

Overview of the RDR and its implications for protection

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The Retail Distribution Review - Introduction

The Retail Distribution Review represents one of the biggest shake ups in the financial services industry for many years. The new rules of engagement laid out by the FSA are now becoming clear, both generally and for protection in particular. The big question however is what this will mean in practical terms for our industry and our customers. SCOR Global Life has produced this short briefing paper to provide a simple summary of what the RDR is all about for those not close to this area of work and more importantly to generate debate as to what opportunities and threats the changes will bring. As is often the case this is an area where there are more questions than answers! We look forward to continuing the debate over the coming months as more reports and guidance come from the FSA.

The 'big picture'

FSA Policy Statement 10/6 March 2010 Distribution of retail investments: Delivering the RDR – feedback to CP09/18 and final rules

In June 2009 the FSA published a Consultation Paper CP09/18 which contained detailed proposals for implementing the Retail Distribution Review (RDR). The proposals sought to:

- Improve the clarity with which firms describe their services to consumers
- Address the potential for adviser remuneration to distort consumer outcomes
- Increase the professional standards of advisers

Policy Statement 10/6 reports on the feedback received and presents final rules on the first two elements of the proposals. The new rules and guidance will come into force at the end of 2012.

Clarity of service to consumers

- Clear distinction between Independent and Restricted advice.
- Independent advice will be truly independent with advisers providing recommendations that consider all the products and providers that could potentially meet a customer's needs. All independent advisers will need to provide unbiased and unrestricted advice that targets the best outcome for each customer, based on a comprehensive and fair analysis of all relevant markets.
- Restricted advice describes the service where firms recommend the products of one or a limited range of providers and must make this clear to customers. FSA has dropped its proposal to specify the exact words to be used when restricted advice is offered to a customer. There is also no obligation on restricted advisers to tell customers that independent advice is available elsewhere. Any product recommended however must pass the 'suitability' test.
- There is also simplified/streamlined advice (see below), basic advice (when using stakeholder products and not brought within the adviser charging requirements) plus non-advised services/execution-only (which falls outside of RDR requirements).
- It is expected firms will build the broad characteristics of the 'Money Guidance' service into their advice and sales processes where relevant. Money Guidance itself will make clear where consumers should go if they need help.

Simplified advice

- The FSA has decided it does not at this stage need to create a separate regime or guidance for simplified advice.
- The ABI however is pursuing development of a strong consumer driven business case for it with an associated request for clear and lighter touch regulation. (In particular allowing a lower qualification standard for advisers engaged in the simplified advice process to help with cost effectiveness with some clarity on future lines to be taken by the Financial Ombudsman Scheme). This is in response to wider industry concerns that RDR changes will narrow consumer access to advice. This could prevent large numbers of consumers from accessing the help they need to save for the future and ensure their families are adequately protected
- ABI research showed that consumers prefer to access investment products with advice, but as full advice costs about £670 it is unaffordable for two thirds of UK adults. Proposals have been developed for an innovative advice process which is automated and IT driven aiming to serve customers who do not require or cannot afford full advice. The process has market tested well taking 30-45 minutes compared to 7hr 40min for full advice.
- ABI have identified products supporting 4 key consumer needs via a simplified advice process as:
 - o **income in retirement** using retirement annuities
 - o **death benefit or income replacement** using term assurance and income protection
 - o **saving for the future** using regular/single investment/savings product such as ISAs
 - o **whether to join a company pension scheme** using group personal pensions

“ A lot is riding on the ABI persuading the FSA to play-ball on creating a workable Simplified Advice Regime facilitated by advisers qualified to a much lower standard than QCF Level 4 as they will have no scope to influence the ‘IT process’ driven advice outcome. In fact it is hard to see why any QCF Level 4 adviser would ever want to get involved with Simplified Advice when they could be delivering full advice to customers willing to pay the appropriate level of adviser charge (whether independent or restricted). A very low cost advice process with pre-determined questions and suitable for customer self-service over the internet or with face-to-face/phone facilitation seems essential to reach mass market customers.”

Remuneration for advice

- Advisers will have to clearly agree the cost of advice in writing up front with customers before providing services and without any involvement of the product provider. This will be called ‘Adviser Charging’. Provided the client makes the request, it will be allowable for Adviser Charges to be deducted from the product but only as and when they are due to be paid on a matched basis. The current system of commission will cease by end 2012, including ‘factoring’. The FSA is toughening rules on inducements and banning initial allocation rates of over 100%.

- The FSA has not given guidance on setting 'adviser charging' structures but may at a future date publish examples of good and poor practice. Initially the FSA proposed that providers monitor this for reasonableness but have dropped this idea. They do however highlight some issues to consider
 - If there is a fixed charge for a specific service, or if based on the amount invested, or on time taken to provide the service (obviously a charge of x% of investment up front and y% annual trail would simply mirror current single premium commission rates, but complicated by the next three bullet points)
 - If there is a separate charge for an initial meeting
 - If the client gets charged even if they do not take up the advice
 - If the client cancels in cooling off period what happens to the adviser charge
- Separate disclosure of the cost of advice in cash terms from any product costs for both 'independent' and 'restricted' advice. This aims to help consumers understand the real value (and obvious cost) of advice and different types of service being offered. In this respect there is no difference between the independent and the restricted advice routes such as the current tied/bank channels.
- Currently there are no FSA proposals for remuneration of individuals who give investment advice for their firm (independent or restricted). They say they will publish a consultative paper on remuneration in Q2 of 2010. This will be of particular interest to the tied/bank channel and networks.

Professional standards

- The FSA want financial advice to work like other professions with a 'Professional Standards Board' improving quality and setting competency levels for the same investment advice roles whether independent or not
- A benchmark minimum qualification for all investment advisers of QCF level 4
- FSA proposals relating to the professional standards of advisers have been set out in Consultation Paper CP09/31

"FSA Consultative Paper CP09/31 asked the open question of whether they should apply increased professional standards to pure protection advisers. They are considering the market feedback on this point and plan to publish a summary in June 2010. The issue this would address is better customer understanding of the cover they have bought as FSA research indicated some problems exist here. The FSA are also reviewing the sales standards of pure protection products by mortgage intermediaries"

The 'protection feature' in focus

FSA Consultation Paper 10/8 March 2010 Pure protection sales by retail investment firms: Remuneration transparency and COBS/ICOBS election

W i d e a n g l e v i e W

This Consultation Paper gives an update on FSA views on reading-across the RDR 'independent' and 'restricted' labels together with two proposals for pure protection (i.e. critical illness cover, income protection and non-investment life insurance).

First, retail investment firms must explain how they are remunerated for pure protection services associated with investment advice and disclose the amount of commission they receive if the customer then purchases a pure protection product. This applies to either personal recommendations for pure protection or arranging the sale of pure protection products.

Second, allowing firms who elect to sell pure protection under the Conduct of Business Sourcebook (COBS), rather than the Insurance Conduct of Business Sourcebook (ICOBS), to continue to do so after the Retail Distribution Review (RDR) is implemented but without having to apply the rules on Adviser Charging to their pure protection sales.

Lights! – Camera! – Action!

The FSA propose that advisers providing pure protection services in association with investment advice to a consumer who will receive investment advice from the firm or who has received investment advice in the previous 12 months must:

- explain before they provide services to the customer how they are remunerated for pure protection services where relevant

- explain if they will receive commission from the product provider in the event the customer purchases a pure protection contract
- disclose any commission received or (for product providers) disclose commission equivalent or an indicative adviser charge as close as practicable to the sale of the pure protection contract.

The rules will apply to advised or non-advised sales of pure protection associated with investment advice, which are sales of pure protection under either COBS or ICOBS. There is currently no requirement in ICOBS for firms selling pure protection to consumers to explain how they are remunerated or disclose the amount of commission they receive for selling pure protection products.

The FSA believe the proposals for increased transparency will put the customer in a better position to evaluate the adviser charge in the context of all the services they are receiving. Understanding the amount of additional remuneration that their adviser will receive on top of the adviser charge may put some customers in a better position to negotiate the adviser charge or seek a reduction of the premium.

Firms who currently choose to sell pure protection under the COBS rules will already be disclosing commission under those rules. These firms need to ensure that they adequately explain how they are remunerated for pure protection advice before they provide services. This must be done orally where information about the adviser charge is given orally. The clear aim is to ensure the customer understands fully what will be paid to the adviser in advance of taking advice which may lead to the sale of investment and/or protection products.

“The requirement to show adviser charging alongside commission for pure protection may throw up some strange numbers for the customer when they compare the amount of adviser time spent face to face ‘justifying’ the investment charge versus that spent to earn the corresponding protection commission, particularly where it is a big indemnified amount from a significant monthly protection premium. Perhaps this may increase demand to product providers for a portion of commission to be rebated to reduce client premiums? The FSA have made it clear that cross subsidising protection commission against adviser charging is not permitted.”

The FSA are not proposing any changes to remuneration transparency for ICOBS sales other than where pure protection sales are associated with investment advice. The need for the change proposed arises specifically because of the RDR – in other circumstances, there is no change in the generally accepted view that the consumer is most interested in the total premium that they will pay.

The FSA have applied the same principle to COBS sales and so are proposing to remove the requirement for commission disclosure for pure protection sold under COBS where these sales are not associated with investment advice, whether it is an advised or non-advised sale.

The FSA have also outlined an alternative option, which requires an explanation of remuneration to be given and commission to be disclosed, depending on whether the firm has permission to give investment advice and also provides pure protection services. This restricts firms’ options, but the FSA suggest it may be simpler as it is less open to different interpretations of the circumstances in which commission should be disclosed.

“The 12 month rule could be quite tricky to apply in practice and there is an issue with the alternative ‘permission based disclosure’ as it can hit transactions not linked to investment advice. For example, if a firm has both investment advisers and a separate team of pure mortgage brokers then the mortgage advisers would still be forced to disclose commission on all their pure protection sales because the rule applies at the level of the firm not the adviser”

Audience feedback on the story so far?

Five FSA feedback questions for response by their deadline of 28 June 2010:

Q1 Do you agree that we should change our rules that allow firms to elect to sell pure protection under COBS so that they can do so without applying the Adviser Charging rules to their pure protection business?

Q2 Do you agree with our proposals for increased remuneration transparency for sales of pure protection products associated with investment advice?

Q3 Do you think our alternative proposal to require remuneration transparency according to the permissions held by a firm, rather than the circumstances of the transaction, is preferable?

Q4 Do you have any comments on our draft rules and guidance, particularly our guidance on the circumstances when a pure protection service is considered to be associated with investment advice?

Q5 Do you have any comments on our cost benefit analysis?

The FSA expect to issue a Policy Statement with final rules in September 2010. The aim is that firms will have to be compliant at the same time as the new RDR rules, by the end of 2012. The FSA also note the review of the IMD and so will consider how possible changes at a European level may impact the proposals and timetable.

Latest FSA script on a possible RDR 'read-across' to pure protection markets

'Independent' and 'Restricted' labels

The FSA have reconsidered reading-across RDR labelling to pure protection following the results of ICOBS Post Implementation Review (PIR) work sampling telesales of critical illness cover and income protection. This indicated too many consumers may have a limited and incorrect understanding of the cover and other features of their policies due to an inadequate explanation of the extent and limitations of cover. The FSA's current priorities for pure protection are to deal with these issues which are not addressed by labelling. There are no plans to consult on read-across of RDR labelling in the near future but it will be kept under review as it is relevant both for investment advisers and mortgage advisers.

Professionalism

The FSA asked an open question in CP09/31 December 2009 about a possible need for increased professional standards for pure protection advisers. They are reviewing feedback and plan to publish a summary in June 2010. Any action will be in the context of the problems with adviser explanations of cover mentioned above. Increased professional requirements may be a way of raising adviser standards and an option for improving outcomes for consumers.

"It will be interesting to see the extent to which better qualified advisers (whether working for independent or restricted advice firms) will produce higher premiums per sale, better persistency and match to customer needs with a broader mix of protection benefits across life assurance, critical illness and income protection. They may also be more likely to follow up with regular protection benefit reviews as customer circumstances change so further increasing new business. It follows that integrated 'menu of protection benefit plans' may grow further in popularity with quality of product, flexibility, online new business process and innovation outweighing pure price in shaping the provider/product recommendation"

Some FSA developing story lines for pure protection

The FSA make it clear they will act where they see new patterns of commission-driven sales arising that are of detriment to consumers. Their Financial Risk Outlook for 2010 outlined an emerging trend of intermediaries, particularly mortgage intermediaries, seeking to increase sales of other products, including pure protection products. FSA are concerned that the movement of intermediaries into product areas where they have little or no experience could give rise to conduct risks. Consequently they will be reviewing the sales standards of pure protection products by mortgage intermediaries.

Reaching out to a wide audience

The FSA estimate up to 3,500 non-bank intermediaries are selling pure protection products and also giving investment advice, 36 banks and building societies, and 68 product providers may be affected. Approximately 40% of pure protection sales by retail investment firms is under ICOBS, and 60% is under COBS. Some providers estimate 80% of their intermediated sales of pure protection sales are under COBS rules.

"An area that may result in real additional cost for adviser firms is the increased length of time required for the advice process. Firms must take reasonable steps to ensure the customer understands how the firm will be remunerated for pure protection advice. Where firms explain Adviser Charging orally, the information about pure protection remuneration is also required to be given orally. As most pure protection sales are carried out face-to-face, it follows that the majority of firms will need to give the explanation orally. There is no current requirement for this in either COBS or ICOBS (the current requirement in COBS is only for written disclosure)"

Future scenarios for protection business

Considering pure protection, who might be winners and losers, what would drive success or failure and will customers be any better off as a result of the unfolding of the RDR story?

Market expectations are that delivering the RDR by end 2012 will cause a reduction in the number of IFAs by an amount ranging from 10% to 30%. Those surviving will tend to focus on more upmarket clients raising the question of how much this will affect the volume and mix of pure protection business in 2013 and beyond.

In volume terms, the implied reduction in market size is from 5% to 16% respectively, all else remaining the same. The mix by channel of individual protection business in 2009 is given below as a baseline. We have also shown how this mix might change by 2013 resulting from a straight reduction in the IFA/WoM volumes of (10%) or [30%], all else remaining the same. On the most extreme scenario IFA/WoM and Single tie have equal weighting as protection channels.

	2009	2013 (1)	2013(2)
IFAWoM	53%	50%	44%
Single Tie	37%	39%	44%
Non-Intermediated	10%	11%	12%
Total	100%	100%	100%
Of which Bancassurance	28%		

It is also generally expected that implementing RDR will open up a 'gap' in the advice market driven by a reduction in the number of IFAs. The ABI have outlined a scenario where there are fewer IFA advisers serving mainly HNW and affluent clients (top 25% of the population) so a clear need emerges to provide access to product advice for the broad mass of consumers (middle 50%) working in tandem with the Money Guidance Scheme (mainly for bottom 25%).

Simplified Advice as proposed by the ABI would be a strong enabler for protection

(and other products) . It will support every channel to an extent but particular winners could be 'direct' and 'bancassurance'. Most product providers with a retail brand are already actively growing their 'direct to customer' channel through the internet as an engaging low cost route to expansion. Similarly the Bank channel which is well placed to intergrate this type of service into its broad overall customer offer through a branch network with appropriate low cost staff for facilitation. Finally big supermarkets are set to advance with 'familiar trusted brands' into banking, investment and protection so Simplified Advice on-line could even become an extension of on-line weekly shopping.

Continued availability of pure protection product

commission will not be enough on its own to give a lifeline to those IFAs expected to lose-out under the burden of minimum QCF Level 4 qualifications and extra capital requirements. It will however keep pure protection products in position as an attractive and remunerative component in the mix of client advice for advisers at all levels. Better qualified professional investment advisers could be expected to be winners driving up volume, mix and quality of sales based on 'advice not price'. Similarly a possible new breed of professionally qualified protection specialist focussed on expertly selling to customer needs. In 2009 the mix by benefit type was

Mortgage Term	30%
Other Term	49%
Whole Life	13%
Income Protection	6%
Stand Alone Critical Illness	2%

A new approach to advice could see significant increase in the percentage of IP and SACI sales in the product mix by 2013. This may also be in parallel with an expansion of the protection market to start to close the estimated £2.3 trillion protection gap in UK provision.

Volatile economic conditions over the next few years could have mixed influences. If investment markets are weak then traditionally protection sales pick up. However continued economic weakness dampening the housing market will mean Mortgage related sales lose out in the mix.

Customers should emerge as winners with increased choice of quality and cost of advice.

Provided Simplified Advice can deliver a good cheap advice service for the 50% of customers in the middle then overall customers will be better off. Money guidance will help start those in the bottom 25% on the route to controlling their finances. The top 25% will benefit from the 'winning' IFAs who make the transition to professionalism and adviser charging which will include most of the current 'fee based' IFA adviser firms.

"The future of the FSA has been under a cloud for some time because of Tory plans pre-election to scrap it and pass all powers to the Bank of England. However, following the formation of the Tory-Liberal coalition, the Government has indicated the FSA will remain intact though further regulatory strength will be given to the Bank. So it seems very unlikely that there will be any intervention to change either content or timing of the RDR. No – one is planning to rewrite the current RDR script which will play out from now to the end of 2012. Perhaps ironically the FSA has already emerged as an early RDR winner!"

The Grand Finale

In conclusion, the RDR is still a work in progress but the finished production is becoming clearer. The vision is to have better qualified advisors selling products to informed customers who understand how they are paying for the advice and what it costs. There certainly is some good progress being made towards this end but there is a wide range of consequences as this paper illustrates.

The next step is the production of draft rules in September and then progression on to full implementation in 2012. We at SCOR will continue to monitor the situation closely and are happy to answer any questions you may have.

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