

FEATURE HEAD TO HEAD

RETAIL DISTRIBUTION REVIEW

How will RDR impact the financial advisory community?



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KEY SPEAKERS

ROBERT REID: We've left A-day behind us with the oxymoron of simplification of pensions, so the complexity has not been diluted, but we're going to see a reduction of advisers in the mid market, which could reduce the IFA population considerably. This is because we have at one end what I would call the equivalent of personal shoppers, ie transactional shoppers, and at the other, people like myself who run chartered financial planning firms, and not a lot flying about in the middle. This could all prove quite damaging from the public's perspective.

JOHN MORET: I wouldn't disagree with that, as I come from the school of thought that the vast majority of individuals are not competent enough to advise themselves, particularly on pension matters. Any suggestion of a reduction in the numbers of advisers immediately throws up the problem of how to square the Retail Distribution Review (RDR) with the bigger issue of the savings gap. It seems to me the RDR is likely to worsen rather than improve matters. The polarisation between the transaction-based sales person – call them an adviser – and the true adviser may become clearer, and that is a good thing? Maybe this time the banks and other providers will get it right, but I don't have a great deal of confidence. Another concern is the area of non-advice, which is a real risk area, because we could see a big increase in firms taking products to the market on a non-advice basis, and in the pensions arena, that is an extremely worrying development.

REID: To be fair, there are some people out there who are capable of

steering a reasonable path, but the general level of ignorance was thrown into sharp focus when investors were going to be able to take residential property into their pensions. The danger with the way the government has approached personal accounts is that the combined contribution of 7% may be perceived as a level of adequacy by the general public, who will not discern that as simply a starting point. The ministers have been saying that I and others are naughty boys because we've been rubbishing the situation over means-testing, but we haven't; we have had our eyes open while they've had theirs shut. Politicians are in for a maximum term of probably eight years and the difficulty with pensions is you're not going to get a result in that time and they simply don't understand the funding that is required to give people a decent lifestyle. As a nation we have to accept that certain people can't afford to build a fund to live on, and therefore the ones who are lucky enough to earn decent amounts, are going to be the ones that are going to have to support them. I would rather pay an extra 2p in the pound in tax if I knew it would get rid of the nonsense of means-testing.

MORET: It comes back to the issue of joined-up thinking. There are areas where the RDR could bring some real benefit. There are undoubtedly parts of the pensions marketplace today that are broken. Some of the areas that are now coming under scrutiny – particularly on the back of Ned Cazelet's report – such as the misuse of incentivisation, in the context of pensions and pension transfers has to be welcome.

There are signs that the Financial Services Authority is looking to take action, but surely more could be done on enforcement to flush out the unscrupulous adviser, although I believe the truly bad advisers are in the minority. Clarification on remuneration would be helpful, but I'm not convinced that what they're currently proposing is going to end up clarifying anything. If anything I would say at the moment it's leading towards greater confusion, as I don't see how you clarify remuneration – call it commission – fees or customer-agreed remuneration (CAR), unless you tackle some of the other issues around it, for example VAT.

REID: There are problems with European law about making advice VAT-exempt, but we could go the other way and make everything liable to VAT, including commission, and allow people to offset personal financial planning fees against their tax liability. If we're trying to encourage people to save, we should encourage them to plan. The problem with the advice structure at the moment is that not enough advisers actually give advice that could stand in its own right without a product sitting alongside to prop it up. The skill leap that firms have to make if they're going to survive the RDR, is to be in a position where they could sell the advice on its own. Ironically, what we're discussing is what Ron Sandler suggested ages ago and the uncomfortable truth for the industry, is that Sandler was right about so many different things.

MORET: One of the dangers with the RDR is in some ways it's devaluing advice, and what we should be doing as an industry is trying to educate investors, the population at

large, to put a value on advice.

REID: Part of that is obviously down to the professional bodies supporting advisers and explaining why it's valuable, but the other important piece of the jigsaw is for the adviser to ensure they stress the connection between what they're advising, what it saves the client in tax and what it will give them at the end, so their influence is tangible. That is what most advisers are worse at. We also need advice at the bottom end of the market, with far more flexibility in product. There are too many Inland Revenue rules that catch people, so if those rules were eased, with adequate caps, you would stop a lot of mis-selling. So it's not about tweaking what's there, but being quite radical, because ultimately all you're trying to get people to do is save, and the problems come when you pick the wrong wrapper to save in.

PF: What about the impact of RDR on the providers and their relationships with advisers?

MORET: Prefunding commission has been one of the biggest problems going back to the year dot, but I don't think changing remuneration structures would stop or radically alter the relationship between provider and adviser. You have to go further than that and I strongly support the removal of upfront commissions on any pension transfer, because in many cases monies will have already had commissions paid on them, and to allow more commissions must introduce an element of consumer detriment. If there is one area of advice ideally suited to fees – or remuneration that reflects the work involved – it's pension transfers.

REID: As long as it's explicit, I ▶

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If the aim is to improve standards of advice and levels of transparency, anything less will be a fudge...

RDR has been with us for what seems like an age and yet we still don't know how the regulator is ultimately going to reshape the advisory market.

Of course, we've had false starts before, and depolarisation (or repolarisation) and simplification have actually improved the position of advisers by making the public more dependent upon them.

There's nothing wrong with that per se, but it has also had the effect of making a virtue of mediocrity yet failing to deliver better advice.

RDR could do this in one fell swoop, although in the medium term it may force out many advisers who are unprepared, unwilling or unable to raise their game.

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This requires courage from the regulator to be radical, but also the industry. Trade bodies are going to have to help their members decide how their businesses will fit into the new order.

That will be painful for some and there will be a degree of mourning for the old regime. But the old regime has demonstrated it is unable and unwilling to increase transparency and improve standards for investors. If that means compulsion is the only way to achieve this, so be it.

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don’t have a problem with that, but the CAR proposals from the Association of British Insurers ignore the fact that a lot of advisers wouldn’t know how to cost the advice in the first place. The vast bulk have had the costing job done for them by the provider up until now – through predetermined commission levels. I know when one major company tried to bring out a group Sipp, they hit the wall because the IFAs didn’t know what to charge in fees.

MORET: But that comes back to this whole point about professionalism and the value of advice, and if people are educated on the value of advice they know whether they’re getting a decent deal or not. If you go and see a doctor or a dentist privately, you don’t haggle over his fees. The argument about independence is also something of a red herring in this context, as you don’t ask your accountant that question. They’re professional and the assumption is they are independent.

REID: If your remuneration is all dependent on the sale of product and you have a restricted access because of where you’re employed, then it’s going to be really hard to work as a professional. It would be the equivalent of your doctor only recommending drugs by one drug company. So you need all the advisers to be independent in some way, or at least their remuneration to be disconnected with the product sale. That provides an enormous challenge to some of the direct sales outfits. If you then move them onto a value add basis, you’re not going to have the capacity to pay all the people there, or you’re going to have to reduce their remuneration level quite significantly. RDR should deliver total transparency and provide the same rules for everybody.

MORET: It could be the final straw for many life companies, if we end up with a radical outcome, particularly in terms of commission, but also in terms of a significant reduction in terms of numbers of advisers. I just do not see how the life companies could survive in such numbers.

REID: They can have a role, but there’s no need for the same number. As advisers get more confidence and more new model advisers appear, I would be surprised if by the time I come to hang up my boots there’s more than four or five of the life companies left.

PF: What you actually think is going to happen with RDR? Will we get the radical answer or the fudge?

REID: The obvious thing would be to say we should have everybody chartered, but I don’t think we need to do that. RDR will happen through market pressure as opposed to regulatory structure, because people will gravitate to professionally qualified advisers. The economics will hurt the providers so they won’t have a choice but to change their model. So I don’t think we’ll get radical change. The danger is, if bits of it get pushed through without joined-up thinking we’re in the same position as we’ve been with pensions – you need all the constituent parts to make it work. The reality is probably you’re going to get a fudge, and it’s going to take a lot longer to make the market professional. One thing they could keep out of the RDR, is that everybody should have to be a member of a professional body. If there’s one thing I’d like to see them keep, is for that professional body to use their teeth through a single disciplinary body. And finally, if they don’t change the capital gains tax regime as proposed under the pre-Budget report, you won’t need RDR, because you’ve cleared out a large percentage of your IFA market anyway.

MORET: You have to find some transitional arrangements that work and are transparent, not a fudge. Other professions change their syllabus or status and people get transitioned across. I totally agree with the idea of one disciplinary code. I’m a bit more optimistic, because the debate has flushed out four or five very big issues, and they won’t all be solved in five minutes because we’re sorting out a generation of mismanagement of the intermediary market. We need a joined-up approach to those issues, but some of those could be tackled sooner, because if they attempt to do it all, it may do a lot of damage to the advisory community and the life companies. But there’s a real opportunity, and some of what I’ve heard makes me reasonably optimistic that we might get something better than we’ve got now.

REID: Oh, I am optimistic, because we’ve now reached a point where I can feel all the hard work and studying to get my qualifications and to remain aware hasn’t been a waste of time. This is most obvious when dealing with other professionals, such as accountants and solicitors, who are now waking up to the fact there’s a massive difference between one adviser and another. **PM**