Personal Finance Society – Keynote Speech 28th September 2012

Crossing the RDR Rubicon – the Benefits of the RDR for consumers

It was the year the Scissor Sisters topped the charts with "I don't feel like dancing". Or, if you are - like me - of a more mature disposition, the year Top of the Pops after a run of 42 years was last broadcast on BBC 2. **It was the year** Scotland led the way by banning smoking in public places. Italy won the World Cup. It was the year the Serious Organised Crime Agency, Britain's equivalent to the FBI, was created and the year of the **biggest yet robbery** when £53 million was taken from a Securitas depot in Kent. The latter scandal has, of course since **paled into insignificance** given the looting of our coffers by the banking community in the years that followed.

2006 was also the year Sir Callum McCarthy, the then chairman of the Financial Services Authority, delivered the now infamous speech about incentives and their influence. Let me remind you what he said.

In the 18th century, we exported our criminals to Australia, and paid on the basis of every convict shipped aboard at the quayside at Bristol or London. On average, 12 per cent of those who were shipped aboard in Britain died en route; on some voyages more than one in three of those shipped died before reaching Australia. In 1792, the system was changed . Shippers were paid for **every convict delivered alive** in Australia, rather than shipped aboard in Britain. In 1793, three convict ships sailed to Australia transporting 422 convicts, of whom 421 were delivered alive – a mortality rate **about 1/50th of what** had previously occurred. The new reward structure produced immediate and dramatic change.

He then went on to say:
Against that statement that incentives matter, let me look at the distribution system for financial services to retail customers. My contention is that we have a system which serves **neither the producer of the services nor the consumer of the services.** It is doubtful whether it serves the intermediary either.

There was more to come in the same vein.
I assume that the provider of the retail financial service wants over time to associate his or her brand with qualities of reliability, trustworthiness, performance, and to establish and develop a long term relationship with customers, so that they can benefit from those parts of the customer's life when he or she is accumulating wealth. If this is the aim, **what we have fails miserably.**

And so the Retail Distribution Review - the RDR - was born. And six years on we are on the verge of its implementation.
Along the way there has been much to question. Much to debate. Much that has upset various stakeholders. Much to praise. Much to anticipate.
So let me explain the Consumer Panel's views and why we have always remained extremely positive about the RDR, viewing it as the single biggest improvement in the advice arena for years. We have likened it to a new dawn
That new dawn would see the elimination of bias, actual perceived or potential. As those of you who might have been following our suggestions for inclusions into the Financial Services Bill currently wending its way through Parliament, it also introduced one of **our favourite topics** – the fact that advisers would become true agents of the consumer. Of course many of you will argue quite rightly you already are and have always been so. Many of your clients would agree. But sadly as many consumers know to their cost, this type of relationship has not been universal. That's why we are arguing for the current Bill to require, as does MiFID, that an adviser should be required to act 'honestly, fairly and professionally in accordance with the best interests of his clients'[1] thus placing this core investor protection principle on a statutory footing

The cost of advice would be clear upfront – though I admit that there are always going to be challenges around how that information is presented and understood – more of this later. But over time – and it will be time - we hope the balance of power will shift more towards consumers, allowing them to engage more effectively, question costs more rigorously, shop around more and exert realistic pressures on prices. We also hope providers will reduce prices accordingly, given they are no longer paying commission, and are expecting the FSA to monitor the situation robustly to ensure providers play fair, with no soft inducements that slip beneath the radar. Incidentally, we are also expecting the FSA to monitor this critical period prior to 2013 implementation to ensure we don't witness a rush to sell highly incentivised and inappropriate products before the new regime kicks in. The FSA has consistently acknowledged the risk that some firms might seek to maximise their recurring revenue stream before the RDR is implemented and has vowed to intervene where high commission levels may be contributing to poor consumer outcomes. Clearly we would be incensed should we see any inappropriate rush to secure an ongoing source of trail commission post 2012.
We trust the FSA will remain vigilant.

And improving confidence in this market has to be a real positive. The University of Nottingham regularly assesses trust in financial services. Its

[1] Proposal for a revised MiFID Directive, Article 24.

September 2012 report found that while trust in financial institutions as a whole continues to be low, when people consider their own individual firm, they put that trust higher than trust in their mobile phone providers and supermarkets. Interestingly, advisers and brokers are the most trusted of financial institutions.

So **it is** worth investing in trust-building (Source: Financial Services Research Forum, Research Note, Trust: Trends and Analysis, September 2012)
I am sure many of you in the audience will be bristling as I call for higher professional standards. You are probably keen to express the view that it is the banking fraternity which should be heaped with derision, and not the adviser community. I can understand that view, but would also have to point out some serious instances of misselling around, for instance, endowments as repayment vehicles for mortgages, pensions and the recent Arch Cru case., where high risk funds were sold as low to medium risk causing considerable consumer detriment. And just a few weeks ago the FSA fined a firm for selling UCISs and structured products to ordinary retail investors when these products were clearly unsuitable[2]. During the period under investigation the firm promoted UCIS to 168 clients, who invested over £6 million, and promoted structured products to 362 clients, who invested nearly £20 million, either directly or indirectly through SIPPs.

So what about the challenges
There will undoubtedly be challenges. For a start, maintaining clients, targeting new clients and convincing consumers of the need to save. In May 2011 the CII[3] estimated the retirement savings gap to be £9trillion.. On average British workers retire on just 30% of their pre-retirement income[4] and that figure will probably plummet with the demise of DB pensions.
But most consumers tend not to wake up thinking: today I must save more. Or today I must seek out advice about retirement planning. They find charges, percentages, ongoing costs complicated and difficult to understand, products complex and risk profiles baffling. So engagement will be key. Clear, meaningful statements and information will be critical. But there is a definite consumer need. Just consider the lack of advice around decumulation when people have to make one of the most important decisions of their life about annuities, but can't access advice. The millions of people stuck in underperforming with profits policies who don't know where to turn for

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[2] Pi Financial Limited fined over £58,000 for breaches of two of the Principles for Business, final notice dated 18 September 2012 on www.fsa.gov.uk

[3] "An age-old problem: developing solutions for funding retirement" 9 May 2011 at www.cii.co.uk

[4] This is Money, 9 May 2011, at www.thisismoney.co.uk

guidance. The millions of people entering auto enrolment in the next few years who, while being effectively ‘nudged’ into DC pensions, will also be expected at some point to engage further, to make more informed decisions about products that are often mind boggling in their complexity, with some of the most opaque and confusing charging structures around.

There are too huge challenges for consumers around the restricted and independent advice labels. While we as a Panel could well understand and strongly supported the FSA’s rationale for introducing these labels, explaining them in meaningful terms to consumers will be a challenge. In terms of labels, there will also be challenges for many advisers. Indeed, I recently heard of one well respected adviser who was still struggling with what to call himself, despite the RDR deadline being only months away. While he considered his business to be independent-minded and presenting a range of appropriate products and services, he argued the new definition of independence would be difficult for him to fulfil or to demonstrate. But he was rebelling about the title restricted because he felt it lumped him in with tied agents and banks – an association he did not relish.

There will too be challenges around charging structures – what will be fair, how will ongoing services be charged, how much will be consumer be prepared to pay, given that so many had no idea they were previously paying for advice, as they did not understand commission. Interestingly, a recent survey from AXA found that 63% of investors would prefer to pay a flat fee for financial advice, rather than an hourly rate. It went on to say that there would be no guarantee that all the clients an adviser has are going to want to pay for their advice the same way and that a flexible, adaptable adviser charging facility could be one of the most important aspects of an adviser's business models post-RDR. It’s my view that clients, though, will want a clear and finite cost for advice. They will need to know upfront the costs and nature of any ongoing service and be convinced that those giving advice have a true understanding of their individual needs.

And then of course we have the whole issue of Platforms, a new tool growing in importance for both advisers and providers and which is likely to play an ever increasing role in how clients’ portfolios are managed. The Panel has, true to form, been emphatic that the principles of the RDR should extend to Platforms. Indeed, earlier this year[5] we strongly supported the FSA’s proposals to prohibit

[5] 9 August 2012 Consumer Panel’s response to CP12/12** Payments to platform service providers and cash rebates from providers to consumers at www.fs-cp.org.uk

platforms from being funded by product providers in both the advised and non-advised sectors and to proceed with earlier plans to ban the rebate of product charges in cash to retail clients, again in both advised and non-advised transactions. We do not think any other approach would provide the necessary level of consumer protection or deliver the right consumer outcomes. The research commissioned by the Panel provides independent evidence that supports the FSA's approach.

I've alluded already to a potential advice gap and this remains a concern.. Take away one service and its replacement doesn't always fill the gap. We remain anxious that low to middle earners, who may have accessed advice under the old commission based regime may lose out, may not be able to access cost effective advice or may turn to the internet as the global panacea. The latter would not be surprising, given that e-retail now accounts for 17% of the total UK retail market, with customers spending £68bn in 2011. [6] And consumers consistently say that when looking for financial advice, they tend to ask friends, family and work colleagues and then opt for DIY options, particularly in the arena of savings and protection products. But execution only has its perils. That's one of the reasons the Panel has been involved in talks to develop simplified advice models which might be accessible and cost effective. We have also been strongly supportive of Carol Sergeant's work on Simple Products.

In this Olympic year of achievement, dare I use the analogy of a new era of professionalism on the starting blocks. This focus on professionalism has to be good. Consumers understand the concept of professional standards. They tend to hold doctors in pretty high regard because, for the most part, they are seen to serve their patients. Similarly, with most lawyers. .

I would also like to emphasise the opportunities I see for advisers, given this era or rising professionalism. The RDR really aims to put clients at the heart of relationships. The Consumer Panel certainly seems more opportunities for focused targeting of clients, for the development of cost effective niche services (clearly efficient tax planning, advice around decumulation or certain life time events). New and appropriate business models will have to be considered. And for clients will we see advisers promoting other types of products that have not been skewed by commission – for instance, investment trusts and National Savings – maybe not by themselves, but as an inclusion in a diversified portfolio?

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[6] IMRG Capgemini eRetail Sales Index,2011

Effective marketing will be critical. Interestingly, a recent report from J. P Morgan Asset Management spoke about key opportunities for the adviser community, estimating that over 800,000 householders in the UK earning over £50,000 may be interested in seeking out an ongoing advisory service, and that around 2.5 million households may be interested in receiving advice on a task by task basis. Chasing the money and moving to service High Net Worth Clients is becoming a squeezed market, so perhaps more advisers should be looking at more focused advice, looking more also at the longer term value of clients. So as well as diversified fund portfolios, perhaps advisers should be looking at balanced client portfolios?

- Now over 20,000 holders of the CII Diploma in Financial Planning - a milestone
- 30,000 CII-qualified financial planning professionals who already meet or exceed the RDR qualification requirements

As these statistics demonstrate, huge strides have already been made in raising standards. The majority of advisers are well on course to meet or exceed the levels required. The rising numbers of Diplomas in Financial Planning and the numbers of professional financial planners who already meet or indeed exceed the RDR qualification requirements is great news. The Panel has always argued that Level 4 should just be seen as the beginning and that even higher standards would be welcome. So watch this space.

Given my role on the insurance stakeholder group of EIOPA, I thought I would also touch on some of the issues of the RDR from an EU perspective.
Clearly the current MiFID II and the IMD II reforms reflect and affect the RDR environment, principally because they also concern themselves with adviser definitions, remuneration and professionalism requirements. As I mentioned previously, MiFID already states that an adviser should act honestly, fairly and professionally in accordance with the best interests of its clients. And just this week there was a vote in the European Parliament over the issue of commission and bias. It wasn't nearly as radical as the Panel would have liked in terms of abolishing commission in its entirety, but at least Europe is waking up – or maybe faintly stirring - to the adverse impact of commission and bias in terms of good consumer outcomes. The investor protection risks which the RDR addresses are now receiving close attention in the EU: important Commission research has also been undertaken on the nature of the advice industry in the EU and the risks to consumers. The UK is clearly not alone in addressing the risks to consumers in the advice context. The Consumer Panel will continue to exert

all the pressure it can in this area. We also hope the issue of firms passporting in to the UK from other jurisdictions and bypassing RDR requirements will be recognised and addressed effectively. As early as last year, The Federation of European IFAs started to report a threefold increase[7] in enquiries from advisers looking to passport into the UK, and there are already firms setting up services to help advisers set up businesses that 'fall outside the FOS, FSCS, and RDR'[8]. This is hugely concerning.

I am sure Fay in her closing speech will talk more about the RDR Rubicon and the rewards to be gained on the other side. Julius Caesar certainly thought crossing the Rubicon a major risk worth taking. He won. I too think this is a major leap worth taking. And going back to that Olympian effort, I think the rewards for both advisers and consumers are huge. OK the challenge is enormous. The path will not always be easy. Engaging consumers will not always be guaranteed. But relationships built on professionalism, on trust, on fair and clear charging, on long-term goals and good outcomes for consumers have to welcomed. The die has certainly been cast.

Kay Blair
Consumer Panel Vice Chair September 2012

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[7] http://citywire.co.uk/new-model-adviser/passporting-enquiries-jump-following-aifa-s-words-of-support/a428294

[8] http://ifapassporting.co.uk/passport.html