



FINANCIAL
SERVICES
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Retail Distribution Review

Implications for the adviser sector

NMG Insight Series
July 2007

Key findings

- 80% of advisers do not hold the appropriate qualification for their chosen designation under the proposals emerging from the Retail Distribution Review
- Less than half of prospective General Financial Advisers are committed to taking the additional professional qualifications required
- The industry faces a major challenge if an advice gap is not to emerge as existing advisers leave the sector or elect for the Primary Advice model

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Introduction

On 27 June 2007 the Financial Services Authority (FSA) published a Discussion Paper (DP07/1) containing the initial findings of the Retail Distribution Review.

Over the period 2 – 5 July 2007, NMG undertook a programme of quantitative research with financial advisers to gain their initial reactions to the outcome of the review.

The research was undertaken using NMG's IFA Census platform and 402 financial advisers completed the survey.

This report and supporting evidence has been undertaken by NMG to inform and further stimulate discussion within the industry.

Key conclusions of the Retail Distribution Review

DP07/1 proposes that the regulated advice channel might be divided into two parts:

- Professional Financial Planning and Advisory Services (offering 'full advice')
- Primary Advice which provides more straightforward advice and help on more straightforward needs using simple products

Within the full advice channel, the Review identifies two possible types of adviser:

- Professional Financial Planners (PFP)
- General Financial Advisers (GFA)

PFPs are likely to require a Chartered level of qualification; to be 'fee' based under a Customer Agreed Remuneration (CAR) structure and may benefit from a lower level of regulatory scrutiny than other types of advisers.

The suggested qualification hurdle for GFAs is the Advanced Financial Planning Certificate / Diploma in Financial Planning. GFAs may adopt the CAR structure but may also be remunerated by commission. DP07/1 suggests that GFAs may not be able to refer to themselves as 'Independent' and are likely to be subject to higher levels of capital adequacy, particularly if commission based.

The Discussion Paper also considers the role for a Primary Adviser to fill the advice gap amongst consumers with more simple needs and who might not ordinarily consider visiting an IFA.

Primary Advisers would be subject to a lower level of professional qualification and would likely make use of decision trees and non price capped, simple products. Primary Advice would be offered with lower levels of suitability than current rules allow.

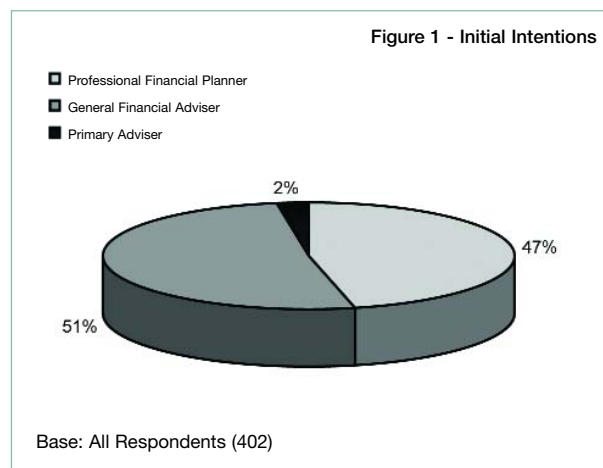
It is suggested that there would be a transition period of at least three years to allow advisers to achieve the necessary qualifications and amend their business model before the new structure came into effect.

The Retail Distribution Review now enters a consultation period with responses to the initial proposals required by 31 December 2007.

Detailed findings

Advisers split on future designation

At this early stage advisers are split evenly in their likelihood to adopt either the PFP or GFA designation with the Primary Adviser role being largely rejected.



Those intending to become PFPs are more likely to be:

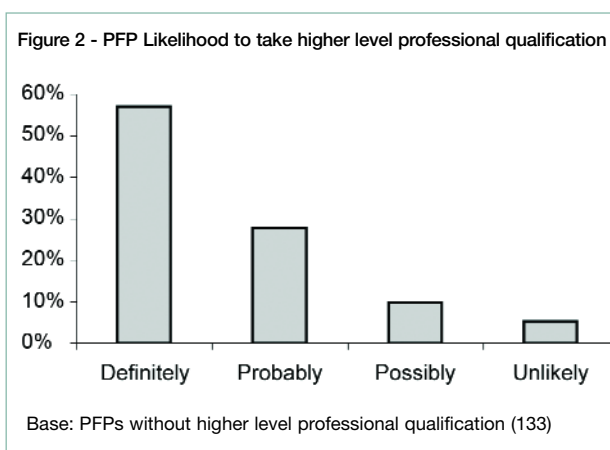
- Generating a higher level of their income from fees
- Younger; 37% age 44 or younger compared to 25% for GFA
- Directly regulated; 67% compared to 48% for GFA

Amongst those likely to become GFAs, the requirement to take a higher level qualification is cited as a 'very influential' reason for not becoming a PFP by 50% of advisers. The requirement to adopt the CAR model is seen as 'very influential' by 40% of advisers. Further attitudinal differences emerge between future PFPs and GFAs which are considered later in this report.

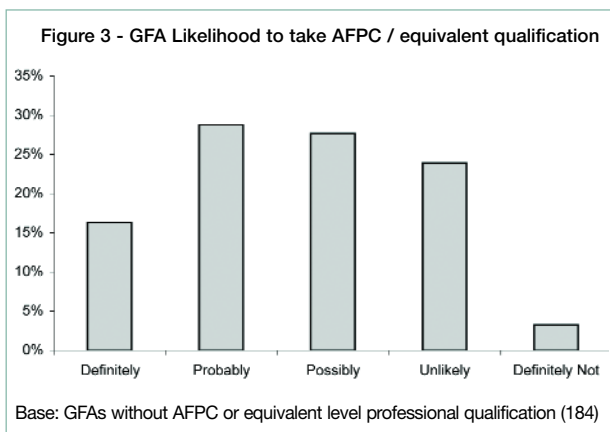
Industry faces major skills gap

Whilst 47% of advisers state an intention to become PFPs, just 29% of this group currently hold the requisite professional qualification. Of the remainder, 57% state that they will 'definitely' take the necessary exams and 28% state that they will 'probably' do so.

"It's time to raise the bar once and for all".



Amongst prospective GFAs, just 13% hold the requisite Advanced Financial Planning Certificate or equivalent qualification and just 16% of this group will 'definitely' take the required exams. Over half are either uncommitted or are not intending to do so.



Overall, just 20% of advisers surveyed currently hold the appropriate qualification for their preferred future designation. We place an estimate of ~8000 on the number of advisers requiring training, based on 50% of those currently not holding the required qualification going on to do so.

Experience considered more valuable than qualifications

There is considerable opposition to the requirement to achieve a higher level of qualification. Many who have been advising for several years take the view that their experience far outweighs the value of a higher level professional qualification.

"The emphasis is biased towards exams and totally ignores experience".

There is widespread rejection of any suggestion that consumers are currently suffering detriment because of a lack of additional qualifications amongst advisers.

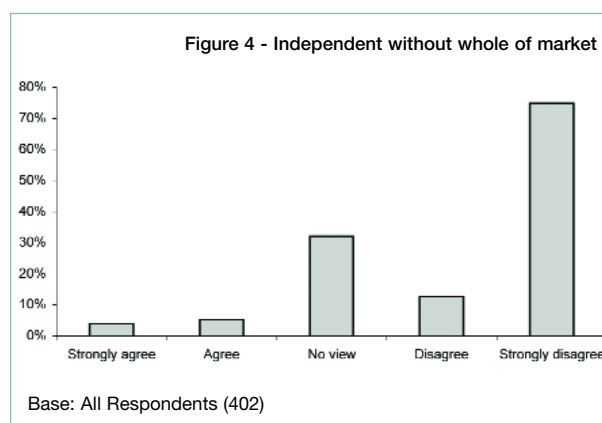
One concern expressed is the lack of a firm proposal to allow grandfathering. Concessions on grandfathering, or a long transition period and training heavily subsidised, will be required if there is not to be a significant impact on the current adviser population.

Our analysis suggests that around 10% of current advisers would exit the industry as a direct result of additional professional qualification requirements. This group are more likely to be older and for around half, this requirement would simply advance their retirement plans.

"I am likely to be among a large percentage who are forced to retire early".

Overwhelmingly whole of market is equated to independence

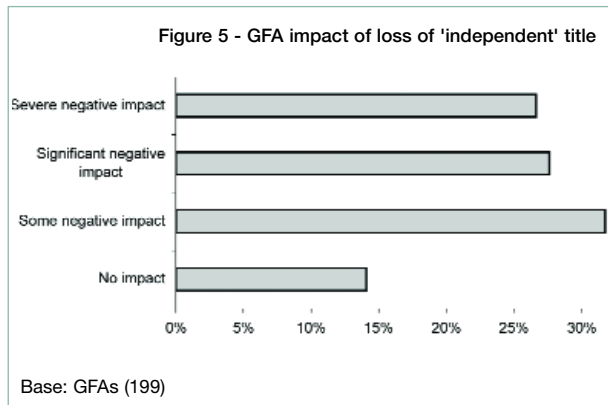
Respondents to the survey reject allowing advisers who do not operate on a whole of market basis to use the term 'independent' with 87% opposing this suggestion.



In spite of a shift towards platform usage and the reality that leading advisers are consolidating product and provider relationships, there is a strongly held view that whole of market = independence. Advisers believe that any alteration in the use of the term 'independent' will confuse consumers.

“Independence must mean whole of market”.

Advisers also reject linking independence to remuneration structures. This view is particularly strongly held by commission based advisers considering the GFA designation who face the potential loss of their independent title.



Future PFPs confident in their ability to implement a CAR model

Amongst would-be PFPs, 56% believe that more than half of their clients would be willing to enter into an agreement to pay CAR for an ongoing service; just 25% of prospective GFAs hold this view. Advisers' response to CAR varies in a number of other ways with PFPs more likely than GFAs to:

- Want to see CAR applied to all products and not just investment and pensions
- Expect to charge a client a fee rather than add CAR to the product charge

However, all advisers are aligned in their attitude towards how charges are recouped in the event of early termination. Both future PFPs and GFAs believe any balance due should be recovered from the policyholder.

There is considerable confusion over how CAR would operate in practice. Many advisers believe they will be required to invoice fees direct to clients, rather than re-coup CAR via explicit charges added to the product.

Primary advice is seen as the domain of the banks and insurers

Primary Advice is perceived to have been developed solely to meet the requirements of the major financial institutions and that only the banks and to a lesser extent insurance companies will wish to operate in this sector. Many feel that the banks and insurers have stolen the agenda and that the Retail Distribution Review has become a review of adviser distribution.

“It looks like a charter for bancassurers”.

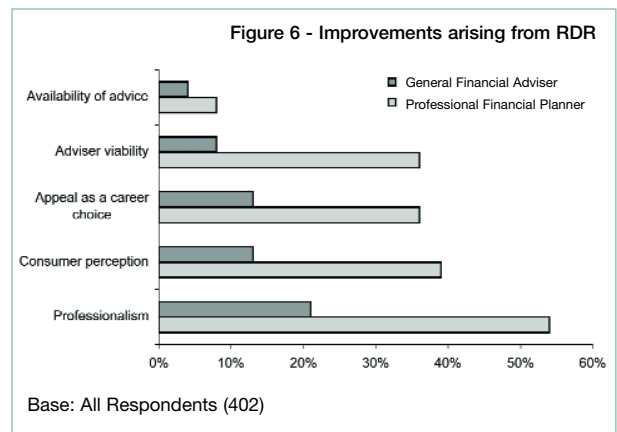
Initial reaction to Primary Advice is negative amongst all respondents with just 2.5% selecting this designation. However, add in those who elect not to take a GFA level qualification and this increases to 11% of respondents.

PFPs more positive over the potential improvements

Would-be GFA respondents are generally negative towards the Review and doubt that it will deliver improvements in the availability and quality of advice, or in the financial viability of adviser business models.

“The proposals will decimate adviser numbers and lead to fewer lower and middle income people having access to sound financial advice”.

Whilst many future PFPs remain sceptical, they are noticeably more positive than GFAs other than in the area of improving the availability of advice.



A majority of PFP respondents believe that the Review will lead to an improvement in the professionalism of the adviser sector.

“The raising of professional standards is a major issue...the RDR is a very good step in the right direction”.

Implications for the advice market

Based on our analysis of the Retail Distribution Review proposals and of the initial adviser response (and we anticipate adviser views to mature over time), we have developed a view on the likely outcome for the adviser channel.

Thriving Professional Financial Planner segment to develop

We believe that the PFP model is on-trend with developments in the market. Our ongoing monitoring of the adviser sector clearly indicates a transition of remuneration models towards fee type structures and ongoing remuneration. This trend is entirely independent of the proposals contained in the Review.

The key driver is in our view the desire of advisers to build value by creating more long term, sustainable business models. We note that it is the emergence of investment platforms as a facilitator of an enhanced service proposition, rather than regulation that has acted as a key catalyst in this process.

Whilst the requirement to achieve a higher level of professional qualification may inhibit some development, we anticipate that the role of PFP will prove to be a more attractive one to those considering entering the adviser community. We recognise that our views are out of line with those of respondents to the survey but we believe that there is precedent in the way becoming an IFA became seen as a more attractive role than a direct sales person or tied agent.

There is also evidence that PFP firms will seek to segment their client base and attract new clients through developing Primary Advice models; 30% state that they would consider recruiting a Primary Adviser to help them grow their business. Even allowing for overstatement we envisage that satellite Primary Advice models will develop within the structure of full advice firms. Primary Advice models may also emerge in the remote (telephone or online) market.

Future doubtful for the General Financial Adviser designation

We doubt the longer term future for the GFA role if the enacted regulation mirrors the current proposals. With just 13% of advisers considering GFA currently holding the requisite level of professional qualification and just 16% committed to taking this, there is a major skills gap to be overcome.

29% of those considering the GFA route are age 55+ and with implementation likely to be at least two years plus a transition period, this group are likely to exit the market rather than re-train.

There is also the potential for an increase in capital adequacy requirements to emerge from the Review of the Prudential Rules

for Personal Investment firms¹ (as trailed in the Retail Distribution Review) which would serve to increase the pace of fall out.

The FSA has already questioned whether four types of adviser (including Generic Advice) may be one too many. We believe the FSA to be committed to PFP and HM Treasury to Generic Adviser and therefore, one of the GFA or Primary Adviser roles is more likely to be sacrificed.

Material Primary Advice sector to grow from within the current adviser community

In spite of strong reservations from advisers we believe that the Primary Advice channel can evolve from within. Once faced with the qualification obstacles to becoming a GFA, around 11% of advisers plan to convert to the Primary Advice route.² We believe that many more will ultimately elect not to take qualifications and instead will opt to become Primary Advisers, with perhaps 20% - 30% of current advisers taking this option.

Growth in this sector may also come from PFP firms seeking to segment their clients and develop their businesses. 30% of PFP firms state their intention to recruit a Primary Adviser as a way of growing their business. We take a cautious view of this projection but even if scaled back by 50%, it still leaves room for substantial growth by existing firms.

One further factor likely to support the growth of the Primary Advice channel is the removal of the price cap on 'simple' products. We doubt that advisers have yet had the opportunity to consider the combined impact of higher commissions on simple products and the potentially higher capital adequacy requirements of the GFA designation. When put together we believe these will add considerably to the financial attraction of the Primary Advice model over the GFA model and will lead to the growth of a Primary Advice channel.

Significant transformational challenges ahead

Our analysis suggests that the Retail Distribution Review will have a significant impact on the structure of the adviser channel. We consider it likely that there will be a reduction of at least 30% in the number of advisers offering full advice services with this number split between those leaving the industry and those moving to a Primary Advice model.

Given the level of change there is the potential for short-term disruption in the availability of advice with advisers exiting, lower sales, higher costs and banks attempting to rapidly increase their share of the market.

¹ DP07/4 was not published until midway through the fieldwork period

² The original figure of 2.5% increases to 11% once the fall out from PFP and GFA is included

We envisage a demand for assistance to support advisers through the transition process potentially opening up new opportunities for networks and adviser support companies as well as provider-supported offers around practice development and succession / transition.

NMG will be addressing the issue of the growing gap between advice supply and demand in an additional UK Insights report later this year.

About NMG

NMG is a multinational consulting firm specialising in insurance and investments. Our proprietary adviser and consumer information platforms provide an information advantage in developing evidence based solutions to strategic issues.

Research Methodology

Quantitative research was undertaken using NMG's IFA Census online research platform between 2 – 5 July 2007. Respondents to the survey comprised a broad mix of whole of market advisers, most of who operate as Independent Financial Advisers. Prior to completing the survey respondents were provided with a synopsis of DP07/1.

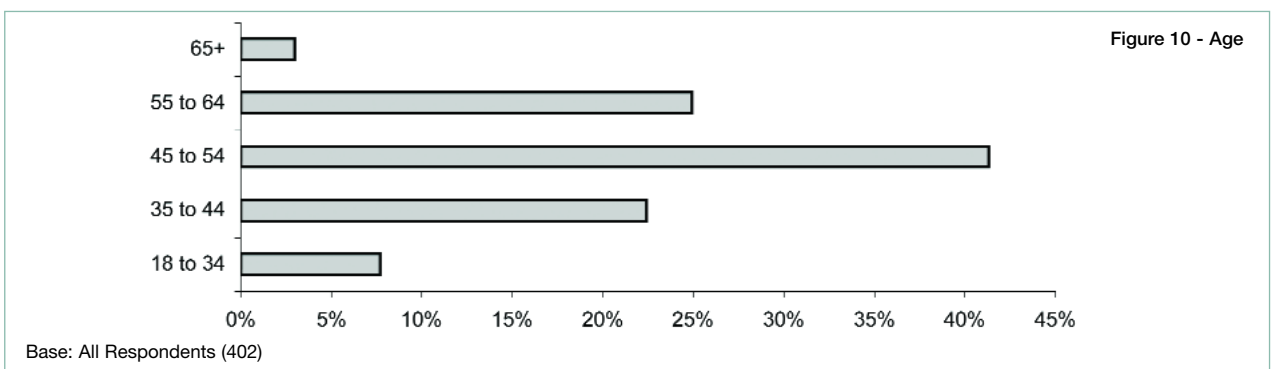
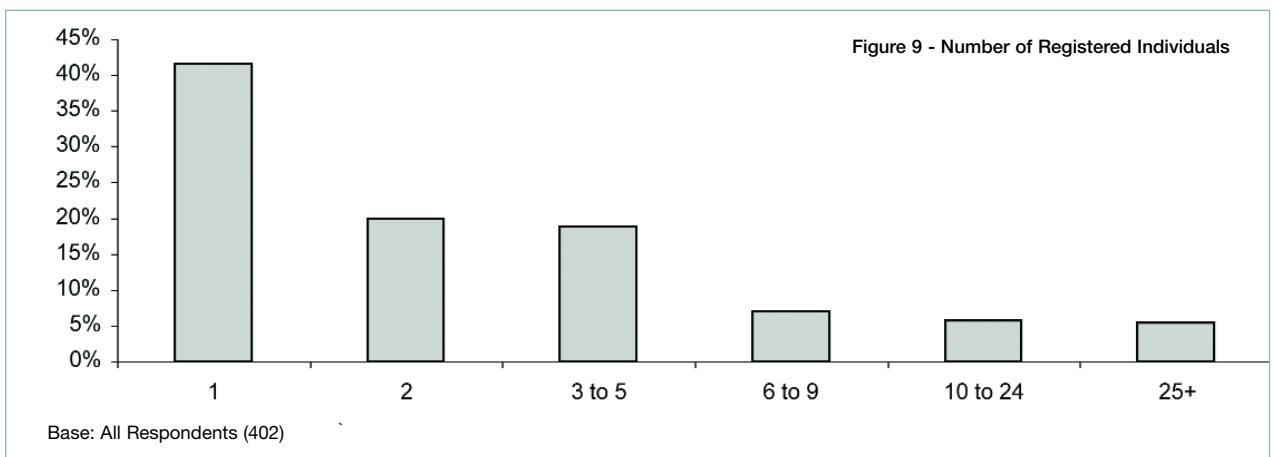
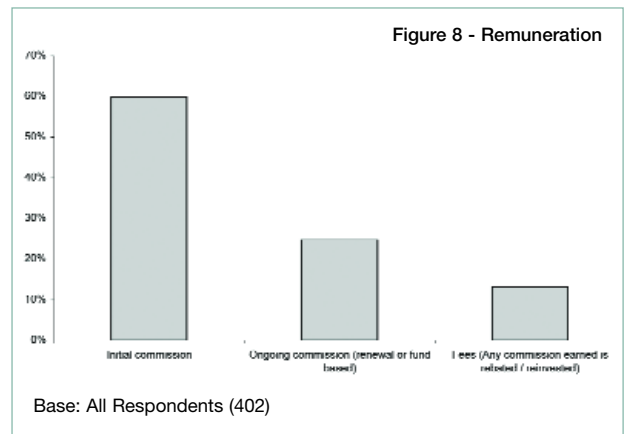
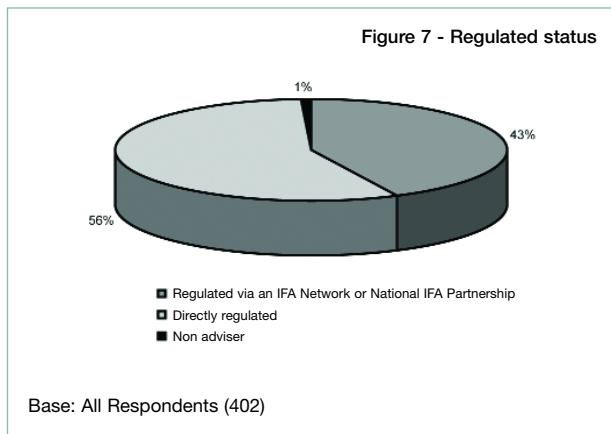
402 advisers completed the survey of whom over 170 provided additional written feedback. NMG believes the sample to be broadly representative of the mass market:

FIG 7 – By regulated status

FIG 8 – Remuneration

FIG 9 – By number of registered individuals

FIG 10 – By age



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