Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

Financial Services Consumer Panel Evidence to Treasury Committee: Retail Distribution Review

Introduction

The Financial Services Consumer Panel welcomes the opportunity to respond to the Committee's call for evidence on whether the FSA's Retail Distribution Review (RDR) will achieve its stated outcomes and whether the outcomes could be achieved in other, potentially better ways.

The Panel has supported the FSA's work on the RDR as well as being involved in its development and, as we have set out in this memorandum, we believe that the outcomes can be achieved. We accept that there are still some significant issues to be resolved – in particular the regime for the regulation of platforms and the development of models for the delivery of simplified advice, on which we have commented later in this submission – but we have not seen any evidence of better ways of delivering the RDR outcomes over the four years that the FSA has been developing its RDR proposals. Nor do we accept the argument that has been put forward by some that the implementation of the RDR should be delayed beyond the end of 2012.

The savings market is undergoing rapid change as defined benefits pensions schemes close. This will undoubtedly increase the demand for advice, even though many companies provide defined contribution schemes. The changing nature of employment means that individuals will need to become more involved in providing for their old age, creating both customer demand and sales opportunities. The RDR presents an opportunity for independent advisers to raise the perceived value of their advice and of professional standards within the industry. It will leave the advice market better equipped to respond to these changing circumstances and the development of models to deliver simplified advice should create an environment in which the needs of those requiring a less holistic service can be met.

Adam Phillips
Chair
Financial Services Consumer Panel

Executive summary

The Panel has taken a close and active interest in the development of the RDR and we continue to support both its objectives and how the FSA proposes to achieve them. In our view the RDR presents great opportunities to the industry as well as challenges, but with consumers being the true beneficiaries of the RDR – the advice market is currently weighted in favour of industry and the RDR will establish much needed equilibrium.

How will this be achieved? By:

- Eliminating bias in the market
- Changing the relationship between the independent adviser and their client to one where the adviser is the agent of the client, not the product provider
- Providing clarity about the nature of the advice service being offered, how it is to be paid for and by whom. As the FSA has said, "it cannot be right to hide the cost of advice from consumers, with the intention that they neither see the cost involved nor value the services they receive. We cannot both support structures that conceal the cost of advice and complain about consumers not being prepared to pay for it. A paradigm shift is needed"[1].
- Ensuring that financial advisers are appropriately qualified, complying with standards of ethical conduct and aware of developments and innovations in the market.

The FSA launched the RDR in 2006 in response to failings in the advice sector – with the remuneration structure described by the then Chairman of the FSA as, amongst other things, suffering from "product bias, provider bias and churn" with customers "not being advised to take action consistent with their priority needs." Five industry working groups were set up to inform the FSA's considerations and there has been a series of public consultations over the last four years or so leading to the current RDR model. Given the detriment that the RDR is designed to address and the length of time spent in active consultation, there can be little excuse, if any at all, for delay now.

We have heard a great deal of late about objections from some industry participants to the FSA's professional qualification requirements in particular. Yet Fay Goddard, CEO of The Personal Finance Society, recently said[2] that 40% of PFS adviser members have already attained CII level 4 or above and that 44% were part qualified ahead of the 2012 deadline. A higher level of qualifications can only enhance the professional standing of financial advisers and the trust that consumers

[1] Speech by Dan Waters to the Personal Finance Society 10 July 2009 at www.fsa.gov.uk
[2] Speech at the PFS event "Are we there yet?" in October 2010 at www.thepfs.org/app/events

place in them – pre-requisites for a revitalised market which delivers what consumers are entitled to expect. “Grandfathering” existing advisers will simply not achieve this and it is an option to which we continue to object.

We accept that there is likely to be some shrinkage in the advice market as some advisers decide to leave rather than meet the RDR requirements, or re-focus their business models on more affluent and more profitable clients. There will be many consumers too for whom a full independent advice service is neither needed nor affordable. We believe that a Simplified Advice service could meet the needs of these consumers and we have taken a close interest in work underway in this area. We plan to meet representatives of the FSA again soon to discuss how the simplified advice debate can be re-energised. Filling the advice gap will be an important step in achieving some of the broad objectives that the RDR was set up to address.[3]

We agree too that there is further work required on the future regulation of platforms. There are significant issues still to be resolved in this area and platforms, along with simplified advice, will be a major subject of engagement between the Panel and the FSA in the immediate future. But these are not reasons to re-think or delay the implementation of the RDR.

Our more detailed views are set out in this paper.

[3] CP09/18 Delivering the RDR at www.fsa.gov.uk: (1) an industry that engages with consumers in a way that delivers more clarity for them on products and services; (2) a market which allows more consumers to have their needs and wants addressed; (3) remuneration arrangements that allow competitive forces to work in favour of consumers; (4) standards of professionalism that inspire consumer confidence and build trust; (5) an industry where firms are sufficiently viable to deliver on their longer term commitments and where they treat their customers fairly; and (6) a regulatory framework that can support delivery of all of these aspirations and which does not inhibit future innovation where this benefits consumers

Objective 1: a transparent and fairer charging system

1. The argument for a fundamental change from the current adviser remuneration model is well made.

2. There are two main issues that need to be addressed: first, actual and potential consumer detriment caused by the commission based model – commission bias; and second, the lack of clarity around how much is actually paid for advice and how that in turn affects the value of the investment being purchased.

Commission bias

3. In January 2008 the Panel published a piece of qualitative research ("the GfK research") into consumer attitudes with regard to financial advice and the implications of the RDR proposals[4]. This confirmed that, in essence, many consumers do not value advice because they are under the mistaken impression that they do not pay for it – and most of those in the sample did not understand what an independent financial adviser was. Most of the sample had a negative perception of financial advisers in general, with the minority who held a more positive view tending to be those who were less financially sophisticated and savvy.

4. The FSA's 2008 research into accessing investment products[5] revealed that, amongst other things, "Advice, whatever its shortcomings, was known to be available, and there was a feeling that at least some of it must be good, even if it is hard to tell good from bad. And the information from advisers, e.g. about what specific technical language and jargon actually mean, was seen as helpful, even if recommendations needed to be treated warily." As regards adviser remuneration, "This was not a subject that was well understood: everyone knew that advisers got paid, but there was confusion about how and with whose money. Furthermore there was little understanding about the true cost of advice, regardless of who was paying… and related to this, and more important, was the effect commission could have on the adviser's impartiality, and thus on the advice itself."

5. In his letter to the Committee of 13 December[6], Hector Sants (Chief Executive Officer of the Financial Services Authority) set out a short table of illustrations of annual consumer detriment found in different mis-selling reviews. This included an annual consumer detriment of up to £18mn in the case of the FSA's investigation of personal pensions mis-selling in 2005. In the same letter Mr Sants goes on to refer to

[4] "Exploration of consumer attitudes and behaviour with regard to financial advice and the implications of the RDR proposals", GfK at www.fs-cp.org.uk
[5] CR73 Accessing investment products November 2008 by Strictly Financial at www.fsa.gov.uk
[6] Published on the FSA website, www.fsa.gov.uk

evidence of product bias in the equity ISA market, where 20% of mystery shops with commission based IFAs and 12% of mystery shops with tied advisers an ISA was not recommended. Instead, clients were advised to purchase products that could potentially pay the adviser higher commission.

6. In May 2005 BBC Radio 4's Moneybox programme[7] looked into commission bias and considered research produced by CRA International for the Association of British Insurers. The research was quoted as finding that a 0.5% rise in commission - from 5% to 5.5% - could lead to an increase in market share of 14 percentage points, from 20% to 34%. The Sales and Marketing Director of Norwich Union told Moneybox that the firm "operated commission as a fine-tuning mechanism... to maintain our position in the market place. We adjust our commission all the time." He also agreed that Norwich Union had cut the commission on unprofitable stakeholder pensions to discourage IFAs from selling them - "We cut our stakeholder commission by two thirds. Sales have been down considerably." In August 2009 Andrew Fisher, chief executive of independent financial adviser Towry Law said[8] "I'm concerned that sales have been made in order to generate commissions ... we have seen initial commissions of up to 9% to entice advisers to sell their products. Investors have faced a sustained period of reduced payouts, falling bonus rates and increased exit penalties."

Lack of clarity

7. The GfK research found that while most consumers were aware that financial advisers were paid by way of commission from providers, the majority were unaware of the existence of trail commission at all. Often, they did not know specifically how they were paying and sometimes "the absence of a visible payment means that advice feels free".

8. Lack of clarity about how much is being paid for advice and how that impacts on the value of the investment being purchased is fundamentally wrong. Consumers are entitled to know how much the advice will cost, how it will be paid and in addition how much the investment itself will cost. It is no surprise that the September 2010 survey[9] by KPMG of over 3,000 consumers found that less than a third would be prepared to pay for one hour's professional financial advice, and that of those who would pay, over half would only be prepared to pay £50 or less while only one percent would be willing to pay over £200. It is the Panel's view that at least part of the reason for this is that consumers are unaware of how much they are paying for financial advice now, so the sums involved seem shockingly high.

[7] Article available at www.news.bbc.c.uk
[8] www.guardian.co.uk/money
[9] At http://rd.kpmg.co.uk/WhatWeDo/23161.htm

9. It cannot be sustainable to offer a service where fees are obscured and where consumers are unaware that they are even paying for the service provided. This is particularly worrying when charges are often high and eat in, sometimes excessively, to the consumer's savings or investments. In a Panorama programme broadcast on 4 October 2010[10] it was claimed that between 60% and 80% of the money contributed to a private pension over 40 years could be taken in fees of various kinds.

10. We believe it is the case too that financial advice is not as valued by consumers as other professional services, nor as trusted. This is borne out by the main findings of the KPMG research. Across the survey sample, levels of trust in any source of financial advice appeared low. Independent Financial Advisors (IFAs) were the most trusted source of financial information (47 percent of consumers) and the most trusted source of financial advice (50 percent of consumers). A third of respondents said that they would trust a bank representative for advice, but only eight percent of consumers would trust a representative of an insurance company to provide financial information and only four percent would trust them for financial advice. Trust and confidence in the sector are pre-requisites of greater consumer engagement. The Panel's recent research on consumer perceptions of fairness in financial services[11] revealed that financial services fare particularly poorly in perceptions of treating customers fairly, with criticism of the lack of individual and personalised service and the lack of transparency, including small print.

Will the RDR proposals deliver what is needed in the best way?

11. It is our view that the FSA's proposed Adviser Charging model will deliver a transparent and fairer charging system and that this will address the failings that have been identified in the current commission based remuneration model. We supported[12] the FSA's proposals[13] to widen the range of products to which the new independence standard will apply to include national savings and investments products, which do not pay commission – the clear implication behind the proposals being that despite National Savings products being 100% secure and backed by HM Treasury, many advisers were not recommending them to clients.

12. The independent adviser will become the agent of the customer not the product provider, changing the relationship into one where the intermediary has a much stronger interest in maintaining a long term relationship with the customer.

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[10] "Who's taken my pension?" at bbc.co.uk/programmes and bbc.co.uk/press office
[11] "Consumer Perceptions of Fairness in Financial Services" by Opinion Leader, June 2010, at www.fs-cp.org.uk
[12] Consumer Panel response to CP09/18 at www.fs-cp.org.uk
[13] CP09/18 Delivering the RDR at www.fsa.gov.uk

13. Over time suspicions of bias in favour of particular products, product types or product providers that will generate high levels of commission for the adviser will fall away and consumers will know – and have the opportunity to discuss – the level of charges set by their advisers, which will be addressed up-front. As with other professional services the adviser's charge will be directly related to the service provided by the firm. Investors who would rather not pay separately for advice will retain the option of having the agreed fee deducted from their investments. The new system will ultimately make it easier for consumers to 'shop around' than at present and to consider such factors as value for money in terms of the advice they receive.

14. As for the question of whether there could be better ways of delivering a transparent and fairer charging system, it may be that there could be variations of the 'factory gate pricing' model that could work, but we have not seen any specific proposals that would achieve the same result as the FSA's proposals. If ideas are put forward now that would not delay the implementation of the RDR we would be happy to consider them from a consumer perspective. But without doubt there must be an end to the commission based remuneration model and an end to the lack of clarity around how much the consumer is paying for what and to whom.

Objective 2: a better qualification framework for advisers

15. As with the issue of commission, the case for improved levels of professionalism and qualification for financial advisers is, in our view, well made. The Professionalism Working Group[14] set up by the FSA to contribute to the development of the RDR recommended that minimum qualifications must be raised. On 7 January this year the FSA published guidance for advisers[15] on assessing suitability. The need for this guidance was clearly demonstrated by the findings of FSA thematic work, where the FSA concluded that "of the investment files assessed as unsuitable between March 2008 and September 2010, we rated half of these as unsuitable on the grounds that the investment selection failed to meet the risk a customer is willing and able to take[16]." This is a fairly fundamental issue[17] and one which goes to the heart of understanding and meeting consumer needs.

16. Although the range of financial advice available is quite wide, consumers will tend to seek advice for what they regard as the most

[14] Chaired by Michael Foot, it included the Chartered Institute of Bankers in Scotland; Chartered Insurance Institute; Institute of Financial Planning; ifs School of Finance; Securities and Investments Institute; and Financial Services Skills Council
[15] Guidance consultation: assessing suitability at fsa.gov.uk
[16] of the 366 cases that the FSA judged to have failed the suitability requirements, 199 did so because the investment selection did not meet the customer's attitude to risk
[17] The FSA has said that the files reviewed were indicative samples and in some cases it was focusing on higher risk firms

important financial decisions they need to make, such as provision for retirement. With the disappearance of defined benefit pension schemes for most of the working population and the introduction of National Employment Savings Trust pensions, the demand for reliable advice can only increase. It is entirely right that the professionals to whom consumers turn have appropriate levels of relevant qualifications and knowledge of the market to deliver advice on these crucial issues.

17. The FSA's 2006 Baseline Survey[18] found that consumers' trust in financial advisers is higher for those that actually use one, than for those who do not. But of those, 40% said that they did not trust financial advice. Further research two years later[19] found that confidence in advisers can be established through the demonstration of knowledge and qualifications. The May 2010 PARN Report[20] also found positive correlations between higher level qualifications and positive consumer outcomes.

18. In terms of specific proposals on professionalism, we see the RDR requirement for QCF level 4 as a good starting point for advisers – we do not think that the equivalent of a first year university standard is too onerous or demanding - but ultimately we believe that Level 5 is the appropriate standard. We strongly support the measures that are being put in place to ensure that a programme of continuing professional development and for compliance with standards of professionalism and ethics will be undertaken and independently verified. As we have indicated, it is our view that these enhanced standards will raise levels of confidence in the industry and lead to greater consumer engagement.

Will the RDR proposals deliver what is needed in the best way?

19. There has been much media coverage recently of suggestions that rather than insisting on advisers achieving level 4 qualifications there should be a programme of 'grandfathering' for experienced advisers. We remain opposed to grandfathering. Such a move would only detract from the important objectives of raising standards within the financial services industry. It is conceivable that it might be acceptable to extend the qualifications deadline for advisers who, say, have largely achieved level 4 but perhaps have one module yet to complete, but given the length of time advisers have had to prepare for the RDR, we would hope that this would be a rare event. In any case the FSA has decided to permit workplace assessments as an alternative to sitting an examination in an approved examination centre, so providing some flexibility.

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[18] Baseline Survey into Financial Capability at www.fsa.gov.uk
[19] Consumer Research Paper 73 Assessing Investment Products, at www.fsa.gov.uk
[20] Linking professional standards to consumer and other outcomes in the financial services sector, at www.fsa.gov.uk

20. We support too the requirements for continuing professional development that the FSA is putting in place. The GfK research showed that some consumers perceived financial advisers as having greater expertise than they did themselves, attributing expertise to having the time to observe the market and follow its trends. In our view CPD would be an important part of delivering this perceived expertise and consequently a driver for a better and more vibrant advice market in the longer term.

21. As regards the question of better ways of achieving this objective, as we have indicated, we would have liked the FSA to go further and ultimately aim for Level 5 as the appropriate professional qualification standard for financial advisers. We would also have liked to see a separate Professional Standards Board, independently chaired; separately accountable for its professional standards function; led by an identifiable senior executive who is responsible for driving the work forward; and with a clear mechanism for ensuring that consumer interests are taken into account. In our view the proposed ‘internal’ FSA model is second best and we will be looking for evidence that it is working.

Objective 3: greater clarity around the type of advice being offered

22. The GfK research concluded that the current advice framework was characterised by a good deal of confusion, with consumers not distinguishing between the different types of advice and advisers when talking about financial advice. The lack of understanding was found to be more pronounced amongst those with less financial sophistication and expertise. Given the significance of the differences between independent and non-independent advice therefore, it is important that the disclosure regime delivers the right messages to consumers.

23. Finding labels to describe the nature of advice is difficult. Post RDR consumers should know from the outset whether their adviser if truly independent and acting as their agent, providing advice that reflects the customers’ interests; or offering a restricted service which is limited in scope in terms of the number of providers or products included within the adviser’s range of business – effectively making clear the distinction between “sales” and “advice”.

24. We agree with the FSA’s split between “restricted” and “independent” advice, but additional supporting information to provide context and clarity is necessary. Following testing[21] of labelling and descriptions, the FSA made its final decision on disclosure requirements in March 2010[22] and although we would have liked to have seen a greater

[21] Consumer Research Paper 78 Describing Advice Services & Adviser Charging by IFF Research June 2009, at www.fsa.gov.uk
[22] PS10/06 at www.fsa.gov.uk

degree of prescription around the additional/contextual information to be provided, we have no specific objection to the FSA's proposals.

Will the RDR proposals deliver what is needed in the best way?

25. The FSA consulted extensively on the split between "independent" and other forms of advice, as well as on labelling. As we have said, we accept that there are real difficulties in describing the differences between types of advice in a way that will help rather than confuse consumers, who will have to decide which type of advice best suits their needs. There will be a number of different, but not necessarily better ways of describing the types of advice service available and in reality, only time and consumer research will tell whether the RDR requirements could be improved to assist both consumers and advisers in the delivery of professional financial advice.

Simplified advice and straightforward products

26. As we have said earlier in this submission, the Panel accepts that there is likely to be some shrinkage in the traditional advice market as a result of the RDR. We are conscious too of the savings gap that exists at the moment, and which has existed for some years, and the general need for consumers to save more. Figures vary, but Aviva's November 2010 research[23] revealed a European annual "pensions gap" of €1.9trillion of which the UK accounted for €379bn. According to the recent YouGov survey[24] on behalf of the Institute of Financial Planning and National Savings and Investments, eight out of ten people in the UK say they would be more likely to save if financial products were more flexible and made easier to understand. Fewer individuals are planning ahead – the same research found that only 14% had goals they were working towards (compared to 26% in 2008), yet 59% of those surveyed were worried about their finances. These findings indicate a real need for affordable financial advice delivering straightforward products, a need which the Panel believes appropriate models of simplified advice could help to fill.

27. The simplified advice debate however appears to have reached an impasse. Our understanding of the key issues from discussions with the FSA, trade bodies and individual firms is that the FSA is satisfied that the current and post-RDR regulatory frameworks allow for the delivery of simplified advice and it is ready to discuss specific proposals from the industry; but the industry is struggling to develop financially viable models for simplified advice in the absence of specific assistance from the FSA on issues such as mandatory level 4 qualifications for advisers and the potential impact of Ombudsman decisions on advice delivered through this process.

[23] www.aviva.com/investor-relations
[24] UK Financial Planning Survey 2010 at www.financialplanningweek.org.uk

28. It is important that this apparent stalemate is resolved in a pragmatic way which both protects consumers' interests and rights and enables firms to make a profit. We oppose any reduction in the professionalism and CPD requirements for advisers per se, but we believe there is a useful debate to be had around the appropriate level of qualification for advisers delivering simplified advice. For example, while we would expect level 4 advisers to be closely involved in both the design of models for simplified advice and in the delivery of models that permit adviser discretion, for IT-based models for which there is no scope for adviser discretion, either level 3 or a level 4 qualification that is limited in scope, might be appropriate. Similarly while we would not support any new restriction on consumers' right of access to the Financial Ombudsman Service, for simplified advice delivered through technology without adviser discretion it might be possible to ensure that the process itself was compliant, thereby ensuring a compliant outcome. Consequently we believe it will be possible to address the needs of consumers whose access to financial advice is and/or will be limited by its cost in relation to the amount they have available to save, without compromising the principles and objectives of the RDR.

Appendix

About the Financial Services Consumer Panel

29. We are an independent statutory body, set up to represent the interests of consumers in the development of policy for the regulation of financial services.

30. We work to advise and challenge the FSA from the earliest stages of its policy development to ensure they take into account the consumer interest.

31. The Panel also takes a keen interest in broader issues for consumers in financial services where it believes it can help achieve beneficial change/outcomes for consumers.

32. Since the Panel was established in 1998, we believe the Panel has helped deliver significant, positive benefits for consumers. We support the FSA where we believe policies can help consumers and challenge the FSA forcefully when we feel consumers would be disadvantaged.

33. Members of the Panel are recruited through a process of open competition and encompass a broad range of relevant expertise and experience. The current membership of the Panel is:

Adam Phillips (Chair)
Kay Blair (Vice Chair)
Stephen Crampton
Mike Dailly
Caroline Gardner
David Harker
Frances Harrison
Tony Hetherington
Bill Martin
David Metz
Dan Plant
Faith Reynolds
Lindsey Rogerson
Claire Whyley