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Financial Advice Market Review & the Retail Distribution Review

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Summary

There was a significant reform of the pensions industry in April 2015. From that date people aged 55 + more choice about when and how to draw their defined contribution pension savings. Individuals had to take responsibility for making crucial financial decisions now that they no longer needed to buy an annuity with their pension pots. Not only did they need to make the right financial decisions, but they also needed protection from frauds and 'scams'. The need for widespread, accessible, professional advice became even paramount.

However, there were concerns that the financial advice industry did not match these needs. There was a perceived 'advice gap'.

A Treasury/ Financial Conduct Authority review - Financial Advice Market Review (FAMR) was established. This reported in March 2016 and made a large number of recommendations addressed to both the supply and demand for financial advice.

The financial advice industry had been distinctively shaped by a previous retail distribution review (RDR) which was a review of the way in which financial products were sold to the public. It came on the back of a series of mis-selling 'scandals' but also reflected long standing disquiet over the use of commission based remuneration systems at the heart of much financial advice. Initial analysis of the impact of the proposals suggested that as a result of the changes proposed, a third of independent financial advisers might leave the industry.

Such forecasts were downgraded over time but the new advice industry which emerged post RDR, was characterised by significantly fewer advisers, more qualified and impartial advisers but more expensive too. This put, it was argued, advice out of the reach of individuals with relatively small pension sums (or indeed other investment needs) leading to accusations of an 'advice gap'. The second part of this Paper describes the historical development and implementation of the RDR.

1. Financial Advice Market Review (FAMR)

1.1 Introduction

FAMR was a review into the financial advice system, in particular whether there were features which prevented access to it from as wide a group of people as possible. One of the drivers of FAMR has been the new pension freedom landscape.

Before April 2015, most people (75%) with defined contribution pension savings used them to purchase an annuity. A key advantage of annuities is that they provide a guaranteed income throughout retirement, protection individuals from longevity, insurance and investment risk. However, they had become unpopular, partly because annuity rates had fallen but also because of reports by important bodies such as the FCA, highlighting ways in which the market did not work well for consumers (see section 2.2). The Government announced in Budget 2014, that it would change the rules to give people aged 55 and over more flexibility about when and how to draw their pension savings. It legislated for this in the *Taxation of Pensions Act 2014* (section 2.3).

Whilst many commentators welcomed the principle of increased choice, almost immediately there were concerns that increased choice would bring with it a significant burden of responsibility for individuals to understand the choices they were making - leaving them bearing the risk that the value of their savings falls (if they remain invested) or that they exhaust their savings prematurely.[1]

As well as inevitable 'option choice' risks, the risk of individuals, with access to significant sums, to be targeted by fraudsters, was also recognised. Put simply, here was an accident (potentially) waiting to happen.

The Work and Pensions Committee said in its report on Pension freedoms guidance and advice (October 2015) that

> readier access to pension pots combined with the difficulties consumers have in making decisions regarding retirement finances mean that the pension freedom reforms have increased the potential for scamming.

The regulators began working on ways to raise awareness. In particular, the FCA has launched a ScamSmart campaign and is taking enforcement action in a number of cases. The Work and Pensions Committee recommended that the Government urgently redouble its

1 See page 1506 Library Note SN06891 Pension Flexibilities – initial responses to the Budget 2014 announcement.

publicity efforts around pension scams and that the FCA tighten its scam awareness and reporting requirements for regulated firms.[2]

Alongside Scam Smart, the Government has introduced a guidance service Pension Wise, to help individuals navigate the options available to them. However, take-up of the service has been lower than expected.[3]

FAMR looked at the role which the financial advice industry could play in helping individuals make sensible choices and whether there was, in the light of findings into how the RDR had developed and in the uptake of Pensions Wise, an 'advice gap'. The FCA/Treasury press release issued on 14 March 2016 when the final Report was published stated that:

> …the review has found that there is a clear need for intervention by the regulator and the government to help both consumers and industry benefit from new and more cost-effective ways of delivering high quality advice and guidance.
>
> The FAMR recommendations will help to address current concerns about the affordability and accessibility of financial advice and guidance, particularly regarding the 'advice gap'. FAMR builds on improvements made to the financial advice industry brought about by the Retail Distribution Review (RDR) which raised the standards of professionalism across the financial advice market.
>
> FAMR outlines practical ways to enable consumers to engage with and access advice and guidance, urges changes to how financial advice is defined and suggests a new advice framework to help firms best meet the needs of consumers. The report makes a range of recommendations aimed at ensuring firms are able to provide more affordable advice for more consumers.

One of the ways in which the FCA hopes that advice can be given in future is by 'robo-advice', automated Q&A procedures which result in generalised advice for savers with lesser amounts to invest. On the day that the Report was published RBS announced that its automated advice service had been approved by the FCA and that it was cutting 220 face to face advisers. Face to face advice would remain for people with in excess of £250,000 to invest.[4]

1.2 Recommendations

The Report's policy recommendations are shown below. In several cases the recommendation comes down to further efforts to resolve known issues, identified since the RDR began, but which there appears to have been no 'market' solution at least.

Implementation

Recommendation 1: To support progress over the next 12 months, members of the FAMR Expert Advisory Panel should form a Financial

[2] Work and Pensions Committee; Pension freedoms guidance and advice; para 25. See also section 4.5 of SN06891.
[3] See section 4.5 of Library Note SN07042 Pension Wise: the guidance guarantee and paragraph para 27 of the Work and Pensions' Committee's report.
[4] BBC News 14 March 2016

Advice Working Group, together with members of the FCA Consumer, Practitioner, and Smaller Business Practitioner Panels.

Affordability

Recommendation 2: HMT should consult on amending the definition of regulated advice in the existing Regulated Activities Order (RAO) so that regulated advice is based upon a personal recommendation, in line with the EU definition set out in the Markets in Financial instruments Directive (MiFID).

Recommendation 3: The FCA should consult on new guidance to support firms offering services that help consumers making their own investment decisions without a personal recommendation. This should include a series of illustrative case studies highlighting the main considerations firms need to take into account when developing such services and dealing with specific areas of uncertainty identified during the Review.

Recommendation 4: The Review recommends developing a clear framework that gives firms the confidence to provide streamlined advice on simple consumer needs in a proportionate way. As part of this, the FCA should produce new guidance to support firms offering 'streamlined advice' on a limited range of consumer needs. This should include a series of illustrative case studies highlighting the main considerations when developing such models.

Recommendation 5: As one of the measures to help develop a simple and clear advice framework, the FCA should consult on modifying the time limits for employees to attain an appropriate qualification in the FCA's existing Training and Competence sourcebook (TC). This will give firms more flexibility to train a new generation of advisers by allowing employees to work for up to four years under supervision to obtain an appropriate qualification and experience.

Recommendation 6: The FCA should consult on guidance about the cross-subsidisation rules in relation to the interpretation of 'long term' and the flexibility allowed.

Recommendation 7: HMT should ensure in transposing and implementing MiFID II that, while meeting obligations under EU law, it does not undermine the FCA's ability to follow through with the proposals which are designed to give firms the confidence to deliver streamlined advice.

Recommendation 8: The FCA and industry should continue to work together with the aim of bringing about improvements to suitability reports, reducing their length, where appropriate, and the time firms spend preparing them.

Recommendation 9: The FCA should build on the success of Project Innovate and establish an Advice Unit to help firms develop their automated advice models.

Recommendation 10: The FCA should consult on guidance to provide clarity on the standard types of information required as part of the fact

find process. In addition, the guidance should also set out key considerations for verifying a fact find that has been performed by third parties.

Accessibility

Recommendation 11: The FCA and The Pensions Regulator (TPR) should develop and promote a new factsheet to set out what help employers and trustees can provide on financial matters without being subject to regulation.

Recommendation 12: The Financial Advice Working Group should work with employers to develop and promote a guide to the top ten ways to support employees' financial health.

Recommendation 13: HMT should explore ways to improve the existing £150 income tax and National Insurance exemption for employer-arranged advice on pensions.

Recommendation 14: HMT should explore options to allow consumers to access a small part of their pension pot before the normal minimum pension age, to redeem against the cost of pre-retirement advice.

Recommendation 15: The FCA should take steps to help ensure that firms and advisers are aware of the existing flexibility in the rules on adviser charging.

Recommendation 16: HMT should challenge the industry to make a pensions dashboard available to consumers by 2019, bringing together industry and consumer representatives to help them set direction and drive progress.

Recommendation 17: The Financial Advice Working Group should publish a shortlist of potential new terms to describe "guidance" and "advice", with the final choice of words and approach to implementing them to be confirmed after market research and consumer testing.

Recommendation 18: The Financial Advice Working Group should lead a task force to design and test a set of rules of thumb and nudges.

Recommendation 19: HMT should assign the continuing responsibility for the rules of thumb and nudges to an appropriate body with financial capability expertise. This body will be responsible for updating the rules of thumb and nudges and encouraging the use of them by employers, government agencies and charities.

Liabilities and consumer redress

Recommendation 20: The FCA regularly undertakes funding reviews of the Financial Services Compensation Scheme (FSCS), and FAMR recommends that the 2016 FSCS Funding Review, should specifically explore risk-based levies, reforming the FSCS funding classes, and more extensive use of the FSCS credit facility. The review should explore the merits, risks and practicalities of alternative approaches.

Recommendation 21: Following its review of FSCS funding, in light of evidence received as to the impact of the professional indemnity insurance (PII) market on FSCS funding, the FCA should consider

whether to undertake a review of the availability of PII cover for smaller advice firms.

Recommendation 23: The Financial Ombudsman Service should publish additional data on its uphold rates, specifically around cases where advice was given more than fifteen years before the complaint was made, and a breakdown of financial adviser uphold rates by product. The Financial Ombudsman Service should consider the best way to do this as part of its review into its approach to publishing data more generally and update its stakeholders later this year.

Recommendation 24: The Financial Ombudsman Service should consider whether to establish a more visible central area for firms on its website by summer 2016, bringing existing resources (e.g. summary of approach, technical guidance notes, case studies etc) together in one place to help advisers.

Recommendation 25: The report of the Financial Ombudsman Service's appointed Independent Assessor should be expanded to include a more in-depth analysis of the cases they consider and identify potential areas for process improvement from 2017.

Recommendation 26: The FCA should not introduce a longstop limitation period for referring complaints to the Financial Ombudsman Service. As part of the review in 2019, the FCA and HMT will consider any ongoing trends and the impact of the Financial Ombudsman Service's complaints data relating to advice on long-term products.

Implementation

Recommendation 27: The FCA and HMT should work together over the next 12 months to develop an appropriate baseline and indicators to monitor the development of the advice market. These should then be tracked on an annual basis and published on the FCA website.

Recommendation 28: The FCA and HMT should report jointly to the Economic Secretary and FCA Board, 12 months after the publication of this document, on the progress made towards implementation. In 2019, both organisations should conduct a review of the outcomes from FAMR.

2. Retail distribution Review

2.1 Introduction

The retail distribution review (RDR) is a review of the way in which financial products are sold and advised upon at the retail level, i.e. to ordinary customers. It was initiated by the organisation then responsible for the regulation of the financial services sector the Financial Services Authority (FSA).

The FSA launched the RDR in June 2006 with the specific aim of identifying and addressing the root causes of problems that continue to emerge in the retail investment market (which includes banks, life insurers, financial advisers, building societies and fund managers). Examples of recent misselling include pension's advice and precipice bonds. Following extensive discussions with the industry and others, the FSA identified the five themes to be addressed by the review. These were:

- Sustainability of the distribution sector
- Impact of incentives
- Professionalism and reputation
- Consumer access to financial products and services
- Regulatory barriers and enablers

Post consultation[5] the FSA identified three measures that they regarded as most fundamental to delivering the desired market outcomes that and "which will materially alter and improve the interactions between consumers and the industry". These are to

- improve the clarity with which firms describe their services to consumers;
- address the potential for adviser remuneration to distort consumer outcomes; and
- increase the professional standards of investment advisers

The main issue was the proposed changes to the way products are sold, specifically the practice of commission payments, from the product provider (e.g. an insurance company) to advisers and the like for each sale. Many independent financial advisers (IFAs) are worried by some of the statements coming out of the Review, particularly, unsurprisingly, those concerning the remuneration and performance of IFA s.

IFAs' remuneration has long been seen as a problem area. Traditionally they have been paid largely by commission on the products they sell. This led to accusations that the unknowing public is sold products on the basis of how remunerative they are for the IFA rather than how good they are for the public. IFAs reply that if they charged up-front fees for their services and advice, the public would baulk at paying and

[5] FSA consultation 09/18 *Distribution of retail investments: Delivering the RDR*, June 2009

the result would be that much needed financial advice would not be disseminated. People would save less, or would be swayed more by advertisements in newspapers into making inappropriate investments.

From the regulator's standpoint, there is a balance to be struck between imposing higher and higher standards of regulation and/or supervision, whilst maintaining an efficient market where the cost of doing business is not prohibitive: in short, to make the cost of regulation so high that people cannot afford to pay for it.

2.2 Classification of advice

The first thoughts of the RDR emerged in the summer of 2007. An FSA press notice of June outlined their ideas:

> The ideas seek to improve the current standards of professionalism; find more cost-effective ways of making advice available to a wider range of consumers; and improve consumer understanding of what they are getting for their money.
>
> To achieve this, the key proposal is that the regulated investment advice market could be divided into two parts giving choices to firms and greater clarity to the consumer. These could be summarised as:
>
> **Professional financial planning and advisory services** - which could be offered by highly qualified advisers serving those consumers who need the full range of advice. There could be two types of adviser. The most highly qualified could agree their remuneration directly with the customer and not with the product provider as is often the case with commission now. They could then call themselves 'independent'.
>
> Those firms not meeting these conditions might wish to use provider-driven remuneration (i.e. commission), but if they did they would not be able to call themselves independent. The FSA would then seek to address the risks of lower professional standards and potential conflicts of interest through increased regulatory requirements. This would provide regulatory incentives to all firms to operate with higher standards.
>
> **Primary advice** - providing advice on more straightforward needs using simple products. This advice could be less costly and more easily explained to a consumer than full professional financial planning and advisory services. It could be aimed at a wider consumer audience than the existing Basic Advice regime, with a wider range of products and without charge caps. It could build on the work of the Thoresen Review of generic advice.[6]

Put very simply, the FSA tried to differentiate between different sectors of the market and apply different, appropriate treatment to each. They have selected an upper sector of directly paid for advice – professional financial planning – and a lower level of service –primary advice – which encompasses the provision of less sophisticated financial services.

6 FSA PN/076/2007

The FSA produced two papers that set out its developing view of the new system of advice classification. The Papers are – CP 09/18 and PS 10/6. An article from *Money Management* attempted to summarise the net outcome of its deliberations:

> From 1 January 2013 firms will be required to describe their advice services to clients as either 'independent' or 'restricted'. The FSA has confirmed what must be included in the advice process for an adviser to call him/herself independent. The new standard of independence will apply to a wider range of products than now, so for example exchange traded funds (ETFs) will be included. This means that from 2013 many IFAs will find that they have to demonstrate that they have taken account of products beyond their traditional fare of life, pensions and unit trusts.
>
> There is still, however, the inexplicable exclusion of deposit based structured products from the scope of advice. The FSA excuses this exclusion on the grounds that the EU's own review of retail investments has not yet reached conclusions about deposit based products. But that seems a lame excuse given that there are other aspects of the RDR that may be affected by EU reviews.
>
> It will be made a condition of independence that a firm bases its recommendations on a comprehensive and fair analysis of the relevant market, and provide unbiased and unrestricted advice. The FSA has presented this as a new standard of independence although many IFAs claim this is what they already do. Whichever view is right it would make sense for IFA firms to overhaul their processes to satisfy themselves that they will be fit for purpose come 2013.
>
> The FSA is not going to ban ownership of IFA firms by product providers. It says that it recognises, however, that there are "a number of valid concerns" over such ownership and warns that an IFA owned by a provider will not be compliant with the new standard of independence if its advisers are rewarded more for recommending its own or its parent's product ahead of others. It also warns that where there is a single product that invests in a number of underlying investments, that would fail to meet the FSA's independence standard.
>
> The FSA seems to have toughened up its stance on firms holding themselves out as specialists in a particular market and on what will constitute a relevant market. It warns, "We would expect - examples of a specialised relevant market to be relatively rare." If, however, an IFA does hold itself out as a specialist the FSA warns that it will have to refer a client to another adviser firm if the client needs a product that is outside the scope of the first firm's specialism. This tougher approach by the FSA seems to mean that firms will need to think long and hard before they hold themselves out as 'specialists' from 2013.
>
> Although the FSA will allow the continued use of panels by IFAs, the process of panel selection is going to get more complicated. New guidance from the FSA says that firms can exclude certain retail investments from their panel provided they have a valid reason to do so.
>
> What the FSA has in mind here is that an IFA firm may conclude that the level of risk in some products may not be appropriate for their clients. This sounds fine in theory but the decision to exclude an investment from the panel will be made on historical

information about existing clients. How can a firm predict what will be the risk appetite of each new client who comes along? So could a firm be found at fault for not having on its panel investments to suit clients who come along in the future with a higher appetite for risk than the existing customer base?

The FSA had proposed dropping the current exemption for GPPs for firms holding themselves out as independent. That idea has now been dropped.

Restricted advice

For advisers giving 'restricted', or non independent advice, the FSA is not now proposing to mandate any form of words about how the firm discloses the nature of its restricted advice to customers.

Furthermore, the FSA is not imposing any obligation requiring restricted advisers to tell customers that independent advice may be available elsewhere.

However, it will not be acceptable for restricted firms and advisers to recommend a product that most closely matches the needs of the consumer from the restricted range offered when that product is not suitable.

Simplified and basic advice

Is it imagination or was one aim of the RDR said to be to simplify the advice landscape for consumers? Now we have something called alternately streamlined advice or simplified advice. This is in addition to basic advice, which the FSA is now keeping, and non-advised services.

The FSA has decided that it does not need to create any separate regime for simplified advice and indeed at this stage it does not even feel ready to issue any guidance on such a process. That is because the industry itself seems to be at sixes and sevens over how a simplified process would work.

Basic advice, however, stays and it is not being brought within the scope of adviser charging, so a firm can continue to get commissions on such sales after 2012. Could that be a trigger for more interest in basic advice by some firms fearful that some of their potential customers are unlikely to take to adviser charges? Basic advisers will, however, have to disclose in future that their advice is restricted.

The FSA has decided that the RDR changes should not apply at all to non-advised business. So, adviser charging does not apply and commissions can still be paid after 2012. And the scope of retail investments is not being enlarged, so the old packaged product rules will continue to apply.

Recognising that there could be a risk that some firms might dress up their services as non-advised so as to evade the adviser charges obligations, the FSA is taking action to close off such attempts. It has added guidance to its rules to the effect that services related to a personal recommendation, and which are subject to the adviser charging rules, include arranging or executing a transaction which has been recommended and conducting administrative tasks associated with the transaction. This means, says the FSA, "that a firm cannot provide 'free' advice and then

receive commission for, say, arranging or executing the recommended transaction."[7]

2.3 Commission payments

On charging, the particular area of concern for IFAs, the FSA proposed:[8]

> We propose that adviser firms should only be paid for the advice and related services that they provide through 'adviser charges'. By this, we mean that adviser firms should be paid by charges that are set out up-front and agreed with their clients, rather than by commissions set by product providers to secure distribution of their products (including so-called 'soft' commissions, paid in non-monetary forms).
>
> Regardless of whether adviser charges are paid directly by a client as a fee (for example, by cheque or direct debit) or are paid as deductions from their investments, these charges should reflect the services being provided to the client, not the particular product provider, or product, being recommended.
>
> **All firms** have a responsibility to act in the best interests of their clients and, for firms that offer advice, this responsibility means making the best available recommendation for the client (including, where appropriate, making a recommendation not to buy a product at all or to take alternative action). Where firms offer restricted advice, relating only to a limited range of products or providers, they must still make their recommendations in their clients' best interests – for example they must recommend paying off debt, rather than buying any of their products, where this would be in a client's best interests. For this reason we propose to apply our Adviser Charging requirements to all firms that give advice on investments.
>
> **Adviser firms** will be expected to decide on their own charging structures, reflecting the services that they offer, and to apply these charging structures consistently to consumers. We are not seeking to prescribe the basis on which a firm might charge for its services – for example, a firm might charge a fixed fee, an hourly rate or a percentage of funds invested – but we will expect to see firms drawing up and operating their own charging structures responsibly. In particular, our draft Handbook text makes clear our expectations as set out below.
>
> • Adviser charges should not vary inappropriately according to the product provider that a firm recommends. While adviser firms may be used to receiving greater amounts of remuneration from some product providers than others, we do not expect to see such variation replicated in the charging structures that adviser firms adopt for themselves. Where different product providers differentiate themselves by offering different levels of service, this can, of course, be taken into account – along with other product features – in making a recommendation to a consumer about what to purchase.
>
> • Adviser charges should not vary inappropriately according to the type of product offered, where different types are substitutable. Where an adviser firm could recommend a number of competing types of products – for example, collective investment schemes,

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7 David Severn, *Money Management* May 2010

8 FSA Consultation Paper 09/18; p23-24;

> investment trusts or life assurance bonds – its charging structure should not incentivise it to recommend a particular type of product, against the interests of the consumer. (In contrast, where a different product type is associated, justifiably, with a different level of service – for example, giving advice on whether to transfer a pension might involve a different service to giving advice on whether to top up an ISA – a different charge could reasonably apply.)
>
> • Adviser recommendations should not be influenced by the existence of terms or facilities offered by product providers to collect adviser charges. We accept that it can be beneficial for a consumer to choose to pay their adviser charges out of their investment (for example, because tax relief may be available) but the convenience to an adviser firm of receiving either up-front or recurring adviser charges through this mechanism should not influence the recommendation made.

2.4 Professional competence

The final big area of concern to small IFAs is the issue of professional competence. This can be divided between two broad areas, professional governance and qualifications.

Professional standards

The FSA announced in its December 2009 consultation[9] that it would work with professional bodies that met certain criteria and which it would recognise.

> The role of professional bodies would become more significant than at present, helping to deliver and evidence their members' observance of the higher standards. We intend to recognise formally professional bodies that meet certain criteria, so that membership will be taken as satisfying the requirement to evidence the new initial and ongoing competence requirements to be set out in our Handbook. These bodies would provide front-line monitoring for their members, amplifying the effect of additional resource we would commit to this work.[10]

The FSA updated its views on professional oversight of standards in a Consultation Paper published in June 2010.[11] The proposed structure is:

- The FSA will carry out the supervision and enforcement of the new professional standards, which will be set through the FSA Handbook (i.e. they will make rules on things such as ethics, customer treatment etc). It will monitor firms' performance and check on known problem areas, for example, higher charges following investment advice or churning of investment activity.
- Firms will train and ensure that advisers meet these rules

[9] FSA Cp09/31 p17
[10] CP09/31 p17
[11] CP10/14: Delivering the RDR: Professionalism

- Advisers will complete an annual return detailing amongst other things their professional training and development progress, that they meet required standards and have the appropriate qualifications. They will send this to an accredited body.
- Accredited body will check on a sample basis that the returns are accurate and issue a Statement of Professional Standing to the individual which acts like a driving licence allowing the individual to work. The accredited body will alert the FSA of any problems it discovers.

The criteria that the FSA will use to accredit bodies are set out in the draft Handbook text in Appendix 1 of the December Consultation. Briefly, it covers four broad areas:

- To act in the public interest and further the development of the profession.
- To carry out effective verification services.
- To have appropriate systems and controls in place and provide evidence to us of continuing effectiveness.
- To cooperate with the FSA on an ongoing basis.

Paragraphs 2.19 to 2.41 of the Consultation set out the details of the accreditation process.

Qualifications

With respect to qualifications, the FSA announced in December 2009 that:

> The FSSC [Financial Services Skills Council] will publish final standards for the content of the new qualifications in March 2010 allowing awarding organisations to create new qualifications. To ensure there is clarity about the date that new qualifications are available, we have agreed that OfQual will approve the first new qualifications in June 2010.
>
> Based on our discussions with the awarding bodies, study materials are likely to be available from October 2010, and new entrants to the industry from then onwards will be able to use the new qualifications.
>
> 2.24 For existing industry practitioners, we re-affirm our original deadline for the qualifications increase of the end of 2012, and give more detail on the 'no regrets' provision which we originally announced in FS08/6 to help make this change. In practice, this means that existing advisers who were unsure whether their existing qualification met the Level 4 requirement, or of which qualification to start studying for, are now in a position to start studying towards the QCF Level 4 standard three years ahead of the deadline of the end of 2012. Finally, we have responded to feedback on alternative assessments, settling on a position which we believe gives better flexibility for existing investment advisers.[12]

[12] CP09/31

An example of the qualification mentioned is described on the National qualifications database as:

> The Diploma in Financial Planning aims to develop advanced technical knowledge and understanding across a broad range of key advisory areas including: personal taxation, trusts, business taxation, pension funding, pension income, investment and supervision in a regulated environment. Further units may be developed as required to ensure that key technical subject areas are covered.[13]

The criteria a qualification has to meet for it to be approved is:

- The level of difficulty should be at, or above, a QCF level 4 qualification (or equivalent such as SCQF, NQF, FHEQ);
- The content must be relevant to the investment adviser's role. For example, where the qualification was awarded after 2004, the test would be whether it met the FSSC appropriate examination standards; and if it was awarded before 2004, the test would be whether it was listed in the rules of the FSA's predecessor regulators; and
- The qualification must be awarded by a recognised UK awarding organisation (for example, one given awarding powers by OfQual, the SCQF or the QAA), or an overseas equivalent.

The list of approved qualifications can be found in Appendix 2 of the June Consultation document.[14] It is a long list of exams and exam providers. Not all parts of all qualifications are required; which are and which are not will depend on the work undertaken. A selection of the approved qualifications is shown below:

13 Accredited Qualifications
14 CP10/14: Delivering the RDR: Professionalism Annex 2

Qualification	Qualification Provider
CFA Program Level 1	CFA Institute
Investment Management Certificate	CFA Society of UK
Associate	CFA Society of UK (Formerly United Kingdom Society of Investment Professionals / Institute of Investment Management and Research)
Member of the Securities Institute (MSI Dip) (where candidates hold 3 modules as recommended by the *firm*)	Chartered Institute for Securities and Investment (Formerly the Securities and Investment Institute)
Masters in Wealth Management	Chartered Institute for Securities and Investment
Registered Representative Full Membership Exams - where holders have all three papers or have both Stock Exchange Practice and Technique of Investment papers	London Stock Exchange (records are now kept by the Chartered Institute for Securities and Investment
Diploma (where candidates hold 3 modules as recommended by the *firm*)	Chartered Institute for Securities and Investment (Formerly the Securities and Investment Institute)

Source: FSA CP 10/14, Annex 2

At first the FSA had insisted upon formal external exams, however, this was replaced by alternatives of continued assessment by recognised outside bodies. This was a major compromise. To some it was an essential move to stem the flow of experienced people from the industry. Others, however, were "not sure if a relaxing of the standards is a good idea".[15]

In the December Consultation the FSA describe this option:

> In CP09/31 we set out our position on alternative assessments (sometimes referred to as work-based assessments), giving the industry scope to develop options, subject to these meeting criteria on relevance, level of difficulty and the requirements of the relevant qualifications regulator. We reiterate that these will not be an easy option.[16]

The FSA consulted on a couple of alternatives to external exams:

- In Consultation Paper (CP) 10/14 - CISI's PCIAM (one day interview and presentation) - covering advising and dealing on securities and packaged products; and
- In CP10/22 - CII's Diploma in Regulated Financial Planning (attained through a CII alternative assessment day) - covering packaged products.

This option is particularly relevant for existing advisers who may only meet part of the qualification requirements. Top – up "qualification

[15] Hargreaves Lansdown representative quoted in Financial Times 17 December 2009.
[16] CP10/14: Delivering the RDR: Professionalism p7

gap filling" as it is described, will be done by a mixture of the individual themselves, the industry and professional bodies. The FSA explains:

> we do not necessarily expect individual advisers to carry out the gap analysis themselves, and we are aware that all of the qualifications providers in our PSAG[17] have told us that they intend to carry out this exercise for individuals against their own qualifications, as well as make appropriate suggestions and arrangements to help individuals to address those gaps. However, this will not cover all qualifications on the transitional list and some individuals may want to do their own analysis. We will allow individuals to do their own mapping, but we expect in 100% of cases this will need to be reviewed and verified by the accredited body before that body issues the relevant SPS [Statement of Professional Standing].
>
> As we stated in CP09/31, we are not requiring further exams for qualification gap fill but, as with CPD [continuing professional development], we expect the prime focus to be on the relevance of the activity to the learning outcome and indicative content. This can be from any source: firm, professional body, training provider, etc, and from any time provided it is completed before end-2012. So as we proposed in CP09/31, CPD carried out in the past can be used to meet the qualification gap fill requirements.[18]

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[17] CFA Society (UK), Chartered Institute of Bankers in Scotland, Chartered Insurance Institute, Chartered Institute for Securities and Investment and the ifs School of Finance.

[18] Ibid p24

3. The predicted impact on the financial advice industry

Note: chapters 2 and 3 were written pre introduction of RDR and are therefore of largely historical interest only. They help illustrate the accuracy, or otherwise, of predictions made around 2009/10. Readers interested only in the current picture may safely skip to chapter 4.

3.1 Doomsday?

A report by the accountants Ernst & Young, published in September 2009, predicted that of the 35,000 IFAs currently in existence, 10,000 might be left three years after the rules come into force in 2012. A further 10,000 would continue but in a restricted capacity, for example only advising on mortgages. Part of this migration is the expected cost of changing charging systems and new, higher, capital requirements. As a rule of thumb, the new rules will add about £6,000 per adviser to a firm's costs. Requirements for further training and exams will deter some and many believe that the volume of traffic through their doors will fall dramatically when people realise that visiting an IFA sets an automatic fee-time clock ticking.

Ernst & Young issued a press release along with its Report. It pulled few punches:

> **An industry transformed**
>
> According to [the Head of research] Shaun, the impact of the RDR simply cannot be underestimated: "The ripple effects will soon become seismic waves as the proposals look set to impact across many areas of the industry, as well as stretching into new markets such as protection and new technologies such as wrap. The true size and breadth of the RDR transformation ahead of us is now becoming apparent."
>
> He notes the unequivocal no to grandfathering and factoring, and says that there is no doubt that the FSA will regard any attempts by providers to 'fill their boots' before the 2012 in a very poor light: "The regulator will be looking out for closing down sales." Shaun is supportive of the way that the paper has successfully addressed the issue of quality, commenting that the 'now almost clear blue water between independent and restricted advice will no doubt please the independent advisor community. At the same time, non-independent advisers should be relieved that they have narrowly avoided the salesperson job title.'
>
> **How many advisers will remain?**
>
> However, he has some concerns around the quantity of future advisers: "A significant rise in the quantity of advice – be it independent, restricted, simplified or basic – is absolutely essential in a country where the vast majority of individuals are under-pensioned, under protected and have far too few savings," Shaun comments.

> "The consultation paper does start to tackle this issue with the introduction of 'simplified' and the continuation of 'basic' advice, but the distinction between the two is somewhat obscure. Given that simplified advice carries the same requirements in terms of advisor charging and qualifications, it is unclear why a firm or adviser would opt for this route over the independent and restricted advice options on the one hand, or over basic advice on the other. It seems unlikely that simplified advice will prove to be a commercially viable option.
>
> "Nevertheless, basic advice (with its exemptions) may offer some real opportunities for the providers and distributors who are prepared to invest time and money exploring this option.
>
> "At the other end of the advice spectrum, there clearly a question over the number of advisers who will remain following on from the current economic climate, increased capital adequacy levels, and the RDR's professional standards proposals. Of a population of over 30,000 advisers, many industry commentators are expecting at least a third to leave by 2012. We do not disagree but we do see the profession being potentially of more interest to graduates given the professional qualification it will offer them," he concludes.[19]

Unsurprisingly, many MPs received letters from IFAs in their constituency worried about their future.

Within the overall contraction of the industry, most commentary reflects the view that there will be a shift away from providing 'advice' and towards the top end 'planning'. The reasoning is that the extra fixed costs of business can only be recouped by fees from wealthy clients willing to pay for complex planning advice. Mass market, mortgage and general insurance sales will become less attractive to a more professional industry. Commenting on the likely response of the financial advice market in Scotland, *Scotland on Sunday* noted:

> The move to fees and higher qualifications means those IFAs adjusting their business models accordingly will increasingly target only wealthy clients....The better quality qualified IFAs are already being more 'picky' about who they will take on and many are shedding clients.[20]

It is not only the IFAs that are adjusting. Insurance companies, which sold most of their products on the old commission payment to IFA route, are now worrying about how these products will be sold. Their response has been to buy up several IFA groups. *Scotland on Sunday* again:

> Earlier this month Standard Life completed its acquisition of financial advisory support business Threesixty, while fellow Edinburgh- based insurer Aegon owns advisory businesses Origen and Positive Solutions.
>
> More generally, there seems to be a divide between the high street offices and the larger wealth managers over the new rules' impact. The latter, already focus most of their attention on the wealthier sections of society and are more accustomed to charging fees. Being larger, they have a wider base on which to spread new overhead costs. By contrast, the smaller operators

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[19] Ernst & Young press release June 2009

[20] *Scotland on Sunday* 28 March 2010

look to face the greatest changes and costs. One view of their plight, and the impact of the review in general, is summarised by a writer in *Money Management*:[21]

Adding up the cost

It is still not possible to reckon the final cost of all the changes and the impact that it will have on the IFA sector as we have yet to see:

- Final decisions on consultancy charging for GPP business;
- Final decisions on the governance of professional standards, CPD and ethics;
- Proposals on changes to platform business;
- Changes that may be needed in the light of the EU's review of retail investment business.

Based on what is known so far, however, there has been a significant increase in the estimate of the costs of the RDR to the financial services industry as a whole. The total net present value of the incremental compliance costs over five years has shot up from an original estimate of £0.6bn to between and £1.4bn and £1.7bn.

Looking at market exit by IFAs and the effect on consumer demand for advice the FSA's consultants estimate that there will be:

- A 9% reduction in overall turnover;
- An 11% reduction in the number of advisers;
- An 11% reduction in the number of advised clients as a result of market exits.
- A possible 25% of intermediary firms considering leaving the sector. Moreover, it is much more likely that it will be the smaller firms - those with less than 10 advisers - that exit the market.

It is difficult to reconcile these estimates with one of the stated aims of the RDR, which was to increase the number of consumers who see the value of taking advice. Of course, not every IFA firm will be crying over the changes. Those at the wealth management end of the market and some of the larger firms will probably find that they can adapt without too much trouble. Indeed they would seem to be well placed to expand in the future as they pick up some business from those small IFA firms that exit the market. But small IFA firms with a less wealthy client base may feel that at best the defence of their interests has been limp wristed and ineffectual.

The Report mentioned in this article was by Oxera, commissioned by the FSA, in the later stages of the consultation period.[22] In general it presents a picture that is less 'apocalyptic' than the Ernst & Young survey, nevertheless its findings do suggest that the IFA market will change substantially with generally, far fewer small firms of advisers in

[21] Money Management May 2010
[22] *RDR Proposals: Impact on market structure and competition*, Oxera, March 2010

the market. Where the Oxera Report differs from some others is that although it sees some of the same magnitudes as some other surveys in terms of the number of firms leaving the industry, it forecasts that this does not translate into a corresponding fall in the number of advisers. In other words, small companies will cease but some of the advisers will move to larger companies that can afford the investment in training and systems which the RDR requires.

3.2 New dawn for consumers?

As stated at the start of this Note, the point of the RDR was to improve the sales and advice environment for consumers by way of:

- improve the clarity with which firms describe their services to consumers;
- address the potential for adviser remuneration to distort consumer outcomes; and
- increase the professional standards of investment advisers

Consumer groups like Which? generally welcomed the RDR whilst calling for it to go further and to be allied with other initiatives. A problem which is linked with the RDR, but is essentially outside of it, and which is fundamental to improved consumer outcomes, is the generally accepted fact that financial services are poorly understood by the public.

In its round-up of retail financial services Which? writes, "Financial decision making is unfamiliar and mysterious territory for most ... Our focus groups revealed that any advice given is judged through a filter of mistrust".[23] In some respects, this is odd. Only a small percentage of purchasers of motor cars or computers genuinely understand how an engine works or how computer algorithms work and yet the same fear and mistrust is less apparent in these markets.

This may be partly because in these markets the consumer is buying a 'thing' that they can immediately use and assess themselves. If they don't like it, there is a ready second hand market that they can use to cut their losses. With financial products, there is less tangible evidence for its value in the short term and the ultimate test of whether the decision to buy was wise might be not apparent for decades. Even at the point of sale, most financial products come with a warning that 'past performance is no guide to the future': the fact that this is true does nothing to reassure a confused purchaser. Thus, whatever impact the RDR has, it is clearly only part of the solution to whatever is dysfunctional in retail financial services. Better generic advice and improved financial capability must also play their part.

Will the RDR improve matters? In truth, the answer will not be clear for some years. The best current guide is in assessing the likely reaction of the industry to the changes as evidenced in surveys and then assessing

[23] Which?, *The Money Maze*, p8

what impact these changes will have. At both stages of this process, there is a broad forecasting error.

On the basis of current information, the evidence suggests a significant reduction in the number of small, high street financial advice outlets. However, the more dramatic claims made in the Ernst & Young survey now looks to be at the extreme end of predictions. The Oxera survey (note, made a year later and after some changes to the proposals) finds that many of those who work in these outlets will transfer to bigger companies. Oxera summarises the likely new shape of the market:

> The report then considers the combined effect of the RDR proposals on market structure. Although the analysis suggests that no single element of the RDR package would lead to significant changes to market structure, consideration must also be given to the possibility that some combination of effects could lead to a significant change. A number of sources have estimated the likely reduction in the number of IFAs as a result of the RDR package as a whole. These consistently suggest that some IFAs will exit the market, but there is no clear consensus on how many. However, only one of the primary research sources suggests a drop of more than 20% in the number of either advisers or firms. Furthermore, all of these estimates were produced before the FSA's proposals for on-the-job assessment.
>
> Overall, the report concludes that the post-RDR landscape is likely to feature fewer small independent IFAs, some of which will leave the market entirely, while others will join larger firms or networks in the independent or non-independent sectors. This may lead some consumers to experience reduced choice in the short term. However, if demand for advice outstrips supply, given that entry barriers are unlikely to be prohibitive (although higher as a result of RDR) new entry or expansion by existing players would fill the gap.[24]

Oxera note that some of their conclusions are based on 'worst case' scenarios.

The actual overall impact on the capacity of the advice market of advisory firms leaving the market is relatively limited. If all the firms that indicated that they are (very or quite) likely to exit the market do so, this would result in a 11% reduction in the number of advisers, a 9% reduction in advisory firms' revenues, and a 11% reduction in terms of clients advised, assuming that this business is not picked up by other firms.

Clearly, some firms that say they will leave may not, and some of the people assumed to not be getting advice will in fact shop elsewhere.

There are undoubtedly potential gains for consumers here. Consolidation in an industry tends to lead to economies of scale and reduced costs. These can be passed on to the public – but only if they use them. Which?'s point about consumer ignorance of financial

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[24] *RDR Proposals: Impact on market structure and competition*, Oxera, March 2010, Executive Summary

products[25] and the mistrust of advice is pertinent here. They found that:

> Even they [consumers] may not like the 'sales' element [of bank advice], many consumers default to their bank who are seen as accessible and familiar." [26]

The accessible point may be significant *if* one in five high street IFA outlets disappear. Interestingly, Which?'s mystery shopping exercise across the industry concluded that:

> While quality [of financial advice] is worryingly low, our surveys tend to show that IFAs perform better than banks.[27]

A majority of current IFAs agree that the RDR will increase competition in the industry, leading to lower revenues and profits, and 80% of the industry think that they will be able to charge the same or less than they do now for the same advice. The transparency of charges under the RDR is clearly something that providers and distributors are acutely aware of.[28]

The impact of the RDR on the price of the products offered is, according to Oxera, 'mixed'. Currently, product providers have an incentive to reduce prices because they compete on the level of commissions they give the distributors. This incentive will disappear post RDR and hence prices might rise. On the other hand:

> Mechanisms which would lead to lower FGPs in the IFA channel post-RDR are also explored. These rely on price being an important driver of competition and the existence of a significant proportion of sophisticated customers whose shopping behaviour could reduce the FGPs both for themselves and for less sophisticated consumers. However, the available evidence suggests that (wholesale) price is not necessarily the main driver of competition.
>
> Furthermore, there is not sufficient evidence of a sizeable proportion of sophisticated consumers. Therefore, it is not expected that, at least in the short term, fierce competition around FGPs would arise as a result of RDR.[29]

Again, the role of the consumer and consumer financial capability is crucial.

Although the quality and standards of advisers and the transparency of their status are important aspects of the RDR, at its heart is the abolition of the commission payments system. That the level of commissions can influence advice is virtually undeniable. One might consider, for example, the fact that whereas unit trust plans are commonly sold by financial advisers, investment trusts, similar in effect in many respects, are significantly less popular with advisers. One is a commission based product the other isn't. Rightly or wrongly, the commission bias in

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[25] In one study 40% of people did not know that the value of an equity ISA varied with the stock market
[26] *Money Maze* p8
[27] Ibid p12
[28] Oxera p14
[29] Ibid, Executive Summary

some products is blamed for some of the mis-selling crises in recent years. It could be argued that any review, whatever other uncertainties or disadvantages it might produce, if it reformed the sort of practice shown below, found by the FSA in one of its mystery shopper exercise, must be an improvement on the existing system:

> Adviser X strongly advised against paying off any of the mortgage with the customer's available £50,000. He convinced the customer that he wanted to invest rather than pay off the mortgage, when this was not the initial case at all. The £50,000 could have been applied to paying off the customer's outstanding loan or some of the mortgage. This course of action would have provided a monthly surplus, which the customer could have used to address potential shortfalls in other areas. However, the whole process concentrated solely on commission-earning investments and so the shopper could well have been severely disadvantaged by not discussing the shortfalls in key areas. After it was established that the customer was a cautious investor the adviser explained that the greater the risk the customer was willing to take, the greater the potential return and suggested the customer might want to increase his initial cautious approach to something a little higher. This may have left the customer open to the potential risk of greater losses than they were prepared to accept, without fully understanding the implications of the course of action.[30]

In its Consultation document published in June 2010 the FSA published its own impact assessment of the RDR. Its summary of its findings is shown below:

> 55. In summary, the costs to the FSA are expected to be in the range of £4m and £5m initially and £3.5m annually. The total costs to advisers will be in the region of £155m to £225m to meet the standards required by end-2012 and then £3m to £4m annually after that. Advisers will also incur the costs of independent verification of their compliance with professional standards. Since this market does not exist currently it is difficult to predict the price of this service. Based on information from potential accredited bodies we expect the on-going cost of obtaining an SPS will fall within a range of £60 to £175 per adviser, leading to additional on-going costs to all advisers in the region of £3m to £8m. This is likely to be an overestimate for those advisers who belong to professional bodies who already meet the accreditation standards and would therefore not incur additional costs.
>
> 56. Benefits are expected to arise through improvements in the quality of advice delivered to consumers as a result of higher, more consistent professional standards and increased compliance with professional standards, through effective FSA monitoring and enforcement of accredited bodies and advisers. These measures will support RDR rules on charging and advice. The FSA will, however, monitor the development of this market, but the benefits of increased compliance with rules on professionalism are contingent on this being effective.

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[30] Financial Services Authority, *Quality of advice process in firms offering financial advice: findings of mystery shopping research*, Consumer Research 52, August 2006

57. In the longer term, we anticipate that higher standards of professionalism will result in greater trust in advisers.[31]

[31] CP10/14: Delivering the RDR: Professionalism Annex 1

4. Implementation

4.1 FSA developments

The FSA did a lot of work in 2011 on the details of implementing the RDR. Some of this involved establishing the 'accredited bodies' who would be the practical lynchpin of the qualifications and professional standards expected in the new regime. An FSA publication sets out what is required of such bodies:

> To become accredited, an organisation will need to satisfy four requirements to:
>
> 1. act in the public interest and further the development of the profession;
>
> 2. carry out effective verification services;
>
> 3. have appropriate systems and controls in place and provide evidence to us of continuing effectiveness; and
>
> 4. cooperate with us on an ongoing basis.
>
> In return for accreditation, the bodies must agree to certain requirements including how they will check advisers are subscribing to standards and the frequency and nature of sampling individual adviser CPD records. This means there will be a more consistent approach in interpreting and monitoring professional standards.[32]

The key 'passport' document which all advisers will need to hold is a Statement of Professional Standing (SPS). It is likely that most IFAs will apply for and receive their SPS from an accredited body, although it is not compulsory that they get it by this route. The SPS confirms that advisers:

• have adhered to the ethical standards;

• hold the required qualifications (including gap-fill); and

• have completed appropriate continuing professional development (CP).

In June 2011 the FSA announced the first six approved accredited bodies. These are:

- Chartered Financial Analyst (CFA) Society of the UK;
- The Chartered Institute for Securities and Investment (CISI);
- The Chartered Institute of Bankers in Scotland (CIOBS);
- The Chartered Insurance Institute (CII);
- The Institute of Financial Planning (IFP); and
- The Institute of Financial Services (IFS).

32 FSA Factsheet for retail investment advisers

4.2 Treasury Select Committee

On 16 July 2011 the Committee produced its Report on the RDR.[33] The Report's summary is shown below:

> The FSA's Retail Distribution Review (RDR) is a major reform of the regulation of retail investment advice and is due to come into force on 1 January 2013. It would in particular require advisers to have qualifications equivalent to a Certificate in Higher Education in order to practise, and remove the system of commission paid to advisers and replace it with Consumer Agreed Remuneration.
>
> Some parts of the financial services advice market are not working properly for consumers. But some elements of the FSA's evidence have appeared weak to the Committee, and the FSA itself concedes that its proposals would cause large numbers of Independent Financial Advisers (IFAs) to leave the market. This would reduce competition and choice for consumers, at a time when the savings rate is already too low. A delay of 12 months in the implementation of the RDR in order to allow advisers to satisfy the requirements of the RDR would be likely to increase the number of firms and advisers making the transition to the new system, while recognising the fact that many advisers have already complied with the RDR's requirements.
>
> A higher level of qualification for advisers can help build a stronger professional ethos among advisers and reflect the considerable of responsibility advisers have for the financial welfare of their clients. By asking for a delay of a year to the introduction of the RDR, we hope that advisers will take the opportunity to meet the new qualification requirements. We also recommend the FSA use other means, such as providing for flexibility for advisers on a case by case basis, and allowing supervision of non-qualified advisers.
>
> Customers of financial advisers have tended to see financial advice as 'free' under a commission-based system. The RDR will mean that customers will clearly see what they are being charged for advice. This is a healthy development but will involve a significant change in culture for the industry.
>
> The FSA is to be replaced by the proposed Financial Conduct Authority (FCA). The FCA will have different objectives to the FSA, and the Treasury should state whether it is content that the RDR as currently constituted would be consistent with the objectives, as it currently sees them, of the FCA. The creation of the FCA also provides an opportunity to examine the accountability mechanisms that will apply under the new system of financial regulation. We will therefore instigate an inquiry to form a view on whether they are adequate.

The main recommendation, that there should be a year delay before implementation was rejected by the Financial Services Consumer Panel:

> "The Treasury Committee has recognised the vital importance of the RDR to consumers. The provision of unbiased financial advice from properly qualified advisers has been a key aim of the Panel. We were disappointed that the Report calls for the FSA to extend the deadline for adviser qualification as the industry has already

[33] Retail Distribution Review, TSC 15th Report 2010/12

had several years' notice of the introduction of the minimum Level 4 qualification.

While we acknowledge the cost in terms of time and fees that some advisers will incur in achieving the minimum qualification level, there can be no justification for the FSA to back away from this important requirement at this late stage. MPs would be rightly outraged if their constituents were treated by doctors with 'A' level qualifications or advised by poorly qualified lawyers. There should not be a double standard when it comes to financial advice.

Four years have already passed since the FSA set out the overall objectives for the RDR. Further delay will only risk harm to consumers as the effects of poor financial advice - and the burden of opaque fees and costs - can last a lifetime.

We know that many in the profession have already welcomed the raising of standards and have reached the appropriate level of qualification well within the original timescales. According to figures from the FSA, referenced by the Treasury Committee, in March 2010, nearly half of all advisers were already appropriately qualified with the majority of the remainder expected to qualify by the 2012 deadline." [34]

34 FSCP press release 16 July 2011

5. RDR in practice

The FSA, and now the FCA, record the number of advisers on a regular basis. Six months after the new system went live (January 2013) they produced figures for the number of registered advisers. At least some of those advisers most upset by the changes are likely to have left the profession before the deadline; hence, the 'base' figure probably already incorporates some of the negative impacts of fewer advisers. Some of this movement is captured by the estimate of advisers made by the consulting firm used by the FSA in 2012. The figures (below) show that the number of independent IFAs may have declined by about 2,000 compared to the figurer now. This is slightly less than a 10% decline in numbers. Interestingly the current total (21,684) is more than 1,000 larger than the figure as at December 2012.

The table below shows a noticeable divide between what might be called 'high street' advice and bespoke advice. Advisers on the high street – the independents and those in banks and building societies declined by over 15%; whereas stockbrokers and 'discretionary management' advisers have almost doubled. This outcome accords to a degree with what both sides wanted or predicted. A higher quality, more transparent 'product' would gravitate towards the more expensive end of the market.

Adviser numbers (estimated 2012 and actual end 2012 and 2013)

	Estimate in summer 2012	Actual 31.12.12	Actual 31.07.13
Source	*RS Consulting*	*FSA*	*FCA*
Financial Advisers	23,787	20,453	21,684
Banks and Building Societies	6,655	4,810	4,604
Stockbrokers	1,202	2,043	2,267
Discretionary Investment Managers	875	1,435	1,784
Other	2,554	2,269	2,221
Waivers	N/A	122	129
Total advisers	35,073	31,132	32,690

Source: FCA website

An article in *Money Management* in January 2014 focussed on the split between advisers who elected to be 'independent' and those which opted for 'restricted' status. In brief, if an adviser opted to only deal with a selected range of providers or only deals with various products then they are 'restricted'.

According to the article about 85% - 87% of advisers have elected to remain independent. There have been criticisms that the split is poorly understood by customers and appears pejorative to the 'restricteds'. In practice the difference between the two services can be very slim indeed

and the FCA is keen to advise that independence does not mean excessive and exhaustive searches by independents in all cases which would of course end up with higher charges.

Further analysis of the reforms was undertaken by Europe Economics in 2014 on behalf of the FCA. The press release announcing the findings included the following:

> Europe Economics, which was commissioned by the FCA to undertake the post-implementation review, found that the RDR has reduced product bias. In particular, there has been 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. This is a sign that commission is no longer a driving factor in advisers' recommendations.
>
> In addition to meeting the required standards, Europe Economics found that an increasing number of financial advisers were gaining further qualifications, demonstrating growing professionalism in the sector.
>
> The impact of the RDR on price has been mixed. While product and platform costs have broadly fallen, adviser charges appear not to have decreased.
>
> There is little evidence that the availability of advice has reduced significantly, with advisers still willing and able to take on more clients. Europe Economics found that while a small group of those with less to invest may find it more difficult to find an adviser, there were still those in the market willing to serve them.[35]

The Report itself is produced in summary form here. The Report finds that the many positive features of the RDR have, materialised:

- Higher commission products are sold less;
- Product prices have generally fallen though partly due to the introduction of simpler, and hence cheaper, products; and
- Overall firms are more profitable and hence less likely to default

On the professionalism aspect – all advisers have to pass exams - the Report is more cautious in its assessment. It states the truism that "The vast majority of advisers are now qualified to the new minimum standards"[36] but only that "there has been an increase in the number of advisers going beyond these minimum standards" when given the standards are new it would be hard for there to be a fall.

On the main argument against the RDR - that at the simpler end of the market, for the less sophisticated investor, the prospect of upfront payment for advice, the worth of which they had little way of assessing, would lead to a decline in people taking such advice the Report notes that

There is little evidence that the availability of advice has reduced significantly as a result of the RDR, with the majority of advisers still willing and able to take on more clients. However by revealing the true cost of advice, the RDR has led some consumers to consider the extent

[35] FCA press release 16 December 2014
[36] In order to be an adviser one has to be qualified

to which the advice they receive represents value for money, and in some cases conclude it does not. This group includes consumers who would be likely to pay for a cheaper form of advice, for example that which may be provided by a simplified advice model.

In the full Report *Europe Economics* identify three groups that might together comprise the 'advice gap':

> *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.[37]

Taking each segment in turn the Report notes that the RDR cannot logically have affected the unengaged, but indirectly there is:

> 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 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.[38]

But it continues by making the valid point that bank advice has not always been up to much judged by the mis selling scandal evidence.

With respect to the 'unwilling to pay' (the chief target of anti RDR sentiment in the build up) the Report finds little impact:

> 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.[39]

The last group is the 'unserved'. The Report finds that whilst some advisers have focussed on individuals with higher net wealth, and have

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[37] Europe Economics, *Retail Distribution Review: Post Implementation Review*, 16 December 2014, p57
[38] Ibid p60
[39] Ibid p61

therefore stopped dealing with existing, but less wealthy clients, the industry as a whole has not deserted this group:

> 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.[40]

In the post compulsory annuity age the need for advice is clearly more important than ever. A Priority for the Government has been to find a model to enable people to make informed decisions. Part of the *Pension Schemes Act 2015* (section 47 and Schedule 3) introduced a guarantee that all individuals with a Defined Contribution pension would be offered guidance at the point of retirement that was: impartial and of consistently good quality; covered the individual's range of options to help them make sound decisions and equip them to take action.

In October 2014, the Government announced that the guidance service would be delivered by Citizens Advice (face to face) and the Pensions Advisory Service (by phone). The Treasury, in conjunction with the Money Advice Service, will design an online service.

It is envisaged[41] that guidance will give way to 'advice', which might, previously, have been provided by the high street adviser. Whether such an infrastructure now exists in sufficient numbers, or is as attractive to those who really should apply for advice is a question as yet unanswered.

40 Ibid p63

41 HM Treasury, *Freedom and choice in pensions,* Cm 8835, March 2014 para 4.17-9

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