CHASM | Centre on Household Assets and Savings Management

# Briefing paper

# The Retail Distribution Review

The Retail Distribution Review (RDR) was launched in June 2006 by John Tiner[1], the Financial Services Authority (FSA) Chief Executive, following work that was commissioned by the FSA and completed by KPMG. This work set out a number of scenarios outlining new models for delivery of financial advice in the future. Subsequently the FSA has conducted a consultation with the relevant stakeholders which has resulted in the legislation due to take effect from January 2013. These new rules will change the basis of how investment and pension advice is delivered by Regulated Financial Advisers (designated CF30 advisers by FSA). The new regime does not include mortgage or protection advice, these advisers will still be able to receive indemnity commission and are not subject to the higher qualification requirements.

The impact of the review from the consumer's perspective is that advisers will no longer be able to receive commission from product providers for business placed with them. From January where an adviser provides advice and arranges any investment or pension product, they will have to be remunerated by the customer. This may be via a deduction from the product or by direct payment.

Below is a summary of main implications of the RDR:

- Independent or restricted advice - advisers will operate on either an independent basis (whole of market) or a restricted basis (a limited range of product

[1] FSA (2006) *Review of retail distribution in the UK*. Speech by John Tiner, Chief Executive of FSA. http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2006/0614_jt.shtml

providers)

- Advice will be full or restricted - advisers will need to inform clients which areas of the advice market they are advising on.
- Adviser charging - advisers will agree a fee (hourly, fixed or percentage based) at the commencement of client meetings. Charges are more likely to reflect the cost of the work completed than the present commission based structure does. This regime will apply to both independent and restricted advisers.
- Indemnity commission is banned - insurance companies will no longer be able to pay advance commissions on regular premium business or offer enhanced allocation contracts that have been used [some suggest] to hide the effect of commission and charges on the money invested. Commission will continue to be paid on pensions for new members enrolled in existing group pension schemes in place at December 2012.
- Adviser Qualifications - by 2012 all investment advisers will be required to be qualified to QCF level 4. Currently the base qualification is a level 3[2].
- Advisers will require a 'Statement of Professional Standing' issued by a professional body, to be able to continue providing advice post RDR.

The effect of RDR for many advisers has been a need to gain the QCF Level 4 qualification and review their business model. This has resulted in some advisers proposing to leave the industry or retire. Estimates vary between 11% and 30% but the result will certainly mean that there is less access to advisers/advice in the shorter term. Many others that remain are focusing their attention on high net worth clients.

For consumers that can still gain access to an adviser, this means better qualified advisers and more transparent charges. Nevertheless advisers still have option to charge based on the value of the monies invested and this may still result in large fees being charged but at least the impression that the cost of advice was funded by

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[2] FSA (2009) *Delivering the Retail Distribution Review: Professionalism; Corporate pensions; and Applicability of RDR proposals to pure protection advice.* http://www.fsa.gov.uk/pubs/cp/cp09_31.pdf downloaded 16/12/2009

the insurance companies will have been removed. However, recent research by KPMG[3] suggests that many consumers have an aversion to paying realistic fees.

The FSA will judge the success of RDR using a number of short and long term success indicators. These include:

- Consumer understanding of advice channels
- Firms sell fewer commission driven products
- Consumer's perceptions of the market improve
- Fewer unsuitable product sales are recorded

It would be good to see more consumers feeling able to engage with the Financial Services Industry and thereby take steps towards securing their financial futures. However, the matter of understanding advice channels is a financial capability issue and won't be resolved by RDR. Furthermore, it seems unlikely that engagement will improve if the number of advisers working in the market place is reduced and those that remain focus on higher net worth clients. With the future of the proposed 'simplified advice regime' looking in doubt and the current friction that appears to exists between the industry and the Money Advice Service, it is difficult to see how access to advice for middle and lower income groups will improve.

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[3] KPMG (2010) *Consumers pose challenge for financial industry under Retail Distribution Review* http://rd.kpmg.co.uk/23161.htm