



Europe Economics



# Retail Distribution Review Post Implementation Review

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# 1 Executive Summary

This is Europe Economics' final report on the impacts of the Retail Distribution Review (RDR). This work is part of the first phase of the Financial Conduct Authority's (FCA's) post-implementation review (PIR) of the RDR.

## 1.1 Introduction

The RDR was launched by the Financial Services Authority (FSA), the predecessor body of the FCA, in 2006. It made a number of significant changes to the way investment products are distributed to retail consumers in the UK, with the aim of establishing a resilient, effective and attractive retail investment market that consumers had confidence in and trusted. In particular these changes included:

- Improving levels of professionalism amongst financial advisers.
- Providing consumers with greater clarity as to the nature of the advice they are receiving and the cost of that advice.
- Changing remuneration arrangements between providers, advisers and platforms to better align with the interests of consumers.

In 2011 the FSA made a public commitment to undertake a PIR of the RDR to determine the extent to which it had delivered the desired objectives. This report feeds into the first phase of the FCA's PIR. Given the recent implementation of the RDR rules this review investigates the impacts of the RDR to date. A definitive evaluation is not possible at this early stage, however subsequent stages of the PIR are planned. The PIR also takes into account that the retail investment market is subject to other dynamic effects, such as the continued growth in platforms as distribution channels for retail investments, both for sales Direct to Consumers (D2C) and where advisers use platforms.

The FCA's statutory objectives differ from those of the FSA. In particular the FCA has a competition remit with a particular focus on consumer outcomes. We have therefore considered topics relevant to the competition remit of the FCA.

## 1.2 Our key findings

The impacts of the RDR are yet to be fully realised. Even so, we are able to identify the following positive impacts, at least partly attributable to the RDR.

- **The RDR has initiated a move towards increased professionalism among advisers.** One indicator of this is the vast majority of advisers now being fully qualified to QCF Level 4 compared to Level 3 pre-RDR, with an increasing number attaining an even higher qualification level, i.e. chartered status. In addition, membership of professional bodies has increased. Another indicator is the increased focus by advisers on the provision of more holistic, ongoing advice services. These are all signs of increasing professionalism in the industry, although more time will be needed before these improvements could be expected to translate into better

consumer outcomes or observable improvements in consumers' confidence and trust in the financial advice industry more generally. Chapter 3 presents the evidence for these findings.

- **The ban on third-party commissions has reduced product bias.** As addressed in Section 6.3 of this report, this is evident, for example, from a decline in the sale of products which had higher commissions pre-RDR and an increase in the sale of those which paid lower or no commission pre-RDR. Although other factors, such as the influence of platforms, will also have effected changes here they do not fully explain the step changes in product mix sold just around RDR implementation of the adviser rules.
- **Consumers are increasingly shopping around between different D2C platforms and exerting competitive pressure on platform charges.** Evidence presented in Section 6.2 of this report shows that the complexity of D2C charging has reduced through the removal of rebates, enabling consumers to compare prices better across platforms — and these charges appear to be declining post-RDR, and may continue to fall in the longer term if platform use continues to grow. Charges for Business-to-Business (B2B) platforms have declined from pre-RDR levels, although the evidence indicates the drivers for this extend beyond the RDR.
- **Charges for retail investment products have been falling post-RDR.** Product prices have fallen by at least the amounts paid in commission pre-RDR, and there is evidence some product prices could have fallen even further, due in part to competitive pressure from platforms and advisers, e.g. to gain access to lower cost share classes, and also the introduction of simpler products with lower charges. Evidence for these findings is discussed in Section 6.3. However there is evidence that the cost of advice has increased. In relation to total cost of investment — or indeed the benefit to consumers from the advice received — the evidence does not yet enable us to draw firm conclusions as to whether this has changed post-RDR. The ranges in pre- and post-RDR estimates of platform, product and adviser payments, and the various ways in which these feature in different investments, means it is not yet clear whether declines in product and platform prices are more or less offset by increases in advice costs. A longer post-RDR trend in prices should bring greater clarity on this. Evidence for these findings is consolidated in Section 8.3 of this report.
- **The initial signs are that advisory firms appear slightly better placed to meet their long-term commitments.** Though there was some exit from the advisory market, particularly in the period leading up to the RDR, by the banks and by some financial advisers, numbers of advisers and advisory firms now appear stable. There remains a large number of advisory firms and advisers to serve consumers. Among advisory firms, average revenues have been increasing over the past few years. Profitability and capital and reserve levels of firms in the retail investment market has also increased, and the percentage of firms posting a loss has decreased, for the majority of firms. Profitability among larger firms is however weaker, although this situation pre-existed the RDR. The evidence for these findings is presented in Chapter 7.
- **Costs of complying with the RDR have been in line with or lower than expectations,** as described in Section 8.2 of this report.

In other areas the market is adjusting and more time may be required for the full effects of the RDR to become apparent. In particular:

- The market is adjusting to offer advice which is more tailored to consumers' demands. Evidence presented in Section 5.3 of this report shows that ban on commission has led many firms to consider the fundamentals of their business models and make key changes, e.g. segmenting their customers, with some focusing on services to those with higher levels of investible assets and more complex (and profitable) investment advice needs. Despite these changes there is little evidence that the availability of advice has reduced significantly, with the majority of advisers still willing and able to take on more clients. At the same time consumers are increasingly buying products on a non-advised basis, such as D2C platforms, as described in Section 5.2.
- In considering the 'advice-gap' attributable to the RDR (in Section 5.4), we distinguish between three groups of consumers who may have a need for investment advice but who may not be receiving it for different reasons: (a) those not engaged in the investment market; (b) those unwilling to pay for advice at true cost; and (c) those seeking advice but where firms are unable or unwilling to provide them advice.
  - The first group, though important, does not constitute an 'advice gap' in that the affected consumers are not actively looking for investment advice (they might, of course, benefit from unregulated, generic advice). The bank exit may have increased the size of this group as evidence suggests bank based advisers were effective in prompting a decision to invest from unengaged consumers. It is debatable whether this is an RDR effect, as bank exit appears driven by a combination of factors, including wider strategic considerations.
  - The second is driven by consumer choice about value for money and existed to a degree prior to the RDR. To the extent that this is a choice by consumers as to whether they are willing to pay for investment advice, whether this group is a 'gap' is arguable. By revealing the true cost of advice the RDR is likely to have increased the size of this group, although the evidence suggests the size of this increase has been limited by the move by the majority of firms to adopt contingent charging structure rather than up-front fees. This group includes consumers who we expect would pay for cheaper forms than the full advice model — the absence of these cheaper models therefore creates a forced choice for this group. There are signs that in time the market will adjust to address at least part of this gap by developing cheaper advice offerings that these consumers may consider value for money.
  - The third group is firm-driven. This group of consumers is likely to have increased under the RDR as a result of firms moving to target higher wealth, higher margin consumers. Some firms are segmenting their client books and focusing on wealthier customers. Where this is the case, the evidence suggests the number of consumers affected is generally small and that these consumers are likely to have been picked up by other adviser firms. Advisers have capacity and have been taking on new clients. There is little evidence that consumers perceive themselves to have been abandoned by advisers. As this gap is likely to be small, to the extent there are firms willing to provide advice to lower wealth consumers, the market should be able to resolve this in time.
- As discussed in section 5.4 and 8.3, the RDR has created an opportunity for innovation in the market, and there are encouraging signs that innovation will occur, but actual innovation to



date has been limited. This applies particularly to simpler or more automated advice offerings. However, there is a widespread perception of regulatory risk which is likely an inhibiting force.

- Those consumers who are receiving full advice now are more likely to be receiving better quality advice due to advisers being better qualified and the reduction in product bias. Definitive conclusions on the quality of advice will be better drawn once sufficient time post-RDR has elapsed and changes are visible on consumer outcomes. However the evidence currently available implies adviser charges have increased post-RDR, at least for some consumers. This is likely to reflect limited competition in the advice market: disclosure by firms still in need of improvement, and limited consumer awareness and understanding of adviser charging, can limit consumers' ability to shop around effectively, and hence exert downward pressure on prices.

Lastly there is one area which may warrant earlier attention:

- The RDR has led to improvements in the disclosure of information provided by firms to consumers. In relation to adviser charging and the nature of the advice offered, however, the clarity of some firms' disclosures still require improvement: consumers can still be confused as to the charges they are paying and the differences between independent and restricted advice. Whilst consumers' understanding may improve as firms' application of the disclosure obligations improve across the board, the complexity of charging structures and the manner in which this information is communicated may increase consumer search costs and limit the effectiveness with which consumers engage with the market. One implication of this is that consumers are less likely to be able to shop around effectively for an adviser and in doing so drive competition between advisers. A lack of appreciation by consumers for the services provided by independent advisers may also undermine the incentives of these to improve the quality of their advice, or increase the attraction of the restricted model. Chapter 4 of this report presents the evidence for these findings.

### 1.2.1 Comparison to the RDR's objectives

Drawing upon the above summary and the underlying evidence presented in the remainder of this report we now consider the overall impact of the RDR to date against its *ex ante* objectives.

#### *Standards of professionalism that inspire consumer confidence and trust*

There are indications of a move towards a more professional advice market. Although higher professional qualification does not automatically translate into improved conduct, higher levels of qualifications and skills can be expected to improve the quality of advised services. However, any increased consumer trust and confidence in the market is not yet evident.

#### *An industry that engages with consumers in a way that delivers more clarity on products and services*

Whilst there has been improvements in the disclosure of information provided to consumers there is still a lack of clarity amongst consumers in relation to advice services and charges which is likely to limit the extent to which consumers exert competitive pressure on advisers.



*Remuneration arrangements that allow competitive forces to work in favour of consumers*

The removal of commission has led to the reduction of product bias in adviser recommendations, resulting in the enhancement in quality of advice for at least some consumers. The removal of platform rebates has reduced the complexity of D2C platform charging, enabling consumers to better compare prices across platforms. This competitive pressure has led to a decline in D2C platform charges post-RDR. Advisers and platforms are now also better able to exert pressure on providers, with platforms increasingly able to negotiate lower product costs. On the other hand, the cost of advice appears to have increased. However the impact on the total cost of investment — and the value obtained by consumers — are not yet clear.

*An industry where firms are sufficiently able to deliver on their longer term commitments and where they treat customers fairly*

Firms appear slightly better able to deliver on their longer term commitments, providing they use their increased profitability to continue to build up capital reserves. Profitability among the larger firms remains relatively low. The costs of complying with the RDR have been in line with or lower than expectations.

*A market which allows more consumers to have their needs and wants addressed*

The market is showing signs of adjusting to offer advice which is more tailored to consumers' demands. There are likely to be a group of consumers who are not willing to pay for full advice at true cost but who may be willing to pay for a cheaper alternative form of advice.

*A regulatory framework that can support delivery of all aspirations and does not inhibit future innovation where this benefits consumers*

Industry commentators suggest that 'simplified advice solutions' designed for the mass market might be profitable and there are encouraging signs of innovation in the market, particularly in relation to simplified or automated advice. However, there is a considerable perception of regulatory risk among potential providers (related to both the FCA and the Financial Ombudsman Service). Recent signals from the FCA, e.g. its guidance consultation on sales which involve a personal recommendation and those which do not and its recent feedback statement on Project Innovate, may help to address this.

## 2 Introduction

### 2.1 What is the RDR?

The RDR was launched by the Financial Services Authority (FSA) in 2006 to investigate how investment products were distributed to retail consumers in the UK. It identified a number of long-running problems that impact the quality of advice and consumer outcomes, as well as confidence and trust, in the UK investment market. In 2012 the FSA implemented provisions to improve the clarity with which advisory firms describe their services to consumers; address the potential for adviser remuneration to distort consumer outcomes; and improve the professional standards of advisers. In April 2014, the FCA implemented similar provisions on remuneration and transparency for platforms.

The RDR had the following objectives:

**Standards of professionalism that inspire consumer confidence and build trust.** As part of the RDR, it was identified that levels of training and professionalism among advisers were relatively low compared to other professions, and that this might raise the risk of poor quality financial advice and negative consumer outcomes, which could in turn undermine confidence in the sector. To address this, a higher minimum level of qualification was introduced in December 2012, along with requirements for continuing professional development and adherence to ethical standards.

**An industry that engages with consumers in a way that delivers more clarity on products and services.** There had been concerns about the clarity with which financial advisers communicate to consumers the type of service they offer (i.e. independent, single- or multi-tied) and the prices associated with these services, which could lead to consumers making poor choices of the service to be received. In light of this, mandatory disclosure requirements on the type of service were introduced from December 2012, along with the requirement for independent advisers to cover the full range of retail investment products. Advisers must also set their own charges (adviser charging) and communicate these clearly to customers.

**Remuneration arrangements that allow competitive forces to work in favour of consumers.** The RDR found that commissions paid to advisers by product providers were distorting the incentives of advisers in recommending retail investment products to clients. Adviser remuneration and product charges were also bundled such that there was limited transparency around cost; indeed many consumers believed that advice was free of charge and did not understand the impact that commissions would ultimately have on their investment product returns. To address this, commissions to advisers were banned from December 2012 and advisers were required to develop, communicate and agree with the consumer their own charges for advice. Payments by providers to platforms and cash rebates by providers to consumers were banned from April 2014 for new business.

**A market which allows more consumers to have their needs and wants addressed.** The RDR was intended to encourage competition through greater price transparency at all levels of the supply

chain; remove distorted incentives; and create a more efficient market where advice is available at an efficient cost to those who would benefit from it.

An industry where firms are sufficiently able to deliver their longer term commitments and treat consumers fairly. The implementation of the RDR was intended to bolster the long-term sustainability of the industry.

A regulatory framework that can support delivery of the required changes and does not inhibit future innovation where this benefits consumers. An overarching aim of the RDR was to implement a regulatory framework that does not inhibit innovation where this benefits consumers.

## 2.2 The Post Implementation Review

This report feeds into the first phase of the FCA's PIR to determine the extent to which it has delivered the desired objectives presented above. Given the relatively recent implementation of the RDR rules this review investigates the impacts of the RDR to date — a definitive evaluation is not possible at this stage, and subsequent monitoring is planned in light of this.

The FCA's statutory objectives differ from those of the FSA. In particular the FCA has a competition remit with a particular focus on consumer outcomes. We have therefore considered topics relevant to the competition remit of the FCA.

In our methodology for assessing the impacts of the RDR we:

- Developed **mechanisms of effect** through which the policies of the RDR could be expected to realise the main objectives and wider economic and competition impacts.
- Identified **indicators** to be measured to test the validity of the mechanisms of effect and the extent to which the objectives and economic hypotheses had been met. These include the short-term indicators on which the FSA had publically committed to report in 2011, and also longer-term indicators identified by the FCA, and additional indicators developed by Europe Economics as part of this study.
- Gathered and analysed **data and information** available in the public domain and that which had been commissioned by the FCA, such as: research into the initial impacts of RDR undertaken by the FCA Practitioner Panel; various market research studies; Towers Watson's advice demand and supply modelling; and the FCA's Product Sales Data (PSD) and Retail Mediation Activities Returns (RMAR) data.
- Undertook **fieldwork** in the form of twenty-five interviews with industry participants to inform our compliance cost estimates and wider analysis of the impacts of the RDR.

## 2.3 Context of the review — overview of market trends

The PIR has been conducted in the context of a number of changes in the wider retail investment market. It is important to consider these changes when assessing the impacts of the RDR. If factors introduced soon before, during or after the RDR are not considered as part of our analysis, then there is the risk that changes attributed to the RDR are in fact the result of some other factor or factors.

We present a brief overview of market trends here, covering regulatory changes, technological development and the growth of platforms, and changes in consumer confidence and product sales.

### 2.3.1 Regulatory and tax-driven shifts in savings

Changes in levels of consumer investment, product sales and the demand for financial advice will be influenced by policies making certain products more attractive, such as reforms to pensions and to ISA allowances.

For example, the gradual introduction of auto enrolment pensions, starting in October 2012, is likely to increase the demand for pension related investments and reduce (relatively) the demand for other consumer savings products. It may also depress aggregate savings figures as individuals may have less disposable income for saving. Up until 2017, auto enrolment requires at least two per cent of income to be contributed to a pension, with employers contributing at least one per cent.<sup>1</sup> To date, it is estimated that only nine per cent of employees have opted out of auto enrolment, suggesting that this is a particularly popular method of saving.<sup>2</sup>

The growth in the sale of pension products after 2012 reflects these changes, as illustrated by changes in the FCA's recorded Product Sales Data (PSD) in the figures below. Group personal pensions,<sup>3</sup> self-invested personal pensions (SIPPS) and stakeholder pension sales have all increased. We note that the PSD do not capture sales through platforms and thus the data on SIPPS, which are predominantly sold through platforms, will not reflect the full sales picture. However, the upward trend is still clearly visible.

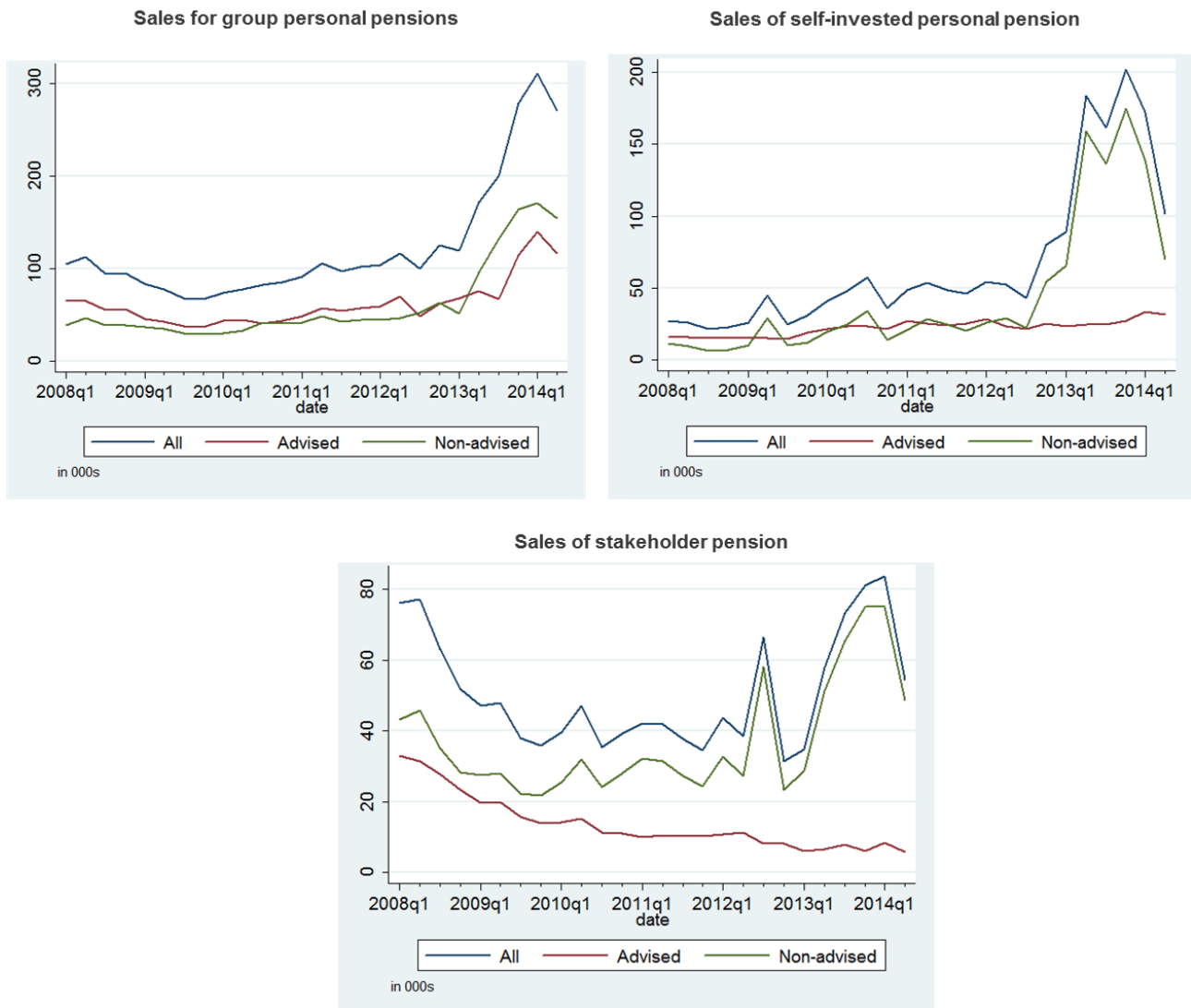
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<sup>1</sup> The Pensions Regulator (2014), "The essential guide to automatic enrolment for employers".

<sup>2</sup> DWP (2013), "Automatic enrolment opt out rates: findings from research with large employers".

<sup>3</sup> Included for completeness.

**Figure 2.1: Sales of pension products, volumes**



Source: Europe Economics analysis of PSD.

The 2014 Budget further changed pension rules, increasing the lump sum that can be taken from pension pots worth up to £30,000, and allowing these withdrawals at the marginal rate of income tax (from April 2015).<sup>4</sup> From April 2015 consumers will also have much more freedom as to how they use their pension pots from age 55. This will mean they will have the option of taking their pension savings as cash, and/or buying an annuity (or other income-generating guaranteed products that may emerge), and/or using pension drawdown but without any limits applied.<sup>5</sup> The decline in the sales of pension annuities shown below reflects anticipation of these changes giving pensioners more flexibility to cash out pensions rather being forced to swap into annuities.<sup>6</sup>

These changes are likely to increasingly affect product sales; they may also increase the demand for advice, as consumers seek help in taking these complex decisions. A further policy change which

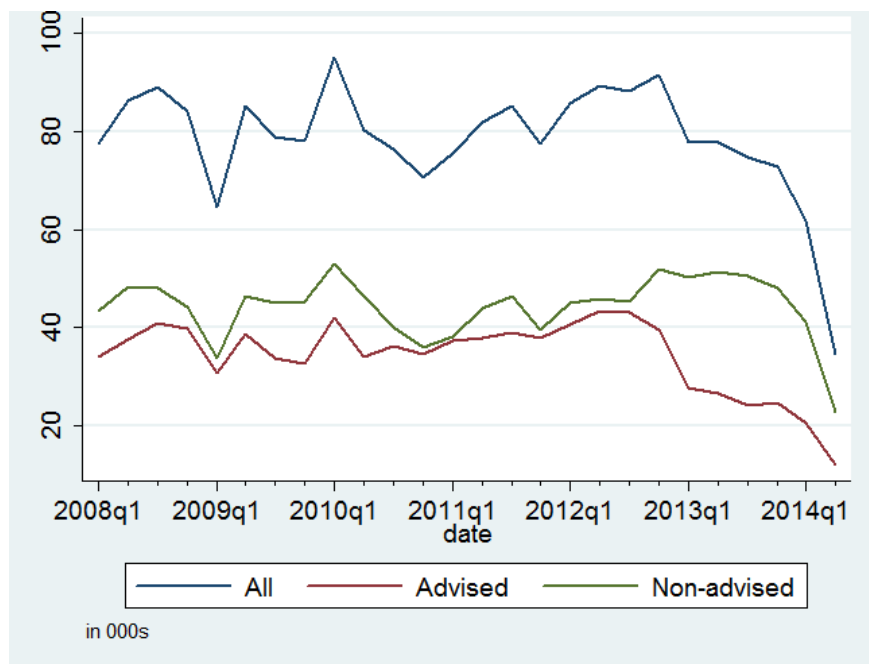
<sup>4</sup> This refers to the 'trivial commutation' limits payable after age 60 — see HM Treasury (2014), "Budget 2014: greater choice in pensions explained".

<sup>5</sup> HMRC (2014), "Budget changes – pension flexibility and changes to Finance Bill 2014".

<sup>6</sup> HMRC (2014), "Budget changes – pension flexibility and changes to Finance Bill 2014".

may affect the demand for advice is the 'Guidance Guarantee' announced by the Government to support the increased flexibility around pensions. This entitles everyone with a defined contribution pension fund to access free (at the point of delivery), impartial guidance, including the option of a face-to-face conversation about their options when accessing their pension savings. The guidance is not intended to replace financial advice given by regulated advisers; rather it is intended that the guidance will signpost people towards additional specialist help where appropriate, including, for example, regulated financial advice or debt advice.

**Figure 2.2: Sales of pension annuity, volumes**



Source: Europe Economics analysis of PSD.

The July 2014 Budget also brought about changes in how ISAs operate, with the introduction of the new ISA (NISA) which increases the ISA limit to £15,000 a year and enables it to be saved in cash, stocks and shares, or in any combination of the two. Increasing the flexibility as to how money can be saved in tax free accounts should in principle increase the demand for ISAs and potentially bring more consumers into the retail investment markets through increased visibility of stocks and share ISAs. This may well drive increased demand for investment advice.

These trends in product sales and the demand for advice will all affect the interpretation of longer-term impacts of the RDR.

### 2.3.2 Technological advancements

Technological advances have had a significant impact upon how individuals choose to invest and how investment products are delivered to them. The internet has created new avenues through which both investors and advisers are able to make investment decisions, potentially broadening the size of the market for retail investment. As discussed in section 2.3.5 direct-to-consumer (D2C) platforms have grown significantly over the years. Increasingly sophisticated platforms enhance the ease with which individuals are able to access information, placing them in a stronger position

to make informed investment decisions themselves (at least provided they are able to process that information adequately). This, combined with an increasingly IT-dependent society, may drive a move away from traditional face-to-face advice to more self-directed investment.

It also makes a “third way” possible whereby an investor seeks out advice (from an adviser) but takes responsibility for execution. This can be seen as both a challenge and an opportunity for advisers.

### 2.3.3 Consumer confidence, saving and investment

Trends in product sales, savings and investments will be influenced by a number of factors, such as consumer confidence, recovery from financial crisis, real disposable income and low interest rates. Attribution of changes to the RDR will therefore need to be made with caution.

For example, the financial crisis has affected the savings behaviour of individuals. The gross household savings rates shown below illustrate this point, with the increases in the rate post 2008 likely attributable to increased precautionary savings in the face of greater uncertainty, and household deleveraging more generally.<sup>7</sup> The financial crisis may also have affected the investing behaviour of individuals — the volatility of financial markets in recent years may have deterred some individuals from undertaking any investments beyond a basic savings account and would have affected the risk appetite of many others.

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<sup>7</sup> The ONS data in the figure represent gross savings, estimated as the difference between households’ total available resources and their current consumption. This measure captures all factors affecting income and consumption, and thus the figure represents a very broad, secular savings trend.



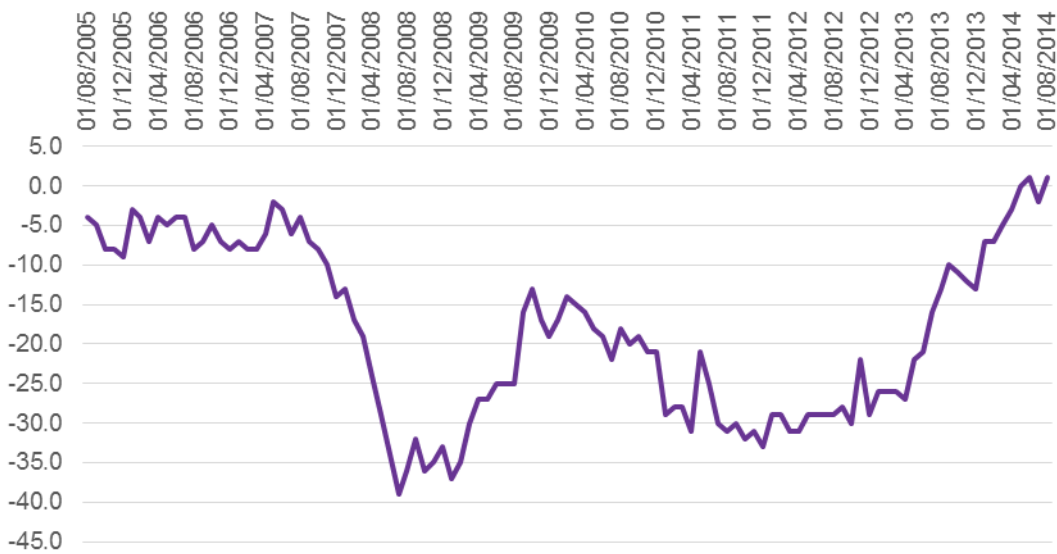
**Figure 2.3: Gross household saving 1997-2013**



Source: ONS. The figure shows annual saving as a percentage of total resources, and gross saving (in £m) for households and non-profit institutions serving households. All data are seasonally adjusted.

Note: More recent data (up to summer 2014) from NS&I 2014 Quarterly Savings Survey show a similar trend.

In addition, the crisis reduced the overall level of trust in the financial system and this may impact upon individual investor behaviour. Figure 2.4 shows the GfK index of consumer confidence since August 2005. While it has been negative for much of this period, the trend has been upward since the end of 2011, implying an increase in consumer confidence which may have driven increased investment activity.

**Figure 2.4: UK Consumer Confidence Index**

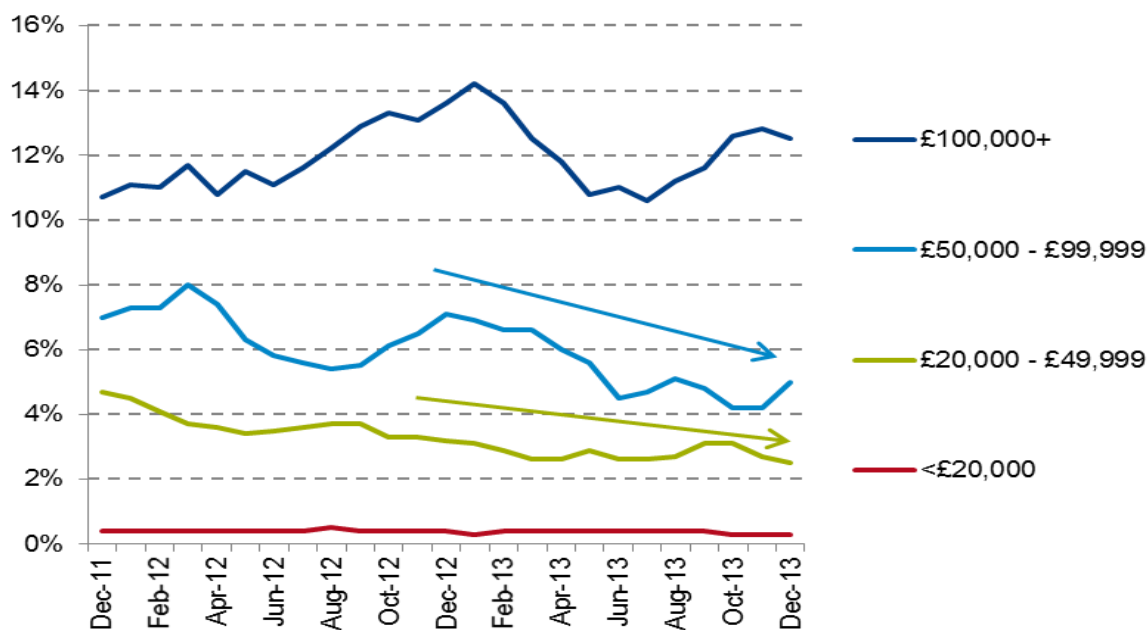
Source: GfK Consumer Confidence Index, accessed through Bloomberg, GfK.

This is consistent with a recent increase in investment evident in IMA sales data, as seen in Figure 2.6 (in section 2.3.4) below.

Despite this overall increase in the value of investment, there is evidence to suggest that new investment among the lower wealth segments has fallen. This may imply that some consumers have simply left (or not entered) the investment market altogether. GfK finds that there has been a decline in the proportion of adults who opened investments post-RDR. The decline has been most notable for those with pre-existing savings/investments in the £50,000-£99,999 segment — the proportion of this group opening an investment in the year up to the date of the survey declined from around seven to five per cent.<sup>8</sup> Those with between £20,000 and £49,999 in savings and investments also exhibited a decline in incidence.

<sup>8</sup> Source: © GfK NOP Ltd, Financial Research Survey (FRS), 6 months rolling data

**Figure 2.5: Proportion opening investments in the last year, by value in savings & investments segments**



Note: Base for the figure is consumers (18+) opening an investment (this is not defined but would include retail investments).

Source: © GfK NOP Ltd, Financial Research Survey (FRS), 6 months rolling data

The factors discussed above will have influenced trends in product sales and market structure. We now describe these trends, as they too contribute to the context within which the RDR has taken place.

### 2.3.4 Total product sales

Since 2010 there has been a general upwards trend in gross sales of investment products. According to IMA data, gross quarterly direct sales, platform sales and other intermediary sales have increased from a four-quarter moving average of £27 billion at the end of 2010 up to an average of just under £37 billion in Q2 2014 — equivalent to a 46 per cent increase.<sup>9</sup> This is shown in Figure 2.6 below.

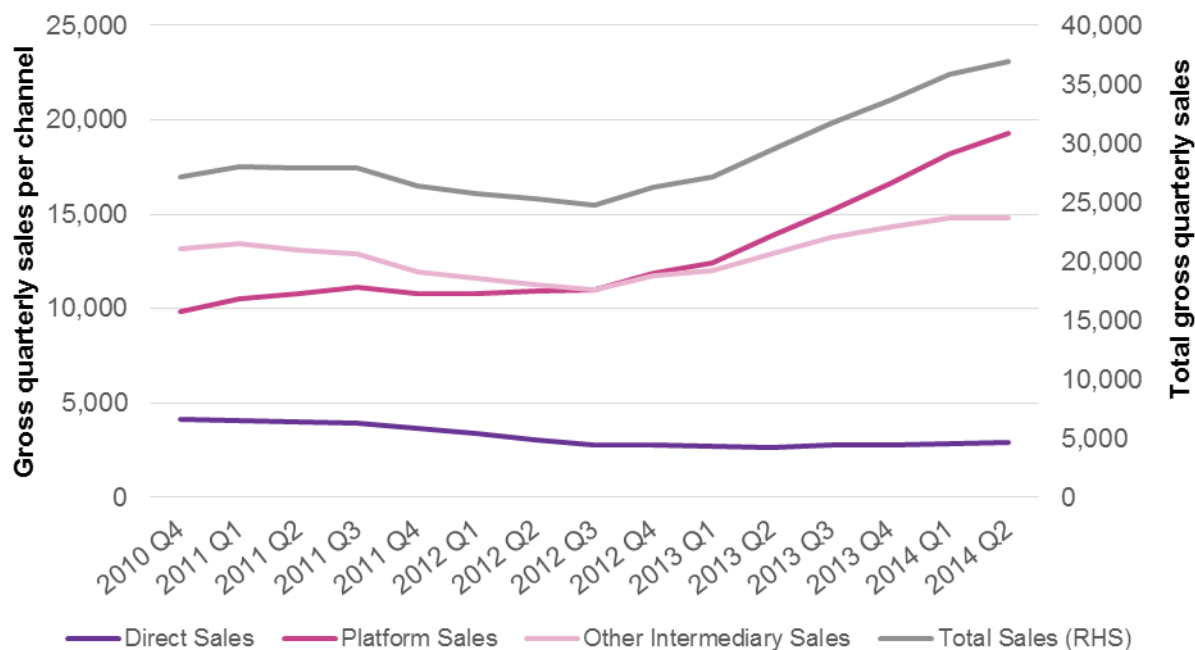
The increase in sales has primarily been driven by growth in platform sales (these IMA platform data are from both D2C platforms and intermediated, or business-to-business (B2B) platforms). Since the beginning of 2013 these platform sales have consistently exceeded other intermediary sales, peaking at £21.9 billion in Q2 2014. This increase has seen the proportion of total gross sales attributable to fund platforms increase from 35 per cent in Q1 2010 to 56 per cent in Q2 2014.<sup>10</sup>

The increase in sales through platforms and other intermediaries is in contrast to the decline in direct sales: between Q1 2010 and Q2 2014 quarterly direct sales fell from £4.1 to £3.1 billion.<sup>11</sup>

<sup>9</sup> The asset classes covered by the IMA data include retail sales in equity, fixed income, money market, mixed asset, property and other assets.

<sup>10</sup> IMA Fund Statistics.

<sup>11</sup> The data in the figure do not distinguish between advised and non-advised sales — platform data are collected from both D2C and B2B platforms, and although direct sales are more likely to be unadvised,

**Figure 2.6: Gross quarterly sales by distribution channel (£m)**

Note: Sales data are four-quarter moving average.

Source: IMA Fund Statistics. Data includes retail sales in equity, fixed income, money market, mixed asset, property and other assets.

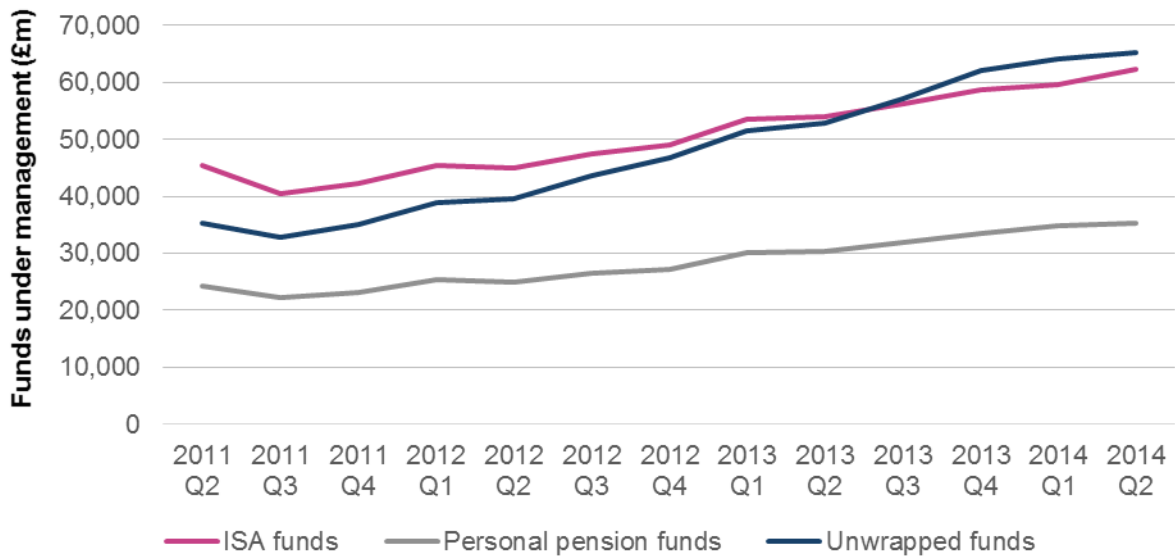
Comparing ISA funds, personal pension funds and unwrapped funds, data collected by the IMA show that in the period between 2010 and 2013, total assets under management by platforms have seen a shift towards unwrapped products.<sup>12</sup> This trend is presented in Figure 2.7,<sup>13</sup> with total funds under management increasing for both ISAs and unwrapped products, but at a slower rate for the former. This corresponds with a spike in sales of unwrapped products through platforms as seen in Figure 2.8.

and intermediary sales advised, the distinction is not certain. Figure 2.10 presents data on advised platform sales, and we discuss the proportion of non-advised sales that make up the PSD (which excludes platforms) in Section 5.2 on the demand for advice.

<sup>12</sup> Table 9 of IMA (2014), "UK equity income continues to lead the way in July 2014", *IMA Press Release*, August 27. Data are collected from Cofunds, Fidelity, Hargreaves Lansdown, Skandia and Transact.

<sup>13</sup> Due to a change in the IMA sample, data are only presented going back to the second quarter of 2011.

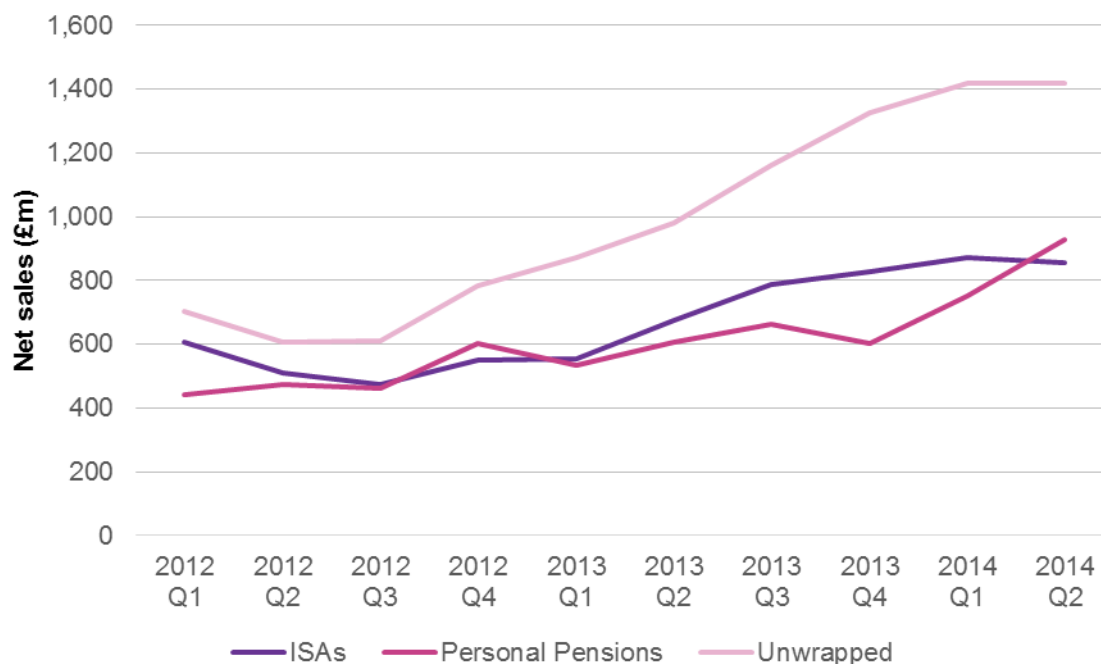
**Figure 2.7: Platform funds under management by product (£m)**



Source: IMA Fund Statistics

Sales of ISAs by platforms were 73.6 per cent higher in July 2014 than in July 2013, as shown in the chart below.<sup>14</sup> Given the changes to the ISA rules introduced in the 2014 Budget, ISA sales and funds under management may well increase at a faster rate in the future.

<sup>14</sup> IMA Fund Statistics.

**Figure 2.8: Platform net sales by product (£m)**

Note: Sales data are four-quarter moving average.

Source: IMA Fund Statistics

### 2.3.5 Growth in platforms

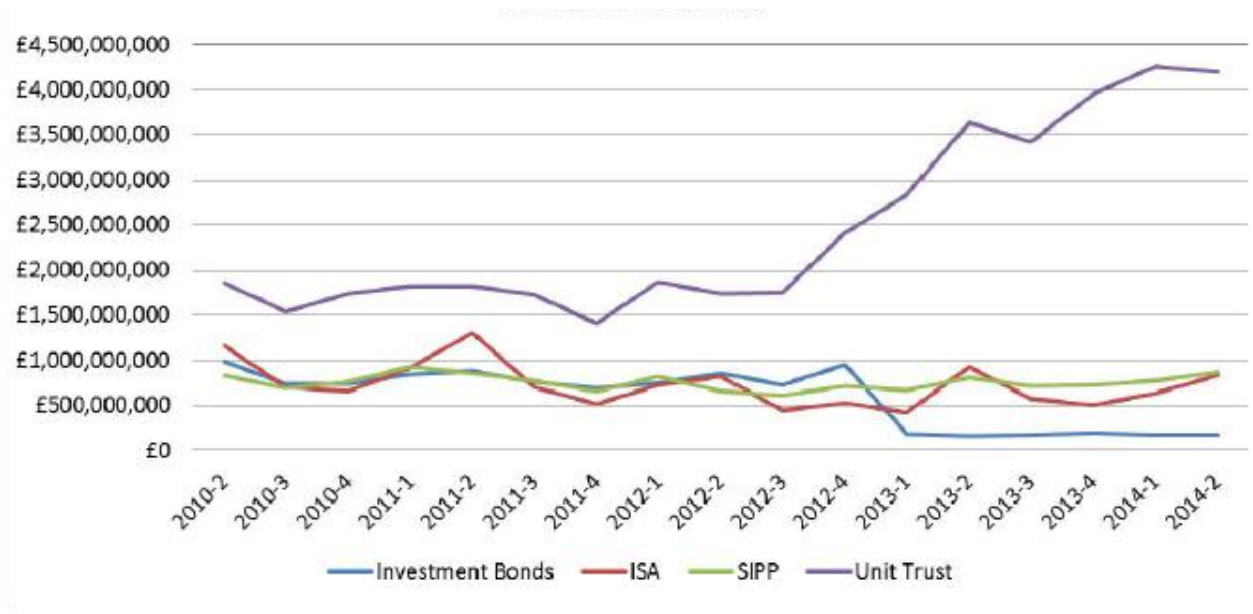
As highlighted above, sales through platforms have increased significantly, most likely driven by technological advancements, changing consumer preferences, and the opportunities for efficiencies and improved research and execution performance provided to advisers.

Platform sales attributable to intermediaries only can explain a small part of the increase in total platform sales. Overall intermediated (i.e. advised) platform sales, as estimated by Touchstone, have increased between Q2 2010 and Q2 2014 from £4.9 billion to £6.2 billion.

Most of the increase in B2B platform sales is attributable to sales in unit trusts, which have increased dramatically from Q3 2012 and totalled £4.2 billion in Q2 2014. ISA and SIPP sales are largely unchanged, while there has been a dramatic drop in investment bonds in the period studied from £1.0 billion to £0.2 billion.<sup>15</sup>

<sup>15</sup> Touchstone (2014), "FCA pre and post RDR data requirements".

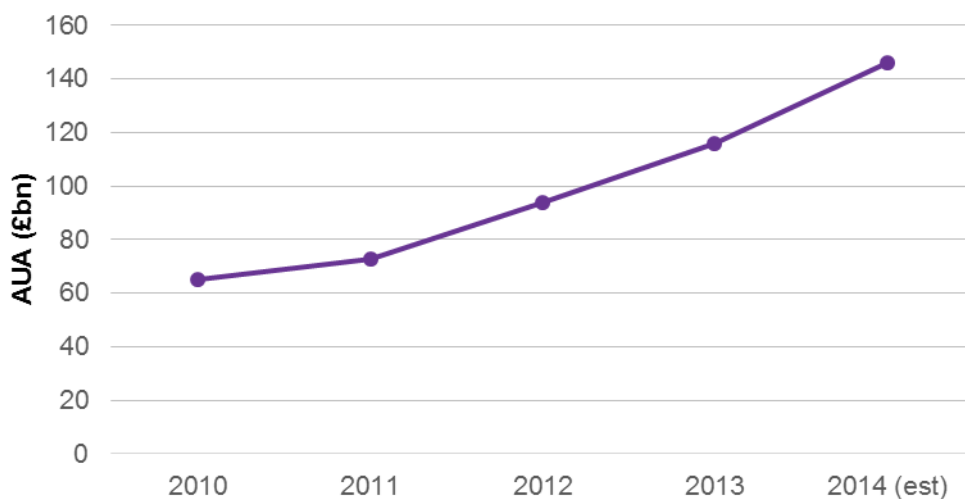
**Figure 2.9: Intermediated platform sales**



Source: Touchstone.

D2C platform growth has been significant, although D2C sales over time are less readily available. According to Platform, total assets under administration (AUA) were £94.3 billion in September 2012, increasing to £116.5 billion in September 2013 (an increase of £22 billion in a year).<sup>16</sup> Platform expect this to continue in 2014, with growth in AUA of 25 per cent, bring the total AUA to £146 billion.

**Figure 2.10: AUA of the D2C platform market (£bn)**



Source: Platform.

<sup>16</sup> Platform (2014), "Guide to direct platforms and investors: A market turned on its head", p.18.



Assuming no divestment over this year, and that all sales occurred just prior to September 2013 and using the 12.5 per cent return on the FTSE 100 as a rough proxy for average asset return, an indicative annual sales figure of £10.4 billion can be estimated.<sup>17</sup>

The increase in platform AUA has been driven by growth in account sizes and in the number of active private investors. The number of active private investors increased to 7.9 million in 2013 from 6.0 million in 2010. The average account size has increased from £25,300 in 2010 up to £28,700 in 2013.<sup>18</sup>

The D2C market is dominated by four platforms which have consistently held at least 58 per cent of all AUA since 2010. The market shares of three of the four largest platforms has declined somewhat over time, whilst the largest (Hargreaves Lansdown) has increased from 28 per cent to 32 per cent between 2012 and 2013.<sup>19</sup>

The growth in platforms is likely to have been driven largely by secular factors. The technological advances have been making the creation and delivery of investment product more accessible and cheaper to a wider audience and are likely to continue to drive the improvement in the functionality and efficiency in the market even without the RDR.<sup>20</sup> Social factors have also helped to drive investors towards platforms: increased levels of IT literacy, more intuitive website design, and faster internet connections are likely to have made platforms more attractive than their alternatives.

## 2.4 Structure of the report

We have structured our report around the main objectives of the RDR, as follows:

- Chapter 3 'Professionalism and Consumer Trust' addresses the objective *standards of professionalism that inspire consumer confidence and build trust.*
- Chapter 4 'Clarity of Service and Consumer Understanding' considers *an industry that engages with consumers in a way that delivers more clarity on products and services.*
- Chapter 5 'The Advice Market' assesses the RDR against three objectives: *remuneration arrangements that allow competitive forces to work in favour of consumers; a market which allows more consumers to have their needs and wants addressed; and a regulatory framework that can support delivery of all these aspirations and does not inhibit future innovation where this benefits consumers.*
- Chapter 6 'The Wider Retail Investment Market' extends the analysis of Chapter 5 beyond the advice market.

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<sup>17</sup> After one year, the original £94.3 billion of AUA would be worth £106.1 billion if the average return was 12.5 per cent. The assumptions made mean that the overall level of net sales is likely to have been smaller, however the gross sales would have been greater since the assumption of no divestment is a very strong one.

<sup>18</sup> Platform (2014), "Guide to direct platforms and investors: A market turned on its head", p.18.

<sup>19</sup> Platform (2014), "Guide to direct platforms and investors: A market turned on its head", p.18.

<sup>20</sup> Cass Consulting (2013), "Impact of RDR".

- Chapter 7 'Sustainability of the Industry' considers the objective *an industry where firms are sufficiently able to deliver their longer term commitments and where they treat their customers fairly.*
- Chapter 8 'Compliance Costs and Overall Impacts' assesses the RDR against expected outcomes and summarises the overall impact.

## 3 Professionalism and Consumer Trust

### 3.1 Introduction

One of the aims of the RDR is to create '*standards of professionalism that inspire consumer confidence and trust.*'

As part of the RDR, it was identified that levels of training and professionalism among advisers were relatively low compared to other professions.<sup>21</sup> This meant there was a risk that advisers lacked the necessary competence to provide good quality advice to consumers,<sup>22</sup> which might flow into a lack of trust and confidence among consumers in the advisory market.

The new professionalism requirements, introduced in December 2012 as part of the RDR, require advisers to hold an appropriate qualification (at the minimum QCF Level 4), adhere to ethical standards, carry out at least 35 hours of Continuing Professional Development (CPD) a year and make an annual declaration that they are meeting these standards by holding a Statement of Professional Standing from an accredited body.

The aim of these requirements is to raise the professionalism of advisers and in so doing improve the level of consumer confidence and build trust in the retail investment advice sector. This has the ultimate aim of enhancing consumers' engagement with the, and benefits from, financial advice.

### 3.2 Has professionalism improved?

The RDR has led to enhanced professional standards with the vast majority of advisers already meeting the higher minimum qualification requirements, and an increasing proportion going beyond these standards and attaining still higher qualifications. With the requirement that advisers have an SPS (Statement of Professional Standing) from a professional body, membership of professional bodies has also increased. Membership of professional bodies has also increased. Adviser research shows that prior to implementation the majority of advisers were already undertaking CPD however we do not have evidence as to whether this has been maintained. Taken together with the impact of other RDR reforms, the RDR has contributed to the advice industry moving to become more professional. In this section we present the evidence for these findings.

The vast majority of advisers are meeting the higher minimum qualification requirements. Data from the Retail Mediation Activities Returns (RMAR)<sup>23</sup> show that the percentage of advisers who hold an appropriate qualification has increased from 89 per cent in 2008 to 95 per cent in 2013, as shown in Figure 3.1 below. This indicates that 95 per cent of advisers are fully qualified to the level

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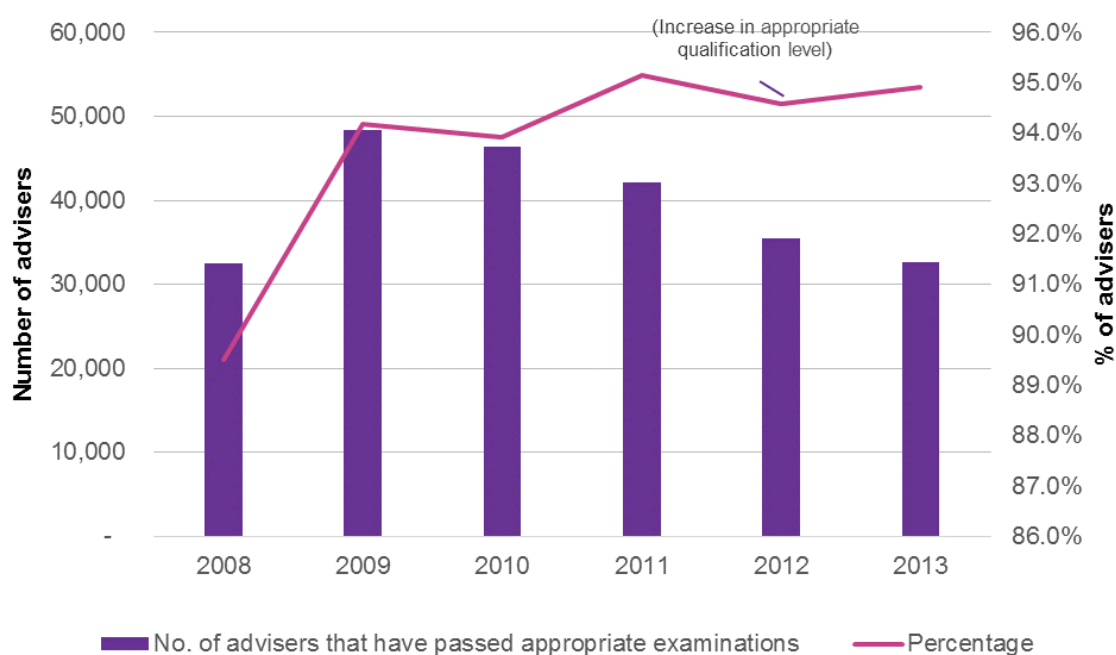
<sup>21</sup> FSA (2007), "Discussion paper – a review of retail distribution", [http://www.fsa.gov.uk/pubs/discussion/dp07\\_01.pdf](http://www.fsa.gov.uk/pubs/discussion/dp07_01.pdf).

<sup>22</sup> For example, failing to explain clearly the benefits, risks and costs associated with a financial product, which could lead to a poor investment decision for the client.

<sup>23</sup> Firms are required to complete in the RMAR full or in part depending on the firms' permissions and business activities and on either a quarterly or bi-annual basis.

of QCF4.<sup>24</sup> The RMAR data do not indicate the status of those not fully qualified. However, it is likely that many of these are in the process of obtaining the qualification (i.e. are part-qualified). This is suggested by the FCA's authorisation data: these data show that around three per cent of advisers were part, as opposed to fully, qualified at September 2014.<sup>25</sup> This proportion of part-qualified has remained stable since June 2013 suggesting there was a concerted effort by advisers, where relevant, to update their qualifications prior to the RDR. Adviser research shows that in 2010 22 per cent of advisers did not have an appropriate RDR-level qualification (i.e. QCF4); another 29 per cent had just started studying for one.<sup>26</sup> By 2012, around 96 per cent of advisers held or were studying to hold a level 4 qualification.<sup>27</sup>

**Figure 3.1: Number and percentage of advisers holding an appropriate qualification**



Note: The minimum level of 'appropriate qualification' change at the end of 2012 from QCF3 to QCF4. The RMAR database underwent an extensive audit in 2008 and thus the figures from 2008 may not be fully comparable to figures from 2009 onwards. This may also explain, at least in large part, the significant change in the number of advisers holding an appropriate qualification between 2008 and 2009.

Source: RMAR

Part of the improvement in the proportion of advisers holding an appropriate qualification could simply reflect the exit of those advisers not willing or able to keep up with the new standards, since otherwise they would not have been able to continue to trade. Pre-RDR surveys of financial

<sup>24</sup> As the relevant RMAR field captures the number of advisers "holding an appropriate qualification" (and does not specify the type of qualification), the consistently high level shown in the figure below disguises the effort by many advisers to reach the new minimum level of QCF4 (i.e. some of the advisers holding 'an appropriate qualification' in 2008 would have held a QCF3 level qualification but not necessarily anything higher).

<sup>25</sup> Appropriate qualification is a criterion for being authorised by the FCA, therefore these data do not include statistics on advisers who are not qualified.

<sup>26</sup> RS Consulting (2011), "Research: Progress towards the Professionalism requirements of the Retail Distribution Review", December, 2011, p. 64.

<sup>27</sup> RS consulting (2012), "RDR adviser population & Professionalism research – 2012 survey".

advisers undertaken for the FCA in 2010 and in 2011 found that four and five per cent of advisers respectively did not intend to reach the new qualification level, largely due to their intention to retire as planned or earlier than planned, to leave the industry, or to stop advising on retail investment products.<sup>28</sup>

More noteworthy is the increase in the proportion of advisers going beyond the minimum standards and attaining higher qualifications. Our fieldwork indicates that many financial advisers consider higher qualification as a source of competitive advantage, and since the RDR has raised this bar, by implication it requires advisers to attain even higher levels of qualification to stay ahead of the market. This is supported by an increasing trend in the attainment of Level 6 qualifications (i.e. chartered or certified status). Figure 3.2 below shows the increase in the proportion of financial advisers holding a chartered or certified status between the end of 2012 and Q2 2014 — this increased from 14 per cent to 29 per cent in Q1 2014 before dropping slightly to 25 per cent in Q2 2014.<sup>29</sup> This relative increase would in part be due to the overall reduction in the number of advisers, with those leaving likely to be those without the higher qualifications. However, evidence of an increase in the total number of chartered financial planners indicates that the relative increase has been accompanied by an actual increase in those with higher qualification status.<sup>30 31</sup>

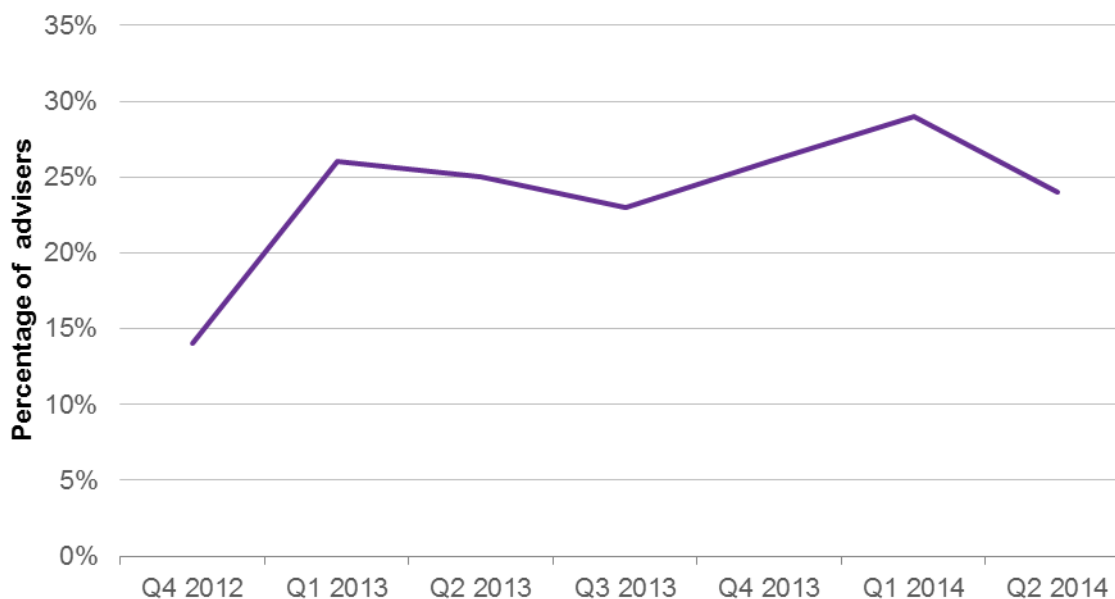
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<sup>28</sup> NMG Consulting (2010), "The cost of implementing the Retail Distribution Review professionalism policy changes" and RS Consulting (2011), "Progress towards the Professionalism requirements of the Retail Distribution Review" both cited in FCA, "RDR post-implementation review – measuring progress and impact", November 2011.

<sup>29</sup> NMG Consulting (2014), "Financial adviser census – business trends report". Also cited in APFA, "The advice market post RDR review", June 2014.

<sup>30</sup> According to the Personal Financial Society as of February 2014 there were 4,000 financial planners having chartered status compared to 1,692 in June 2009, which represent a 136 per cent increase: The Personal Financial Society, <http://www.thepfs.org/knowledge/news/articles/record-number-of-advisers-achieve-chartered-status/29071>, and <http://www.thepfs.org/knowledge/news/articles/personal-finance-society-tops-3,000-chartered-financial-planners/20376>.

<sup>31</sup> The Chartered Institute of Insurers also shows a steady increase in the number of chartered financial planners between 2007 and 2013: CII "The importance of being chartered" May 2013.

**Figure 3.2: Proportion of advisers holding a chartered or certified status**

Source: NMG Consulting (2014), "Financial adviser census – business trends report".

There is also evidence of a growth in the proportion of advisers who belong to a professional body, which is consistent with an increasingly professional industry. By 2012, around 89 per cent of advisers were members of a professional body, an increase from 77 per cent in 2011.<sup>32</sup> However, part of this increase will be due to the role that several professional bodies play as accredited bodies, from which advisers are required to obtain a Statement of Professional Standing as part of their compliance with the RDR rules.

Prior to implementation the majority of advisers were already compliant with the requirement to conduct at least 35 hours of CPD in a year. The adviser survey carried out in 2011 found that the majority of advisers were already meeting or exceeding this requirement (around 80 per cent of those respondents who provided an estimate of CPD hours).<sup>33</sup> The proportion of all advisers (including those who could not provide an estimate of their hours) meeting the requirements increased from 58 per cent in 2011 to 66 per cent in 2012, with the proportion of advisers who stated they were not meeting the requirements stipulated by the RDR was 14 per cent in 2011 and 12 per cent in 2012. However, in that and in the 2012 survey, RS Consulting reported warning signs that not all advisers felt they would be able to meet the CPD requirements after 2012.<sup>34</sup> We do not have evidence as to whether this has in fact been the case.

When considered alongside the impact of other RDR reforms, there is evidence that the RDR has contributed towards the advice industry moving to become more professional. For example,

<sup>32</sup> RS consulting (2012), "RDR adviser population & Professionalism research – 2012 survey".

<sup>33</sup> RS Consulting (2011), "Progress towards the Professionalism requirements of the Retail Distribution Review" cited in FCA, "RDR post-implementation review – measuring progress and impact", November 2011. About 74 per cent of respondents provided an estimate of CPD hours.

<sup>34</sup> The percentage of respondents who believed that they would meet the CPD requirements after 2012 was 63 per cent in 2012, compared to 66 per cent in 2011. See RS consulting (2012), "RDR adviser population & Professionalism research – 2012 survey".

research for the FCA Practitioner Panel finds that the advice industry is moving towards becoming a genuine profession.<sup>35</sup>

### 3.3 Has the RDR improved consumer trust?

There are many factors which affect levels of trust in financial advisers, for example negative or positive events in the broader financial services sector. As such, it is difficult to attribute any changes in levels of trust to RDR specifically. Trust in financial advisers amongst those who are currently advised remains high, but among the general population is much lower and has remained broadly stable post-RDR implementation. However we expect to see evidence of improved confidence and trust in the advice market in time as the effects of the RDR feed through. We present evidence for these findings here.

At present, trust in financial advisers amongst those who are currently advised remains high, and indeed our fieldwork and the FCA's third cycle of the Thematic Review finds that financial advisers believe their clients place high levels of trust in them.<sup>36</sup> This is derived from the personal and long-term nature of the adviser-client relationship. The Thematic Review found that the key benefit to consumers of receiving ongoing advice is the peace of mind that someone with expertise and awareness of the market is taking care of their investments — trusted relationships underpin this.

However, amongst the general population, trust in financial advisers is markedly lower, though it is comparable with levels of trust in other financial services firms. The 2014 Omnibus survey shows that around 36 per cent of respondents disagreed that banks and building societies, insurance providers or financial advisers were trusted to act in the best interest of their customers (see Figure 3.3).

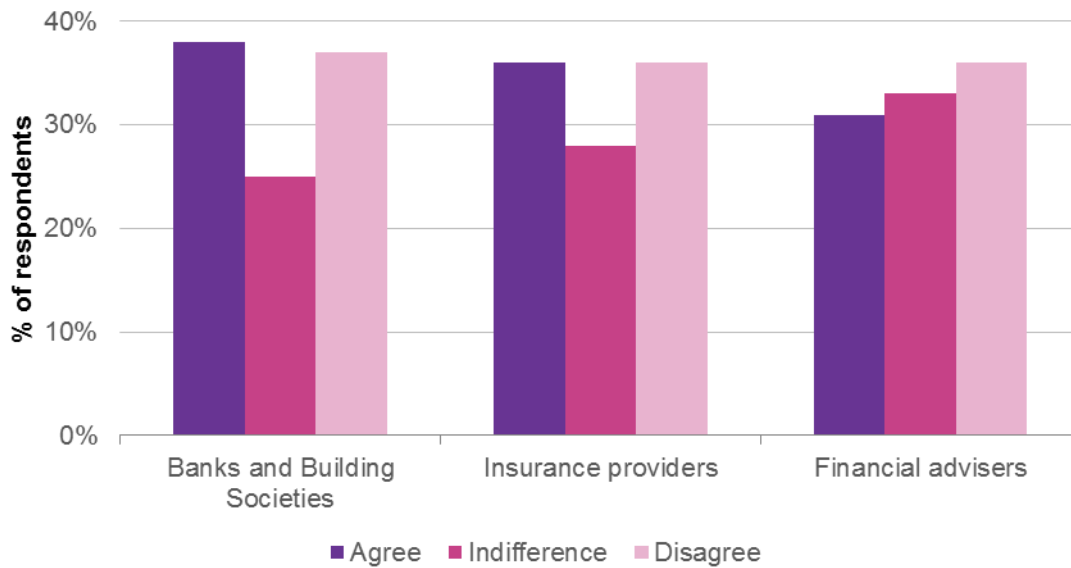
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<sup>35</sup> KPMG, 2014, "Initial impacts of RDR — research summary", industry research of senior executives undertaken on behalf of the FCA Practitioner Panel.

<sup>36</sup> FCA "Retail investment advice: Adviser charging and services", December 2014.



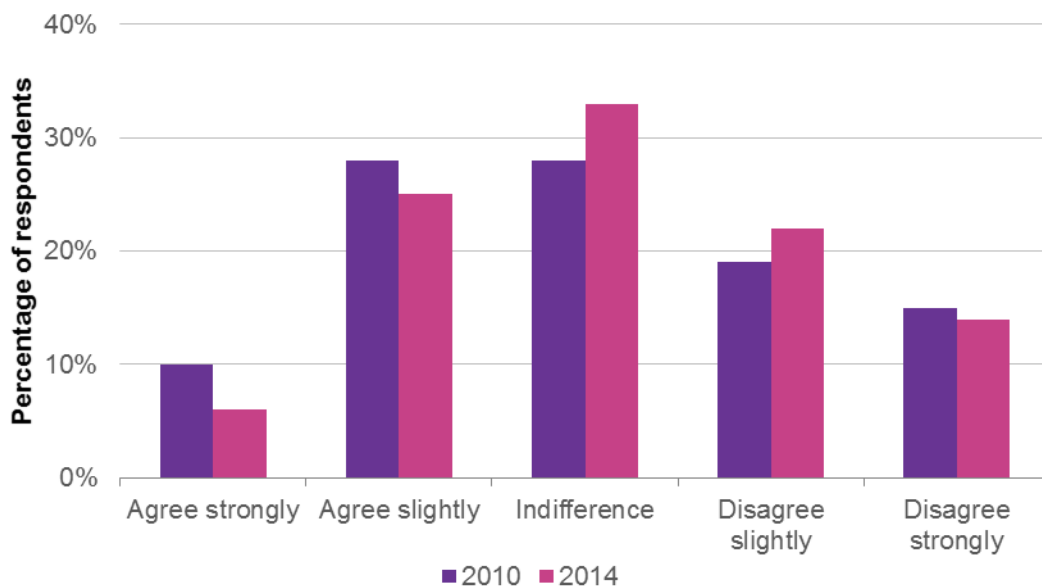
**Figure 3.3: Consumers’ trust and confidence in the retail investment industry, by firm type, 2014**



Source: Consumers’ views on the question — “To what extent do you agree or disagree with the following: ‘I trust Banks and Building Societies to act in the best interests of their customers.’, ‘Insurance providers can be trusted to provide the service I expect from them’, ‘Financial advisers make all their recommendations based on what they think is best for their clients’, Omnibus survey in 2014.

There is little observable evidence of a *change* in levels of trust and confidence amongst the general population following the RDR. The omnibus survey conducted for the FCA reveals that the proportion of respondents who disagreed either slightly or strongly that financial advisers make recommendations based on the best interests of their clients has remained broadly stable, at 34 per cent in 2010 compared to 36 per cent in 2014 (see Figure 3.4).

**Figure 3.4: Perceptions of whether financial advisers make recommendations in the client’s best interests, 2010 and 2014**



Source: Consumers views on the question — “do financial advisers make recommendations in the client’s best interest?” Omnibus surveys in 2010 and 2014.

There is also little evidence to suggest that consumers' perceptions of problems in the industry have improved since the implementation of the RDR. Although many participants in our fieldwork expressed the view that the RDR will help to improve consumers' trust and confidence in the advice market, none of them reported any notable improvement in that respect so far.

We would not expect to see evidence of improved confidence and trust in the advice market just yet (notwithstanding the difficulties in measuring something so intangible) as it is likely to take longer for the effects of the RDR to flow through into improved trust. This will be influenced by consumers' overall awareness and understanding of the changes brought about by the RDR, which at present is low.<sup>37</sup> However there are some positive signs that the effects of the RDR, such as higher levels of professionalism and the weakening of product bias — these should flow through into better consumer outcomes and confidence in due course.

For example, there has been a drop in the proportion of complaints received by the FOS relating to financial advisers, from 1.5 per cent in 2010 to 0.5 per cent in 2014.<sup>38</sup> This may suggest a potential reduction of unsuitable advice in the market after the introduction of RDR. However further investigation of the driving factors behind the decline in complaints would be needed before this could be attributed to RDR.<sup>39</sup>

We expect the improvements in professionalism to be reflected in improved consumer confidence and trust in future. Our fieldwork indicates a widespread industry belief that consumer confidence and trust will improve in time.<sup>40</sup>

### 3.4 Are consumers more engaged in the industry post-RDR?

There is no evidence directly pointing to an increase in consumer engagement after the RDR, although research on post-RDR consumer interaction finds that the RDR does not appear to have *discouraged* consumers from interacting with the retail investment market.<sup>41</sup>

This lack of evidence might in part be explained by the general lack of awareness of the changes generated by the RDR among consumers, which means there is an absence of a prompt to consumers to reconsider their views of the industry. Consumer research undertaken by the Chartered Insurance Institute (CII) found that consumer awareness of the RDR-driven changes in professionalism requirements and remuneration structures is not extensive, but has increased from around 20 per cent of advised and non-advised consumers in 2011 to around 30 per cent in 2013.<sup>42</sup>

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<sup>37</sup> The Personal Finance Society Survey on the RDR and Consumers (2014) shows that awareness of the RDR is low among consumers, particularly those not currently receiving financial advice.

<sup>38</sup> APFA, "The advice market post RDR review", June 2014.

<sup>39</sup> We also do not have access to the absolute number of complaints, and thus cannot rule out that the relative decline in complaints about financial advisers is due to increases in complaints in other sectors.

<sup>40</sup> NMG Consulting, "Assessment of ongoing services: summary of research findings for the FCA", October 2014.

<sup>41</sup> NMG Consulting, Impact of the RDR on consumer interaction with the retail investment market, September 2014.

<sup>42</sup> CII issue paper (2013), "The RDR and consumers: a research report into consumer views on the financial advice regulatory reforms".

However, there is some evidence that indirectly indicates that engagement may have increased. Data from the RMAR show that post-RDR a notable number of clients *began* paying for ongoing advice (nearly one third of the total number of clients paying for ongoing advice services), and a negligible number stopped paying for advice over the same period. This transition from previously not explicitly paying for a service to now doing speaks to increased consumer engagement. Levels of savings and investment have also largely increased, suggesting a possible increase in the engagement in the market.

Overall, although there are indirect indications that consumer engagement may have increased, more information post-RDR is needed to distinguish these changes from secular market trends and to draw conclusions on the impact of the RDR on engagement.

### 3.5 Summary

Overall, the RDR has initiated a move towards increased professionalism among advisers. One indicator of this is the vast majority of advisers now being fully qualified to QCF Level 4 compared to Level 3 pre-RDR, with an increasing number attaining an even higher qualification level, i.e. chartered status, in the hope of gaining a competitive advantage. In addition, membership of professional bodies has increased. The undertaking of CPD has been increasing since before the RDR and in 2012 the majority of advisers were meeting the set requirements, however more recent evidence is not available to ascertain whether this trend has continued or changed post-RDR. Although higher professional qualification does not automatically translate into improved conduct, higher levels of qualifications and skills can be expected to improve the quality of advised services.

Another indicator is the increased focus by advisers on the provision of more holistic, ongoing advice services. These are all signs of increasing professionalism in the industry, although more time will be needed before these improvements could be expected to translate into better consumer outcomes or observable improvements in consumers' confidence and trust in the financial advice industry more generally.

There is no direct evidence that consumer engagement has increased post-RDR. However there is some indirect evidence which provides tentative indications that it has improved — overall levels of investment have increased (although this is not attributable to the RDR), and post-RDR a notable number of clients began paying for ongoing advice (nearly one third of the total number of clients paying for ongoing advice services), and a negligible number stopped paying for advice over the same period.

# 4 Clarity of Service and Consumer Understanding

## 4.1 Introduction

An objective of the RDR is to create *an industry that engages with consumers in a way that delivers more clarity on products and services.*

Prior to the RDR, there were concerns about the transparency of the type of financial advice services and charging structure offered to consumers. Consumers who have little investment experience tend to have limited understanding of the scope of services available to them, e.g. if financial advice is independent or restricted. As a result, these consumers can make poor choices about the type of advice service they purchase which could lead to sub-optimal investment decisions.

To improve the clarity around products and services available to consumers, the FCA introduced mandatory disclosure requirements as part of the RDR in December 2012. Specifically, advisers are required to disclose their services as being either independent or restricted. Independent advisers are also required to cover the full range of retail investment products. Restricted advisers need to disclose the nature of their restriction. Advisers are also required to establish a charging structure that reflects the need of their clients and provide the information on charging to clients in a clear and upfront manner through appropriate adviser charges disclosure.

The aim of these requirements is to increase the clarity around services and charges and enable consumers to make better decisions, including the ability to compare services and prices across advisers. This in turn is intended to help lead to better consumer outcomes, and to increase consumers' engagement in the market.

## 4.2 Has clarity of charges increased?

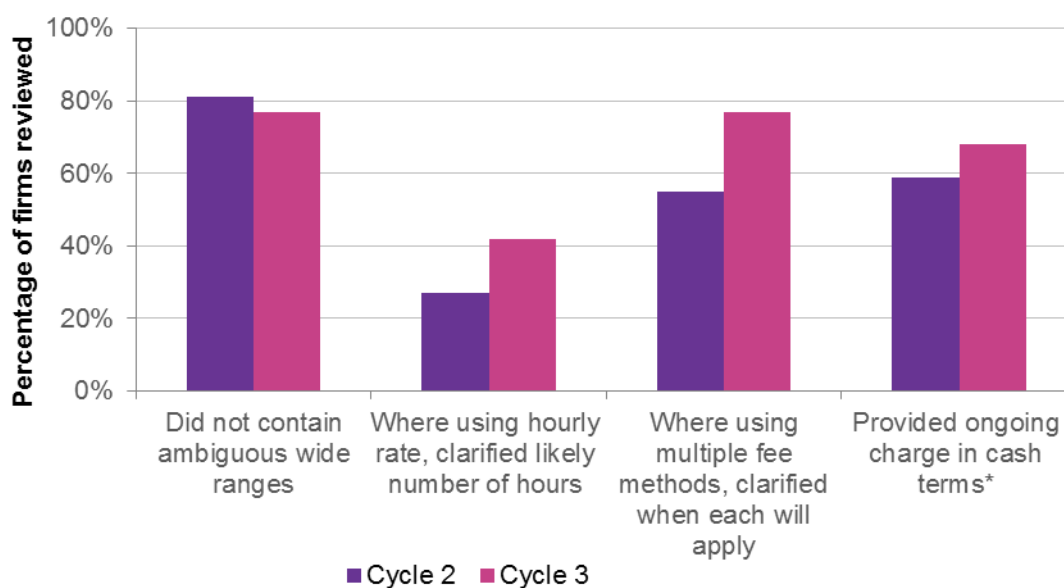
The disclosure of information provided to consumers by firms in relation to adviser charging post-RDR has notably improved, although, with a small proportion of firms still failing to explain aspects of their charges, there remains scope for further improvement. There is still confusion among some consumers regarding adviser charging and limitations in understanding of how, and how much, they are paying for advice. Although some of these consumers' understanding may increase as firms' clarity around disclosures continues to improve, the heterogeneity of charging structures (as described in more detail below) and the search costs incurred by consumers in obtaining price information is likely to continue to complicate price comparison between advisers and may act as a limiting factor on consumer engagement.

Firms are making progress in providing consumers with clarity as to the costs of advice, although there is still room for improvement. In its first cycle of the Thematic Review on adviser charging in

2013, the FCA found that firms had made much progress in implementing the RDR adviser charging disclosure requirements, with many firms providing clear and timely information on adviser charges.<sup>43</sup> However, the FCA also identified a number of issues related to non-disclosure and poor quality of information. For instance, some firms failed to provide charges in monetary terms or, when hourly rates were used, an estimation of the likely overall cost of services provided to clients.

The recent third cycle of the Thematic Review (December 2014) shows a material improvement by firms in clearly disclosing to clients the cost of their advice.<sup>44</sup> Issues around disclosure do remain – around 32 per cent of firms covered in the review did not disclose total adviser charges for their ongoing services in cash terms relevant to the individual client, and around 20 per cent use wide ranges in their generic disclosure which can make it difficult for the client to be clear about the likely cost. Just under 60 per cent of firms using hourly rates did not clarify the approximate number of hours the service was likely to require. The figure below presents the results for a selection of metrics from the second and third cycles of the Thematic Review, illustrating areas for further improvement.

**Figure 4.1: Thematic Review findings on the disclosure of adviser charges**



Note: \* relates to specific disclosure of total adviser charge, as opposed to generic disclosure of adviser charge.

Source: FCA, "Supervising retail investment advice: how firms are implementing the RDR", July 2013 and FCA "Retail investment advice: Adviser charging and services", December 2014.

Consumer research also suggests that there remains some confusion around adviser charges. For example, a survey investigating how consumers who purchased retail investment products post-RDR had paid for their advice found that more than a quarter of advised consumers claimed that their adviser received a commission when, assuming firms were compliant, this would not have

<sup>43</sup> FCA, "Supervising retail investment advice: how firms are implementing the RDR", July 2013.

<sup>44</sup> FCA "Retail investment advice: Adviser charging and services", December 2014.

been the case. Other advised consumers claimed not to have paid any fee for the advice.<sup>45</sup> Our fieldwork indicates that many advisers use a charging structure based on a percentage of investment — and which is contingent on the investment being made — which may drive some of this confusion, as the end result to consumers is likely to appear very similar to a commission structure.

The adviser charges introduced as a result of the RDR can be heterogeneous, which could make comparison across advisers difficult. There is a wide range of charging models used (e.g. hourly fee, fixed fee, and per cent of funds invested). RMAR returns data show that while the majority of advisers opt to charge based upon a percentage of funds invested (between 80 and 90 per cent of firms, depending on size), some still offer a charge based upon an hourly fee, or a mixture of the two. While offering choice, this may increase the complexity of making comparisons across different advisers (although many advisers appear to charge as a percentage and also provide the equivalent hourly/total fee to help consumers). The percentages of assets under advice charged, particularly as initial fees, often have a stepped structure — i.e. lower percentages are applied where the investment (or portfolio) is larger. This may mean that as the size of investment increases, a point may come where one adviser becomes cheaper than another; different charging structures may make it less clear when an investor is better off, at least in pecuniary terms, switching adviser. The way in which charging information is made available may also increase search costs for consumers and further limit comparisons — anecdotal evidence suggests firms do not always display charging information online, requiring firms to engage directly in order to gain information.

This heterogeneity of charging structures and the existence of consumer search costs is likely to continue to complicate effective price comparison of different advisers by consumers, even with resolution of the issues around the clarity of charging found by the FCA's Thematic Reviews.<sup>46</sup> Research undertaken by KPMG for the FCA Practitioner Panel found that the mix of ad valorem and fixed fees, transaction and administration charges and account fees adds complexity for consumers, and so impedes consumer understanding.<sup>47</sup> As we note in section 5.2 price is only one dimension by which consumers select advisers, with reputation and trust being more important: in other words, further enhancing clarity is likely to lead only to marginal improvements in such price comparison and in driving competition. On the other hand, an increased range of options is positive, provided it does not create consumer confusion.

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<sup>45</sup> NMG Consulting, "Impact of the RDR on consumer interaction with the retail investment market", September 2014. Consumers in the sample were those who had made a purchase after January 2013. The report states that, assuming firms are compliant, neither of these statements can be accurate, if the consumers in question did in fact receive regulated advice. It is possible that either that they did not receive regulated financial advice but believe that they did, or that they received advice but did not appreciate that they were directly paying for this advice.

<sup>46</sup> KPMG, 2014, "Initial impacts of RDR — research summary", on behalf of the FCA Practitioner Panel.

<sup>47</sup> KPMG, 2014, "Initial impacts of RDR — research summary", on behalf of the FCA Practitioner Panel.

### 4.3 Has clarity of service increased?

The disclosure of information by firms to consumers in relation to the nature of advice they offer has improved with the majority of firms compliant with the requirements to clearly disclose whether they provide independent or restricted advice, although issues remain in relation to disclosing the scope of restricted advice. However, NMG consumer research and FCA analysis shows that a significant proportion of consumers still do not fully understand the difference between restricted and independent advice, with a tendency to assume advice is independent unless clearly stated otherwise.

The majority of firms are now providing consumers with clarity as to the nature of advice they offer, although there remains room for improvement. The first stage of FCA's Thematic Review in 2013 found that most of the firms were compliant with the disclosure requirement on the type of their services as either independent or restricted. However, the FCA raised concerns on the validity and clarity of some disclosure practices in its Thematic Review.<sup>48</sup> Some firms, despite describing themselves as independent, might have not provided fully independent advice in practice.

Effective disclosure of restricted status remained an issue in the second cycle of the FCA's Thematic Review which found that around 31 per cent of firms failed to fully comply with the requirement.<sup>49</sup> While 19 per cent of firms did not use the word "restricted" when describing their services, 23 per cent were unable to provide clear and succinct information on the nature of their restrictions. However, the third cycle of the Thematic Review shows that there was a significant improvement in the compliance with disclosure requirements, with all restricted firms using the word "restricted" when describing their services and only 11 per cent of restricted firms not explaining clearly the nature of the restriction.<sup>50</sup> We present the findings from the second and third cycles of the Thematic Review below.

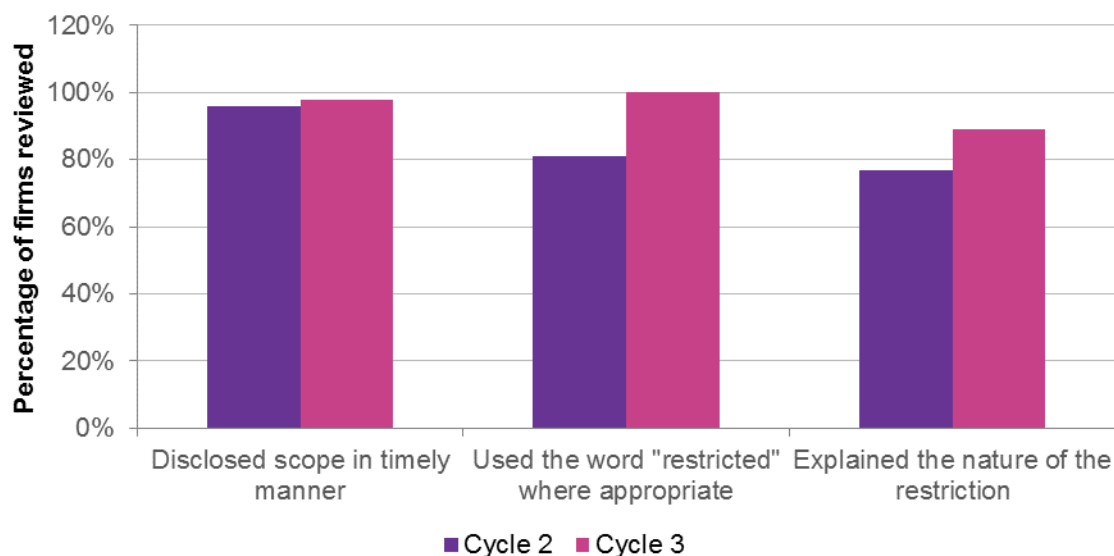
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<sup>48</sup> FCA, "Supervising retail investment advice: how firms are implementing the RDR", July 2013 and FCA "Retail investment advice: Adviser charging and services", December 2014.

<sup>49</sup> FCA, "Supervising retail investment advice: how firms are implementing the RDR", April 2014.

<sup>50</sup> FCA, "Retail investment advice: Adviser charging and services", December 2014.



**Figure 4.2: Thematic Review findings on the disclosure of type of service**

Source: FCA, "Supervising retail investment advice: how firms are implementing the RDR", July 2013 and FCA "Retail investment advice: Adviser charging and services", December 2014.

Consumer research indicates that differences between independent and restricted advice are still complex and confusing for consumers. Pre-RDR, consumers were found to have considerable confusion over the type of services being offered to them.<sup>51</sup> According to the Consumer Purchasing Outcomes survey in 2010, around 40 per cent of respondents indicated a lack of understanding of the type of services provided by their advisers.<sup>52</sup> More recent NMG Consulting research indicates that it is still complex for consumers to fully understand the type of services (independence or restricted) that are available and offered by an adviser since the scope of restricted services can be very wide ranging and vary across advisers.<sup>53</sup> The research found that consumers may lack an understanding of the scope of restricted services, and by implication the nature of the services they can expect to receive.

Consumers often assume that the advice that they received is independent unless they are told explicitly otherwise. This is supported by FCA evidence mapping consumers' perceptions of the type of advice they received (independent / restricted) with the firms' advice status. Consumers' accuracy in correctly identifying the type of advice provided was significantly higher for independent firms than for restricted firms, implying a tendency among consumers to assume that advice is independent even when it is not (although a notable minority of consumers (35 per cent) did correctly identify the advice they received as restricted). If consumers do not understand the differences between restricted and independent advice they may not make the correct choices (e.g. they may not appreciate the (potentially) higher cost of independent advice if they do not understand what this will provide them with, and thus may avoid taking independent advice). In particular, we note that KPMG research undertaken for the FCA Practitioner Panel finds that

<sup>51</sup> FSA (2011), "RDR post-implementation review – measuring progress and impact".

<sup>52</sup> FSA (2011), "Consumer purchasing and outcomes survey 2010", May 2011.

<sup>53</sup> NMG Consulting, "Adviser charging and scope of service – qualitative research to investigate consumer understanding of adviser disclosure documents", 2013.

disclosure about the services offered by advisers has not brought greater clarity to the majority of consumers of average or low capability, with the meaning and materiality of the regulatory definitions of independence and restricted unclear to consumers.<sup>54</sup>

#### 4.4 Impacts on consumer behaviour

The impact of price and service transparency on consumer behaviour must be considered in light of the nature of advice services. These are generally characterised by long-term relationships in which the treatment of the consumer is valued by the consumer more highly than prices or outcomes (e.g. improved investment returns). This may in part reflect the fact that retail investments and the associated advice in particular are credence goods, where the judgement of quality is extremely difficult.

Research for the latest FCA Thematic Review shows that, while competence is an important factor, a consumer's decision to use a financial adviser depends heavily on the rapport felt with that adviser.<sup>55</sup> This will often 'solidify' over time, deepening the understanding and generating meaningful consumer loyalty. The research finds that the impact of trust is such that, even when faced with the possibility of making marginal gains, consumers will resist switching to another adviser. Trust is particularly evident in long-standing relationships where consumers will tend to overlook minor losses (generally ascribed to market unpredictability) and maintain the relationship. The research also found that gaining awareness of charges in the post-RDR landscape would generally *not* lead to consumers terminating the adviser relationship due to the value they place on the service. The majority of respondents who were unaware that they were paying for ongoing services, or were unclear on the exact amount, believed that they would be likely to continue to pay for these services going forward. This suggests that switching or shopping around among consumers would not increase significantly, even in the event of full compliance with transparency and disclosure requirements.

#### 4.5 Summary

Firms have made notable progress in implementing the RDR requirements around the disclosure of information by firms on adviser charging and the nature of advice offered, with material improvements observed between the implementation of the rules and the latest FCA review. Issues still remain in relation to both charging and type of service so there are still further improvements to be made. However many consumers are still confused as to the charges they are paying for advice and do not understand the differences between independent and restricted advice. Consumers' understanding may improve as firms' clarity around disclosures continues to increase. However the heterogeneity of charging structures and the manner with which this information is communicated may increase search costs and limit the extent to which consumers engage.

The implication of this is that consumers are less likely to be able to shop around effectively for an adviser and in doing so drive effective competition between advisers. For example, consumers may

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<sup>54</sup> KPMG, 2014, "Initial impacts of RDR — research summary" on behalf of the FCA Practitioner Panel.

<sup>55</sup> NMG Consulting (2014), "Assessment of ongoing services: summary of research findings for the FCA", October 2014.

not experience a clear choice of advice reflecting efficient cost, i.e. they may not appreciate the (potentially) higher cost of independent advice if they do not understand what this will provide them with. A lack of appreciation by consumers for the services provided by independent advisers may undermine the incentives of these advisers to improve the quality of their advice, or else increase the attraction of the restricted model to them.

# 5 The Advice Market

## 5.1 Introduction

Three of the RDR objectives were focused on improving the market for retail investment advice. These were to create *a market which allows more consumers to have their needs and wants addressed*, to introduce *remuneration arrangements that allow competitive forces to work in favour of consumers*, and to implement a *regulatory framework that can support delivery of all the RDR's aspirations and does not inhibit future innovation where this benefits consumers*.

This chapter assesses progress on these three objectives focusing particularly on the market for advice. The next chapter extends the analysis by looking at impacts in the wider retail investment market.

The RDR aimed to improve the market for advice by addressing a number of issues that were present prior to it:

- The payment of commissions from product providers to advisers distorted advisers' incentives to recommend products which paid the highest commissions rather than those that were in the best interests of consumers.
- The payment of commissions also meant that there was little transparency on the different elements of charges associated with investment, such as product, platform and adviser remuneration. This limited the ability of consumers to compare prices across the different elements of the supply chain.
- The remuneration structures also increased the likelihood of cross-subsidisation between advisers' clients. The true costs of advice were not visible to consumers and in some cases to the firms themselves.

In order to correct these problems and to create a more competitive and efficient market, the following provisions were introduced:

- Ban on commission payments from providers to advisers for advice given on retail investment products, introduced in December 2012.
- Ban on payments by providers to platforms and cash rebates by product providers to consumers who use platforms, from April 2014 for new business.
- Requirements for advisers to establish a charging structure for advisory services to consumers and disclose the relevant information on charges in a clear and upfront manner, introduced in December 2012.

These provisions aimed to increase transparency of prices and enable competition at each level of the supply chain (among advisers, platforms and product providers). With the removal of commission from providers and greater clarity of adviser charging, the provisions intended to create a more efficient market where the true cost of advice is revealed to consumers and firms, and where a choice of advice is available at a price reflecting efficient cost to those who would

benefit from it. Improved consumer outcomes were anticipated to arise from the removal of distorted incentives among advisers.

## 5.2 Demand for investment advice

Consumers have different needs and preferences for advice. Though some (self-directed) consumers prefer to select investments for themselves, as the overall level of their investment portfolios grows consumers increasingly tend to prefer to get advice (i.e. a consumer with a large portfolio will be more likely to seek advice than an otherwise identical consumer with a smaller portfolio). Nevertheless consumers' demand for investment advice has been falling over recent years, a trend which began long before RDR implementation and is correlated with the growth of alternative methods of investing, such as D2C platforms. However there is little evidence that explicit adviser charging introduced by the RDR has led to significant numbers of consumers no longer being willing to pay for advice.

When choosing an adviser consumers value quality indicators such as trust and reputation over cost. There is some evidence that consumers are driving firms to compete on quality of advice, with some firms increasingly using levels of professionalism as a source of competitive advantage. However, with relatively low levels of understanding amongst consumers in relation to adviser charging, there is little evidence consumers are driving firms to compete on the cost of advice. In addition, advice can be seen as a credence good, with its fundamental quality difficult for the consumer to assess *ex ante* — or even *ex post*. This means that there is scope for advisers to compete on measures which consumers believe are good proxies for quality, but which may not in fact be reliable indications of underlying quality.

### 5.2.1 Consumer needs and preferences for investment advice

Consumers' need for investment advice depends on the amount they have to invest and their circumstances and preferences. Some consumers may have investible assets but are not engaged with the investment market due to a lack of awareness or interest.

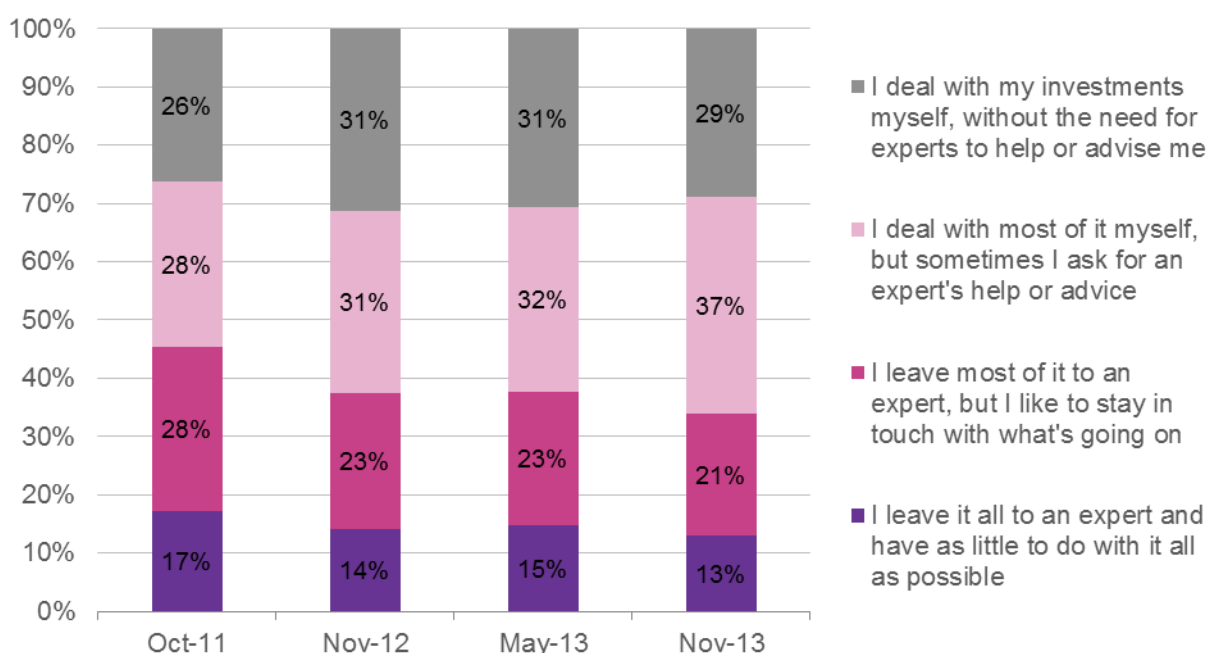
Consumers who are engaged with the retail investment market have different preferences which affect their demand for investment advice and how they would want to access that advice. In this respect, we identify two archetypes:

- Self-directed consumers are those who are able to (or think they are able to) research and decide on suitable products themselves. Some consumers will be entirely self-directed. Others may research products themselves and seek out advice only when necessary, for example at key life events like retirement (even if only for reassurance value).
- Other less confident or more time-poor consumers would tend to use expert help, especially when it is perceived to be freely provided or is easily accessible. They are likely to have a preference for face-to-face advice and once they form a trusted relationship with an adviser have a strong preference for remaining with that adviser. The advice market (in particular the face-to-face adviser relationship currently offered by most financial advisers) has traditionally been more successful in serving wealthier consumers — the revelation of the true costs of advice to consumers is likely to embed this. Some consumers may leave looking after their

investments entirely up to their advisers and wealth managers whilst others may keep themselves updated from time to time.<sup>56</sup>

According to Platum, a significant proportion of those consumers with risk-based investments are entirely self-directed (29 per cent in November 2013), with those who do the majority of research themselves, seeking out advice only where necessary, increasing to form the largest group (from 28 per cent in October 2011 to 37 per cent in November 2013).<sup>57</sup> The figure below shows a decreasing share of consumers who leave most of their investment to an expert.

**Figure 5.1: Consumers' attitudes to investment and advice**



Source: Platum (2014).

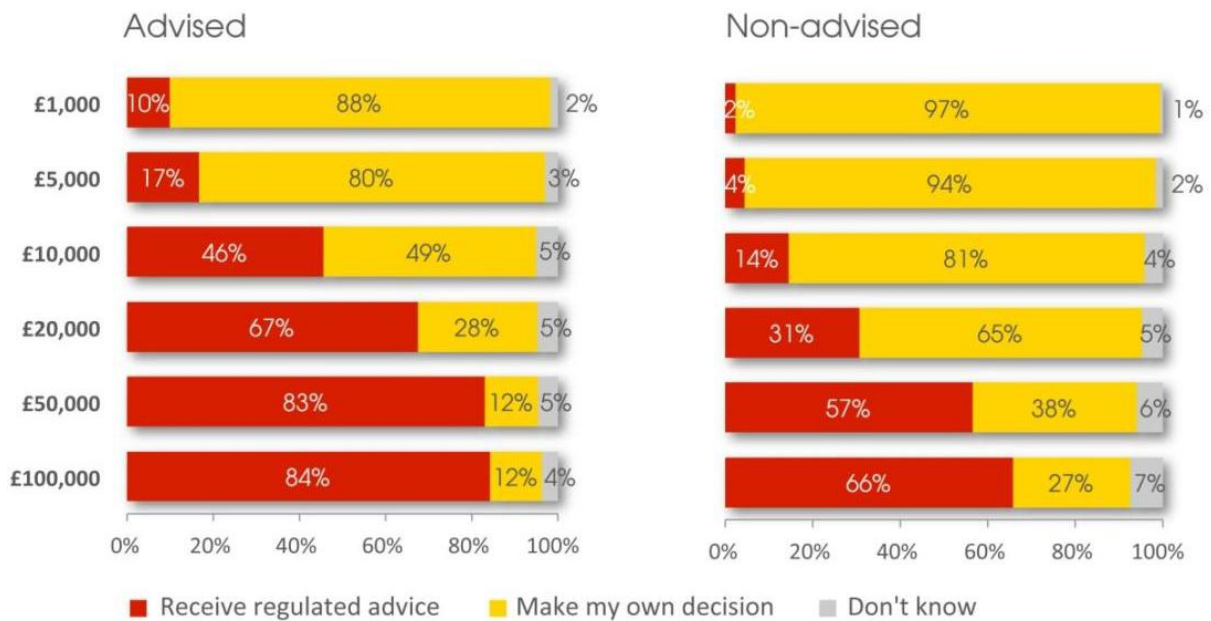
Similarly, in their survey of consumers with £5,000 or more in invested assets, NMG Consulting conclude that consumers are not wedded to a particular distribution channel (advised or non-advised) but elect to use different channels depending on their circumstances, amount to invest and complexity of requirements at that point in time.<sup>58</sup> As shown in the figure below, the NMG Consulting survey suggests that £20,000 is the key point at which more advised consumers expect to turn to an adviser for another investment. While at £50,000 the majority of both advised and non-advised consumers would opt for advice over making a decision on their own.

<sup>56</sup> We provide an extended discussion of the interaction between such broad consumer categories and different distribution models in the insurance market at <http://www.ania.it/it/pubblicazioni/?c=pubblicazioni%2Fmonografie-interventi-position-paper%2FDistribuzione%2F&l=it>.

<sup>57</sup> Platum (2014), "Guide to Direct Platforms and Investors: A Market Turned on its Head".

<sup>58</sup> NMG Consulting, "Impact of the RDR on consumer interaction with the retail investment market: A quantitative research report", September 2014.

**Figure 5.2: Expected channels for future investment, by size of investment**



Base: Those who received regulated financial advice when completing their most recent investment activity (730 unweighted)

Base: Those who completed their most recent investment activity without regulated financial advice (810 unweighted)

Source: NMG Consulting, Impact of the RDR on consumer interaction with the retail investment market, September 2014.

Likewise, research from Deloitte in 2012,<sup>59</sup> also shows that then consumers were only more likely to use an IFA<sup>60</sup> than alternative channels for purchasing savings/investment products if they were investing more than £50,000. For amounts of less than £50,000 they were instead more likely to purchase savings or investment products from an alternative source, such as a bank or website/internet platform.

<sup>59</sup> Deloitte (2012), "Bridging the advice gap".

<sup>60</sup> It is not clear if Deloitte define an IFA strictly as an independent adviser, or whether it is intended as a catch-all badge for all advisers.

**Table 5.1: Deloitte's analysis of channel selection by customer segment (2012)**

Customer segment/cash savings level		Bank	IFA	Website/ Internet platform
<b>Affluent</b>	Wealth rich' £100k+ cash savings	23%	32%	14%
	Wealthy aspiring' £50k-£100k cash savings	21%	26%	22%
<b>Mass affluent</b>	Wealth modest' £30k-£50k cash savings	21%	19%	24%
	Wealth poor' £10k-£30k cash savings	28%	18%	15%
<b>Mass market</b>	£5k-£10k cash savings	12%	10%	14%
	Up to £5k cash savings	15%	11%	10%
<b>Average</b>		17%	13%	11%

Source: Deloitte 2012. Deloitte does not provide further breakdowns: e.g. 'IFA' may include both advisers who are truly independent as well as 'restricted' models. Deloitte also does not specify that banks are retail banks (as opposed to private banks), but the description in the report implies it is retail banks being considered.

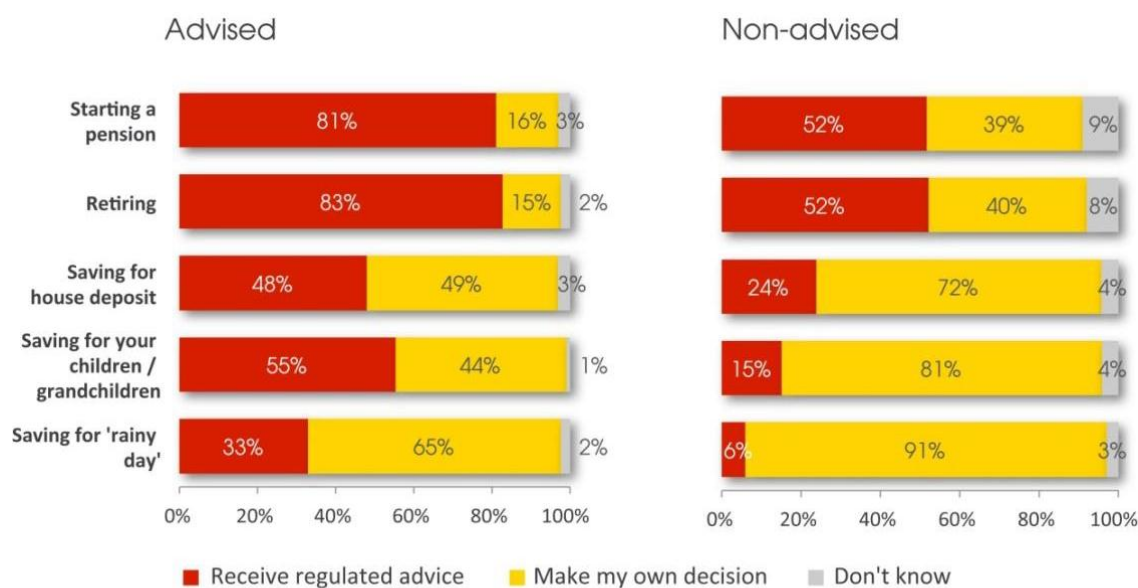
The Deloitte research also shows that on average 13 per cent of adults who have purchased a savings or investment product went through an IFA, but this proportion rises to 26 per cent and 32 per cent for the two higher wealth segments (above £50,000 and £100,000) respectively.<sup>61</sup>

The NMG Consulting survey also highlights that complexity and having a clear purpose of the investment matters for consumers in their expected future preferences for advised versus non-advised channels, with consumers considering more complex, retirement products more likely to express an intention to access advice, while those simply 'saving for a rainy day' expect to be content to go non-advised.

<sup>61</sup> Mintel (2014) "Consumers and Financial Advice", UK, April 2014, p. 46.



**Figure 5.3: Expected channels for future investment, by purpose of investment**



Base: Those who said each purpose may be relevant to them (varies for each, always >125)

Source: NMG Consulting, Impact of the RDR on consumer interaction with the retail investment market, September 2014

This all suggests that while some consumers are content to self-direct for some investments, as investment amounts grow consumers are more likely to look for advice. In particular, when they have £20,000 or more to invest they appear to prefer advice and they tend to prefer full, holistic-type advice with about £50,000 or more to invest. And, as complexity of the investment grows and it has a clear purpose, they are more likely to go advised.

### 5.2.2 How has consumers' demand for investment advice changed post-RDR?

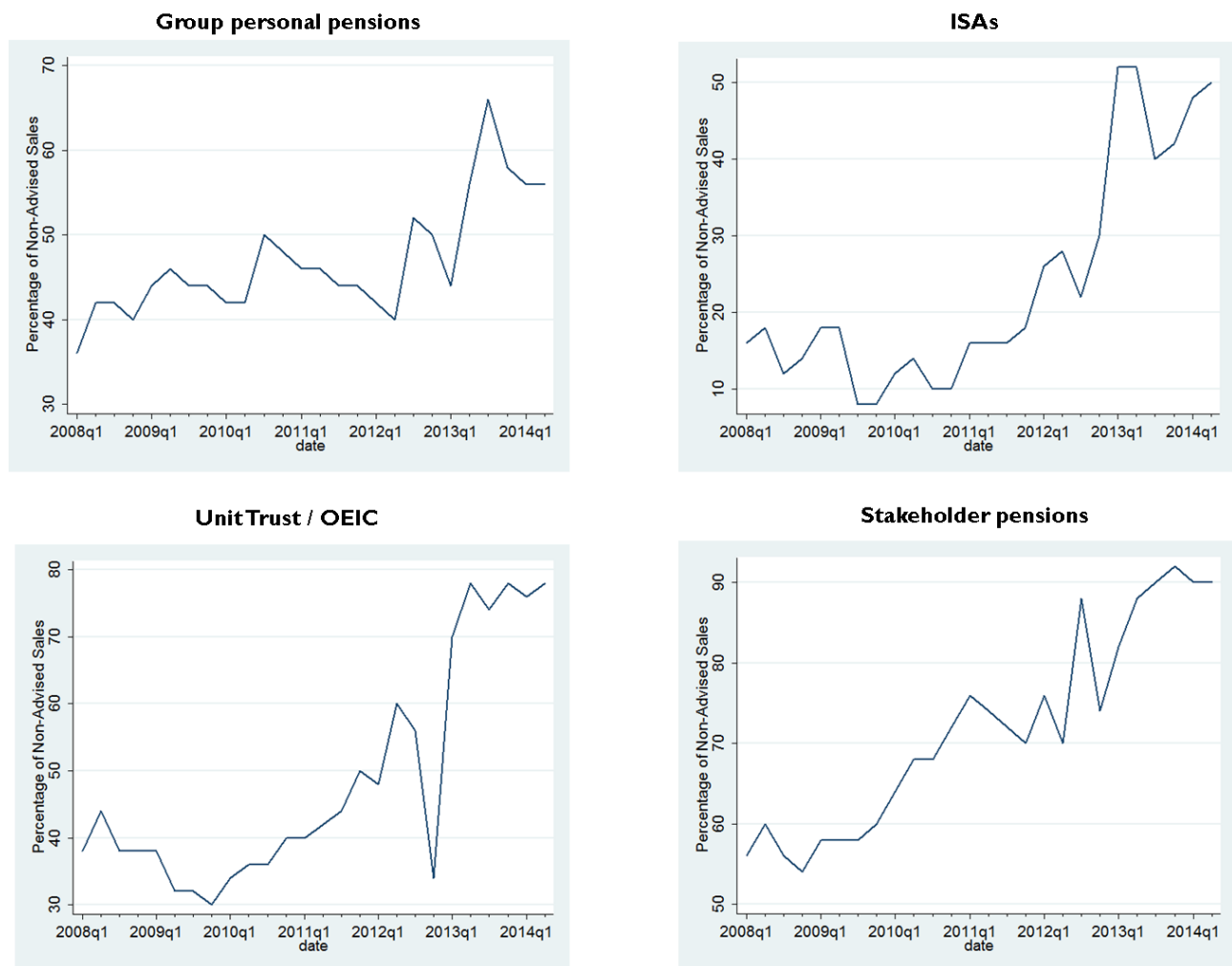
Consumers' demand for investment advice has been falling over recent years, a trend which began before the RDR's implementation. For example, FCA data show that the proportion of the population who have sought advice across products (including investments) declined from 25 per cent in 2008 to 13 per cent in 2012.<sup>62</sup> Product sales data also show an increasing proportion of non-advised sales, as seen in the figure below.<sup>63</sup> These trends may also be driven by changes in the supply of advice, as discussed in the following sections.

The trend of declining demand for advice has led to a fall in the volume of advised sales. Instead, consumers are increasingly buying products on a non-advised basis, using technology such as platforms.

<sup>62</sup> FSA "Consumer awareness of the FSA and financial regulation' reports from 2009 – 2012".

<sup>63</sup> The PSD does not include platform sales, but the relative trends towards non-advised sales should still hold.

**Figure 5.4: Relative increase in number of non-advised sales**



Source: PSD 2014.

Research by Mintel suggests consumers have become more confident at directing their own financial affairs. Mintel found that 74 per cent thought that it is better to research financial products before considering financial advice, and 44 per cent thought that it is actually better to make the investment decisions without obtaining professional advice.<sup>64</sup> Given this, many consumers who would previously have paid for full regulated advice are increasingly turning to alternatives such as investing on a non-advised basis, e.g. via platforms. Consistent with this has also been growth in consumers investing themselves through platforms as set out in section 2.3.<sup>65</sup> Mintel research also points to an increase in the number of financial decisions made without professional support.<sup>66</sup>

As we discuss below, there appears to be little evidence that explicit adviser charging has led to significant numbers of consumers no longer being willing to pay for advice.

<sup>64</sup> Mintel (2014), "Consumers and Financial Advice", UK April 2014, p. 16.

<sup>65</sup> Platform (2014), "Guide to direct platforms and investors: A market turned on its head".

<sup>66</sup> Mintel (2014), "Consumers and Financial Advice", UK, April 2014, p. 16.

### Explicit adviser charging

Prior to the RDR, many consumers believed the investment advice they received was 'free', with little transparency as to the costs they were in fact incurring for products, platforms and advice, or how these costs were being paid. Research by Deloitte found that 87 per cent of customers who purchased a savings/investment product via (in this particular case) a bank adviser in the three years prior to May 2012 assumed the advice was 'free', with the provider incurring the cost.<sup>67</sup> The changes introduced as part of the RDR mean that charges for investment advice must now be set out explicitly and clearly disclosed to consumers.

In their research commissioned for this review, NMG Consulting concluded that the implementation of the RDR has not deterred a significant proportion of consumers from seeking advice.<sup>68</sup> Of those who received advice prior to the RDR, 14 per cent had shifted to a non-advised channel post-RDR. When the reasons behind this were explored, 42 per cent stated that the reason for choosing to make their own decision was that the activity, product or investment value did not justify receiving advice. When the reasons for all consumers investing on a non-advised basis were explored (including those who invested on a non-advised basis pre-RDR) only seven per cent of these cited advice not being value for money as a reason.<sup>69</sup> This means that, now consumers are in a position to judge the value of the advice received, this is not in itself significant in driving those consumers away from advisers.

NMG Consulting also considered whether consumers had chosen to no longer invest as a result of the RDR's implementation. NMG Consulting concluded that although a considerable proportion of respondents had not completed any investment activity since the RDR was implemented (40 per cent), this was more likely to reflect them not having any investment needs rather than a direct result of RDR.

The lack of an effect of adviser charging may appear surprising. For example, an experiment by Decision Technology found that a significant minority of people may be averse to paying an upfront fee for advice. Between 20 and 30 per cent of the online subjects displayed evidence of "narrow framing" and loss aversion making them excessively averse to paying for advice which is not contingent on investment.<sup>70</sup> However, when one considers that the majority of advisory firms have been adopting charging structures with contingent fees as a percentage of investments rather than upfront lump-sum fees, as discussed below, it is less surprising that consumers could be less sensitive to the switch to explicit adviser charging. Also, our fieldwork did not highlight any concern among advisers of customers being unwilling to continue receiving advice due to cost.

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<sup>67</sup> Deloitte (2012), "Bridging the advice gap".

<sup>68</sup> NMG Consulting (2014), "Impact of the Retail Distribution Review on consumer interaction with the retail investment market", September 2014.

<sup>69</sup> The majority of non-advised investors in the sample did not take advice as they did not consider it worthwhile/justified for a number of reasons other than cost. Mintel consumer research found that 50 per cent of customers would prefer to pay for advice only when they need it rather than on an ongoing basis (with only 12 per cent disagreeing with the statement).

<sup>70</sup> Decision Technology (2010), "Consumer decision-making in retail investment services: a behavioural economics perspective".

### 5.2.3 Are consumers driving effective competition between advisers?

Effective competition between advisers relies on a sufficient number of consumers shopping around between advisers and choosing the adviser which they feel best satisfies their needs. In order to be able to do this, consumers need access to information about both the cost and quality of advice offered.

There is evidence that other features are more important to consumers in choosing an adviser than the cost of advice. One survey found that when consumers were asked which qualities were important to them when choosing a financial adviser, trust was rated the most important followed by reputation, with cost third.<sup>71</sup>

There is some, albeit indirect, evidence that consumers may be driving advisers to compete on quality. Consumers are likely to find quality difficult to judge and instead use simple indicators such as professional qualifications which are unlikely to provide accurate quality measures. As set out in chapter 3, our fieldwork indicates that a number of financial advisers consider higher qualification as a source of competitive advantage, and since the RDR has raised this bar, by implication it requires advisers to attain even higher levels of qualification to stay ahead of the market. This is supported by an increasing trend in the attainment of Level 6 qualifications (i.e. chartered or certified status). A cautionary note here is that advice can be seen as a credence good, with its fundamental quality difficult for the consumer to assess *ex ante* — or even *ex post*. This means that there is scope for advisers to compete on measures which consumers believe are good proxies for quality — but which may not be reliable indications of advice's underlying quality.

In any event there is little evidence that consumers are driving effective competition on cost. As set out in chapter 4, there is still confusion among some consumers regarding adviser charging and limitations in understanding of how and how much they are paying for advice. This is limiting the extent to which consumers are able to place a competitive constraint on the cost of advice charges by advisers.

In addition, the impact of price and service transparency on consumer behaviour must be considered in light of the nature of the advice service. These are generally characterised by long-term relationships in which the treatment of the consumer is valued by the consumer more highly than prices or outcomes (e.g. improved returns on an investment portfolio). As above, this may in part reflect the fact that retail investments and the associated advice in particular are credence goods.

## 5.3 Changes in the supply of advice

The ban on commission has led the majority of firms to fundamentally consider their business model and, where necessary, make key changes. Firms are increasingly segmenting their customers and considering the service they provide to different groups of consumers, with some focusing on services to those with higher levels of investible assets. Some firms have also moved to increase ongoing charges, in part coincidental with the provision of more extensive ongoing

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<sup>71</sup> Morningstar (2014) "What's Stopping Investors Taking Financial Advice?" 13 May 2013 <http://www.morningstar.co.uk/uk/news/124417/whats-stopping-investors-taking-financial-advice.aspx>.

service offerings. Lastly firms are trying to become more operationally efficient, for example through their increased use of B2B platforms or of paraplanners. Notwithstanding these changes there is little evidence that the availability of advice has reduced significantly, with the majority of advisers still willing and able to take on more clients.

### 5.3.1 Business models

One of the most important changes resulting from the RDR was the ban on commission payments from providers to advisers for advice given on retail investment products. This key change to adviser remuneration, along with other important changes, such as the need for advisers to either be 'independent' or 'restricted', and the need to raise professionalism standards, drove a more general examination of business models in preparation for the RDR.

Our fieldwork indicates that firms generally took the opportunity of the changes implied by the RDR to define and clarify their service offerings and the profitability of the business, and this included reassessing their client base and the needs of different segments of clients.

The key areas which have received the most focus from firms include:

- Their client base and the service they offer to different consumer segments, including the type of advice offered, their new advice charging structure, consumer segmentation and the level of service provided.
- Their operational efficiency.

#### Impacts on the types of advice offered — independent or restricted

The RDR rules prompted many firms to consider the service proposition offered to their customers. In particular the type of advice offered (independent or restricted), the level of service (one-off versus ongoing) and the associated charging structure offered.

Prior to the RDR coming into effect many anticipated that advisers' need to cover the full range of investment products to remain 'independent' would increase the costs and the resources required to operate. This was expected to incentivise the adoption of the restricted model, with more advisers specialising in advising on particular products.

Survey data on advisers from NMG Consulting indicate there has been a gradual increase in the proportion of restricted advisers, and this share is expected to continue to rise.<sup>72</sup> Most advisers, however, remain independent and are expected to do so into 2015. The same research also indicates that most revenue is expected to be derived from independent rather than restricted advice.

Our fieldwork does support the view that some advisers are moving towards a restricted model, for example through joining restricted networks. One reason given for this is advisers' desire to avoid any regulatory risk associated with operating too widely and in areas where they are not fully confident or skilled. Indeed at least part of the industry expects this trend towards restricted advice

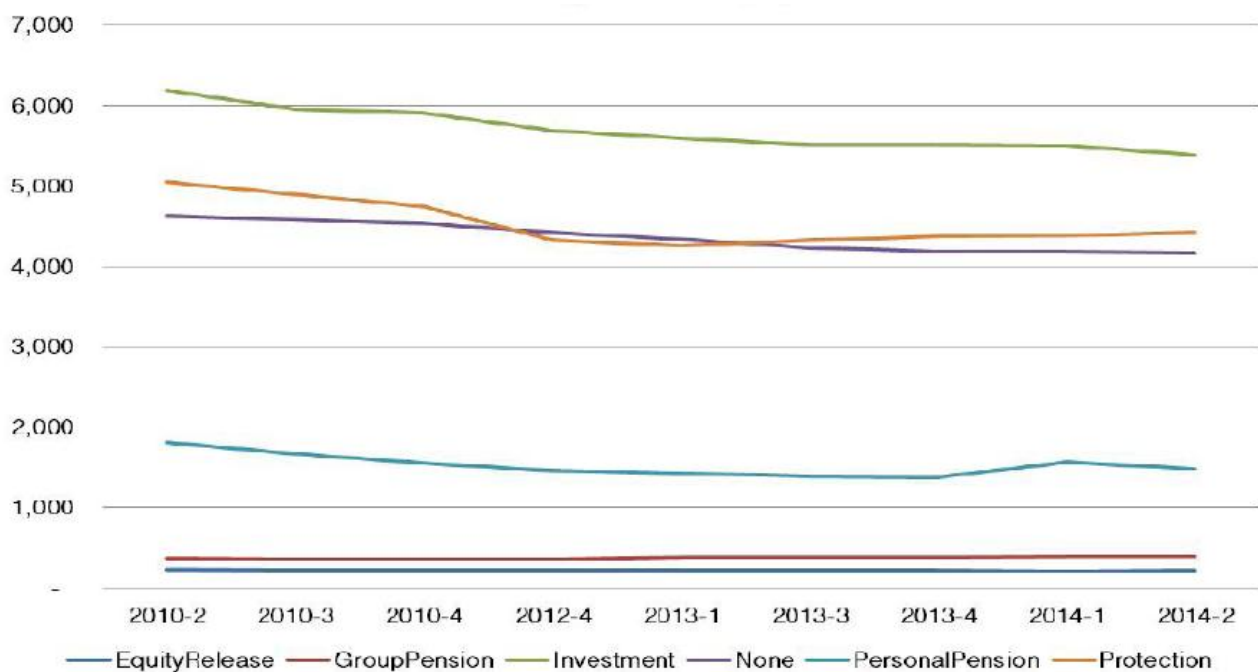
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<sup>72</sup> NMG Consulting (Q2 2014), "Financial adviser census – Business trends report".

to become even more significant. Research by KPMG for the FCA Practitioner Panel expects the restricted model to make up in time 50–75 per cent of advised business.<sup>73</sup>

The figure below, from Touchstone, does not indicate a notable change in the proportions of intermediary firms that specialise in different products (defined as more than 60 per cent of a firm’s business being in a particular product group throughout the time period). However, this evidence is somewhat limited by the grouping together of investment products, which does not allow identification of growing specialisation in subgroups of investment.

**Figure 5.5: Number of intermediary firms specialising in certain products**



Source: Equifax Touchstone report 2014.

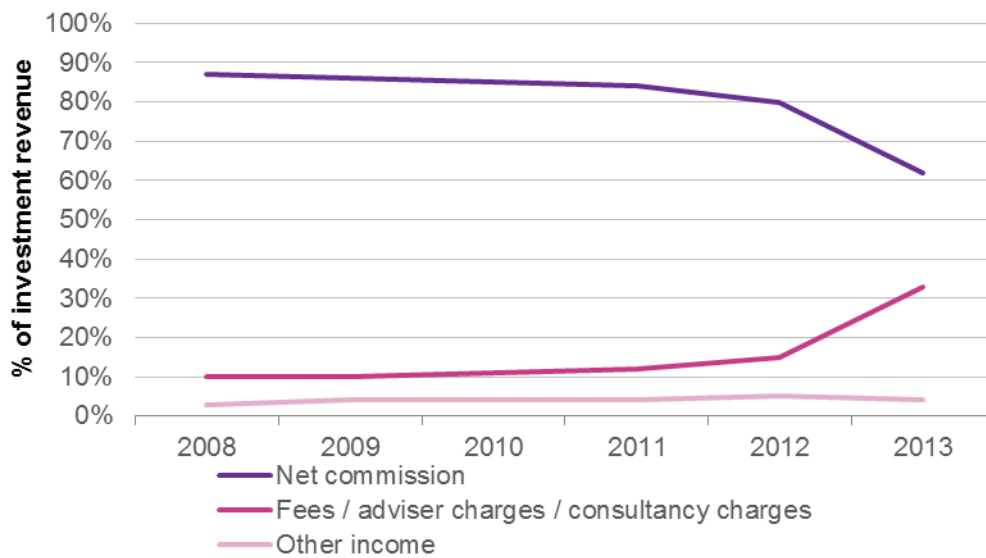
### Impacts on revenue sources and adviser charging structure

The impact of the ban of commissions is evident in the decline in the share of advisers’ revenues made up from commissions. Data on revenue sources for financial advisers show that the proportion of revenue from product commissions has indeed been declining since the introduction of the RDR, as seen in Figure 5.6 below.<sup>74</sup>

<sup>73</sup> KPMG, 2014, “Initial impacts of RDR — research summary” on behalf of the FCA Practitioner Panel.

<sup>74</sup> Some 2013 figures may include RDR commissions as part of revenue earned in 2012. The figures will also include trail commission on legacy products still being received in 2013.

**Figure 5.6: Proportion of different sources of investment business revenue for financial advisers**



Note: The figure will include trail commission on legacy products still being received in 2013.

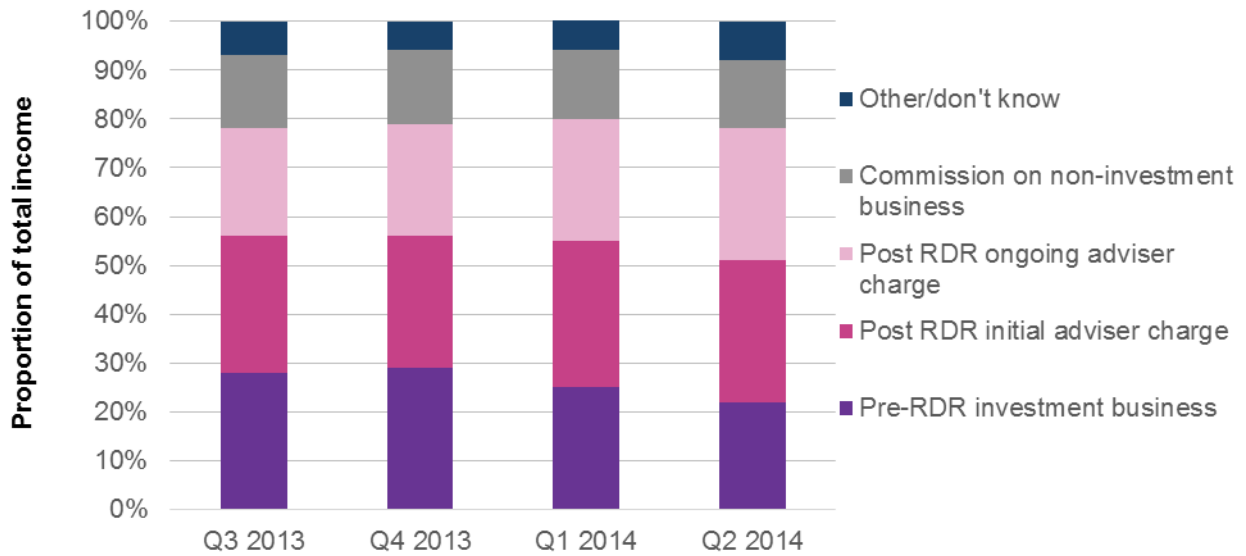
Source: Europe Economics' analysis of RMAR data (2013).

The market responses in the survey conducted by NMG Consulting on post-RDR income support these findings.<sup>75</sup> The distribution of advisers' income is dominated by adviser charges, made up of initial and ongoing fees. The proportion of the revenues generated from those charges continued to increase between Q3 2013 and Q2 2014. Commission on non-investment business remains broadly stable at around 15 per cent of total income, i.e. there is not clear evidence at this level of granularity of a shift away from investment business to recoup commissions from other products. The proportion of income related to pre-RDR investment business has dropped to around 22 per cent of total income from 28 per cent, but remains substantial.

<sup>75</sup> NMG Consulting (2014), "Financial adviser census – Business Trends Report".



**Figure 5.7: Proportion of different sources of advisers' income**



Source: NMG Consulting (2014), "Financial adviser census – business trends report".

The majority of advisers have a charging structure based on a percentage of funds invested, and a large proportion of charges are contingent on investment. RMAR returns show that in 2013 the majority of firms (between 80 and 90 per cent, depending on size) classified an initial charging structure based on percentage of funds invested as "typical". That said, a large minority also classified other initial charging structures as typical, such as a fixed fee or an hourly rate, which suggests that firms use a variety of charging options, possibly depending on the preference of the client. The data do not specify whether the charge as a percentage of funds invested (or under consideration to be) is contingent on the investment being made (indeed, if the customer is offered a choice between a fixed fee or a percentage of funds invested then if the latter is contingent it may be rather skewed choice). The table below presents more detailed information on adviser charging structures as provided in the RMAR.



**Table 5.2: Typical charging structures of advisers**

Initial charges by firm size	% of firms in group typically applying charging approach	Ongoing charges by firm size	% of firms in group typically applying charging approach
<i>Per hour (£)</i>		<i>Per hour (£)</i>	
1	41%	1	32%
2-5	42%	2-5	35%
6-20	40%	6-20	30%
21-50	44%	21-50	33%
51-200	27%	51-200	18%
201+	55%	201+	33%
<i>As a % of investment</i>		<i>As a % of investment</i>	
1	90%	1	94%
2-5	91%	2-5	95%
6-20	91%	6-20	96%
21-50	88%	21-50	94%
51-200	86%	51-200	90%
201+	88%	201+	100%
<i>Fixed fee (£)</i>		<i>Fixed fee (£)</i>	
1	46%	1	30%
2-5	46%	2-5	30%
6-20	40%	6-20	26%
21-50	46%	21-50	29%
51-200	39%	51-200	41%
201+	67%	201+	44%
<i>Combined charging structure (£)</i>		<i>Combined charging structure (£)</i>	
1	23%	1	21%
2-5	23%	2-5	21%
6-20	19%	6-20	18%
21-50	30%	21-50	17%
51-200	25%	51-200	24%
201+	53%	201+	35%

Source: Europe Economics' analysis of the RMAR (2013 data).

Consumer research conducted by NMG Consulting suggests that many firms charge for advice only when a product is purchased: of consumers who had considered an investment product but did not go on to purchase one, 72 per cent of this group said they did not pay a fee, with 28 per cent making some form of payment either via a direct fee (20 per cent) or through an ongoing subscription service (8 per cent).<sup>76</sup>

As set out earlier, there is evidence indicating consumers could be put off taking advice by the initial adviser charge, being disproportionately averse to paying an up-front fee for advice. This may well explain the charging structures adopted by the majority of advisers, where fees are a percentage of investments rather than upfront lump-sum fees.

<sup>76</sup> NMG Consulting (2014), "Impact of the Retail Distribution Review on consumer interaction with the retail investment market", September 2014.

## Client segmentation and cross-subsidisation

Pre-RDR there was a concern that the ban on commissions and introduction of more transparent adviser charging would lead some firms to remove previous implicit cross-subsidies between customer groups. As a result, customers with low levels of investable wealth and simple ongoing advice needs may no longer be profitable for some firms (as the fixed costs around the provision of advice are significant), at least not at fee levels which consumers would be willing to pay (or indeed might be rational to pay given the level of funds being invested).<sup>77</sup>

Post-RDR there is evidence that firms are indeed segmenting their client books. Part of this process involves deciding what services are needed by different customer segments — some firms want all their customers to be individually profitable and so are differentiating between the level (and, implicitly, cost) of service based on clients' investable wealth. NMG Consulting Business Trends survey shows that the majority of advisers have 'segmented their clients' either recently or in the last three years (66 per cent in Q2 2014) and 'calculated the cost of the range of services offered' (75 per cent), which shows advisers have at least been considering their offerings. Schroders' research confirms this, with just under 60 per cent of advisers in their sample segmenting their client base by asset size and a further 14 per cent planning to do this in the near future.<sup>78</sup>

There is also evidence of a move among some advisers towards higher net-worth customers. Although sources suggest minimum thresholds vary by firm, some firms have moved to minimum wealth levels of between £50,000 and £100,000. However much of this evidence relates to what firms were planning pre-RDR.<sup>79</sup> The research is also varied in its conclusions as to what this level is: a report by Fundscape states that most financial advisers seemed to have settled on a minimum of £100,000 in investable assets,<sup>80</sup> whilst other sources suggest a threshold of £50,000.<sup>81</sup> This contrasts with research from Schroders which shows that for the majority of firms the minimum levels are lower. In their survey 50 per cent of advisers reported that their cut-off level for investment, which was used to determine which clients were asked to leave, was below £25,000, and over 30 per cent saying it was below £50,000.<sup>82</sup> Mintel contends that the availability of advice has declined post-RDR especially for customers with less than £20,000 to invest.<sup>83</sup>

Evidence of the structure of adviser charges post-RDR also shows that a large majority charge fees on the basis of a percentage of funds invested. If firms are unwilling to cross-subsidise consumers investing smaller amounts from those investing more, it implies that a minimum level of wealth is required of customers for firms to recoup the required revenues.

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<sup>77</sup> The requirements around ongoing advice may also lead some firms to develop more detailed ongoing advice offerings which again may be too expensive or unnecessary for certain customers.

<sup>78</sup> Schroders (2013), "Advisers drive RDR awareness". The survey was conducted in 2013 and included 332 firms.

<sup>79</sup> For example, Fundscape (2014), "Navigating the post-RDR landscape in the UK" and Deloitte (2012) "Bridging the advice gap. Delivering investment products in a post-RDR world".

<sup>80</sup> Fundscape (2014) "Navigating in the post-RDR landscape in the UK", 2014, p.49.

<sup>81</sup> For example, Deloitte (2012), "Bridging the advice gap".

<sup>82</sup> Schroders (2013), "Advisers drive RDR awareness", Questions 15 and 16.

<sup>83</sup> Mintel (2014), "Consumers and Financial Advice", UK April 2014.

However the evidence also suggests — crucially — that the number of consumers affected is small. Research undertaken by Schroders found that less than 15 per cent of advisers have asked ‘smaller’ clients to leave. This is supported by NMG Consulting research which finds that although 38 per cent of advisers stopped servicing some existing clients because they might be unprofitable, on average this number was small — 16 clients in the twelve months to Q3 2013 and nine clients in the twelve months to Q2 2014. On average advisers refused to take on only three clients for reasons of insufficient profitability.<sup>84</sup> The survey shows further that on average adviser firms took on more clients over the period (an average net increase of 26 clients) which suggests that at least some of the unserved clients were absorbed by other firms. In addition, feedback from our interviews finds only one firm had significantly reduced its client base post-RDR, and as this was at a very high threshold in investable assets which implies a particular business model.

Instead our fieldwork suggests firms are segmenting their customer base in order to offer more tailored ongoing advice services for the different investment needs. As noted previously, Schroders shows that almost 90 per cent of advisers clearly differentiate between different levels of service depending on clients’ levels of investable assets. Towers Watson also concludes that adviser business models must be at least beginning to adapt to meet and service the transactional demand that exists.<sup>85</sup> (Otherwise, a much faster reduction in the number of advisers would have been visible due to declining prices and profitability resulting from excess supply).

### 5.3.2 Improved operational efficiency

The RDR has contributed towards many firms considering the nature of their business models and the efficiency of their business operations. This has led to some firms making changes to their operations (e.g. staff and technology), structure (network and consolidation) and some firms, such as the banks, exiting altogether.

There is also evidence that adviser firms are making greater use of means of improving operational efficiency. This is likely to be driven by a number of factors, some of which are directly related to the RDR:

- The ban on commissions has revealed the true costs and profitability of advice services, most likely lower profit margins on certain customer types. This would contribute towards a drive to greater efficiency and cost reductions, especially for firms which are limited in their ability to target higher-margin clients.
- Cost pressures from complying with the RDR provisions and other business or compliance costs may drive the need for cost reductions in other areas.
- In particular the emphasis on independent advisers to be able to cover all retail investment products is costly for these advisers and should encourage them to find efficiencies.
- The growth in technological solutions for advice and investment also provides some opportunities for advisers to adopt more cost efficient ways of working.

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<sup>84</sup> NMG (2014), “Financial Adviser Census Business Trend Report”, April-June 2014, p. 4.

<sup>85</sup> Towers Watson (2014), “Advice Gap Analysis: Draft Report to FCA”, December 2014.

## Changes in operations

The clearest trend is a move towards platforms, which advisers use on behalf of their clients to search for and manage their investments. Reduced search costs and the ability to track investments for all clients in one place means that the use of platforms will increase the efficiency of firms and reduce costs. The growth in intermediated sales through platforms has been significant. For example, a report by Dunstan Thomas shows that in 2013 around 54 per cent of advisers planned to migrate in excess of 70 per cent of client's assets onto wrap platforms.<sup>86</sup> This strong trend is likely to be driven by a range of secular factors, most notably supply-side improvements in technology and a general business need to improve profitability, and has been at most enhanced by the RDR.

Adviser firms are also increasing their use of paraplanners (non-regulated financial planners involved in preparing and administering financial advice and plans). For example, the NMG Consulting Business Trends survey shows that making greater use of paraplanners was the most common recent business activity among advisers in the first half of 2014 and also most likely to be undertaken over the next six months. Feedback from our fieldwork indicates that a greater number of non-advice staff is required to manage increased regulatory compliance requirements and additional administrative work related to adviser charging as a result of the RDR. Adviser firms have also noted that administrative support and training from product providers has decreased post-RDR, requiring them to carry out more of this work themselves.

These changes in operation are evident in the decrease in the ratio of advice- to non-advice staff. Data from the RMAR in the table below show that the median and average ratio of retail investment advisers to non-advice staff has fallen in 2013.

**Table 5.3: Ratio of retail investment advisers to non-advice staff**

	Median	Average
2009	1.00	1.15
2010	1.00	1.12
2011	1.00	1.10
2012	1.00	1.10
2013	0.75	0.97

Source: RMAR data. This sample includes approximately 4,000 firms providing retail investment advice.

Looking across different firm sizes (in terms of the number of retail advisers), it is clear that this trend is evident in firms with fewer than 20 advisers. With the larger firms, the ratio has either remained unchanged or actually increased between 2012 and 2013. This may be driven by greater centralisation of compliance and other non-advice staff in larger firms. Also, interestingly, the median firm in almost every size band has at least as many non-advice staff as retail investment advisers.

<sup>86</sup> Dunstan Thomas (2013), "Life after the retail distribution review".

**Table 5.4: Ratio of retail investment advisers to non-advice staff, by firm size**

	Median	Average
<b>Size: 1 adviser</b>		
2009	1.0	0.7
2010	1.0	0.7
2011	1.0	0.7
2012	1.0	0.7
2013	0.5	0.7
<b>Size: 2-5 advisers</b>		
2009	1.0	1.2
2010	1.0	1.2
2011	1.0	1.2
2012	1.0	1.2
2013	0.8	1.0
<b>Size: 6-20 advisers</b>		
2009	1.1	1.8
2010	1.0	1.6
2011	1.0	1.6
2012	0.9	1.5
2013	0.8	1.2
<b>Size: 21-50 advisers</b>		
2009	0.7	1.8
2010	0.8	1.6
2011	0.7	1.3
2012	0.6	1.5
2013	0.6	1.3
<b>Size: 51-200 advisers</b>		
2009	0.6	1.2
2010	0.5	1.1
2011	0.6	1.1
2012	0.5	1.2
2013	0.5	1.3
<b>Size: 201+ advisers</b>		
2009	0.4	3.9
2010	0.6	2.7
2011	0.7	3.5
2012	0.6	8.6
2013	0.7	7.0

Source: RMAR data.

Leading up to and after the RDR, the number of Appointed Representatives also increased, indicative of a shift of individual advisers to network arrangements, where advisers can work as Appointed Representatives rather than as employees. Our fieldwork suggests that joining a network as an Appointed Representative can be an attractive solution for some advisers seeking to reduce the operating costs associated with running a Directly Authorised advice firm (including avoiding the costs of maintaining the independent status), and yet wanting to retain a greater degree of autonomy than available from joining a tied advice/sales force. In this case, the move towards greater numbers of Appointed Representatives does appear to be strongly influenced by the RDR.

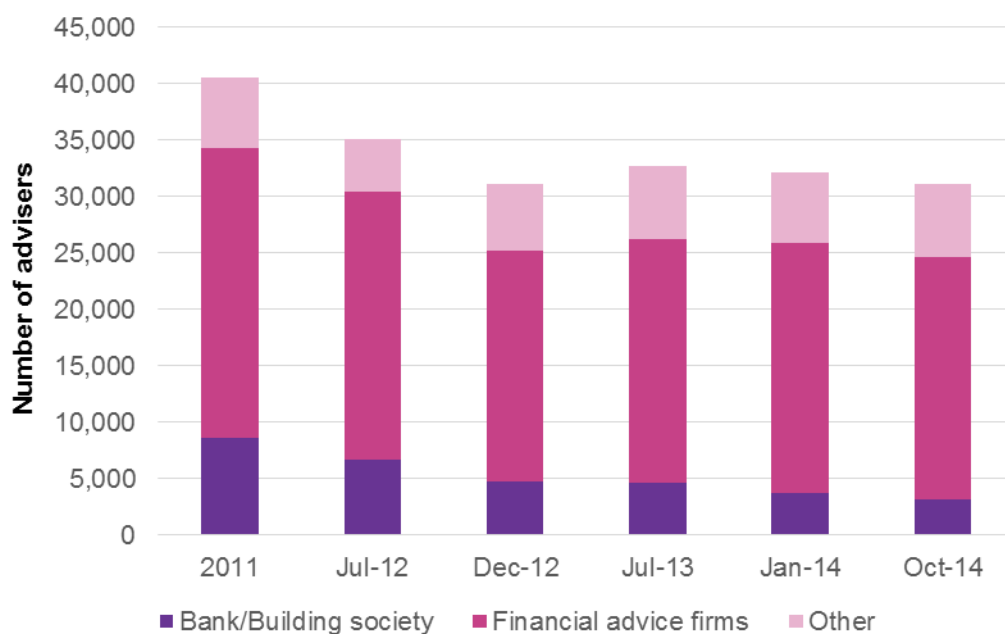
Also highly significant has been the exit of banks from the advice market, largely in the lead up to the RDR. This exit appears to have been driven by a mix of factors. Barclays, for example, cited ‘a decline in commercial viability for such services over recent years’ in its decision in 2011 to withdraw financial advice from its branches and offer an online service instead.<sup>87</sup> HSBC, RBS, Lloyds and Santander also re-structured their advisory businesses, leading overall to a partial withdrawal from the advice market — and a decline in adviser numbers. Overall, the exit appears to have been in anticipation of the RDR, partly the challenge maintaining a viable in-branch advice model in the face of growing competition online, and in a context where regulatory sanctions had recently been imposed on several banks for poor conduct in their selling of retail investments.<sup>88</sup>

### 5.3.3 RDR impacts on adviser numbers and adviser capacity

While there was some exit from the advisory market, particularly in the period leading up to the RDR, by the banks and by some financial advisers, numbers of advisers and advisory firms now appear stable. There remains a large number of advisory firms and advisers to serve consumers.

There has been a significant decline in the number of advisers from an estimated 40,500 in 2011 to 31,150 in 2014, as shown in the figure below.<sup>89</sup> Most of the exit occurred before implementation at the end 2012. Since 2013 adviser and advisory firm numbers have been stable.

**Figure 5.8: Change in the number of advisers between 2011 and 2014 by type of advisory firm**



Sources: RS Consulting (2011) and FCA (2012 onwards).

<sup>87</sup> <http://www.newsroom.barclays.com/Press-releases/Barclays-UK-Retail-Banking-announces-proposals-to-focus-its-investment-service-offering-online-74a.aspx>.

<sup>88</sup> See, for example, FSA (2013) “FSA publishes the results of a mystery shopping review into the quality of investment advice in banks and building societies”, FSA/PN/014/2013.

<sup>89</sup> RS Consulting, “Progress towards the professionalism requirements of the Retail Distribution Review”, December 2011 and FCA Professional Standards data, January 2014.

At face value, at least, the majority of this decline (58 per cent of advisers who left) can be attributed to banks' exit. (In practice, at least some of these bank advisers will have joined firms in other parts of the advisory market.)

The RDR is likely to have expedited an existing trend of exit by firms and advisers, as it pushed advisory firms to evaluate and adjust their business models and levels of qualification. Other market factors contributing to this may include:

- Exit by many retail banks — bank advisers form the largest proportion of advisers who have left the market in recent years. This is largely due to restructuring on the part of retail banks and the closure of advice services. This has taken a mix of forms:
  - Barclays ended branch-based financial planning to focus on its online offering; HSBC closed its tied (restricted) service but has partly offset this by expanding its independent advice offering;<sup>90 91</sup> by contrast, RBS has shifted from independent to restricted advice;<sup>92</sup> Lloyds re-focused its independent advisers to those with £100K+ in investable assets;<sup>93</sup> the Nationwide took steps to increase its advisory team in 2012, although it has subsequently dropped headcount to reflect a shift online;<sup>94 95</sup> and Santander has first downsized, and is now expanding its advisory staff.<sup>96 97</sup> Whilst this has coincided with the RDR, and attribution of these changes to the RDR has been a popular narrative, there are a number of other factors at play. As we noted above Barclays, for example, cited a decline in the commercial viability of branch-based services in the years leading to its 2011 decision, noting the growing customer preference to act online. Compliance failings have also been apparent: demonstrated by the results of the FSA's mystery shopping exercise<sup>98</sup> and the payment of mis-selling fines. It can also be noted that the RDR "raised the bar", making the investment to rectify such poor-quality performance likely greater. Overall, our view is that declining profitability — and the declining role for branch-based activity — mean that the bank exit should be viewed as in large part strategic. This is also suggested by the heterogeneity of the structural changes described above. Whilst the RDR is likely to have accelerated this

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<sup>90</sup> <http://citywire.co.uk/new-model-adviser/news/hsbc-scraps-tied-advice-service-650-jobs-go/a584819>.

<sup>91</sup> [http://www.newsroom.hsbc.co.uk/press/release/hsbc announces changes in the](http://www.newsroom.hsbc.co.uk/press/release/hsbc%20announces%20changes%20in%20the).

<sup>92</sup> <http://www.moneymarketing.co.uk/rbs-to-axe-ifa-arm-and-create-specialist-restricted-advisers/1053513.article>.

<sup>93</sup> <http://www.moneymarketing.co.uk/lloyds-axes-mass-market-investment-advice/1058592.article>.

<sup>94</sup> <http://www.nationwide.co.uk/about/media-centre-and-specialist-areas/media-centre/press-releases/archive/2012/6/comment-on-rbs-job-cuts>.

<sup>95</sup> <http://citywire.co.uk/new-model-adviser/news/nationwide-sheds-130-financial-advisers/a731156>.

<sup>96</sup> <http://www.moneymarketing.co.uk/santander-cuts-724-jobs-as-it-pulls-out-of-investment-advice/1068712.article>.

<sup>97</sup> <http://www.moneymarketing.co.uk/news-and-analysis/advisers/santander-set-for-adviser-recruitment-push/2013948.article>.

<sup>98</sup> FSA (2013), "FSA publishes the results of a mystery shopping review into the quality of investment advice in banks and building societies", FSA/PN/014/2013. <http://www.fsa.gov.uk/library/communication/pr/2013/014.shtml>.



shift, e.g. through the professional requirements, attribution of the banks' exit from advice to the RDR is likely to be partial and indirect at most.<sup>99</sup>

- Natural exit — with an aging financial advice workforce, it would be reasonable to expect a decline in the number of advisers as mature individuals retire from the market. It is likely that the RDR, in particular the increased minimum standards of qualification, has acted as a catalyst for earlier retirement among some older advisers. Adviser research in 2011 found that of the advisers planning an early retirement in 2012, around 40 per cent of them indicated the professionalism requirements of RDR were the main cause of their decision.<sup>100</sup> We do not have age distribution data for advisers post-RDR implementation to assess the effect of this.
- Technological advancement — the recent development of the market for retail investment has been driven by technological advancement, and the increasingly technical and quantitative nature of financial planning and associated innovative products may be challenging for more traditional advisers to adapt to. Those unwilling or unable to keep up with market development may leave.
- Natural growth of the non-advised market — with an increasingly computer literate society, consumers, particularly in the mass market, use and transact on the internet more often than before and are more willing to by-pass advisers with self-directed investing via web-based services to save time and money.<sup>101</sup> NMG Consulting consumer research found that a significant proportion of consumers, particularly when investing smaller amounts, were happy to direct their investments themselves.<sup>102</sup> Earlier research conducted by Cass has revealed that a significant proportion of the UK's population would be willing to use a 'financial guidance service' instead of using a financial adviser to help them make their savings and investment decisions.<sup>103</sup> These services can be accessed via non-advised D2C platforms.

The exit of adviser firms has been less significant than adviser numbers, with only an eight per cent fall in the number of Directly Authorised advisers between 2008 and 2013 (and a marginal decline in the number of Appointed Representatives over that period).<sup>104</sup> And, as with adviser numbers, the fall in the number of the advisory firms predates RDR implementation.

The fall in adviser numbers need not lead to a corresponding decrease in the capacity for advice. Existing advisers in the market have taken on more clients — research by NMG Consulting shows on average advisers took on a net increase of 26 clients in Q2 2014.<sup>105</sup> There is also evidence to suggest that advisers may have the capacity to take on even more clients. Tower Watson's model

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<sup>99</sup> Indeed, the banks interviewed as part of our fieldwork, at least, stated that their restructuring was not directly due to the RDR. Indirect impacts may be related to the rules around vertical integration.

<sup>100</sup> RS Consulting (2012), "RDR adviser population & Professionalism research – 2012 survey".

<sup>101</sup> Deloitte (2013), "Recognising RDR reality".

<sup>102</sup> NMG Consulting (2014), "Impact of the Retail Distribution Review on consumer interaction with the retail investment market", September 2014, p.37-38.

<sup>103</sup> Cass Consulting (2013), "The Guidance Gap: An investigation of the UK's post-RDR savings and investment landscape". The research is based on a representative YouGov Omnibus survey.

<sup>104</sup> Aggregated FCA RMAR data for firms with Primary Category "Financial Adviser", as published in APFA's "Financial Adviser Market: In Numbers", April 2014.

<sup>105</sup> NMG Consulting (2014), "Financial adviser census – business trends report".



estimates that the aggregate supply of full regulated advice outstrips demand.<sup>106</sup> This model implies that increased efficiencies among advisers are possible. This is somewhat supported by evidence that advisers are making greater use of technology (e.g. adviser — i.e. B2B — platforms and social networking sites) and paraplanners to grow their businesses and increase efficiency.<sup>107</sup> Consumers whose advisers have left the market could therefore be able to access advice through the remaining advisers, all else being equal. (All else is not necessarily equal, however, as we describe below.)

The RDR has also potentially increased barriers to entry, in terms of professional requirements and service standards more generally. KPMG describe the economics of attracting new talent as ‘challenging’.<sup>108</sup> This is a natural consequence of raising standards — provided such raised standards are valued the economic appeal of such entry should increase.

Finally, we note that it does not appear that consumers perceive that they have been abandoned by advisers. NMG Consulting consumer research in 2014 finds that of unadvised investors, only one per cent gave as a reason for investing without advice ‘an adviser wouldn’t be interested in serving me’.<sup>109</sup>

## 5.4 Has the RDR led to an ‘advice gap’?

There has been much concern expressed about an ‘advice gap’. However what is meant by ‘advice gap’ can vary. In order to be able to consider whether or not there is an ‘advice gap’, it is important to define the potential concern.

### 5.4.1 Investment advice versus other forms of generic financial advice

Given the context of the RDR, this report is focused on investment advice only and so access to and availability of broader forms of generic advice such as debt advice or general money management are not considered relevant here. This means that the focus is only that proportion of the population that has the financial resources to make investment an option and so potentially have a need for full regulated investment advice. There is no precise definition of this number, although one rule-of-thumb suggests that precautionary and other savings equal to 3–6 months outgoings would be appropriate, implying only wealth above a certain level should be invested. Office for National Statistics data on financial wealth do not provide a precise answer to this — however the work by Towers Watson commissioned by the FCA as part of the PIR estimates demand for

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<sup>106</sup> The demand can be translated back into the number of customers and broken down into types of advice — in total the report estimates there would be 5.6 million clients (couples are counted as one) seeking advice. Of these 2.4 million would be requiring ‘legacy ongoing advice’, and 5.6 million would seek initial advice. Both categories might use either transactional or holistic advice with different number of hours of adviser’s time assumed for each type of advice.

<sup>107</sup> For example, the NMG Consulting Business Trends Report shows that making greater use of paraplanners was the most common recent business activity among advisers in the first half of 2014 and also most likely to be undertaken over the next six months.

<sup>108</sup> KPMG (2014), “Initial impacts of RDR — research summary”, on behalf of the FCA Practitioner Panel.

<sup>109</sup> NMG Consulting (2014), “Impact of the Retail Distribution Review on consumer interaction with the retail investment market”.

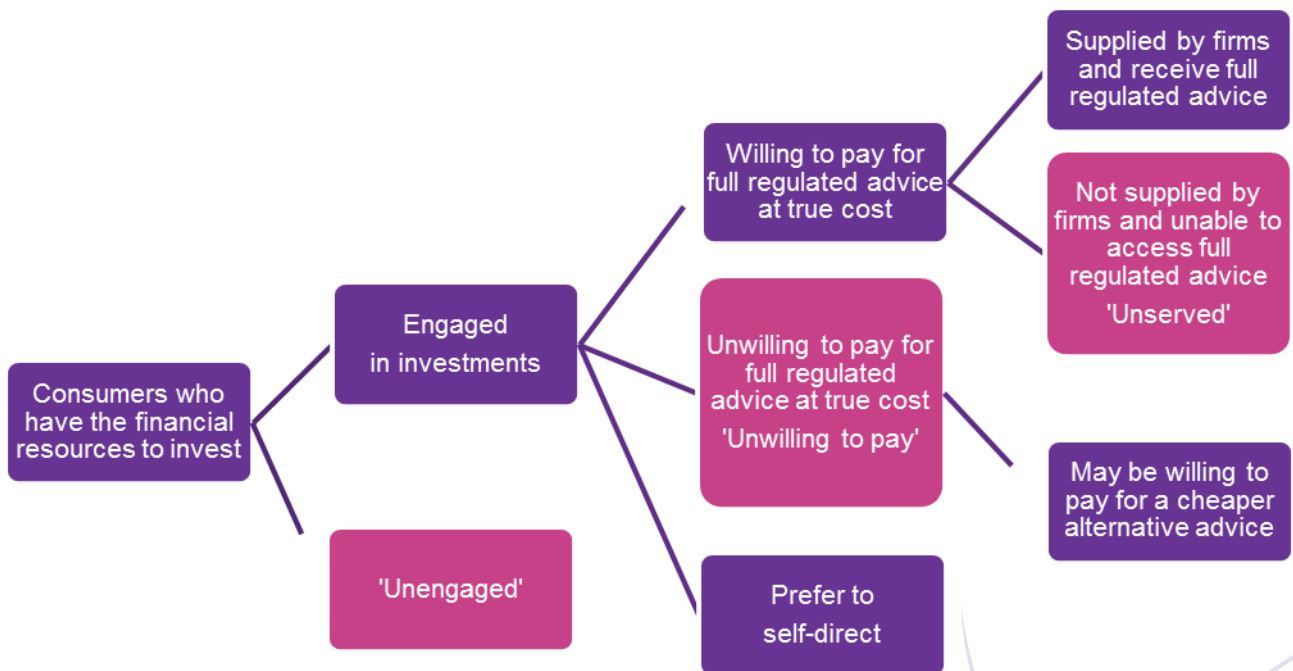
approximately 3.4 million initial advice cases in 2014. This is out of a population of about 15 million with investments, not all of whom will seek investment advice in a given year, or indeed at all.

### 5.4.2 Defining the ‘advice gap’

We have defined three groups who may have a need for investment advice:

- *The unengaged* — Those consumers who have the financial means to invest but are not engaged in the investment markets.
- *The unwilling to pay* — Those consumers who have the means to invest, are engaged in the investments market but are not willing to pay for full regulated advice at true cost or prefer to self-direct. Some may however be willing to pay for a cheaper alternative source of advice. This group may also include some consumers making a somewhat forced choice, as we explain below.
- *The unserved* — Those consumers have the means to invest, are engaged in the market, are willing to pay for full regulated advice at true cost but are unable to find an adviser willing to advise them.

**Figure 5.9: Different possible needs for investment advice**



#### Previous estimates of the ‘advice gap’

A series of reports have been published and have come up with different estimates for ‘the advice gap’ based on differing definitions, as presented below:

**Table 5.5: Summary of past published advice gap estimates**

Report	Estimate	Which advice gap(s) does it address?
<b>Deloitte (2012)</b>	This report from pre-RDR estimated that there could be an advice gap of up to 5.5million consumers who received advice pre-RDR but who afterwards would either choose not to pay for advice or who would not have access to it post-RDR. <sup>110</sup>	<p><i>Unengaged</i>: those who would have engaged with investments through advisers that left.</p> <p><i>Unwilling to pay</i> those who not pay for advice now cost is revealed.</p> <p><i>Unserved</i>: firms moving away from advising certain consumer groups.</p>
<b>Towers Watson (2014)</b>	Estimates the demand for 'full' regulated advice and compares it with the number of advisers active in the market. According to this analysis there is not an advice gap in this sector because there are sufficient advisers to meet demand (approximately 30,000 advisers compared to 25,000 required by customers). <sup>111</sup>	<i>Unserved</i> : looks at whether sufficient advice capacity in the market to meet demand for full advice.
<b>Financial Services Consumer Panel (FSCP)(2012)<sup>112</sup></b>	The FSCP interprets advice in a much wider sense and reports there are a significant number of consumers who would benefit from financial advice who are not receiving it. All consumer groups contributing to the FSCP recognise a big gap for as evidenced by demands for their various helpline and other advisory services.	<p>Wider gaps in provision of financial advice (e.g. investment, protection products, financial planning)</p> <p><i>Unengaged</i></p> <p><i>Unwilling to pay</i>: in particular firms not providing more varied forms of advice (simplified advice, generic) meaning that consumers choose not to pay for full advice</p> <p><i>Unserved</i>: full advice firms targeting wealthier clients.</p>
<b>GfK (2013)</b>	GfK estimate that, in December 2013, there were approximately two million savers with sufficient capital to invest in retail investment product, but only 480,000 stated any intention of doing so,	<i>Unengaged</i>

<sup>110</sup> Deloitte (2012), "Bridging the advice gap". This methodology likely overestimates the advice gap as it counts all sales through a bank adviser as advised sales whereas it is likely that not all these consumers were receiving regulated advice. It also considers savings as well as investments. It also ignores any scope for efficiency enhancement.

<sup>111</sup> Towers Watson (2014), "Advice Gap Analysis: Report to FCA", December 2014. The estimates are based on an estimated propensity to seek advice by different customer segments. This is applied to the sizes of particular customer segments to estimate how many instances of advice comprise demand. Using assumptions about adviser efficiency and activity Towers Watson then estimate the number of advisers needed to service each customer segment.

<sup>112</sup> Financial Services Consumer Panel (2012), "Researching the Advice Gap" – Providers' perspective.

Report	Estimate	Which advice gap(s) does it address?
	leaving an 'investment gap' of around 1.5 million people. <sup>113</sup>	
<b>GfK (2013)</b> <sup>114</sup>	GfK also developed a hypothetical estimate of those unwilling to pay for advice for future investments over the next 12 months of between 120,000 and 600,000. The range is determined by those who would not consider advice for the future investments (lower bound) and those who expressed their preference for direct channels (upper bound).	<i>Unwilling to pay</i>
<b>Fundscape (2014)</b> <sup>115</sup>	Fundscape estimate a decline in the proportion of UK citizens using professional advice (10-13 per cent before the RDR compared to only 7-10 per cent after the RDR implementation).	<i>Unwilling to pay</i> <i>Unserved</i>

### 5.4.3 Is there an 'advice gap'?

#### The unengaged

There is a group of consumers who have the means to invest but who are not engaged in the investment market. Some of these consumers would likely benefit from being more engaged in the investment market. Others may have investments and cash savings that they have built up without engaging.

As these consumers are not engaged in the market we see no 'gap' between supply and demand in the sense they do not demand full investment advice.

Some measures of the RDR may have had an effect on levels of engagement in the industry, in particular those aimed at increasing professionalism and trust in the industry. However, as discussed in Chapter 3, there are no signs of yet of increases in trust or engagement from consumers generally in the advised investment market.

The RDR is unlikely to have influenced this gap significantly. We know that overall levels of savings have remained generally stable and levels retail investment have increased since the RDR (see Chapter 2). On the other hand, as identified at Figure 2.5, GfK does find some evidence suggesting a slight decline in the number of existing investors who opened investments post-RDR, with this most notable for investors in the £50,000–£100,000 segment. Whilst not definitive proof, it is consistent with the contention that — for example — bank-based advisers were effective in prompting a decision to invest and that, with their exit, this has resulted in a slight drag on

<sup>113</sup> © GfK NOP Ltd, Financial Research Survey (FRS), 12 months ending December 2013 data, 18,688 adults interviewed.

<sup>114</sup> © GfK NOP Ltd, Financial Research Survey (FRS), 12 months ending December 2013 data, 227 adults interviewed. The estimate is based on the assumption that all those estimated to have an existing IFA relationship would take out an investment in this period.

<sup>115</sup> Fundscape (2014), "Navigating in the post-RDR landscape in the UK", 2014, p. 28.

investment levels. This is supported by research by the FCA Practitioner Panel which finds that the reduction in mid-market advisers has reduced mass market access to advice with many less capable consumers not seeking advice or investing.<sup>116</sup> However, it is also important to note that there was repeated evidence of banks mis-selling investments pre-RDR, which suggests that though the banks may have been bring some otherwise unengaged consumers into the market, these consumers may not always have benefited from the advice received. This is a difficult group to size, not least because if these are mostly 'mass market' then investment rates in any given year can be low.

### The unwilling to pay

There is a group of consumers who have the means to invest, who are engaged in investment markets but are not willing to get advice, either because they are unwilling to pay for full regulated advice at its true cost, or else they consider it unnecessary (e.g. these can be seen as self-directed consumers choosing to go direct or to D2C platforms). Rightly or wrongly, they believe they are better-off not obtaining advice. From the demand analysis above, this is more likely to be the case where the consumer has less to invest, or simpler invest needs, or is looking for advice for reassurance value only. In both cases the expected value of advice may not be seen to outweigh its cost.

These consumers may turn to direct channels or D2C platforms. The impact of this choice on consumers will be affected by their past experience. Many new users of platforms and direct channels are likely to be on the whole sufficiently competent to cope given their past interactions with advisers.

However others would benefit from additional educational offerings (which several D2C platforms and certain direct providers are striving to provide) or forms of simplified advice. This may be particularly true for those consumers previously using banks for advice. This group can be seen as consumers making a somewhat "forced" choice — having relatively low levels of investable wealth (and by implication being only occasional investors), and with no or limited experience with full independent advice they may not be sufficiently financially competent to invest without any advice.<sup>117</sup>

The RDR has influenced this group by making the price of advice clearer. Consumers can now better assess how much advice is costing and make a choice about value for money of advice. As a result some are choosing not to get full advice, but have a dearth of opportunities to access cheaper alternatives (as noted by, for example, the FSCP). As discussed in 5.2.2 adviser charging does not appear to have deterred a significant proportion of currently advised consumers from seeking advice, so this group is likely to be small, although there may be new consumers who are not willing to pay for full advice.

As we have discussed elsewhere, the exit by banks has been in large part strategic, due to declining profitability and regulatory failings. As we note at 5.3.3 above whilst the RDR is likely to have

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<sup>116</sup> KPMG, 2014, "Initial impacts of RDR — research summary" on behalf of the FCA Practitioner Panel.

<sup>117</sup> See for example Calcagno and Monticonez (2013) "Financial Literacy and the Demand for Financial Advice".

accelerated this shift, e.g. through the heightened professional requirement, but attribution of the banks' exit from advice to the RDR — whilst a popular narrative — is likely to be partial and indirect at most.

*Will this advice gap be addressed by the market?*

Currently consumers who choose to go non-advised are likely to be served by D2C platforms and through execution-only sales. However, it is likely that some of these consumers who are unwilling to pay for advice might instead pay for a cheaper, simplified advice. Firms may be able to develop 'simplified advice' which could be both cost-reflective and affordable to the mass market, meeting the needs of consumers with lower levels of investable wealth and less complex investment needs. If simplified advice *can* be provided by the market then this form of advice gap is likely to reduce over time as the market re-adjusts and new service offerings develop.

Industry commentators suggest that 'simplified advice solutions' designed for the mass market would be profitable,<sup>118</sup> and that in time firms will seize this opportunity. According to the FSCP's interviews among providers and trade associations there is a great potential in offering simplified advice, especially for those who have a client base focused on the mass market. Indeed there are some indications that banks are looking to re-enter the market, perhaps with more technology-supported applications. In addition new start-ups could provide the new offerings without being weighed down by a need to promote a restricted set of providers' products or by costs associated with banks' legacy systems.

Automation is not necessarily a panacea here. Whilst it may likely be part of a simplified advice solution there is also caution that, whilst cost-efficient, an algorithmic error could result in systemic advice problems — and with a ready-made evidence trail demonstrating this easily furnished to supervisors. In this respect, simplified advice could necessitate the introduction of simpler products to mitigate some of the risks associated with liabilities. This implies a significant role for vertically integrated firms, which would be in a position to develop the products and then promote them through their newly developed simplified advice offerings.

However, there is a considerable perception of regulatory risk among potential providers, particularly around differences between liabilities related to providing full advice and simplified advice — if simplified advice cannot be guaranteed to involve lower liabilities it may not be commercially worth the risk to provide it. This is supported by our fieldwork, which highlights concerns about regulatory certainty (related to both the FCA and the Financial Ombudsman Service). The FCA has been taking steps to address the perceived regulatory uncertainty. It will be shortly publishing its final guidance on the differences between advised and non-advised sales. This is supported by research by the FCA Practitioner Panel which sets out that 'non-advice'

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<sup>118</sup> We note there are different definitions of simplified advice. The Financial Services Consumer Panel (FSCP) defines simplified advice as an advice where adviser "applies a standard series of questions, typically in the form of a decision-tree, to establish a client's needs and priorities to drive recommended product actions from a limited range of simpler products", see FSCP (2012) "Researching the 'Advice Gap'", March 2012, p. 12.



propositions will grow subject to greater clarity on the boundary of advice (and a viable Guidance Guarantee model).<sup>119</sup>

It should be added that there may be some latent benefits in the provision of simplified advice whereby investors (or savers more generally) who have never engaged in advice could then have access to advice that is affordable and meets their needs. This could conceivably help with the unengaged group described above.

### The unserved

This would relate to those consumers who have the means to invest, are engaged in the market, are willing to pay for full regulated advice at true cost but who are unable to find an adviser willing to advise them, for example because of the move by some firms to focus on those consumers with relatively higher levels of investible assets. However the evidence again suggests this group of consumers is likely to be small.

As set out above, some firms are segmenting their client books and focusing on wealthier customers with large amounts of investable assets and more complex (and profitable) investment advice needs. However where this is the case, evidence suggests the number of consumers affected is generally small and that these consumers are likely to have been picked up by other adviser firms. Advisers have capacity and have been taking on new clients. There is very little evidence that consumers perceive that they have been abandoned by advisers.

A slight variation on this group is the view expressed by Towers Watson that there could be a mismatch between the transactional advice demanded by the majority of consumers and the holistic advice now offered by the majority of firms. Towers Watson sets out that under the new requirements a long lasting relationship with clients (resulting in a holistic rather than transactional type of advice) has become relatively more profitable for advice providers, leading to a shift in the type of services provided away from simpler services. As Towers Watson estimates that nearly two-thirds of demand for retail investment advice is likely to be transactional rather than holistic in nature, the exit of simpler advice providers and a move towards holistic financial advice would lend itself to a capacity application mis-match and a shortage of transactional advice offerings — especially at the lower end of the mass market.<sup>120</sup>

Some advisers have sought to terminate unprofitable client relationships. Data from NMG Consulting, for example, imply that in the year to Q1 2014 about 310,000 clients stopped being served for this reason.<sup>121</sup> On the other hand 820,000 clients were gained in the same period. The same survey indicates that advisers refused to serve about 60,000 (potential new) clients in the same period. If we assume that many of those clients with relationships terminated on the grounds of inadequate profitability sought out another adviser, the positive net increase in customers served suggests that such looking around for a replacement was largely successful. We cannot rule out the existence of a residual group of consumers denied service in this way. However these data do not speak to a significant issue here.

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<sup>119</sup> KPMG, 2014, "Initial impacts of RDR — research summary" on behalf of the FCA Practitioner Panel.

<sup>120</sup> Towers Watson (2014), "Advice Gap Analysis: Draft Report to FCA", December 2014.

<sup>121</sup> NMG Consulting (2014), "Financial adviser census – business trends report".

### *Will these consumers be served by the market?*

Given there are sufficient firms providing advice to consumers who are willing to pay for it at true cost and providing transactional advice, then for these consumers there is likely to be more of an advice 'hunt' than a structural 'gap.' It may be that they could benefit from better sign-posting towards those firms offering the services they demand. However you might expect that those firms still offering advice to consumers with less to invest and/or offering transactional advice might look to attract these consumers.

## 5.5 Cost of advice

Comparing adviser remuneration pre-and post-RDR is complicated by the absence of comprehensive data, and the fact that pre-RDR charges to consumers were expressed as commissions that were split between intermediaries and providers. Analysing revenues from adviser charges is also challenging as current figures still include legacy trail commissions. Adviser fees also vary across products, and product mix continuously changes.

On average, the RDR appears not to have led to a reduction in adviser remuneration: post-RDR one-off charges appear in line with pre-RDR initial commissions paid to advisers, and ongoing charges have increased relative to ongoing commissions for at least some firms and in some regions of the UK.

We lack the comprehensive evidence base (particularly for the pre-RDR period) to tell whether payments to advisers have increased more generally, or whether any such changes will be long-term. A longer post-RDR trend in adviser charges will help inform this, but at this stage we have no evidence that charges have declined. The competitive mechanisms through which the remuneration arrangements were intended to work — namely consumer price pressure driven by increased transparency — have not developed fully to date. This may improve as clarity around firms' disclosure of adviser charging continues to increase, and hence consumer understanding, grows — however, price competition may be limited as consumers are relatively price insensitive compared to measures such as trust. The credence good nature of advice may further inhibit shopping around.

The evidence currently available implies adviser charges have increased post-RDR, at least for some consumers. On the other hand, given that at least some advisory firms have been removing cross-subsidies between consumers, this does suggest higher wealth clients are likely to be paying less than pre-RDR. These are also likely to be more able to negotiate down prices with their adviser. Given this, we would expect some price falls have been experienced for at least some consumers also — however we do not have direct evidence of this.

Touchstone's data provided to the FCA provides a selection of intermediary commissions prior to the RDR. These vary between different asset classes as follows:

- Investment bonds — Commission typically ranged between five per cent and 7.5 per cent of investments. Reduced initial commission plus trail commission (a percentage of the funds invested) was also available, and there was a direct correlation between the amount of initial commission that was payable and the alternative reduced initial plus trail commission. For



example, 7.5 per cent initial commission or alternatively 4.5 per cent initial plus 0.5 per cent trail would be on offer.

- Unit trusts and ISAs — Typically charged three per cent initial commission with a 0.5 per cent trail charge going to intermediaries.
- Pensions — Commissions varied greatly due to different premium payment structures, product providers would have had some ability to claw back commissions where premiums ceased after a short period of time.

Evidence from Touchstone and the RMAR shows that current adviser charges range from between one and three per cent in initial charges, and between 0.5 and one per cent in ongoing charges.

This suggests that if pre-RDR trail commissions were in the region of 0.5+ per cent ongoing, then current ongoing charges are higher now for at least some firms and in some regions. Our fieldwork indicated typical pre-RDR trail commissions ranging from 0.5–0.75 per cent. This is supported by research for the FCA Practitioner Panel which finds that ongoing advice prices are higher post-RDR.<sup>122</sup>

Given the low levels of price competition among advisers it is likely that there are incentives for advisers to increase charges on new investments, in large part to compensate for lost trail commissions on legacy investments. In line with this, our interviews imply that more detailed, 'holistic' ongoing advice services is now being offered in order to justify higher charges. However, this may also be due to the RDR requirement for there to be a clear ongoing service where there is an ongoing charge (pre-RDR, an ongoing charge did not guarantee an ongoing service).

The case for higher adviser remuneration is supported by evidence from the NMG Consulting Business Trends survey which shows that the proportion of advisers who have seen a rise in incomes has increased steadily between 2012 and Q2 2014. In Q2 2014, 42 per cent (net) had seen their income increase over the past year. This is not consistent with a substantial fall in adviser charges, although increased volumes or wealth levels of clients (and legacy trail fees) would also affect incomes.

NMG Consulting data show how advisers obtain their revenue post-RDR.<sup>123</sup> Since the beginning of 2014, around 30 per cent of revenue has been due to initial adviser charges; 25 to 27 per cent of income due to ongoing adviser charges and fees; and commission on non-investment businesses around 14 per cent of income. Pre-RDR investment business still accounted for 22 per cent of income in the second quarter of 2014, although this had declined from 28 per cent of income in the third quarter of 2013.

Data from the RMAR show that the proportion of annual revenues from adviser charges between initial and ongoing advice in 2013 were largely similar. Median shares are more aligned than average shares, with revenue from ongoing adviser charges accounting for a lower share of revenue for the majority of firm sizes. This, combined with the average initial and ongoing fees seen above, implies that advisers are not drawing significantly more revenue from ongoing

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<sup>122</sup> KPMG, 2014, "Initial impacts of RDR — research summary" on behalf of the FCA Practitioner Panel.

<sup>123</sup> NMG Consulting (2014), "Financial adviser census business trends report: Q2 April – June 2014".

charging nor using low initial fees to attract consumers and following this up with high ongoing fees.

## 5.6 Summary

Consumers' demand for investment advice has been falling over recent years, a trend which began before RDR implementation and is correlated with alternative methods of investing, such as D2C platforms. There is little evidence that explicit adviser charging has led to significant numbers of consumers no longer being willing to pay for advice. There has been a fall in the volume of advised sales and instead, consumers are increasingly buying products on a non-advised basis, using technology such as D2C platforms.

The ban on commission has led many firms to consider the fundamentals of their business models and make key changes, e.g. segmenting their customers, with some focusing on services to those with higher levels of investible assets. However despite these changes there is little evidence that the availability of advice has reduced significantly, with the majority of advisers still willing and able to take on more clients.

In considering the 'advice-gap' attributable to the RDR, we distinguish between three groups of consumers who may have a need for investment advice but who may not be receiving it for different reasons: (a) those not engaged in the investment market; (b) those unwilling to pay for advice at true cost; and (c) those seeking advice but where firms are unable or unwilling to provide them advice.

- The first group, though important, does not constitute an 'advice gap' in that the affected consumers are not actively looking for investment advice (they might, of course, benefit from unregulated, generic advice). The bank exit may have increased the size of this group as evidence suggests bank-based advisers were effective in prompting a decision to invest from unengaged consumers. It is debatable whether this is an RDR effect, as bank exit appears driven by a combination of factors, including wider strategic considerations.
- The second is driven by consumer choice about value for money and existed to a degree prior to the RDR. To the extent that this is a choice by consumers as to whether they are willing to pay for advice, whether this group is a 'gap' is arguable. By revealing the true cost of advice the RDR is likely to have increased the size of this group, although the evidence suggests the size of this increase has been limited by the move by the majority of firms to adopt contingent charging structure rather than up-front fees. This group includes consumers who we expect would pay for cheaper forms than the full advice model — the absence of these cheaper models therefore creates a 'forced choice for this group. There are signs that in time the market will adjust to address at least part of this gap by developing cheaper advice offerings that these consumers may consider value for money.
- The third group is firm-driven. This group of consumers is likely to have increased under the RDR as a result of firms moving to target higher wealth, higher margin consumers. Some firms are segmenting their client books and focusing on wealthier customers. Where this is the case, the evidence suggests the number of consumers affected is generally small and that these consumers are likely to have been picked up by other adviser firms. Advisers have capacity and

have been taking on new clients. There is little evidence that consumers perceive themselves to have been abandoned by advisers. As this gap is likely to be small, to the extent there are firms willing to provide advice to lower wealth consumers, the market should be able to resolve this in time.

The evidence available does imply that adviser charges have increased post-RDR, at least for some consumers. This is likely to reflect limited competition in the advice market, with improvements around disclosure still required by firms, limited consumer awareness and understanding of adviser charging. Consumers can value trustworthiness and reputation of advisers over cost, further inhibiting shopping around. The credence good nature of advice may mean that consumers make judgements on more or less good proxies for quality — whilst this is not a new feature of the market it could further limit effective competition in the adviser market. However, the evidence that advisory firms have been removing cross-subsidies between consumers, suggests higher wealth clients may well be paying less than pre-RDR. These are also likely to be more able to negotiate down prices with their adviser, once these became visible. Given this, we would expect some price falls for at least some consumers — however we do not have direct evidence of this.

# 6 The Wider Retail Investment Market

## 6.1 Introduction

In this chapter we assess the progress of the RDR towards its objectives, extending the analysis of Chapter 5 to the wider retail investment market. In particular we consider the aims of the RDR in reducing distorted incentives among advisers driven by third-party commissions, and increasing transparency of charging across all elements of the retail investment market supply chain in order to facilitate competition and drive down prices. Our analysis considers the impacts of the RDR on platform charges, product charges and on the types of products sold.

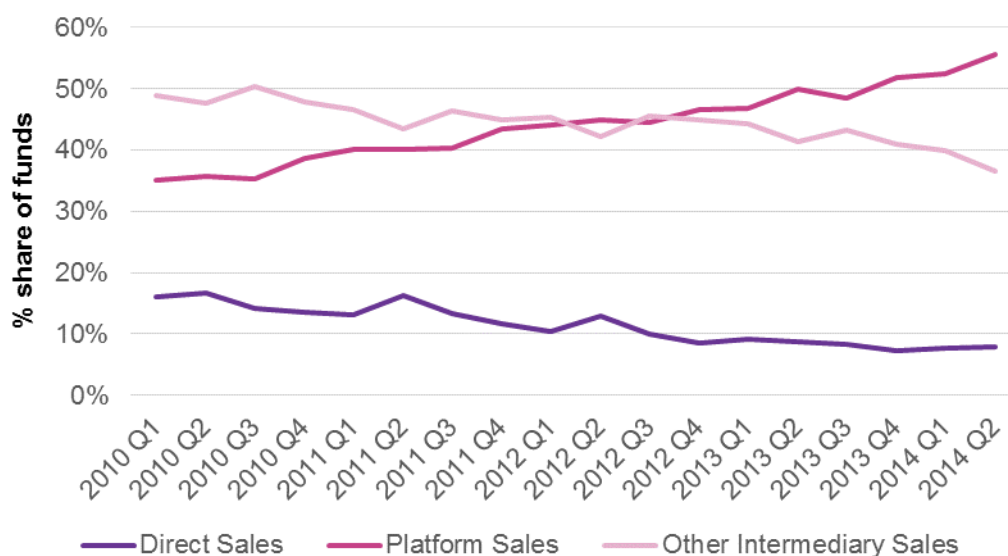
## 6.2 Impact on platforms

Platforms have been directly affected by the recently implemented RDR rules (in April 2014) requiring them to be remunerated directly from consumers for their platform services by a 'platform charge' and preventing them (in most circumstances) from paying rebates from product providers to consumers. This applies to both advised and non-advised consumers. However, platforms can continue to take payments from providers (and rebating) on legacy business until April 2016.

The RDR has reduced the complexity of D2C platform charging, enabling increased shopping around by consumers and driving down overall platform charges. Charges for B2B platforms have declined from pre-RDR levels. The drivers for this extend beyond the RDR — however we note that headline platform charges may also not account for all costs, making pre- and post-RDR comparisons difficult.

### 6.2.1 Growth in platforms

The impacts of the RDR must be considered in the context of wider platform growth. As described in the Introduction to this report, there has been a continuing growth in platforms as distribution channels for retail investments, both for direct sales to consumers (D2C) and advised sales where advisers use (B2B) platforms. Data from the IMA shown in Figure 6.1 show how the proportion of gross retail investment sales through platforms has been increasing since 2010. Increased retail sales through platforms have been at the expense of (off-platform) direct sales, which have declined from 16 per cent of all sales in Q1 2010 to eight per cent in Q2 2014. Sales through other intermediaries, which include financial advisers, wealth managers and stockbrokers, that do not use a platform, have also seen their share of gross sales decline from just under 50 per cent in Q1 2010 to around 36 per cent in Q2 2014.

**Figure 6.1: Share of gross retail sales by distribution channel of UK domiciled funds**

Note: Sales data cover equity, fixed income, money market, mixed asset, property and “other” sales. Platform sales includes intermediated sales.

Source: IMA.

### Consumer demand for platforms

The growth in D2C platforms as seen in section 2.3.5 is evidence of increasing consumer demand, through both a greater number of active private investors (increasing by nearly two million between 2010 and 2013) and increased account sizes.<sup>124</sup> The increase in demand is also evidence of an increasing trend towards self-directed investment, as described in Chapter 5. (At the same time, D2C platforms enable self-directed consumers to fulfil more processes independently given the ease of use and focus on the provision of information and guidance; the causality of this growth is therefore mixed). Platform estimates that, in early 2014, 29 per cent of UK investors are entirely self-directed investors, with 37 per cent being mostly DIY investors — with the remaining 34 per cent leaving investment decisions more or less entirely up to an adviser.<sup>125</sup>

### The role of the RDR

The long-term growth in platforms sales suggests this is coincidental to, rather than driven by the RDR — improvements in technology have driven platform growth, and social factors have helped to drive demand towards platforms, for example from increased levels of IT literacy and faster internet connections.

However, the RDR may have acted as an accelerant to this trend. In the context of B2B platform growth, platforms have been used increasingly by advisers for greater cost efficiency, which may have been accelerated by the removal of product commission by the RDR and the incentives for firms to adjust their business models, as described in Chapter 5. The increasing trend towards self-directed investment through D2C platforms may have been boosted by consumers who no longer have access to advice as a result of the RDR, either because they are unwilling to pay for full advice

<sup>124</sup> Platform (2014), “Guide to direct platforms and investors: A market turned on its head”.

<sup>125</sup> Platform (2014), “Guide to direct platforms and investors: A market turned on its head”.

or because the type of advice they are willing to pay for (e.g. some form of simplified advice) is not adequately available.

## 6.2.2 Changes in the cost of platforms

In this subsection we look at evidence on how platform charges have changed since the RDR was implemented. First we consider B2B platforms, then D2C platforms.

### B2B platform charges

Evidence of B2B platform charges pre-RDR is not extensive. Fundscape quotes an indicative payment of 25bps to platforms out of total fund charges.<sup>126</sup> In April 2012 Fidelity's FundsNetwork announced a flat 0.25 per cent fee, with an additional £45 annual account fee also being charged.<sup>127</sup> In October 2013, not long after the RDR was implemented, Platforum cited typical platform fees in the range of 25bps to 40bps, and also noted "a gradual decline in charges across the platform market,"<sup>128</sup> suggesting platform fees may have been falling from before 2013.

We have also collated a sample of current charges from B2B, presented below.

**Table 6.1: Cofunds platform charges**

Value of investment	Rate for tier
£0 - £100,000	0.29%
£100,000 - £250,000	0.26%
£250,000 - £500,000	0.23%
£500,000 - £1,000,000	0.20%
Over £1,000,000	0.15%

Source: Cofunds website.

<sup>126</sup> Fundscape (2014), "Navigating in the post-RDR landscape in the UK".

<sup>127</sup> Money Marketing (2012), "Fidelity FundsNetwork reveals unbundled pricing model". Available at: <http://www.moneymarketing.co.uk/fidelity-fundsnetwork-reveals-unbundled-pricing-model/1049067.article>.

<sup>128</sup> Platforum (2013), "Platform Pricing: An Adviser's guide to the Pricing Galaxy: Issue 2". Available at: <http://www.theplatforum.com/files/Platform-Pricing-2.pdf?v=3> (p.11).

**Table 6.2: Skandia platform charges**

<b>Value of investment</b>	<b>Rate for tier</b>
<b>£0 - £25,000</b>	0.50%
<b>£125,000 - £100,000</b>	0.35%
<b>£100,000 – £500,000</b>	0.30%
<b>£500,000 - £1,000,000</b>	0.25%
<b>Over £1,000,000</b>	0.15%

Source: Old Mutual Wealth Management.

With the exception of the 0.5 per cent charge for investments for Skandia investments under £25k, these platform charges fit within the range of 25bps-40bps cited by Platforum in 2013 or are lower (i.e. for larger investment amounts). There also appears to be increased competition between platforms in terms of making pricing simpler (e.g. reducing the number of tiers) as well as lower. (It is possible, however, that cuts to headline rates are simply reflecting / formalising discounts that advisers were already getting from the platforms.) The 25bps-40bs range still appears a reasonable estimate for current post-RDR platform charges incurred by moderate (and more common) investment amounts.

Further evidence for declining B2B platform charges is largely in relation to the 2014 Budget pension reforms, where platforms are seeking to attract increased business as consumers engage more with the pension product market. A number of B2B platforms (including those owned by providers) have reduced their charges for pensions and drawdown services following the Budget pension reforms, for example AXA Wealth, Old Mutual, Aviva, Ascentric, Aegon, Cofunds and Zurich. Zurich has also merged the two top tiers of its current platform charging structure so that a greater share of assets will be charged at the lower rate, a move also credited to maximising client engagement following the pension reforms.

In sum, comparing current B2B platform charges with pre-RDR charges the evidence is mixed. The 25bps-40bps range is higher than the indicative pre-RDR charges indicated by Fundscape (25 bps). In contrast, Platforum note an ongoing decline in platform charges in October 2013 when presenting the 25bps to 40bps range, and there is evidence of price competition between platforms, at least on headline charges. Given the lack of evidence on pre-RDR charges more generally it is not possible to conclude at this stage that the RDR in isolation is driving lower B2B platform charges; indeed much of the observed reduction in charges can be attributed to the recent pension reforms rather than to the RDR. There may also be other costs associated with platforms over and above the headline charges, which makes assessing the nature of any change still more challenging. Our view is that B2B platform charges are likely to have declined from pre-RDR levels, although the drivers for this extend beyond the RDR.



## D2C platform charges

D2C platform charges appear to be declining post-RDR. Platform<sup>129</sup> and Langcat<sup>130</sup> cite a pre-RDR standard of 150bp annual management charge, with about 75bp going to the platform. Platform then compares the old 75bps charge with lower new charges of 20bps, 25bps and 35bps adopted by a range of platforms for post-RDR clean share classes.<sup>131</sup>

An indicative example from Barclays Research shows how typical fees through a D2C platform may have changed pre and post RDR:<sup>132</sup>

Pre-RDR:

- Customer initially pays 150bps management fee to provider.
- Provider retains 75bps, and passes 75bps to platform in the form of a rebate.
- Platform retains 60bps as its fee, and passes a 15bps 'loyalty' rebate to the customer.
- **Customers' net fee is 135bps.**

Post-RDR typical fees are as follows:

- Customer pays a direct management fee to the product provider: 60-75bps.
- Customer pays direct fee to platform: 30-60bps.
- **Total fee to customer: 90-135bps.**

In addition to showing a potentially lower platform charge, this example shows how the complexity of D2C charging has reduced post-RDR. Pre-RDR there was little visibility to the customer on how the fees to the platform and provider were broken down. With the RDR rules, consumers pay separate fees to the platform and to the product provider, making it easier for them to search the market for platforms and products, which should increase competitive pressure on both. It is also likely that direct consumers are more price sensitive and more willing to shop around compared to those using financial advisers.<sup>133</sup> This implies that platform prices should have fallen and this appears to be the case as indicated in the evidence above.

In sum, due to the RDR the complexity of D2C charging has reduced through the removal of rebates, enabling consumers to better compare prices across platforms. This has driven increasing competition between platforms and led to declining D2C charges post-RDR. Longer term, D2C platform charges may fall even more as increasing numbers of consumers invest through them (due to both a growing secular trend and some shift away from advised investment) and as competition increases.

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<sup>129</sup> Platform (2014), "Guide to direct platforms and investors: A market turned on its head".

<sup>130</sup> The Lang Cat (2014), "Come and have a go: A direct approach to platform investing".

<sup>131</sup> Platform (2014), "Guide to direct platforms and investors: A market turned on its head".

<sup>132</sup> Barclays Research "European Diversified Financials: Superclean – coming to a platform near you" December 2013.

<sup>133</sup> To the extent that these consumers are more financially literate, they may well appreciate the strong influence of such product and associated charges on investment performance.

## 6.3 Impacts on products

We would expect the RDR to have had a significant impact on retail investment product providers. The ban on commissions to advisers and platforms means that providers can no longer incentivise advisers and platforms to sell particular products. Also the need for adviser and platform charges to be stripped out has meant providers have had to introduce 'clean' share classes for retail investors. Both of these changes are highly significant and we would expect them to affect the mix of products sold.

### 6.3.1 Changes in types of products sold

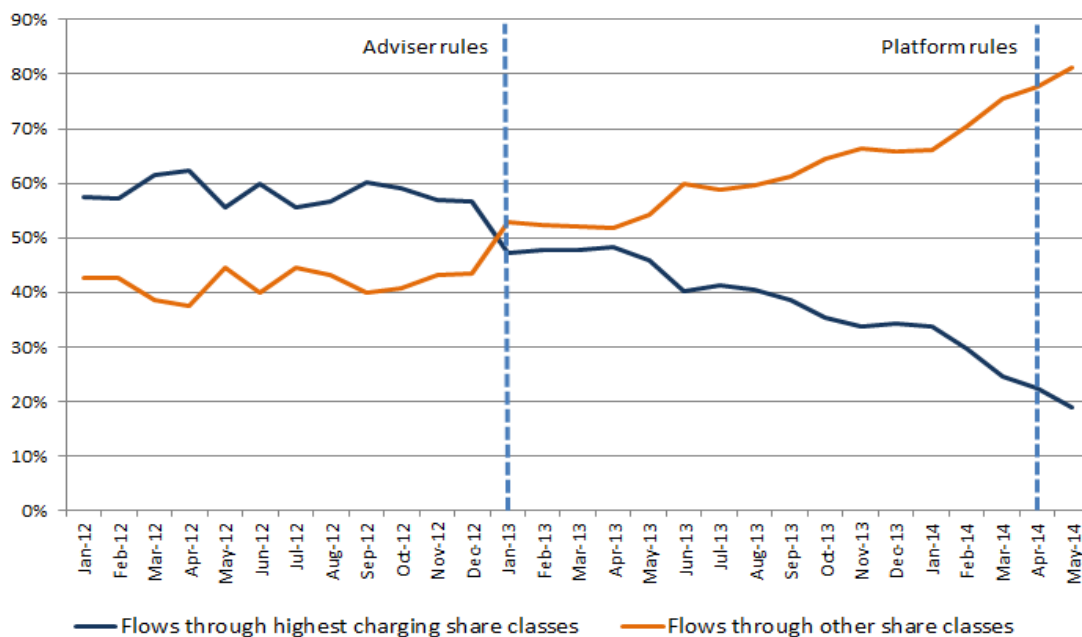
The ban on third-party commissions on retail investment products appears to have reduced product bias. This is evident from a decline in the sale of products which had higher commissions pre-RDR and an increase in the sale of retail investment products which paid lower or no commission pre-RDR, and a general decline in the proportion of investment products sold from the highest charging share classes relative to other, lower cost share classes. This is consistent with a removal of distorted incentives, whereby advisers recommend product purchases based on those which paid high commissions rather than those which best met consumers' needs.

The decline in the proportion of investment products sold from the highest charging share classes is shown in an IMA analysis below.<sup>134</sup> In January 2012, 60 per cent of all gross retail flows was through highest charging share classes. As of May 2014, 80 per cent of flows were through shares classes other than the highest-charging classes. This shift begins coincident with the implementation of the RDR (with a small element of anticipation of the RDR). In part this reflects increased access to lower charging classes.

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<sup>134</sup> An investment product can have multiple share classes with differing Annual Management Charges. The highest-charging share class in this sense is that with the highest AMC.

**Figure 6.2: Gross retail flows through highest-charging class shares and other shares**



Source: IMA (2014), "Asset management in the UK 2013 – 2014".

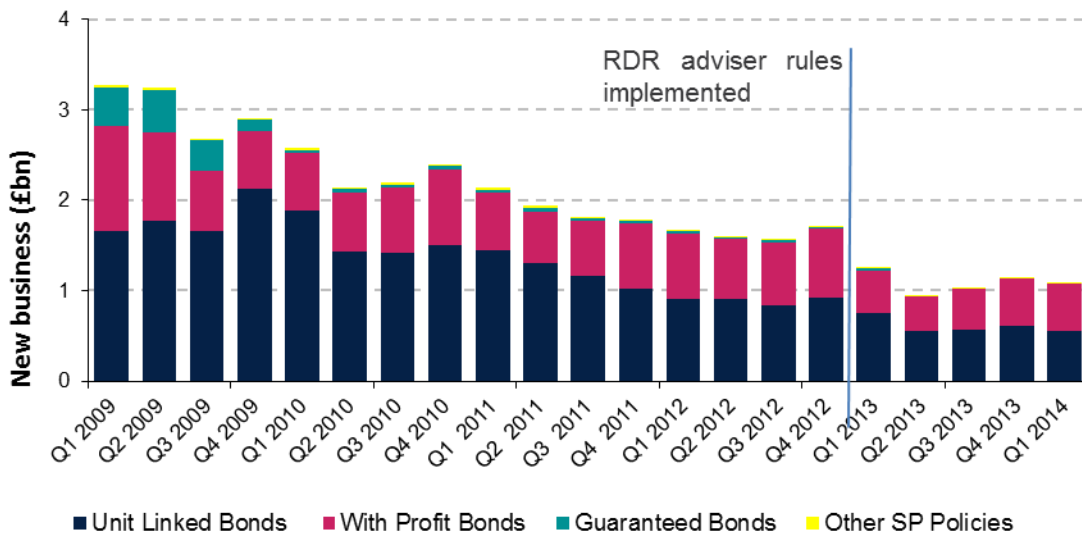
Our fieldwork supports this trend — advisers are increasingly demanding that product providers enable them to invest in lower charging ‘institutional’ share classes on behalf of their clients rather than the higher charging retail share classes available pre-RDR.

The decline in the sale of investment bonds, shown in the figure below, presents further evidence of a trend away from products which were high-commission pre-RDR (e.g. an initial charge of up to 7.5 per cent of initial funds invested).<sup>135 136</sup>

<sup>135</sup> See for example FSA (2011), "RDR post-implementation review: measuring progress and impact".

<sup>136</sup> The spike in sales pre-RDR could reflect a "buy now while stocks last" drive caused by ending commissions and fact that many providers did not have an RDR-compliant product at Jan 2013.

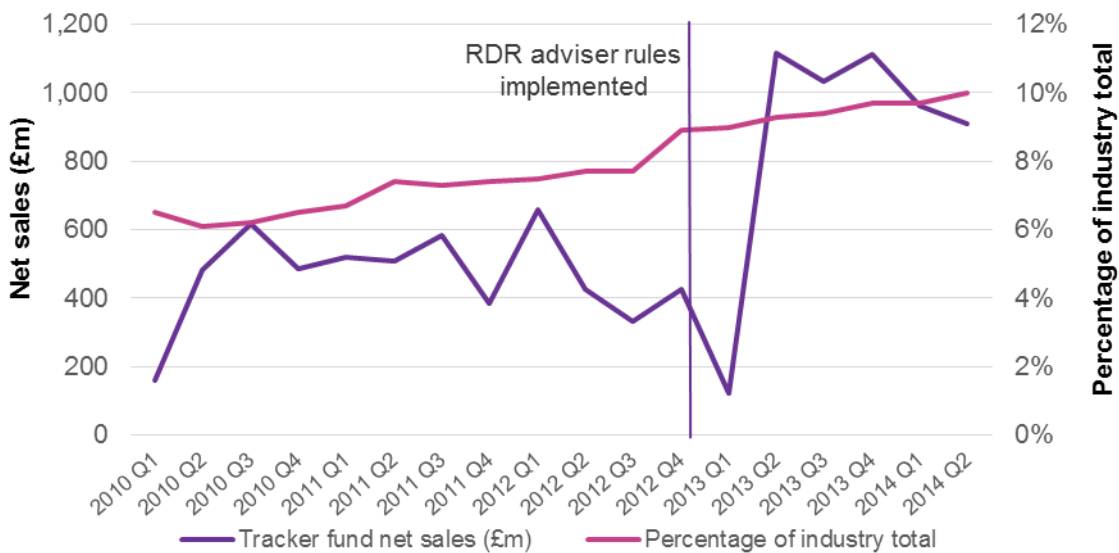
**Table 6.3: Decline in investment bonds**



Source: Association of British Insurers (2014). Note data refer to ABI members only.

The data also show a move towards lower-cost products and those which did not attract high commissions pre-RDR. For example, tracker funds typically have low costs and IMA data in the figure below show an increase in tracker fund sales post-RDR, with a spike in net sales at the beginning of 2013.<sup>137</sup>

**Figure 6.3: Tracker fund net sales and percentage of total funds under management**



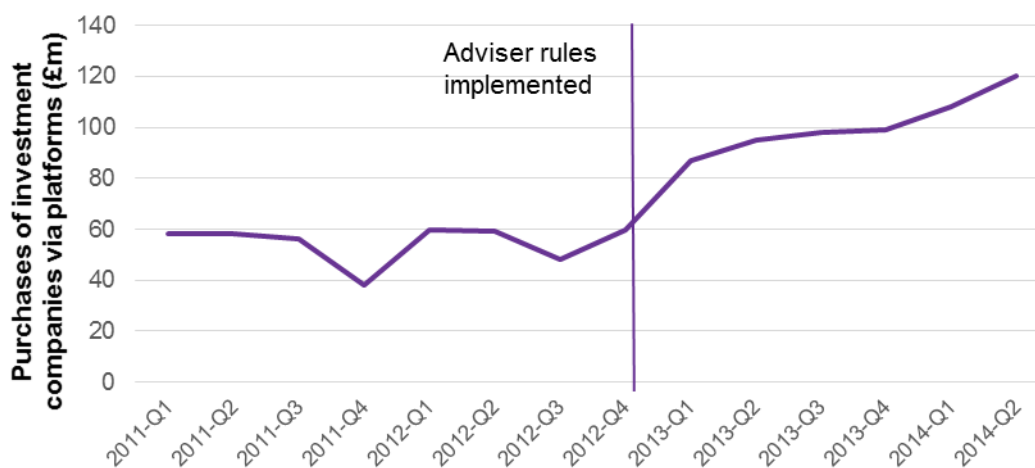
Source: IMA.

There is also evidence of post-RDR growth in products which have never paid commissions, such as sales in investment trusts / investment companies. Despite being still low in absolute terms, sales through advisory (i.e. B2B) platforms have more than doubled since the second half on 2012, as shown in the figure below. Similarly the AIC (Association of Investment Companies, which

<sup>137</sup> We select tracker funds as representing a simpler product with typically lower fund charges.

represents closed-end investment companies) data show that adviser-intermediated sales of investment companies have increased by 50 per cent post-RDR.<sup>138</sup>

**Figure 6.4: Purchases of investment companies through platforms**



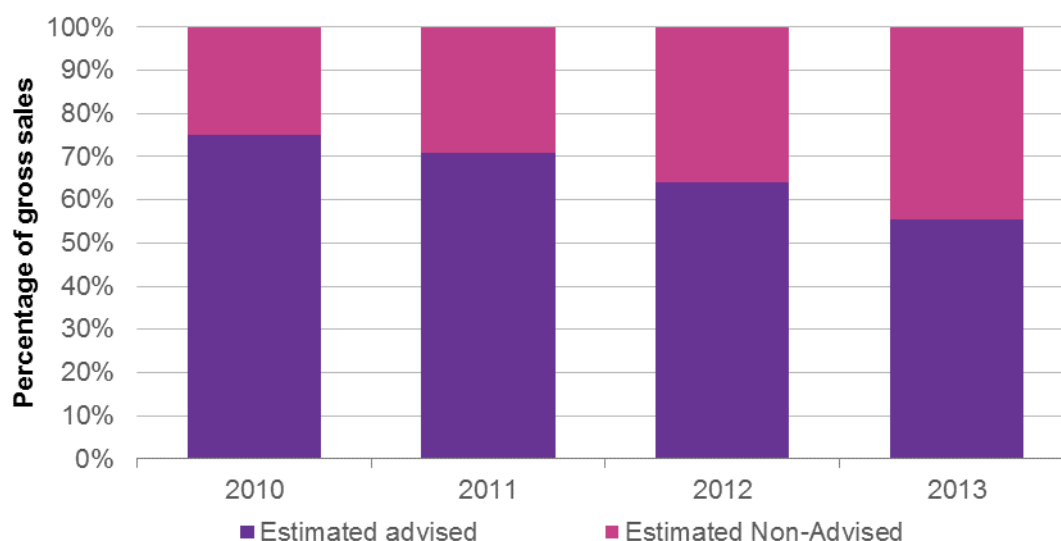
Source: AIC (2014) 'Demand for Investment Companies via Platforms Q4-13'.

### 6.3.2 Did the RDR change product mix?

An important question is whether or not the change in product mix was driven by the RDR ban on product commission. We would expect this to be the case, as advisers are no longer incentivised to recommend products with high commissions, and instead now place more importance on product characteristics such as price and suitability for the client. However, there could be other explanations for the change in product mix. For example, banks were responsible for selling a large proportion of investment bonds and their exit from the market could explain the observed reduction in these product sales. Platforms could also be influencing the product mix through their selection of products for their panels. We think the latter is likely to be happening to a certain extent, given the importance of platforms as a distribution channel. However, although these factors are likely to have contributed to the change in product mix, neither fully explain the trends in the figures above, particularly the step changes in product mix sold just around RDR implementation of the adviser rules (retail bank exit in particular began well before the implementation date of the adviser rules).

In addition to the clear step-changes in product sales just around the implementation of the RDR, there are other factors which indicate that the change was influenced by the RDR. Most of the retail investment sales of the affected products appear to be advised. ABI data show that investment bond sales are predominantly advised (e.g. 96 per cent in 2013) while the figure below, an estimated split of advised and non-advised sales for Unit trusts/OEICs, indicates that these are also likely to have been predominantly advised sales during implementation of the RDR. This indicates that the above changes in overall sales largely reflect changes in advised sales, which were affected by the RDR.

<sup>138</sup> AIC (2014) 'Demand for Investment Companies via Platforms Q4-13'.

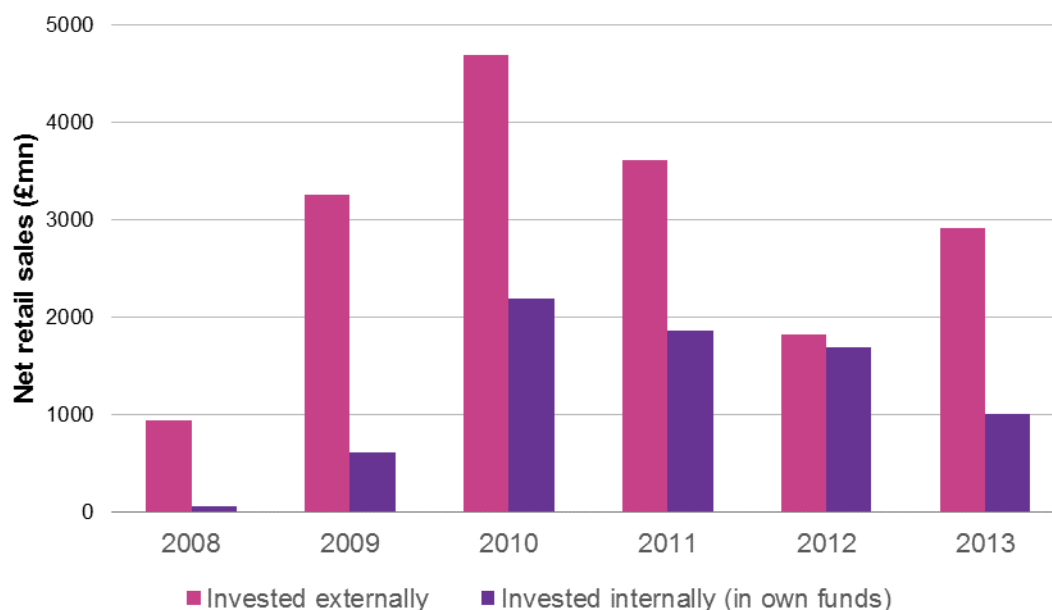
**Figure 6.5: Estimated proportion advised vs. non-advised gross sales in Unit trusts/OEICs**

Note: The figure includes platform sales.

Source: The split in advised and non-advised sales is estimated using the FCA's PSD, IMA published annual statistics on fund sales available at: <http://www.investmentfunds.org.uk/press-centre/2014/press-release-statistics1014/>, and the split between advised and non-advised for retail platform sales as reported by Fundscape in their press releases on their quarterly platform reports, for example, <http://www.fundscape.co.uk/blog/wp-content/uploads/2014/08/Fundscape-Platform-Press-Release-Q214.pdf>.

If we take the RDR as responsible for these shifts, it could be argued that advisers are simply recommending products with lower charges to maximise their own charges for advice (say if a consumer has a mental limit of what total costs she is willing to incur, and up to which she may be relatively price insensitive). This point is made by KPMG in work undertaken for the FCA Practitioner Panel.<sup>139</sup> This would raise the risk of a transfer in product bias from high-cost to low-cost products which may still not be in the best interests of consumers. Though this may be the case for some advisers, there is evidence of the continuation in growth of more expensive products post-RDR — Figure 6.6 shows that net retail sales of funds of funds, (typically) active funds with higher fund charges, have remained positive after the RDR. Whilst this is suggestive that advisers are not indiscriminately switching away from recommending higher cost products, further evidence is needed to draw full conclusions on this issue and the effect it may be having on the suitability of advice.

<sup>139</sup> KPMG (2014), "Initial impacts of RDR — research summary", on behalf of the FCA Practitioner Panel".

**Figure 6.6: Net retail sales UK domiciled funds of funds (Unit Trust/OEICs)**

Source: IMA data.

In summary, we consider the evidence of the changes in products sold are fully consistent with a reduction in pre-RDR product bias towards high-commission products, with advisers changing their recommendations once the ban on product commission was introduced, although some of the changes may in part be attributable to other factors. All else being equal this is an indicator of an improvement in the quality of advice provided to consumers.

However, the RDR may not have completely removed provider bias. The FCA's 2013 thematic work on inducements and conflicts of interest found concerns that a significant proportion of product providers and advisory firms had agreements in place that could breach Principle 8 (on conflicts of interest) and the inducements rules, such as soliciting or providing payments or other benefits that would have the same effect as commissions in securing distribution.<sup>140</sup> The review noted that this indicates that some advice to consumers may still be inappropriately influenced by providers. However, the review was conducted soon after the implementation of the RDR and the FCA subsequently published guidance in January 2014 on inducements and conflicts of interest; firm compliance in this regard should therefore be improving as the RDR rules bed down, reducing the potential for provider bias.<sup>141</sup>

Distorted incentives may also still remain in relation to adviser charging. Evidence from the RMAR, adviser surveys and our fieldwork shows that the majority of advisers have a charging structure based on a percentage of funds invested, and that further a large proportion of charges may be contingent in investment. This may therefore partly undermine the aim of the RDR to better align advisers' incentives with those of consumers, at least to the extent that it creates an incentive for

<sup>140</sup> FCA (2013) "Supervising retail investment advice: inducements and conflicts of interest: Guidance Consultation", September 2013.

<sup>141</sup> FCA (2013) "Supervising retail investment advice: inducements and conflicts of interest: Finalised Guidance", January 2014.



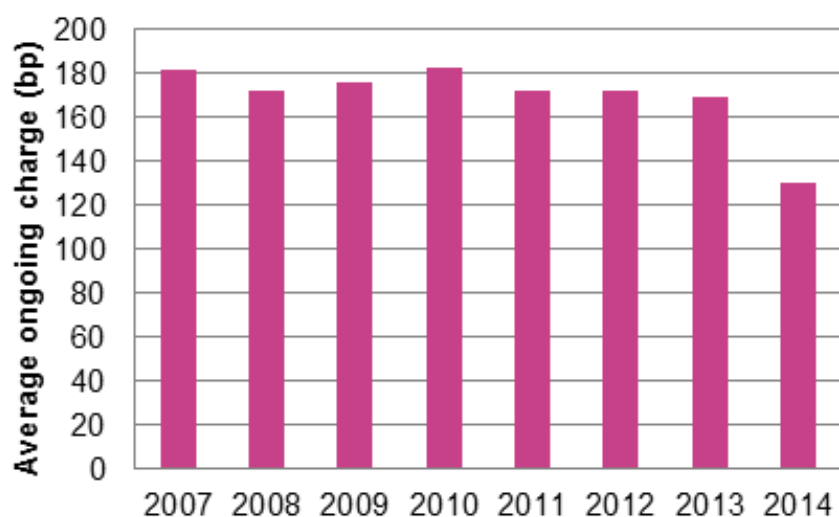
the adviser to recommend investing (or investing a larger sum than otherwise) which may not be optimal for the consumer.

### 6.3.3 Changes in the cost of products

Overall we would have expected product charges to decline post-RDR due to the removal of the commission element. In considering consumer outcomes, we assess whether product charges have fallen over and above these expectations. We find that charges for retail investment products have been falling post-RDR, driven by increased pressure on providers from advisers and platforms as a result of the RDR. Part of this decline is attributable to the introduction of simpler products and funds which are more straightforward to manage and thus have a lower charge. If these products are just as beneficial to consumers then this represents positive innovation; but does not shed light on the impact of the RDR on prices of existing products. The available evidence is not sufficient to enable us to conclude whether *existing* product prices have declined, although there are indications that they have. Products sold direct to consumers may not see a fall in prices as there is not the same downward pressure from consumers as from advisers and platforms. We discuss the evidence for these findings here.

Data from Lipper presented in the figures below indicate how current ongoing charges for the retail share classes launched post-RDR are lower on average than those for share classes launched before the RDR, for (UK domiciled) active and passive funds sold in the UK.<sup>142</sup> The first chart shows a difference of about 40bps on average ongoing charge for active funds, and about 25bps for passive funds. However, this large difference is likely to be due to adviser and platform charges having been stripped out of the ongoing charge in the new 'clean' share classes.

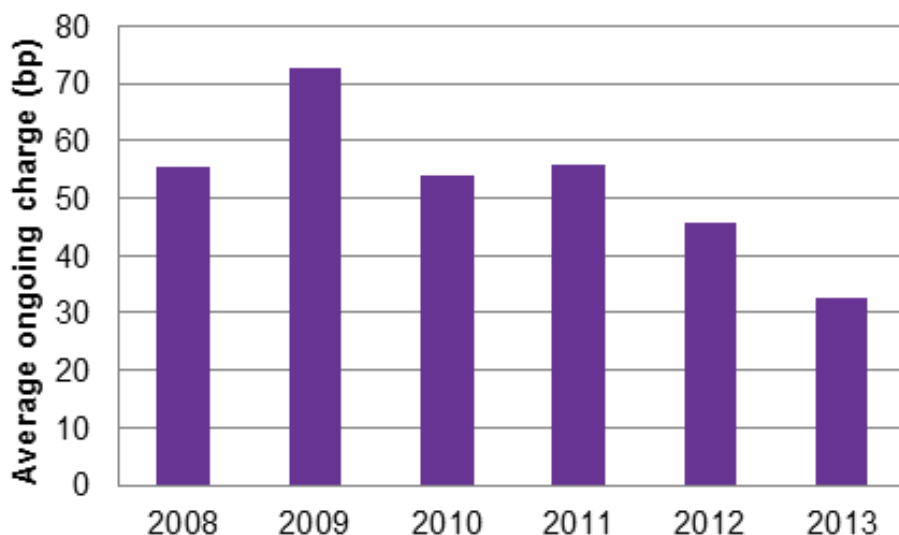
**Figure 6.7: Average ongoing charge for UK-domiciled and UK sold active funds, by retail share class launch year**



<sup>142</sup> The Lipper fundfile data gives the latest reported ongoing charge. This means the charts above do not give, for earlier funds, the ongoing charge when the share class was launched. However, we do not expect for most funds widespread systemic deviations from the original ongoing charge, e.g. providers are likely launching new clean share classes rather than adjusting charges on old share classes, so average ongoing charges should be (roughly) indicative of historical charges.

Source: Lipper fundfile.

**Figure 6.8: Average ongoing charge for UK-domiciled and UK sold passive funds, by retail share class launch year**



Source: Lipper fundfile.

To compare how product charges have changed, we therefore need to consider how pre- and post-RDR charges compare net of adviser and platform commissions.

Before the RDR, typical examples of ongoing charges<sup>143</sup> levied by product providers were:

- Equity funds typically charging 1.5 per cent.
- Balanced and higher-risk bond funds charging 1.25 per cent.
- Core bond funds charging 1 per cent.<sup>144</sup>

We understand equity funds would usually entail commissions of 50bps to advisers, and, where platforms were used a further 25bps to platforms.<sup>145</sup> Thus for equity funds, providers would receive around 75bps pre-RDR. We do not have indicative commission and rebate figures for the lower-charging funds, but would expect given their lower overall ongoing charge, these would pay somewhat less than 75bps.

In addition, as also noted by Fundscape, large distributors often received commissions and rebates greater than the 75bps quoted above — often between 55 and 60 per cent of the overall fund charge. For a fund charge of 150 bps this equates to between 82.5bps and 90bps in commission, with 60–67.5bps going to the provider. For a fund charge of one per cent this equates to between 55bps and 60bps in commission, with 40–45bps to the provider.

This implies that pre-RDR providers could have received between around 40bps and 75bps net, depending on the type of fund and type of distributor / adviser.

<sup>143</sup> It is not clear whether these figures relate to an ongoing fund charge or just the asset management charge (AMC) — Fundscape refers only to the 'pricing models' of firms. AMC may exclude additional expenses. The pre- and post-RDR figures discussed in this section are referred to in the same way throughout the Fundscape report.

<sup>144</sup> Fundscape (2014), "Navigating the post-RDR landscape in the UK".

<sup>145</sup> Fundscape (2014), "Navigating the post-RDR landscape in the UK".

On post-RDR charging, Fundscape cite some examples of ongoing fund charges on new (clean) share classes — in Sep 2013 Investec introduced a share class charging 65bps on its leading funds, and Hargreaves Lansdown quotes industry average fund prices of 71bps, with specific prices including 54bps on its core fund offering, and 66bps on its Wealth 150 panel. Taken together this implies a post-RDR range of 54-71bps (although as 71bps is an average, actual range is likely to be somewhat broader).

Comparing these pre- and post-RDR ranges (40bps-75bps versus 54bps-71bps) does not suggest a marked change in ongoing fund charges from the RDR. However, survey evidence of product providers shows a widespread perception of declining charges and pressure on product margins. Of providers participating in the Dunstan Thomas Survey,<sup>146</sup> most thought there was some fall in product charges, 41 per cent thought retail investment product providers' charges were already falling, while nearly a quarter said pension providers are reducing prices and just over a quarter reported decreasing fund manager charges. Industry commentary also points to the role of the RDR in increasing pressure on prices.<sup>147</sup> Our fieldwork indicates that advisers are also putting more pressure on providers to let them invest in lower charging institutional share classes rather than higher charging retail share classes. There is also a view that advisers are placing far greater emphasis on the relationship between fees and performance to make sure that the overall cost for the investor does not rise and certainly that it remains on a par with pre-RDR costs.

Altogether the evidence is suggestive of slightly reduced product prices. The change in product mix discussed above is also likely to be driving lower fund costs in general for investors. For example, advisers are now more likely to recommend tracker funds, which typically have lower fees than actively managed funds. This is consistent with the trend shown in Figure 6.3.<sup>148</sup> Due to their passive nature, tracker funds can often have extremely low charges, sometimes as little as 9 basis points, and there has been a general trend for these charges to decrease over time.<sup>149</sup> There is also evidence that the cost of tracker funds has declined following the RDR. For example, in September 2014 Vanguard cut its charges by up to 50 per cent for some of its tracker funds,<sup>150</sup> although this could also be driven by intensifying competition between platforms.

It is possible that product providers with their own platforms may compete more heavily on platform charges than on product charges. As an example, Fidelity changed their fee structure from February 2014 onwards.<sup>151</sup> Previously, a single charge was levied on each fund totalling 170 bps, with the fund manager receiving 95 bps and the distributor splitting the remaining 75 bps with the platform provider. The recent approach adopts a clean pricing strategy, whereby the fund

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<sup>146</sup> Dunstan Thomas (2013), "Life after the Retail Distribution Review".

<sup>147</sup> Fundweb (2013), "The implications of the Schroders deal with Cazenove". Available at: <http://www.fundweb.co.uk/fund-strategy/issues/17th-april-2013/the-implications-of-the-schroders-deal-with-cazenove/1069682.article>.

<sup>148</sup> Fundweb (2013), "The implications of the Schroders deal with Cazenove".

<sup>149</sup> Financial Times (2014), "More transparency for platforms, but more complexity too".

<sup>150</sup> Fundweb (2014), "Vanguard slashes trackers fees by as much as 50%". Available at: <http://www.fundweb.co.uk/news-and-analysis/passives/vanguard-slashes-trackers-fees-by-as-much-as-50/2013685.article>.

<sup>151</sup> Fidelity (2014), "Announcing clearer, low cost pricing". Available at: <https://www.fidelity.co.uk/investor/funds/fund-charges/fund-charges.page>.

manager still receives 95 bps, and a separate platform/distribution charge is levied to the customer. In the case of Fidelity's own platform, this fee is 35 bps compared to 75 bps previously.<sup>152</sup> While this indicates that the total price to consumers has dropped, the product charge has remained unchanged. This may imply that vertically integrated providers may be able to retain higher product charges compared to providers with no platform of their own.

Products sold directly to individual consumers may not see a fall in prices as there has been no change in terms of charge unbundling (as commissions were not paid on these pre-RDR). Indeed, the cost of managing funds for individual consumers is likely to remain relatively high as there are not the same scale economies as with products distributed widely through intermediaries. Anecdotal evidence from providers indicates that the charges for servicing direct customers can remain high, e.g. an annual management charge of 150 bps compared to the often quoted figures of between amount 50 bps and 100 bps for advised products. This may be cost reflective given the typically small amounts invested.

## 6.4 Summary

There has been continued growth in platforms as distribution channels for retail investments, both for direct sales to consumers (D2C) and advised sales where advisers use platforms (B2B). There is evidence to suggest that, in relation to D2C platforms, consumers are increasingly shopping around between different platforms and exerting downward competitive pressure on platform charges. This has been facilitated by the reduction in the complexity of D2C charging through the removal of rebates, enabling consumers to compare prices better across platforms. D2C charges may continue to fall in the longer term if platform use continues to grow. Charges for B2B platforms have declined from pre-RDR levels, although the drivers for this extend beyond the RDR.

Charges for retail investment products have been falling post-RDR. Product prices have fallen by at least the amounts paid in commission pre-RDR, and there is evidence some product prices could have fallen even further, due in part to competitive pressure from platforms and advisers, e.g. to gain access to lower cost share classes, and also the introduction of simpler products which are more straightforward to manage and thus have a lower charge.

We noted in the previous chapter that the cost of advice appears to have increased. In relation to total cost of investment — also the value obtained by consumers from that advice — the evidence does not yet enable us to draw firm conclusions as to whether this has changed post-RDR. In part this reflects the sometime opaque nature of the data and the difficulty in disentangling the various elements of interest. The ranges in pre- and post-RDR estimates of platform, product and adviser payments, and the various ways in which these feature in different investments, means it is not yet clear whether declines in product and platform prices are more or less offset by increases in advice costs. A longer post-RDR trend in prices should bring greater clarity on this.

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<sup>152</sup> Wealth Manager (2014), "Fidelity undercuts Hargreaves with 0.35% platform charge". Available at: <http://citywire.co.uk/wealth-manager/news/fidelity-undercuts-hargreaves-with-0-35-platform-charge/a729589>.

The ban on third-party commissions on retail investment products appears to have reduced pre-RDR product bias among advisers. This is evident from a decline in the sale of products which had higher commissions pre-RDR and an increase in the sale of retail investment products which paid lower or no commission pre-RDR, and a general decline in the proportion of investment products sold from the highest charging share classes relative to other, lower cost share classes. Although other factors, such as the influence of platforms, will also have effected changes in this area, they cannot fully explain the step changes in product mix sold just around RDR implementation of the adviser rules.

# 7 Sustainability of the Industry

## 7.1 Introduction

Another objective of the RDR is to promote the long-term sustainability of the industry where *firms are sufficiently able to deliver their longer term commitments and where they treat consumers fairly*.

There are no RDR provisions specifically designed to meet this objective. However, the increases in professionalism levels, and the creation of a more efficient advice market whereby the true cost of advice is now visible to firms and consumers, were intended to encourage firms to develop business models that better met consumer needs, including longer term needs.

To assess progress against this RDR objective, this chapter looks at how sustainability of the industry has changed as a result of exit of firms, business model changes and firm profitability.

## 7.2 Are firms better able to meet their long-term commitments?

Initial signs are that advisory firms appear slightly better placed to meet their long-term commitments, although the evidence does not enable us to conclude whether this is attributable to the RDR. Though there was some exit from the advisory market, particularly in the period leading up to the RDR, by retail banks and some financial advisers, the numbers of advisory firms and advisers now appear stable. Among advisory firms, average revenues have been increasing over the past few years. Profitability of firms in the retail investment market has also increased, and the percentage of firms posting a loss has decreased. Capital and reserve levels have remained stable or increased for the majority of those firms with a retail investment focus. This indicates an industry where advisory firms are better placed to meet their long-term commitments, provided they continue to build up capital reserves from greater profits. We discuss the evidence for these findings in the following sections.

### 7.2.1 Adviser and firm exit

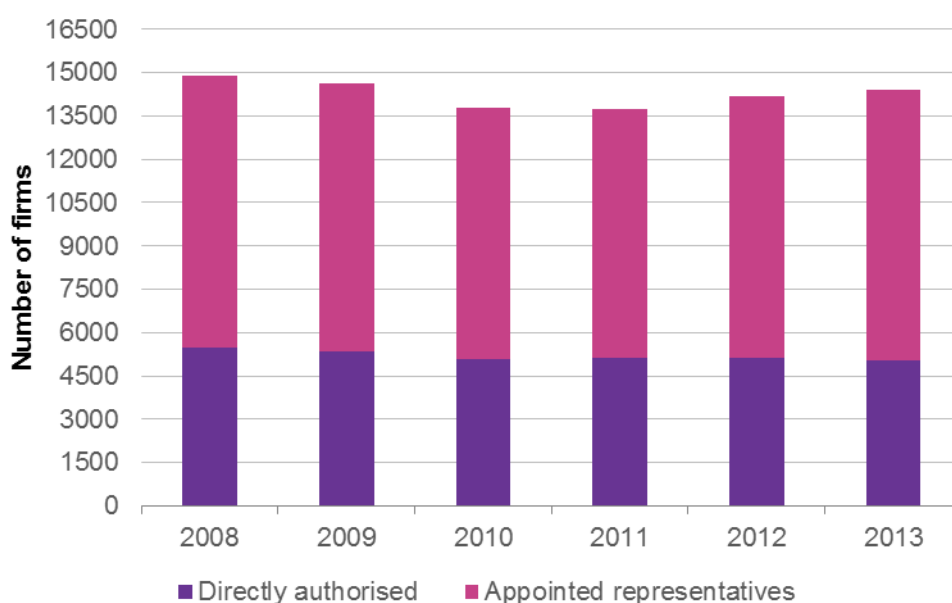
Section 5.3 describes the adviser and firm exit following the RDR. Though there was some exit from the advisory market, particularly in the period leading up to the RDR, by the banks and by some financial advisers, numbers of advisers and advisory firms now appear stable. The RDR is likely to have expedited an existing trend of exit by firms and advisers (the RDR pushed advisory firms to evaluate and adjust their business models and levels of qualification) with a number of other market factors contributing.

As set out in section 5.3.3, the exit of adviser firms has been much less significant than adviser numbers, with only an eight per cent fall in the number of Directly Authorised advisers between 2008 and 2013 (and a marginal decline in the number of Appointed Representatives over that

period).<sup>153</sup> And, as with adviser numbers, the fall in the number of the advisory firms predates RDR implementation, with the total number of firms increasing since 2011. This can be seen in Figure 7.1 below. There is no clear reason for the downward trend in firm numbers between 2008 and 2011 — this could be due to the impact of the financial crisis in 2008 and the wider contraction of the economy.

The increase in firm numbers leading to and after the RDR is driven by an increase in the number of Appointed Representatives, indicative of a shift of individual advisers to network arrangements, where advisers work as Appointed Representatives rather than employees. Our fieldwork suggests that joining a network as an Appointed Representative can be an attractive solution for advisers seeking to reduce the operating costs associated with running a Directly Authorised advice firm (including avoiding the costs of maintaining the independent status), and yet wanting to retain a greater degree of autonomy than available from joining a tied advice/sales force. In this case, the move towards greater numbers of Appointed Representatives does appear to be strongly influenced by the RDR.

**Figure 7.1: Number of advisory firms between 2008 and 2013**



Source: FCA RMAR data on firms with the primary category 'Financial Adviser'.

We note that this contrasts with the research conducted by KPMG for the FCA Practitioner Panel which concludes that the RDR has led to the demise of Appointed Representative networks and the growth in Directly Authorised firms.<sup>154</sup>

### 7.2.2 Revenues and profitability

Among advisory firms, average revenues from retail investments appear to have been increasing over the past few years. Profitability of firms in the retail investment market has also increased, and

<sup>153</sup> Aggregated FCA RMAR data for firms with Primary Category "Financial Adviser", as published in APFA's "Financial Adviser Market: In Numbers", April 2014.

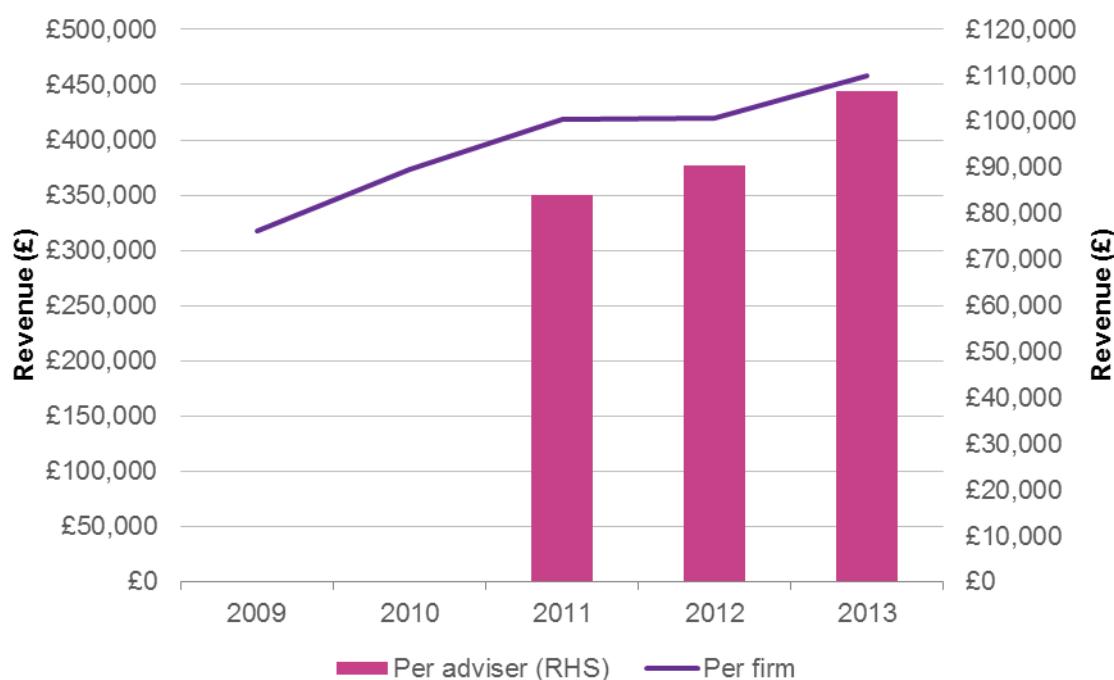
<sup>154</sup> KPMG, 2014, "Initial impacts of RDR — research summary" on behalf of the FCA Practitioner Panel.



the percentage of firms posting a loss has decreased. Capital and reserve levels have also increased recently.

Analysis by APFA of the RMAR indicates that average revenue from retail investments for Financial Adviser firms has been increasing over recent years, as illustrated in the chart below. This may be explained by the exit of less efficient advisers / firms, or a general increase in profitability stemming from operational efficiencies.

**Figure 7.2: Average revenue from retail investments per advisory firm and per adviser**



Note: The data relate only to firms recorded as Financial Adviser firms in the RMAR.

Source: FCA and RMAR data as quoted by APFA. Revenues per adviser only available from 2011 as robust adviser numbers pre-2011 not available.

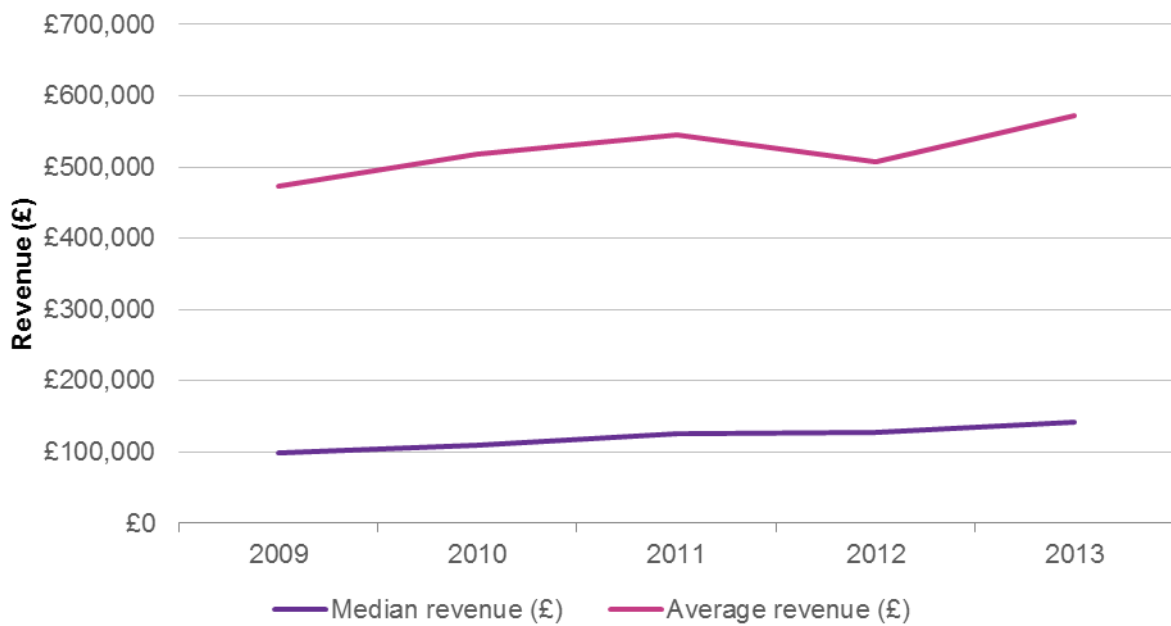
The total revenue figure indicates that the RDR has not had a notable negative impact on firms remaining in the market. Further, increases in revenue are, holding everything else constant, not consistent with a significant surplus of advisers or strong downward competitive pressure on prices.

The figure below presents the average and median revenue from retail investment products. These have been increasing since 2009, with a dip in average revenues in mid-2012.<sup>155</sup> In addition, revenue from retail investment products as a proportion of total revenues has increased across firms across the period (from 73 to 80 percent).<sup>156</sup> This indicates that the RDR has not had a negative impact on firms' retail investment business and is consistent with an increase in focus by these firms.

<sup>155</sup> The median revenue is significantly less than the average revenue in all years, which indicates that there are some larger firms bringing the average revenue up, and a greater number of smaller firms in the market.

<sup>156</sup> RMAR data.

**Figure 7.3: Average and median revenue related to retail investment products across all firms reporting in RMAR**

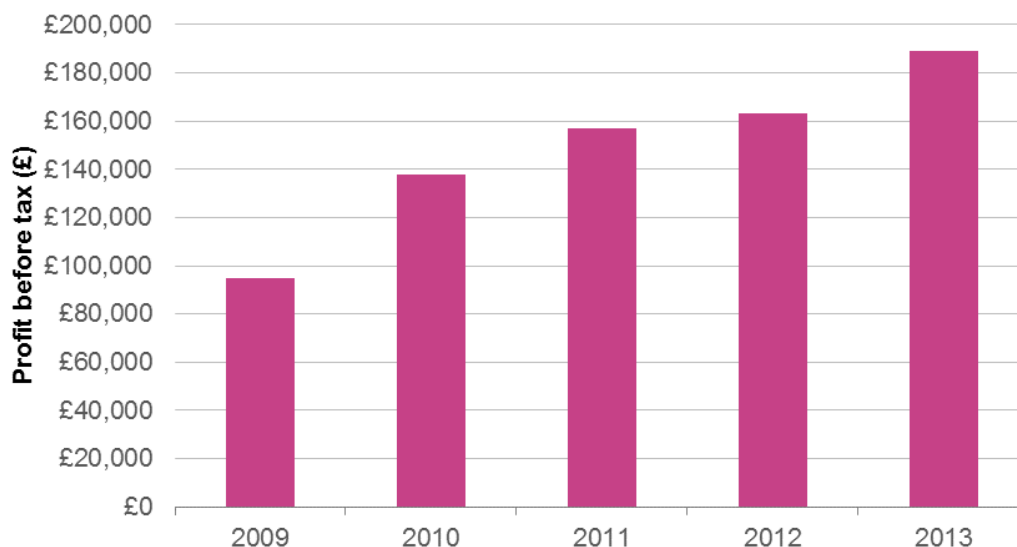


Note: All RMAR figures are in nominal terms. Figures adjusted for inflation show a similar trend.

Source: RMAR. Sample size for this question is around 4,500.

According to APFA, the average level of profits (before tax) generated by a financial advice firm has increased from around £157,200 to £189,281 between 2011 and 2013, representing an increase of around 20 per cent. Similarly, the average profit per adviser has increased by around 36 per cent to £41,826.<sup>157</sup> The profitability of an average financial advisory firm is shown in the figure below.

<sup>157</sup> APFA (2014), "The advice market post RDR review".

**Figure 7.4: Average profit generated by directly authorised financial advice firms**

Source: APFA (2014), "The advice Market post RDR review".

Although average pre-tax operating profits have increased, retained profits have fallen slightly, i.e. taxes, exceptional items and dividends paid to shareholders have exceeded pre-tax profits — according to RMAR data (as quoted by APFA) retained profits decreased from £136 million in 2011 to £100 million in 2012, before recovering slightly to £128 million in 2013.<sup>158</sup>

The table below uses the RMAR to show the average capital and reserves and profits across firms providing retail investment advice of different sizes. This replicates the form of analysis conducted for the FSA's RDR PIR baseline, and we focus on firms where retail investment revenue is greater than 50 per cent of total revenue.<sup>159 160</sup>

<sup>158</sup> APFA (2014), "The advice market post RDR review".

<sup>159</sup> FSA (2011) "RDR post-implementation review: measuring progress and impact", page 16. As it is not possible to separate out the financial activity of the retail investment part of a firm which also conducts other business, firms where this activity is likely to be very small have not been included in the analysis.

<sup>160</sup> We note that our results for 2010 differs slightly to the FSA's analysis for 2010, most likely due to differences in reporting dates for firms and some discrepancies in the way the data have been cleaned.

**Table 7.1: Total profits and capital and reserves, by firm size for firms with retail investment revenue greater than 50 per cent**

	Number of firms	Average total capital and reserves (£)	Average total profit (£)	Number of firms posting a loss	% of firms posting a loss
<b>Size: 1 adviser</b>					
2010	1,534	68,977	48,228	101	7%
2011	1,659	69,853	55,400	75	5%
2012	1,756	70,028	55,494	89	5%
2013	1,731	75,992	59,621	84	5%
<b>Size: 2 advisers</b>					
2010	792	84,048	80,554	48	6%
2011	819	91,173	93,837	36	4%
2012	837	90,112	93,340	42	5%
2013	814	119,845	109,952	38	5%
<b>Size: 3 advisers</b>					
2010	400	101,025	92,620	22	6%
2011	413	169,273	222,580	24	6%
2012	421	208,701	123,492	24	6%
2013	396	273,659	140,514	19	5%
<b>Size: 4 advisers</b>					
2010	263	116,954	120,165	15	6%
2011	257	139,326	139,432	11	4%
2012	262	187,032	159,668	13	5%
2013	231	195,794	175,017	9	4%
<b>Size: 5-10 advisers</b>					
2010	357	244,542	218,368	33	9%
2011	379	204,426	171,615	28	7%
2012	369	279,715	334,605	26	7%
2013	352	236,196	190,678	21	6%
<b>Size: 11-20 advisers</b>					
2010	79	425,009	192,321	10	13%
2011	78	402,113	286,071	8	10%
2012	75	610,978	291,410	11	15%
2013	73	537,861	271,579	8	11%
<b>Size: 21-50 advisers</b>					
2010	31	1,128,306	534,549	7	23%
2011	26	1,746,761	470,354	3	12%
2012	22	1,462,889	527,664	3	14%
2013	22	2,119,874	1,263,434	5	23%
<b>Size: 50+ advisers</b>					
2010	15	10,807,684	- 55,974	6	40%
2011	16	8,058,510	- 963,770	6	38%
2012	12	6,621,996	- 840,498	6	50%
2013	15	8,685,655	1,730,375	7	47%

Source: RMAR.

To the extent the patterns reflect retail investment business activity (the data for individual firms can also reflect non-retail investment activity, up to 50 per cent of total activity), the data suggest that average total profit has generally been stable or grown for firms, although the picture is more mixed for the largest firms. The percentage of firms posting a loss has decreased since 2010, again with the exception of the larger firms (although profitability has improved since 2012). Total capital and reserves have also increased for most firm categories in 2013 compared with 2010, with the exception of firms with between 5 and 10 advisers, and firms greater than 50 advisers (although again the picture has improved since 2012). The higher likelihood of larger firms posting a loss may reflect scale diseconomies in the provision of advice or, given the relatively small number of large firms, may simply reflect firm-specific considerations. However, this lower profitability was evident since before the RDR (similar results were obtained in the FSA's earlier calculations).

Overall, the RMAR data we have analysed and the APFA analysis suggest growing average revenue and profitability among advisory firms from pre-RDR to now. The greater profitability and revenue should put firms in a stronger position to meet long-term commitments, as does the increasing capital and reserves. These patterns may reflect the exit of less profitable firms over time (as the data are averaged across firms), including exit driven by the RDR. However, they are likely to be only partly driven by the RDR. Given the limited data set available it is not possible to attribute fully such changes to the RDR, or other particular market trends. We also note that research conducted by KPMG for the FCA Practitioner Panel reaches a very different conclusion: raising doubts about the sustainability of 'sub-scale' advisory firms as well as noting that the sustainability of firms is unclear given the delay in applying capital adequacy rules.<sup>161</sup> This research was based on a survey of the opinions of various industry firms and trade associations: we prefer our analysis based on the RMAR because it is based upon actual reported data from a much larger number of firms across the industry.

Of course, we also note that missing from the above are those firms with less than 50 per cent in retail investment revenues. This is likely to include some of those firms, e.g. banks, which have re-structured or even eliminated their retail investment activities.

### 7.3 Summary

The initial signs are that advisory firms appear slightly better placed to meet their long-term commitments. Though there was some exit from the advisory market, particularly in the period leading up to the RDR, by the banks and by some financial advisers, numbers of advisers and advisory firms now appear stable. There remains a large number of advisory firms and advisers to serve consumers. Among advisory firms, average revenues have remained stable or have been increasing over the past few years. Profitability of firms in the retail investment market has also increased, and the percentage of firms posting a loss has decreased. Capital and reserve levels have increased. Taken together, these indicate an industry where advisory firms should be better placed to meet their long-term commitments, provided they continue to build up capital reserves from greater profits.

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<sup>161</sup> KPMG, 2014, "Initial impacts of RDR — research summary" on behalf of the FCA Practitioner Panel.

# 8 Compliance Costs and Overall Impacts

## 8.1 Introduction

This chapter presents the overall impact of the RDR as part of a high-level *ex post* cost-benefit analysis. The aim is to present how the compliance costs that were incurred by firms compare with what we originally expected, and more broadly, to draw together the analysis above to compare the wider impacts of the RDR with those that were expected when the FSA consulted on the package of proposals. As noted previously, a definitive evaluation is not possible at this early stage and our assessment is of the impacts of the RDR to date.

## 8.2 Compliance costs of the RDR

### 8.2.1 Expected compliance costs

Part of the costs anticipated as a result of the RDR were the costs to firms in complying with and implementing the new requirements. There are two relevant sources for the *ex ante* estimates of these compliance costs:

- PS10/6 sets out the revised estimates of the incremental compliance costs, based on an extensive survey with over 1,100 responses.
- PS13/1 sets out the revised estimates associated with the changes in the platform rules.

The PS10/6 study provides estimates of compliance costs distinguishing the following two categories of firms:

- Intermediaries: includes Directly Authorised (DA) and Appointed Representative (AR) firms, banks, stockbrokers, network providers, financial services conglomerates, and insurer and asset manager distribution arms.
- Providers: includes conglomerates, insurers and asset managers (excluding their distribution arms).

One-off intermediary compliance costs were estimated at £275–£370 million. The most significant costs were expected to be incurred by financial advisers (both DA and AR), with the combined cost between £95 and £130 million. Banks (£80 to £110 million) and insurer distribution arms (£40 to £50 million) were also expected to incur substantial incremental costs. The one-off cost of training advisers to obtain QCF Level 4 was expected to be the largest cost driver, with other drivers of one-off costs expected to relate to adviser charging and clarity of service.

Ongoing intermediary compliance costs were estimated at £100–£120 million. Again financial advisers (both DA and AR) were expected to incur the most significant combined costs (£55 to £65 million) followed by insurer distribution arms (£10 to £15 million).

One-off provider compliance costs were estimated at £330–£385 million. The highest share of these costs were expected to be incurred by insurers (£185–£225 million), followed by asset managers (£80 to £85 million) and conglomerates (£65–£75 million). Whilst the significance of different cost categories varied depending on the type of firm, considerable costs were identified as system costs, providing additional share classes, and redesigning products for factory gate pricing.

Ongoing provider compliance costs were estimated at £70–£85 million, being distributed quite evenly among insurers and asset managers. These costs were mostly attributed to administration of new share classes and systems maintenance costs.

PS13/1 anticipated £33–£67 million in one-off costs, with the vast majority being incurred by platform providers but with non-trivial impacts for fund managers.<sup>162</sup> The one-off estimates largely reflect the cost of changing systems to accommodate the new rules banning cash rebates, with the largest cost item being driven by firms changing their systems to ones that support unit rebating. Per firm impacts were expected to be greatest for non-advised platforms. Ongoing costs were expected to be £8–£15 million.

### 8.2.2 Our findings on compliance costs

The *ex ante* estimates of the incremental compliance costs of the RDR were largely based on an analysis underpinned by an extensive survey of those firms expected to be affected. Our approach has been different: much more small-scale in scope (about 25 interviews), but with greater scope to challenge and consider the estimates received from market participants.

We assessed the incremental compliance costs across different types of firms affected by the RDR, based on our fieldwork, namely:

- Providers, including integrated firms (10 firms interviewed).
- Intermediaries (this is more narrowly defined than in the *ex ante* studies, being more focused upon financial advisers; 12 firms interviewed).
- Platforms (four interviewed).

We begin with our qualitative analysis before presenting our quantitative estimates — and comparing these to the *ex ante* figures.

#### Providers, including integrated firms

This group covers providers of retail investment products, predominantly asset managers and insurance companies (life and pensions). Where providers have relatively large sales/distribution arms employing advisers — or form part of groups which incorporate both provider and sales arms — these have been included also in this category.

Many providers incurred significant costs in absolute terms. The costs were experienced heterogeneously across various cost categories (i.e. system costs, clarity of service and documentation). The largest share of costs was incurred on technology changes (IT systems), e.g.

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<sup>162</sup> The Discussion Paper updated the cost estimates originally presented in the FSA's CP12/12.



related to the adviser charging requirements. These requirements also prompted the development or amendment of price tariffs and training staff.

Integrated firms are those that produce retail investment products and also have significant distribution capacity through advisers and/or platforms. These firms in our sample were unable to sufficiently disentangle their costs between these different elements (with the exception of a few categories such as the professionalism requirements) as compliance with the RDR was treated as a single project, with a number of overlaps across business areas.

The compliance costs incurred were high, likely driven by the scale and complexity of services. The main driver related to developing or amending IT systems and/or procedures. The second and third biggest cost components were attributed to adviser charging and the professionalism requirements. Following that, there were cost related to product redesign and pricing. The cost of product redesign (including administration of new share classes) was not considered to be particularly significant. The costs attributed to the pricing of products includes developing and implementing price tariffs and amending the price structure so that it does not involve paying commissions. This cost might have been underestimated by firms, because of interaction with costs that could have been included in general/system costs. In addition to the types of costs incurred by providers (without distribution arms) these firms tended to incur large costs relating to professionalism (staff training and exams). The last significant element of compliance costs was documentation.

This category of firms also has the most significant ongoing costs related to the RDR, with the biggest share due to system maintenance. The clarity of service requirements also contribute by increasing the time spent on client communication.

### Intermediaries

The direct costs of complying with the RDR were generally small for the firms in our sample. Some of the firms had already developed business models compliant with the RDR's requirements but significantly in advance of its implementation — or even its announcement (i.e. the firms had successfully anticipated the direction of travel in the FSA/FCA's regulation of third party commissions). This meant that no (or at least very limited) changes were needed to business models, albeit several of these firms still needed to incur cost to bring their advisers into line with the professionalism requirements.

Indeed the biggest challenge for the independent intermediaries was to comply with the new professionalism requirements, and this is the category of costs that was incurred by most firms with only some of the smaller companies already had sufficiently qualified staff; others had to pay for exams and training and/or provide time for studying.

In terms of the drivers of other costs, whilst 'Independence standards' were more frequently cited, the costs due to 'Clarity of service' and 'Adviser charging' requirements were more notable. Even those firms providing independent advice pre-RDR had to improve their IT systems or procedures (e.g. for reporting purposes) or else needed additional support staff.

Costs linked to 'Adviser charging' or 'Clarity of service' included both costs directly and indirectly resulting from the RDR requirements. Among the direct effects were amending price tariffs or

spending more time with customers explaining services. The indirect costs were not well-defined, relating to a general increase in the cost of doing business.

For smaller firms changes were often priced in services they normally obtain (provided, for example, by compliance or IT service providers, for whom incorporating regulatory change is part of the business as usual package). The larger advisory firms incurred one-off investments, but expect limited ongoing costs.

### Platforms

Whilst the sample size is very small (as is the population of platforms) we understand that the nature of the technology underlying particular platforms was a driver of differential cost experience. This meant that the newer “wrap” platforms (i.e. those which are often D2C focussed) were less affected than at least some of the more well-established platforms (i.e. those focused on servicing the advisory market). The latter have incurred very substantial one-off costs in several categories, driven in particular by being forced to make changes to their IT system resulting from new adviser charging requirements. The general costs of renegotiating contracts, changing literature and documentation, upgrading system capabilities and increased communication with advisers and providers contributed to the final cost experienced.

### Quantitative results

We discuss our key results with respect to the groupings identified:

- **Providers and integrated firms.** Based upon our fieldwork we constructed the following range estimates for incremental cost impacts in this group. This range is wide, but captures nearly all of the estimates received.

**Table 8.1: Providers and integrated firms compliance costs per firm (£m)**

	One-off (£m)		Ongoing (£m)	
<b>Large integrated (15)</b>	15	25	2	4
<b>Medium integrated (30)</b>	2	6	<1	<1
<b>Small integrated/ other providers (200)</b>	<1	<1	<1	<1

Note Two large integrated providers incurred costs above this range. This has been accounted for discretely in the summary table below.

- **Intermediaries.** Our fieldwork indicated a surprisingly high number of firms which incurred little or no cost other than those related to professionalism. Whilst the firms contacted were randomly arrived at, not all responded and it may be that this is not fully representative of the wider sector. We have based our findings below on the *ex ante* estimates per firm (which held up well by comparison to the firm-level data that we collected), but with revised population data. The population of advisers working at such firms dropped by about thirteen per cent between 2011 and mid-2012 according to RS Consulting data (there are no corresponding 2010 data from RS). The number of adviser firms increased slightly over the period, by about three per cent (RMAR data) which is understood to be driven largely by an increase in AR firms. Overall we have adjusted the cost impacts downwards by approximately five per cent. Our view is that this is likely to be a conservative approach for this category of firm.

- **Platforms.** We interviewed two well-established platforms offering wide market choice to advisers and also two platforms with substantial D2C offerings. We are not able to disclose the firm-level estimates, as this would reveal confidential information to, at the least, these participants. Interestingly, the interviews and associated fieldwork indicated that the larger advisory platforms were more affected than (newer) wrap platforms and also the D2C platforms. This is not what was expected by the pre-RDR analysis: instead the compliance cost impact on the latter were expected to be the more considerable.

Overall, the aggregate incremental compliance cost impacts are as follows:

**Table 8.2: Industry-wide incremental compliance costs (£m)**

	One-off (£m)			Ongoing (£m)		
<b>Intermediaries</b>	109	-	152	71	-	81
<b>Providers</b>	355	-	625	32	-	76
<b>Platforms</b>	32	-	48	11	-	15
<b>Total</b>	<b>496</b>	<b>-</b>	<b>825</b>	<b>114</b>	<b>-</b>	<b>171</b>

Note: Intermediaries include financial advice firms, stockbrokers, DIMS and networks as identified in PS10/6 — however we have reallocated other groups (e.g. the distribution arms of insurers) to the Provider category.

### 8.2.3 Comparison to *ex ante* estimates

The table below presents our *ex post* estimates in comparison to the *ex ante* estimates.

**Table 8.3: Comparison of *ex ante* and *ex post* RDR compliance cost estimates**

	Estimates pre-RDR £m		Estimates post-RDR £m	
	<i>One-off</i>	<i>Ongoing</i>	<i>One-off</i>	<i>Ongoing</i>
<b>Intermediaries</b>	275 - 370	100 - 120	109 - 152	71 - 81
<b>Providers</b>	330 - 385	70 - 85	355 - 625	32 - 76
<b>Platforms</b>	33 - 67	8 - 15	32 - 48	11 - 15
<b>Total</b>	<b>638 - 822</b>	<b>178 - 220</b>	<b>496 - 825</b>	<b>114 - 171</b>

Market participants contributing to our fieldwork were not always able to distinguish clearly between the RDR and the later ban on cash rebates and it therefore made sense to consider both together. This means that comparison of *ex ante* and *ex post* estimates should be done at the total cost level.

It is apparent then that there is considerable overlap in terms of the one-off costs with a similar upper bound estimate, but with our estimate of the lower bound well below the *ex ante* one (the mid-point of the *ex post* range presented here is a little over 10 per cent below that of the *ex ante* estimates of one-off costs).

On the other hand the ongoing cost estimates are below those arrived at *ex ante* — there is no overlap in the range and the mid-point is about 30 per cent lower. A likely contributing factor here is that such ongoing costs (other than say systems related costs) have largely been successfully absorbed into business as usual costs by the industry.

## 8.3 Wider costs and benefits: the overall impact

### 8.3.1 Expected wider costs and benefits

The FSA's *ex ante* analysis also discussed wider costs and the benefits expected to arise from the RDR and the cash rebate ban. In terms of wider impacts:

- The greatest potential for market exit was expected for small independent intermediary firms, with substantial exit and/or consolidation expected. This, in turn, could reduce choice of advice for consumers — but this was expected only in the short term as the entry barriers were deemed low enough as to not be too prohibitive for new entrants in the longer term. Thus, firm exit was not expected to create a net cost in terms of economic welfare because the supply of advice would not be impaired in the long run.
- A move from advised to non-advised sales was considered to be low in likelihood.
- The ban on commissions leading to the removal of cross-subsidies from customers investing a lump-sum to those investing regular sums.
- A further acceleration in platforms gaining market share.
- Consumer confusion and the cost of processing errors resulting from additional share classes and the consequent complexity of pricing structures might reduce the effectiveness of competition.

The key benefits identified by the FSA's papers are:

- Higher quality of advice driven by the higher qualification requirements, professional standards, supervisory monitoring and enforcement. The delivery of services more suited to the needs of consumers would then result in better consumer outcomes — and ultimately an improvement in consumer trust and confidence in advisory market.
- Reduction in provider, product and sales bias resulting in reduced incidence of mis-selling. The ban on commissions was expected to eliminate provider bias, whilst the other two biases were expected to be at least reduced by the independence requirements, effective monitoring and higher professionalism standards.
- Increased competition among providers, with greater focus on competition on enhanced quality.
- Increased shopping around by advisers, prompted by the ending of cash rebates.

### 8.3.2 Our findings on the overall impact of the RDR so far

#### Overall impact on advised consumers

It is likely that those consumers who are receiving full advice now are more likely to be receiving better quality advice due to increased levels of qualification and professionalism among advisers, and more detailed ongoing services. It is also likely that at least some consumers are receiving better advice on the basis that product bias has reduced. This is due to the ban of commissions that has removed distortionary incentives among some advisers to recommend products based solely on the level of commission paid. There were some residual concerns about provider bias in the form of agreements between providers and distributors that could be perceived to influence

distribution, although we do not have evidence of whether this continues to be an issue following the FCA's action in this area. Definitive conclusions on the quality of advice will be better drawn once sufficient time post-RDR has elapsed and changes are visible on consumer outcomes.

The change in the total cost of investment to these consumers is however unclear. On the one hand, there is evidence that product charges have declined (i.e. some charges now are lower than what providers received from the total charge pre-RDR after the adviser/platform commission slice). However, there is evidence that adviser charges have increased in some cases (certainly, there is no notable evidence to suggest that these have fallen), and lower product charges may not offset this. There is also the possibility that some advisers are channelling more of their clients' portfolios to lower-charging (i.e. passive) funds in order to keep total costs to clients low, rather than reducing their own charges. Further, for advisers using platforms there may be an additional explicit platform charge.

The table below uses figures presented in Chapters 5 and 6 to estimate the indicative total cost to investors pre- and post-RDR, based on an investment of £10,000 for Equity funds (or ISAs).

**Table 8.4: Illustrative changes in costs to advised investors**

	Pre-RDR	Post-RDR min	Post-RDR max
Provider charge	75	54	66
Adviser charge	50	50	100
B2B platform charge	25	29	50
Initial	300	100	300
<b>Total ongoing</b>	<b>150</b>	<b>133</b>	<b>216</b>
<b>Total initial</b>	<b>300</b>	<b>100</b>	<b>300</b>

#### Overall impact on consumers not receiving advice

For those consumers who invested via platforms pre-RDR and continue to do so post-RDR, they are likely to be better-off relative to before the RDR given the fall in D2C platform charges.

For those consumers who invested directly pre-RDR and continue to do so, there is likely not to have been much change.

For those consumers who received advice pre-RDR and are now investing via platforms or directly, whether they are better-off will depend on the quality of advice they would have received pre-RDR and the suitability of the products they choose post-RDR.

For consumers who were previously receiving advice and who are now no longer investing, whether they are better-off depends on the quality of advice they would have received pre-RDR and what they are choosing to do with their assets instead.

#### Overall impact on firms and market structure

As set out above, we have found that compliance costs to firms of complying with the RDR are likely to have been as expected or lower than originally estimated.

Among advisory firms, average revenues have remained stable or have been increasing over the past few years. Profitability of firms in the retail investment market has also increased, as have

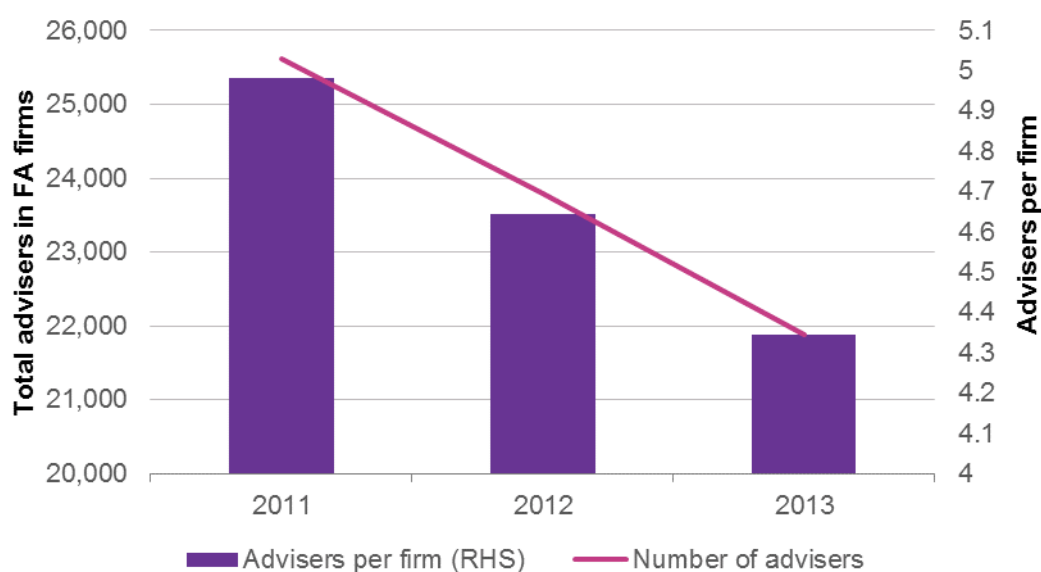
levels of capital and reserves for most firms, and the percentage of firms posting a loss has decreased. This implies improved sustainability for the industry as a whole.

In their report for the FSA's RDR consultation in 2009, Oxera analysed competition and the structure of the market for retail investment products.<sup>163</sup> In their discussion of market structure, they found the market to be characterised by a large numbers of providers and advisers, with a number of different types of distribution channel. Oxera found little evidence of barriers to entry for providers or advisers, and there was some evidence of vertical integration.

Since 2009 and in the lead up to the RDR there was some exit from the advisory market, particularly in the period leading up to the RDR, by the banks and by advisers working at other firms. However the number of advisers leaving the industry was in line with expectations, and numbers of advisers and advisory firms now appear stable.

Overall, the RDR does not appear to have reduced competition between adviser firms. Despite the decline in adviser numbers there is no evidence of significant horizontal consolidation, particularly among independent financial advisers. Together with the decline in total number of advisers there has also been a decline in the number of advisers per firm (of around 12 per cent between 2011 and 2013). (We do note, however, that this could mask a consolidation among the top few companies).

**Figure 8.1: Average number of advisers per Financial Advice firm**



Note: The figure excludes banks.

Source: APFA (2014), "The advice Market post RDR review". Only includes advisers in firms recorded as 'Financial advice' firms.

Our calculations of the Herfindahl–Hirschman Index (HHI, an index of competition in a market) among financial adviser firms using RMAR data on retail investment revenues further indicates that concentration has not increased. Between 2009 and 2013 the HHI has fluctuated between around 300 and 500 and, although it has increased overall across the period, it remains well below 1,000

<sup>163</sup> Oxera (2009) 'Retail Distribution Review proposals: Impact on market structure and competition'. Available at: <http://www.oxera.com/Oxera/media/Oxera/RDR-proposals-June-2009.pdf?ext=.pdf>.



(the range typically considered to signify a concentrated market). Broadly, this suggests that competitive pressure between firms does not appear to have weakened from the exit observed in the market.

There has been a strong trend in the growth of D2C and B2B platforms. The large infrastructure investment required, economies of scale, and tailing off of the technology boom suggests that new entry will be limited and that competition among platforms may decline over time. Dunstan Thomas suggests that the minimal level of assets under management for a platform to run effectively is around £1 billion, which they consider to mean that some of the 30 or so smaller wrap platforms currently on the market will consolidate or be forced out of business over time.<sup>164</sup> That said, evidence of increasing consumer shopping around between platforms is likely to maintain competitive pressure on prices. This is consistent with an *ex ante* market assessment which predicted that the ban on rebates would lead to increased price transparency through charge unbundling, and enhance inter-platform competition.<sup>165</sup>

New entry in other areas of advice is visible, in particular in relation to technology-driven innovation aimed at self-directed investors, which may further enhance competition. As discussed above, there is an expressed interest among firms in developing advice offerings for the mass market. Firms are proceeding with caution however due to concerns about future liability and associated regulatory risk, and there are no imminent entrants here.

In terms of vertical integration between advisers and providers, the most significant development has been the exit of large vertically integrated firms, in the form of the withdrawal of some of the retail banks from the advice market. The RDR rule<sup>166</sup> banning cross-subsidisation of advice charges by product charges among vertically integrated firms has not appeared to be a particularly notable factor in driving this exit, nor was it raised as a particular concern among vertically integrated firms in our fieldwork.

Besides this there is only limited evidence of increases in vertical integration. Examples include Old Mutual acquiring Intrinsic (financial advisers) and Quilter Cheviot (wealth managers) in 2014; Succession Advisory Services launching a platform for advisers in 2012; and Legal and General acquiring Cofunds platform in 2013. The stated rationale behind these acquisitions includes adaption to the post-RDR world including operation efficiencies and growth. However, such activity is limited. Vertical integration between providers and adviser firms may increase in the future as providers seek alternative routes to regain their influence on the retail market. The impact of such integration on consumers can be mixed. On the one hand, the integration may benefit from cost synergies and result in lower prices for consumers and increased competition at the retail levels. On the other, it could lead to a reduction in product choices offered to consumers since advisers operating under a provider are likely to be restricted to offers products offered by the provider only; for example the IMA notes that vertical integration continues to occur and expresses the view that this could restrict fund choice.<sup>167</sup>

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<sup>164</sup> Dunstan Thomas (2013), "Life after the retail distribution review".

<sup>165</sup> Deloitte (2012) "Analysis of the introduction of rebate bans on the platform market".

<sup>166</sup> COBS 6.1A.9.

<sup>167</sup> IMA (2014), "Asset Management in the UK 2013 – 2014. The IMA annual survey".



### Overall impact on competition

In their 2009 report, Oxera found that competition in pre-RDR retail investment markets was driven by providers persuading advisers to recommend a particular provider's products, rather than by advisers marketing products to consumers and consumers actively choosing. They also found that competition between advisers was limited, with most consumers not appearing to shop around for advice. They found the competition between advisers that did exist appeared to be on quality of service and access to products, rather than price.

From our evidence, competition post-RDR between advisers remains limited. Drivers of this appear to be historically poor disclosure by firms, a lack of understanding amongst consumers in relation to adviser charging, and factors such as adviser trustworthiness and reputation being more important to consumers than cost. These inhibit consumer shopping around and also make it difficult to make informed decisions, which is already challenging with advice since its quality is inherently difficult to assess. These limit the competitive pressure consumers can exert on advisers.

Nonetheless, our fieldwork also revealed a common contention by the industry that some consumers are more aware of costs with the new focus on adviser charging and that some are negotiating with their advisers. This is supported by research by Mintel which found that a third of advisers have reported that their clients want to pay less for advice post-RDR.<sup>168</sup> So, even if this awareness does not translate to switching behaviour, it may lead to some degree of downward price pressure on advisers. However, our view overall is that the scope for increasing price pressure on advisers remains limited.

In light of this, our findings on adviser charging and examples of possible total costs of investment which indicate that these are similar or slightly higher than pre-RDR are unsurprising. However, alongside is the evidence that advisers are now increasingly competing on the quality of their ongoing services to justify their explicit adviser charges. This fits with consumers' focus being on quality of service rather than cost.

Post-RDR consumers' use of platforms has continued to grow and there are indications that the reduction in the complexity of D2C platform charging through the removal of rebates has enabled consumers to better compare prices across platforms. These consumers are more inclined to shop around and it appears the resulting competitive pressure has led to a decline in platform charges post-RDR, and if this continues charges may continue to decline in the longer term.

On the firm side, our evidence is unclear as to how competition between B2B platforms for advisers is evolving. However, as advisers are well-informed and strongly incentivised to focus on platform cost and services, there are reasons to expect pressure on B2B platform prices and services from advisers. However, future consolidation among platforms could weaken this.

Generally, there appears to be increased competitive pressure on providers. The evidence on the change of product mix suggests that, with the removal of provider commission, advisers are exercising price pressure on providers. The removal of product bias appears to have contributed to a change in the products sold. This may also be indicative of an improved quality of products (in

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<sup>168</sup> Mintel (2013), "Savings and Investing – Intermediary Focus", UK, November 2013, p. 20.

terms of performance and fit with consumers' needs) from better quality advice, but it is too early to assess this at this stage.

Likewise, the growth of platforms has also led to greater pressure on providers. Due to their scale, platforms typically have greater bargaining power. The competitive pressure exerted by platforms on providers is also expected to increase as platform rules banning commissions and rebates bed down. The growth in platforms and the recent decline in direct sales also suggest an increasing ability of platforms to negotiate lower product costs. In addition, our fieldwork indicates a levelling of the playing field between providers, as advisers search for the cheapest products rather than highest commissions or the most well-known providers. Some providers from this fieldwork have noted an increase in price pressure (e.g. in the form of more protracted negotiations).

Taken altogether, post-RDR there has been a shift in the dynamics of competition, with providers no longer competing via commission for advisers to sell their products. Instead, providers now compete, at least partly on price, for business from platforms and from advisers. The greater clarity on pricing appears to be strengthening competition between D2C platforms, and to a much lesser extent may be adding some downward price pressure on advisers from some — but not many — consumers' willingness and ability to negotiate charges. Overall, however, the continued weak ability of advised consumers to assess costs and the quality of advice means advisers still face limited competitive pressure on price and as a result appear to be offering adviser charges in line with or greater than the commission they received pre-RDR. On the other hand, they appear to be competing more on the features on which consumers do focus, such as the quality of the services (e.g. ongoing services) they provide. As noted previously, there is scope for consumers to pick poor proxies for the underlying quality of the investment service received. Given the observed change in product mix, changes in competition also appear to have led to changes in advice and product recommendations, but at this stage it is too early to assess whether this has driven any improvement in the quality of advice.

### 8.3.3 Comparison with *ex ante* objectives

In considering the overall impact of the RDR to date, we now compare this with the *ex ante* objectives.

#### *Standards of professionalism that inspire consumer confidence and trust*

There are indications of a move towards a more professional advice market. Although higher professional qualification does not automatically translate into improved conduct, higher levels of qualifications and skills can be expected to improve the quality of advised services. However, any increased consumer trust and confidence in the market is not yet evident.

#### *An industry that engages with consumers in a way that delivers more clarity on products and services*

Whilst there has been improvements in the disclosure of information provided to consumers there is still a lack of clarity amongst consumers in relation to advice services and charges which is likely to limit the extent to which consumers exert competitive pressure on advisers.

#### *Remuneration arrangements that allow competitive forces to work in favour of consumers*

The removal of commission has led to the reduction of product bias in adviser recommendations, resulting in the enhancement in quality of advice for at least some consumers. The removal of

platform rebates has reduced the complexity of D2C platform charging, enabling consumers to better compare prices across platforms. This competitive pressure has led to a decline in D2C platform charges post-RDR. Advisers and platforms are now also better able to exert pressure on providers, with platforms increasingly able to negotiate lower product costs. On the other hand, the cost of advice appears to have increased. However the impact on the total cost of investment — and critically the value obtained by consumers — are not yet clear.

*An industry where firms are sufficiently able to deliver on their longer term commitments and where they treat customers fairly*

Firms appear slightly better able to deliver on their longer term commitments, providing they use their increased profitability to continue to build up capital reserves. Profitability among the larger firms remains relatively low. The costs of complying with the RDR have been in line with or lower than expectations.

*A market which allows more consumers to have their needs and wants addressed*

The market is showing signs of adjusting to offer advice which is more tailored to consumers' demands. There are likely to be a group of consumers who are not willing to pay for full advice at true cost but who may be willing to pay for a cheaper alternative form of advice.

*A regulatory framework that can support delivery of all aspirations and does not inhibit future innovation where this benefits consumers*

Industry commentators suggest that 'simplified advice solutions' designed for the mass market might be profitable and there are encouraging signs of innovation in the market, particularly in relation to simplified or automated advice. However, there is a considerable perception of regulatory risk among potential providers (related to both the FCA and the Financial Ombudsman Service). Recent signals from the FCA, e.g. its guidance consultation on sales which involve a personal recommendation and those which do not and its recent feedback statement on Project Innovate, may help to address this.

### 8.3.4 Evolution of the market and the ongoing impacts of the RDR

As this is the first PIR, many of the impacts analysed in this report will evolve over time as the new rules bed down and the market adjusts further. We identify the following as likely short- to medium-term changes:

- Whilst adviser numbers have stabilised, there may be further exit of advisers — or further adjustment to business models — as the proportion of legacy commissions contributing to revenues declines and firms face a clearer economic reality of adviser charging.
- Linked to this, the ongoing costs of complying with the requirements around independent advice may make the restricted model increasingly attractive to advisers, leading to a reduction in the proportion of independent advisers. This will be exacerbated if confusion among consumers regarding types of service continues, and if advisers feel there is insufficient comparative advantage in being independent rather than restricted.
- Advisers are likely to become increasingly well-qualified, with chartered status being used as a competitive advantage. This increased professionalism should in turn feed through to improved quality of service.

- Vertical integration between product providers and intermediaries/distributors may continue, or even accelerate, particularly given the increasing pressure on providers by platforms and advisers.
- Some exit by at least the smaller wrap platforms is likely.
- Simplified or automated advice may take off — despite the concerns around regulatory liability there is a significant opportunity for firms here. Such innovation is very likely to exhibit ‘first mover’ risks, but if these are sufficiently overcome through regulatory clarity then the scope for growth is large.
- Consumer demand for advice may increase. The recent pension reforms and aging population is likely to drive an increase in the number of consumers looking for advice on retirement, including self-directed consumers who value advice at key life stages. A factor may be the sometimes relatively small-scale of pension pots which may limit demand. Consumers benefitting from simplified advice (if this develops) will also most likely value more structured and personal advice around planning for retirement, given the lasting and complicated nature of pension decisions.