"History repeats itself: first as tragedy, second as farce” Karl Marx

In this article, we consider the implications of the Retail Distribution Review (RDR) for investment product design and the future distribution landscape. Several Sandler and Depolarisation themes continue to reverberate through the RDR but will these new outline proposals be better or just different again? Will the protection market be immune from the RDR? And what will a ‘re-polarisation’ of advisers mean for life offices and wrap providers?

In January 2002, the FSA issued Consultation Paper (CP) 121. It invited discussion on two-tier adviser structures to improve access to advice, the role of product design standards and unbundling the cost of advice and portable fact finds. Then, in 2003, came CP166 with depolarisation and the introduction of the ‘menu’ to make the cost of advice more transparent. It seemed as though IFAs would succumb to a dominant multi-tied distribution model.

It has not quite worked out that way. In part, this was due to the significant dilution of the FSA’s position, leaving John Tiner, as he exited the CEO position this summer to rue:

“On reflection, I wish we had stuck to our guns in 2002, when we made a similar proposal [to abolish commission for IFAs] in the infamous CP121 on depolarisation.”

Tiner also cast some doubt on the move towards a principles-based approach, if the regulator is keen to improve supply to and access by the mass market, with the question:

‘In order to lower regulatory costs and regulatory risks, is it necessary for there to be tightly defined product specifications and risk parameters which would fly in the face of the FSA’s market-orientated, principles-based approach?’

Let’s remind ourselves what the Review is aiming to address through its five main themes and working groups:
- Sustainability of the distribution sector
- Impact of incentives on advice processes
- Professionalism and reputation of the sector
- Consumer access to financial products and services; and
- Regulatory barriers and enablers for the market solutions

One of the key differences from CP121 is the coupling of formal professional qualifications with the type of advice that can be given in future and the use of the term ‘independent’. The RDR envisages independence as a label conferred only on Professional Financial Planners or advisers offering multiple choices within a focused area of expertise. Whilst the definition of independent has been loosened (see below), the introduction of tiers of advisers

Change in sight – the Life and Pensions distribution landscape
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defined by their qualifications (and experience) is a new step. Only around 10% of IFAs have the AFPC qualification at present and under these rules even this group would become General Financial Advisers providing generic advice. The Review recognises that this proposal is likely to diminish the number of firms and advisers, especially those currently serving the middle-income bracket, but anticipates that Generic Advice services, Personal Accounts and new regulated advisory services will make up any gap².

Transparency of remuneration
Many advisers have been moving to a business model based on trail commission, if not fees. The RDR definition of fee-based covers any advisory remuneration agreed with the consumer and not influenced by the provider. Thus, remuneration can be based on a product sale, as long as the customer explicitly agrees. This allows providers to remunerate advisers on a different basis to the customer-agreed payments which then filter into product charges. These non-matching payment mechanisms remain problematic and somewhat unresolved in the RDR so far and are skirted around in lauding the merits of Customer Agreed Remuneration (CAR). In the case of Primary Advice, from FPC qualified advisers, the outcome seems very similar to today in terms of commission disclosure.

Primary Advice – Basic Advice Plus?
Basic Advice clearly failed to take off but whether the removal of price caps and broadening the product range will make the difference is a moot point.” Primary Advice is a new take on the concept of light-touch sales and covers savings, investments and protection. The key will be reducing sale costs, invigorating bancassurance, workplace and tied sales, whilst gaining the approval of FOS. The RDR seeks ideas on standardising the advice process for Primary Advice, just one of 70 questions the paper raises, but arguably the key point.

Market reaction to-date
The IFA community has voiced some strong negative opinions on the proposals, for example:

“They want the Banks and Insurance companies to sell products without much regulation, competing on quality not commission (i.e. via tied sales forces). They want to see the end of IFAs. There is no doubt about this. It is minority group persecution. This is the fox hunting ban all over again”3.

Others have pointed out that the proposals are incompatible with EU directives and that ‘gold plating’ at national level is not permitted.

Scottish Life, one of the early adopters of factory gate pricing (per the RDR’s CAR definition) states on its website:

“… big-brand insurers will be delighted by all this and will reconstitute their direct sales forces, probably by taking stakes in existing distribution mechanisms such as networks”.

It is concerned about “re-polarising” the market and allowing bancassurers the freedom to use Primary Advice to sell overpriced products to a “largely hapless customer base”. It also questions whether the General Financial Adviser role will even last out the Review as this group has all of the onerous capital adequacy requirements with heavier regulatory supervision than Professional Financial Planners, minus the upside of the current IFA status (unless “fee-based”!). Any such paper was bound to draw out a diverse range of views and this is only a Discussion Paper after all. It is possible however to anticipate some of the possible outcomes if and when this is implemented (2009 at the earliest).

So, in summary, we can forecast:
- The concept of a tiered adviser community will take hold. The RDR definition of a Professional Financial Adviser will be widened to accommodate experience as well qualification as the entry ticket,
boosting numbers. This group of qualified, whole of market, advisers will serve the current HNW IFA segments in retirement planning and more complex financial affairs. Wrap providers will have a smaller target market to aim at but the quality and value of advisers may be enhanced.

The mid-market, commission based IFA, relying on high initial payments is already in retreat. This will accelerate this group’s exit or switch to Primary Advice, probably as tied direct sales people. Lower cost sales and improved productivity will see bancassurance and workplace marketing advance. Providers relying on unit-linked bonds and pension transfers will need to compete for distribution agreements with banks and others with approachable customer bases.

The RDR anticipates competition will be centred on quality of service rather than commission or product features. The winners seem to be the bancassurers and those that can field economic salesforces under Primary Advice, coupled with more interactive e-business capabilities. The tied or multi-tied channel is likely to become the main distribution method (but PFP firms may be hybrids with FFPs and PFAs in their midst).

Changes in corporate pension markets will see renewed interest in workplace marketing. The combination of generic advice, leading into Primary Advice for individual contracts, potentially sitting alongside corporate wraps and PFPs for the higher paid employees makes the larger employer workplace a microcosm of the wider market of the future. Banks have still to use corporate relationships fully but they and life offices with a strong DC book will have most to gain. The combination of flex benefits, share save, wrap and SIPP functionality will see more providers targeting direct relationships with employers and challenging (or acquiring) benefit consultants in the run up to personal accounts. (As one of Bluerock’s specialist areas, we will be producing further thought-pieces on the employer as distributor in the near future).

Platform partnerships, acquisitions and mergers, both amongst distributors and providers, will see the market divided into fewer but larger portions. Whilst the advisory sector will polarise in a sense, the hybrid model, an amalgam of adviser types in a single organisation is likely to be the dominant model.

The impact of the RDR on distribution strategies and its knock-on effects for operating models will be profound. This consultation period is a prime time for providers to consider whether they are built to last and the degree to which they have the flexibility and adaptability to form around the emerging distribution landscape. Re-examining markets and alternative channels should be coupled with early operational change – the penalty for missing the direct and tied channel opportunities post RDR could otherwise be terminal for providers.

¹Reported speech, Citywire, 2 July 2007
²RDR DP07 / 1 Overview p7
³Charlie Palmer writing in Financial Standard newsletter