomes for consumers, whilst providing viable business opportunities for advice firms and product providers.