

Debate on the Retail Distribution Review over the coming months will determine the shape and tone of the regulatory framework for the foreseeable future. **Financial Solutions** rounds up initial reaction and identifies the main emerging themes while, on page 16, **Elliot Lane** outlines the need for professional standards to elevate the standing of financial advisers

Guiding the profession on RDR

In more than two decades since the Financial Services Act 1986 reached the statute book, the regime governing businesses and those they employ has been in constant flux. This has led to frustration and disenchantment in some quarters and prompted critics to suggest that excessive amounts of resource and energy are being diverted into the regulatory process with questionable benefit, either for those being regulated or their customers.

The counter-argument is that financial services regulation is inevitably characterised by change and evolution – how could it be otherwise if it is to keep pace with contemporary markets? Think of the products and distributions channels that exist today compared with the mid-1980s, says this camp. The market has changed beyond all

recognition, and it would be unrealistic to expect the regulator to remain in splendid isolation, especially as it is required to take a proactive stance in pursuit of its objectives.

The latest milestone in the regulatory journey is the Financial Services Authority's Retail Distribution Review (RDR). The FSA spent six months gathering insight and opinion from across the market, including consumer representatives, in a bid to address what it sees as the root causes of persistent problems in the retail investment arena.

Objectives of the initiative include:

- finding ways to improve the current standards of professionalism;
- finding more cost-effective ways of making advice available to a wider range of consumers;

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RDR focus on five key issues

The Retail Distribution Review has five work-streams:

The sustainability of the distribution sector

The FSA concedes that, if the advice sector is to survive, it must be commercially viable.

Professionalism and reputation

The FSA wants to know whether poor advice is the consequence of commission-led bias or a lack of competence and professionalism. It wants to know why financial advisers are not held in the same esteem as other professionals, such as accountants and solicitors, and how parity with other professions might be achieved.

The impact of incentives

In looking at the effect of incentives within and between firms, the FSA wants to determine whether commission leads to consumer detriment such as provider bias, product bias and product churning. The FSA has stated that no conclusion has yet been reached on whether commission per se is good or bad.

Consumer access to financial products and services

FSA wants to examine whether a basic advice regime could stimulate consumer demand for and access to simple products.

Regulatory barriers and enablers

The FSA will continue to look at how regulation in general affects the efficiency and effectiveness of the retail market.

“the regulated investment advice market should be divided into two parts, giving choices to firms and greater clarity to the consumer”



McCarthy highlights essential profitability of advisers

In a speech given to launch the RDR discussion paper, Callum McCarthy, FSA chairman, addressed issues of commercial success for the retail market, acknowledging that firms must be profitable if they are to provide ongoing, high-quality service to consumers.

He said: “What is the business model which will allow firms who provide the retail customer with sound investment products accompanied by sound advice to do so profitably – that

is on a basis which makes investment of capital and management time in such an activity attractive as an investment opportunity relative to other investment opportunities? For it is only if we make the distribution of investment products, done responsibly, a profitable business that it will thrive.

“Regulation cannot achieve this, though it may impede it. At present, I do not believe we in the FSA know enough about the costs associated

with the business – and I am not sure that the firms themselves know enough. We – and they – need to be able to answer questions like what is a cost that a potential investor will pay for different products; what are the components of that cost; how much difference would a change to the regulatory regime make to those costs; how much difference would a change to compensation obligations make. We need to know answers to these and other questions if we are to identify

what changes will make a real difference.

The FSA chief also considered commission: “Is commission – an effective way, if properly controlled, of incentivising a salesforce – really be reconciled with the provision of advice? Is it really in the interest of product producers, who have so much riding on their brand reputation, to continue to use commissions as an incentive when it so clearly risks inappropriate consequences?”

- » improving consumer understanding of what they are getting for their money.

The key proposal the RDR has put forward to tackle these issues is that the regulated investment advice market should be divided into two parts, giving choices to firms and greater clarity to the consumer.

The FSA summarises these levels of advice provision as:

Professional financial planning and advisory services

The regulator suggests this could be offered by highly-qualified advisers serving those consumers who need the full range of advice. Within this category, it says there could be two types of adviser. The most highly qualified could agree their remuneration directly with the customer and not with the product provider (ie, payment by fee rather than as commission). The FSA sees these advisers being able to call themselves ‘independent’.

The second type would be made up of those firms not meeting these conditions and which might wish to use provider-driven remuneration (ie commission).

Controversially, the FSA says such firms would not be able to term themselves “independent”.

The FSA says, if such a model emerged, it would seek to address the risks of lower professional standards and potential conflicts of interest through increased regulatory requirements. It argues this would provide regulatory incentives to all firms to operate with higher standards.

Primary advice

This level of advice would focus on consumers’ more straightforward needs using simple

Role of wraps and fund supermarkets

Alongside its work on retail distribution, the FSA issued a discussion paper on wraps and fund supermarkets. Here, the FSA identifies the potential benefits and risks involved in firms using wraps and examines the extent to which platforms might fit into retail distribution in the future.

Many platforms offer advisers facilities designed to support them in making changes to the services they offer, such as moving away from being paid by commission, or building ongoing client relationships instead of offering purely transactional advice.

The consultation period for DP/07/2 “Platforms: the role of wraps and fund supermarkets” closes on 26 October 2007.

products. According to the FSA, this advice could be less costly and more easily explained to a consumer than full professional financial planning and advisory services. It could be aimed at a wider consumer audience than the existing Basic Advice regime, with a wider range of products and without charge caps. It could also build on the work of the Thoresen Review of generic advice (the Thoresen Review is ongoing and is due to publish an interim report later this year; however, Otto Thoresen has indicated that he does not favour the use of the words “generic” or “advice” in any system which emerges as these might lead to

confusion and unrealistic expectations of what might be delivered).

Regarding the RDR, Clive Briault, head of retail markets at the FSA, said: “Tackling the root causes of the problems within the retail investment market is a challenging and complex issue and is not something that can be solved overnight. To move this ahead, continued engagement is vital. The major changes that have been proposed could have many consequences for the market and a full and lengthy debate during the six month consultation period with consumers and industry is required. We will play our full part in continuing to facilitate and enable market-led change. Once it is clear that significant benefits can be achieved, this will be reflected in the final proposals.”

The RDR consultation period ends on 31 December 2007. The FSA aims to publish a feedback statement in Q2 2008.

Alongside the main RDR paper, the FSA published a Discussion Paper reviewing the prudential requirements for personal investment firms. It discusses options to help reduce the impact of any mis-selling by firms in the sector.

The paper suggests that prudential requirements should focus on reducing the risk of a firm causing detriment to consumers, and other firms paying the FSCS levy, by mis-selling investment products. It explores options for using capital resources requirements and professional indemnity insurance to provide better incentives for firms to address this risk. Among the options discussed are risk-based capital requirements, and for the insurance industry to link PII premiums more closely to mis-selling risk. **FS**

For more information on the RDR, visit www.thepfs.org

CII urges advisers to focus on professionalism

An independent report commissioned from Deloitte and Touche by the CII/Personal Finance Society, shows its members strongly advocate a framework to raise standards for the public benefit and encourage professionalism and trust across the intermediary sector.

Around 90% of the CII Group membership believe the future prosperity of the financial services

industry depends on achieving parity with other professions such as accountants and lawyers.

The CII/Deloitte and Touche report suggests adopting a ‘tiered professionalism’ approach to create the opportunity to raise existing standards:

- Clearly-defined tiers of service from professional through to primary/generic advice;
- Significant consumer input and

research to refine ideas developed by the industry;

- A regulatory dividend for any changes that are proposed;
- Any distinction between the role of professional bodies, the FSA and the EU needs to be clearly defined;
- The adoption of a model for professional self-regulation in the future.

Lord Hunt of Wirral, CII president, said: “What our membership survey clearly shows is that the industry must now head for the high ground. It must stand as a beacon of trust to the consumer. The research findings make it clear that our members believe standards must improve and professional membership will enhance the standing of firms in the eyes of the consumer and the regulator.”