

Retail Distribution Review (RDR) (For Professional Adviser Use Only)



“We have at present a business model which is based on incentives which produce results which are unattractive to reputable providers, unattractive to their customers, and whose benefits to intermediaries are questionable.”

This assessment of the financial advisory industry was made by Sir Callum McCarthy, then Chairman of the Financial Services Authority (FSA), the industry regulator, in September 2006. Sir Callum’s comments were made three months after the FSA launched the Retail Distribution Review (RDR). With widespread public mistrust, in no small part due to an ongoing stream of mis-selling scandals, the FSA wanted to examine how financial advice could be delivered more effectively to consumers.

The Feedback Statement of the RDR, detailing the final proposals, was published on 25 November 2008. The FSA wanted to ensure that these proposals meant that consumers:

- have a proper understanding of the service they are receiving;
- are more confident that their adviser is professionally qualified; and
- receive unbiased advice with charges laid out clearly and transparently.

This all sounds eminently sensible, and the proposals announced in the RDR will mean that the FSA is able to achieve these goals. This represents a major victory for consumers.

Independence

The problem that consumers face today is that the advice of many independent financial advisers is compromised. The majority of advisers earn their income from commissions paid by product providers for selling products such as investments and pensions. Advisers in these firms only get paid if they sell a product and the amount they get paid will vary from product to product and product provider to product provider. The risk for the consumer is that their adviser has a financial incentive to ‘give them advice’ to buy the product that pays the highest level of commission. This would explain the high sales levels of investment bonds, some of which can pay initial commission up to 9% of the investment amount.

The FSA has recognised that ‘independent’ advice is potentially compromised while this conflict of interests remains. It is therefore replacing the existing criteria that allow advisers to call themselves independent, with more stringent measures related to advisers being able to give genuinely unbiased advice, agree fees with clients and be

better qualified. This should give consumers more confidence in the independence of the advice they receive.

Those firms that do not meet the requirements for providing independent advice will be deemed to provide 'sales advice', i.e. they are providing advice in relation to selling a product. This will help to create a clear distinction for the consumer between whether they are receiving independent financial advice, which is in their best interests, or more limited advice.

Adviser remuneration

The easiest way to ensure that all financial advice is in the clients' best interests would be to remove the influence of commission. Towry Law has campaigned for the abolition of all commission payments to financial advisers, believing that commissions cause a conflict of interest that can lead to consumers receiving inappropriate advice.

Sir Callum McCarthy agreed with the view that the payment of commissions can influence financial advice, saying, "The consumer does no better than the providers under the present remuneration model. This suffers from product bias, provider bias and churn. Product bias, in other words, the customer not being advised to take action consistent with their priority needs – is arguably the most detrimental." He then added, "consumers are not always advised on transactions which fail to remunerate the adviser, or which offer little by way of commission to the adviser."

Whilst the FSA has not explicitly banned commissions, for legal and practical reasons, it has proposed that any payments from a product provider to an adviser are agreed with the client beforehand and are deducted from the amount invested. This increased transparency will explode the myth that commission-based advice is free. The 'old world' pretence of "this advice is free for you because the insurance company will pay" is over. Advisers going forward will be forced to show consumers how much their advice will cost and the consumer will have the opportunity to determine whether they consider it is value for money.

So, if an adviser wants to sell a £100,000 investment bond to their client and they want to take 'commission' of 7%, they are going to have to agree with the client how much they are paid. They will also need to explain that this amount will come directly from the investment, in this instance leaving just £93,000 in the bond. This will greatly empower consumers because how many clients are going to opt to pay £7,000 for an hour or two of advice to buy an investment bond?

This increased transparency cannot be over-stated. Whilst commission payments should currently be disclosed to clients, it is very easy for the actual costs of commission to be concealed. In the above example, if the client invests £100,000 in the investment bond, and the adviser takes their 7% commission, yet on day one the bond is still worth £100,000, then it is not clear to the client where the commission charges are coming from. The answer, very simply, is that it is paid for from ongoing charges coming from the client's investment; so it is the client that pays.

The FSA's Treating Customers Fairly document, published in 2006, highlighted this issue, stating, "Firms need to be open with customers about their fees and whether they will be receiving commission when selling particular products. As part of our quality of

investment advice processes work, in a significant number of mystery shops, firms failed to give accurate information to customers on how the firm will be remunerated.” The RDR proposals will rectify this.

Professional qualifications

The FSA also wants to improve qualification levels in the industry, particularly with regard to the industry benchmark qualification. The current benchmark, the Certificate in Financial Planning, is astonishingly low and needed to be raised; it is sarcastically compared with a GCSE in Woodwork by some in the industry.

The FSA has recommended the adoption of a new Qualifications & Curriculum Authority (QCA) Level 4 industry benchmark, this being considered equivalent to the first year of a degree course. This is a positive step, but Level 4 should only be used as a stepping stone to all financial advisers achieving Chartered Financial Planner status, the highest in the industry. It is pleasing to note that the FSA has said, “it would be highly desirable to seek to move the minimum level of qualification for all new entrants up to honours degree-equivalent (Level 6) as soon as possible”.

Setting Chartered status as the ultimate industry benchmark should give consumers more confidence in the quality of advice they receive, and the professionalism of the person giving that advice, and will help to put the financial advice industry on a more level playing field with other professions such as law, accountancy and medicine.

This may sound sensible but it is also radical. An estimated 75% of advisers (as at February 2009) have not yet achieved the Level 4 benchmark. This is why consumers should always ask their adviser how well qualified they are.

Towry Law has 70% of its Wealth Advisers qualified to at least QCA Level 4 standard (as at February 2009) and all advisers, who have not already achieved it, are taking further qualifications to progress to Chartered Financial Planner status.

Conclusion

When assessing the success or failure of the RDR, it is important to look at the initial aims. The RDR was launched to address the poor service that consumers receive from the financial advice industry and to provide them with a better solution.

Following a comprehensive review process, the final outcomes are ones that will significantly improve that position.

While some of the proposals will take up to four years to be implemented fully, the financial advice industry is now on a path from commission-based product sales, made in the interests of the adviser, to truly independent fee-based financial advice, which is made with the clients' interests to the fore at all times. Consumers, and their other professional advisers, looking for professional and truly independent financial advice, should rejoice.



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If you would like to learn more, please contact your usual Private Client Wealth Adviser or Corporate Client Consultant at Towry Law or Jon Bowes on 0207 936 7157

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