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Retail Distribution Review – an introduction

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Introduction

The Retail Distribution Review ("RDR") was launched in 2006 and the resulting legislation was implemented on 31st December 2012.

This has changed how retail investment products are sold.

Contents of this presentation

- Key features of the new legislation
- Impacts of the RDR on the market
- Risks and opportunities created by the RDR
- The roles actuaries can play in the post-RDR landscape

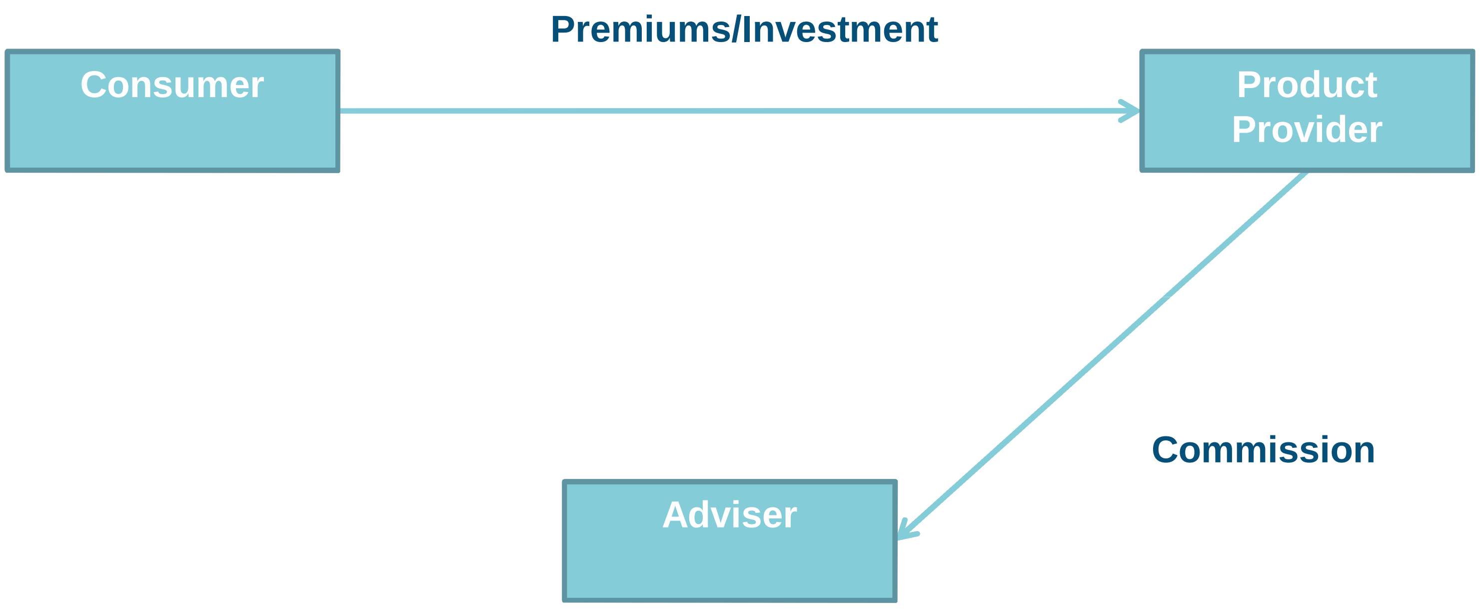
We note that this is a brief overview into the topic.

Distribution & Advice Channels

Independent Financial Advisers	Tied Agents	Own Salesforce	Direct
Act independently of all product providers	Only offer products of specified providers	Usually just sell the products of the provider	Generally involves no advice and involves no intermediaries
Typically remunerated by commission payments from companies	Could be remunerated via commission payments, a level salary, or a mixture of both	The salesforce would be remunerated in a way similar to tied agents	

Introduction

The Pre-RDR Sales Process



Introduction

Issues with the Pre-RDR approach

There were a number of issues identified within the above sales process structure, these issues included:

- Free Advice?
- Bias
- Churning
- Lack of Advice
- Product Selection

FSA Issues with the Pre-RDR approach

- The FSA noted two key issues with the retail investment market, which are largely an aggregation of the points covered in the previous slide:
  - **Poor outcomes for consumers and firms**
  - **“Inherent conflict” in an inefficient market**

- For other products (such as pure protection and general insurance), the FSA concluded that the current system does not suffer the deficiencies noted to the same extent, and thus no amendments to the current structure were proposed.

- Hence the RDR legislation would only address life policies, pension schemes and any other investment which offers exposure to the financial asset underlying the product.

Key features of the legislation

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Key Features of the New Legislation

Overview

The final legislation consisted of three key initiatives:

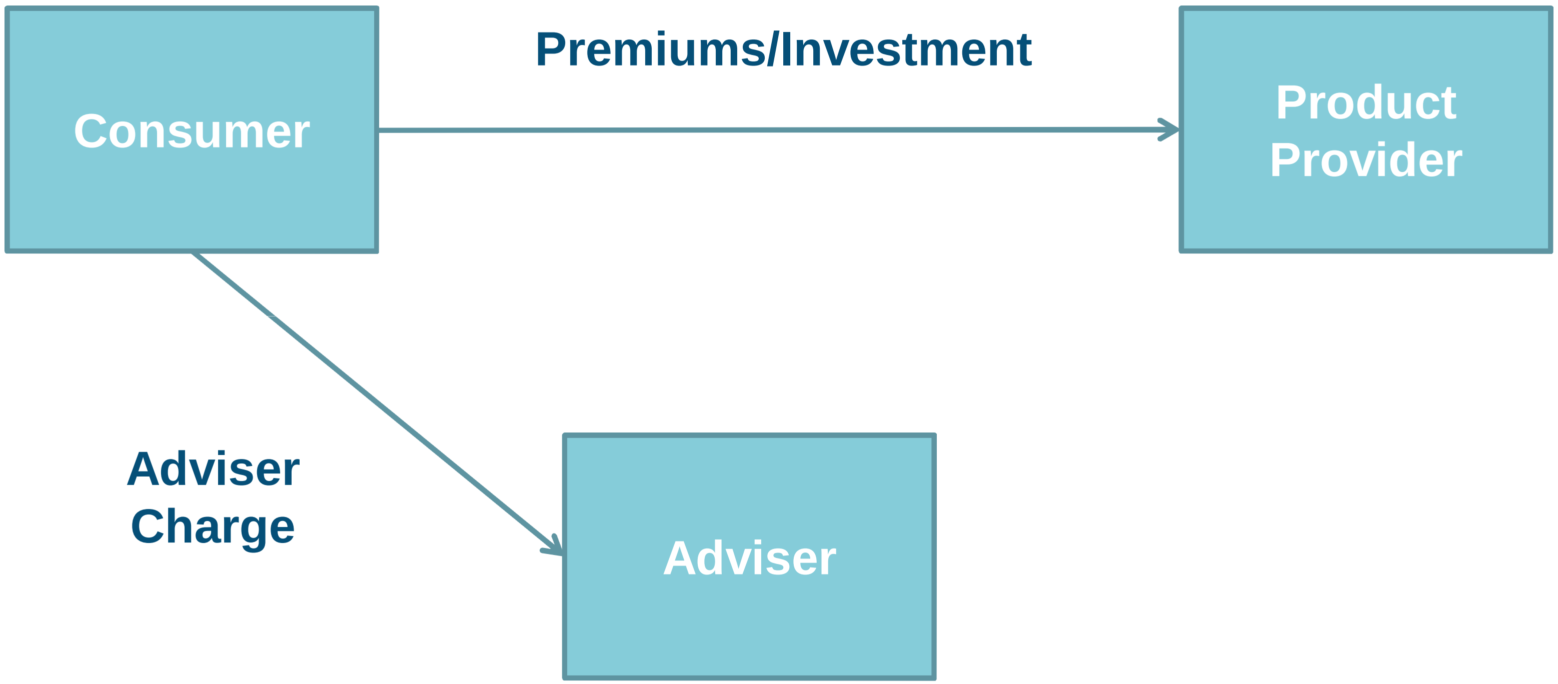
- Banning Commission
- Clarity of Advice
- Professional Standards

Key Features of the Legislation

Banning of Commission

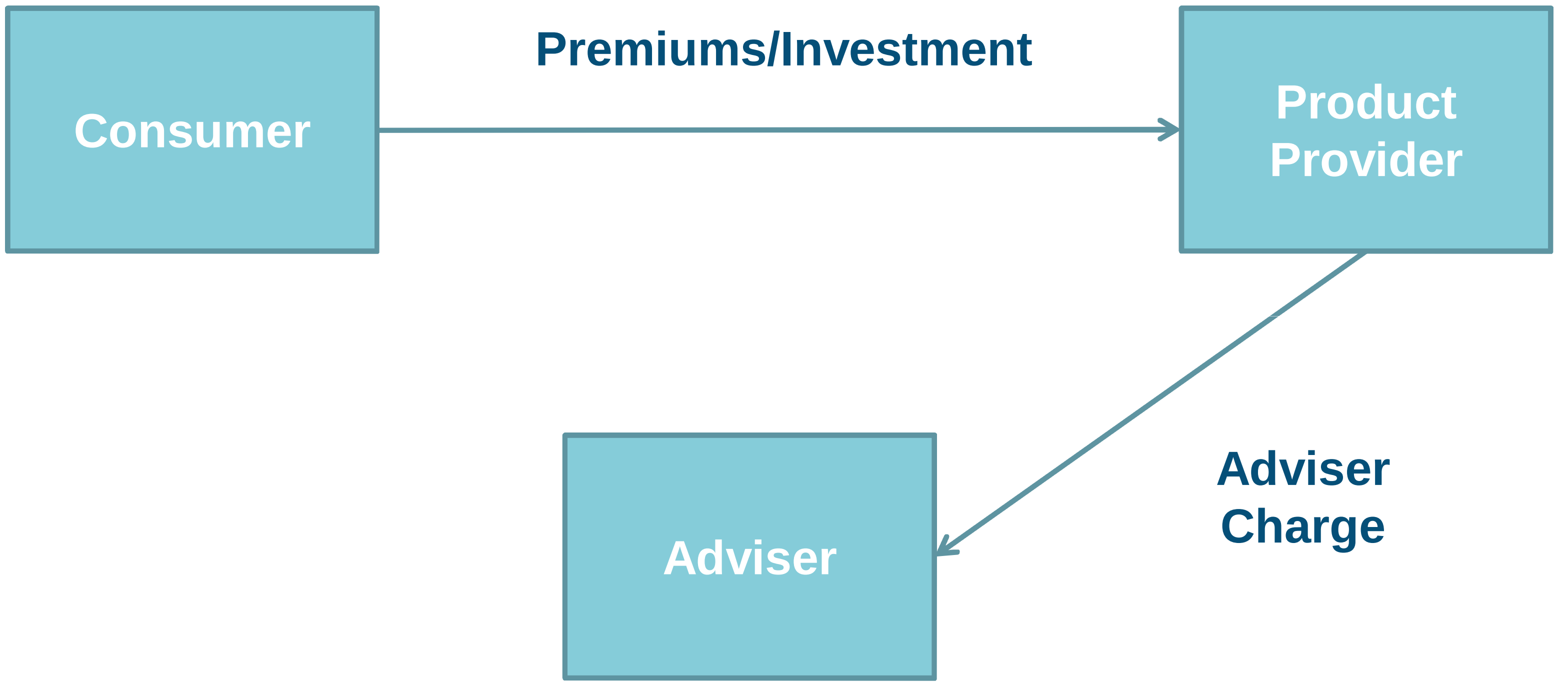
- For investment products, the remuneration mechanism of product commission is replaced by adviser charging
- The adviser charge is agreed upfront and reflect services given to the consumer
- Factoring (where a product provider pays the adviser charge at a discounted rate and recovers it over time via the product) is also banned
- For vertically integrated firms (i.e. those with in-house IFAs, tied agents or own sales force) adviser and product charges must be separated
- It should be noted that commission can continue to be received on a product sold before the implementation of this legislation

The Post-RDR Sales Process (without facilitation of Adviser Charging)



Key Features of the Legislation

The Post-RDR Sales Process (with facilitation of Adviser Charging)



Key Features of the Legislation

Clarity of Advice

- Advisers are required to disclose services under two categories; **independent advic**e and **restricted advice**

- Consumer is now aware of exactly what products have been considered

Key Features of the Legislation

Professional Standards

- The minimum professional qualification for all advisers is now raised

- Advisers must also complete 35 hours of Continuing Professional Development (CPD) each year

- Must maintain a Statement of Professional Standing (SPS), which can only be issued by a recognised professional body

Impacts of the RDR

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Impacts of the RDR

The impacts of the RDR on the market can be best understood by considering the impacts on the various stakeholders:

- Consumer
- Adviser
- Provider
- Regulator
- Auditor

Impacts of the RDR

Consumers

The intended impact of the RDR proposals on consumers is to:

- Increase confidence in financial advice
- Increase understanding of advice charges
- Remove provider bias

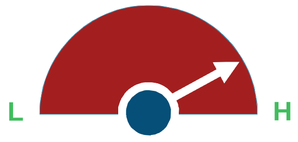
PwC consumer research in 2010 revealed the following consumer behaviour insights:

- Satisfied mass-market consumers would only pay c**.£100-c.£150** for **current advice** service
- Post-2012 advice proposition would significantly increase willingness to pay for advice
- However, **c.30%** of mass-market consumers are likely to self-direct and exit the retail advice market

Impacts of the RDR

Advisers

Advisers

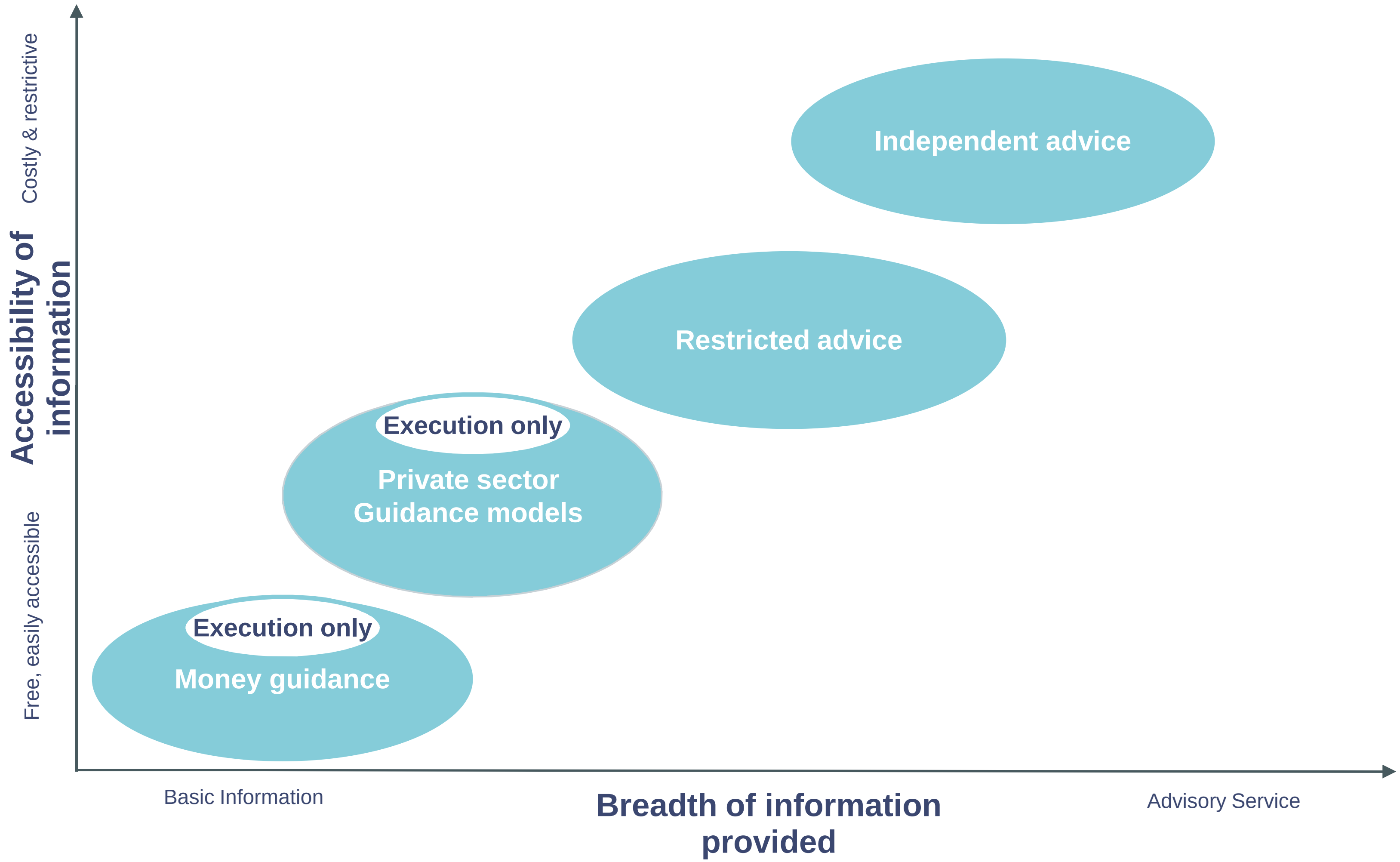


Impact

- Adviser Charging
- Restricted or Independent advice proposition
- Advisers will have to qualified and maintain their Statement of Professional Standing (SPS)

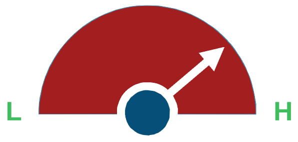
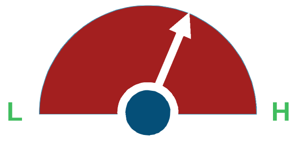
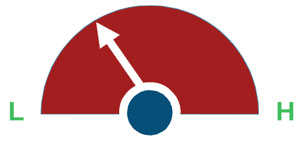
Impacts of the RDR

Advisers – The Post-RDR advisory landscape



Impacts of the RDR

Providers

Platforms	Life companies	Asset managers
 Impact	 Impact	 Impact
• Adviser Charging • Execution-only capabilities • Cash rebates • Transparent charges	• Commission ban • Facilitating charges • Advice and professional standards rules, particularly those with tied sales forces • Transparent charges	• Commission ban • Facilitating charges • Cash rebates • Transparent charges

Impacts of the RDR

Providers

Broadly, we can categorise companies' approaches into three types:

Refresh Distribution	Refine Products	Last Minute
Vertical Integration	Remove commission	Wait and see approach
+ Potential increase in market share and profitability - High cost, market may move in a different direction	+ Low cost, minimal impact, quick - May not be competitive, not maximising opportunities	+ Can see where market is heading - May lose distributors

Impacts of the RDR

Regulator

- The regulator will need to ensure compliance with the new legislation
- It may also need to clarify or amend legislation where necessary

Impacts of the RDR

Auditor

The RDR is wider than just a pricing change, there is an impact on the auditor looking at a company's balance sheet.

There are two primary areas which need to be considered:

- Lapse Rates
- Expense Assumptions

Risks and Opportunities

Risks of the RDR

Consumers may not pay the fee previously charged for the post-RDR proposition

New players enter the advice / distribution market and could disrupt the value chain and / or proposition

Ambiguity around the RDR and impact of other regulatory initiatives continues, risking the suitability of element(s) of the company response

Macroeconomic deterioration continues, impacting sales volumes

Opportunities of the RDR

Develop an online, execution-only proposition

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Retain focus and capture greater share of the mass market

Maintain momentum in strengthening your advice proposition

The role Actuaries can play in the post-RDR landscape

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Actuarial Involvement

The RDR provides an opportunity for actuaries to use their skill set to be involved in further areas. These can include the following areas:

- Expense Rates
- Modelling distribution structure and impact on capital and profitability
- Lifetime pricing
- Data analysis (and modelling data)
- Data analytics to challenge the statistical robustness consumer analysis
- Implementing a strategy / Risk analysis
- Consumer analysis and impact on persistency
- Comments on impacts to consumers
- Developing an adviser Charging structure
- Opportunity to improve the market chain
- Vertically Integrated Firm / Distribution profitability

Reaction to the RDR in other countries

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How have other countries responded?

Europe

Some European regulators have similar measures.

No Europe-wide consensus.

Rest of World

Other regulators may respond as a result of the RDR in the UK.

Commercial considerations

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Commercial considerations

How is the RDR impacting business models?

Final Comments

This is designed to be an introductory presentation, for further detail, please see the FSA website: http://www.fsa.gov.uk/

Alternatively, please contact us if you have any further queries:

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