Post Implementation Review of the UK's Retail Distribution Review

Ross Dawkins, 22nd April 2015

Europe Economics

Three questions:

Was there bias in the UK retail investment market and what impact has the RDR had on it?

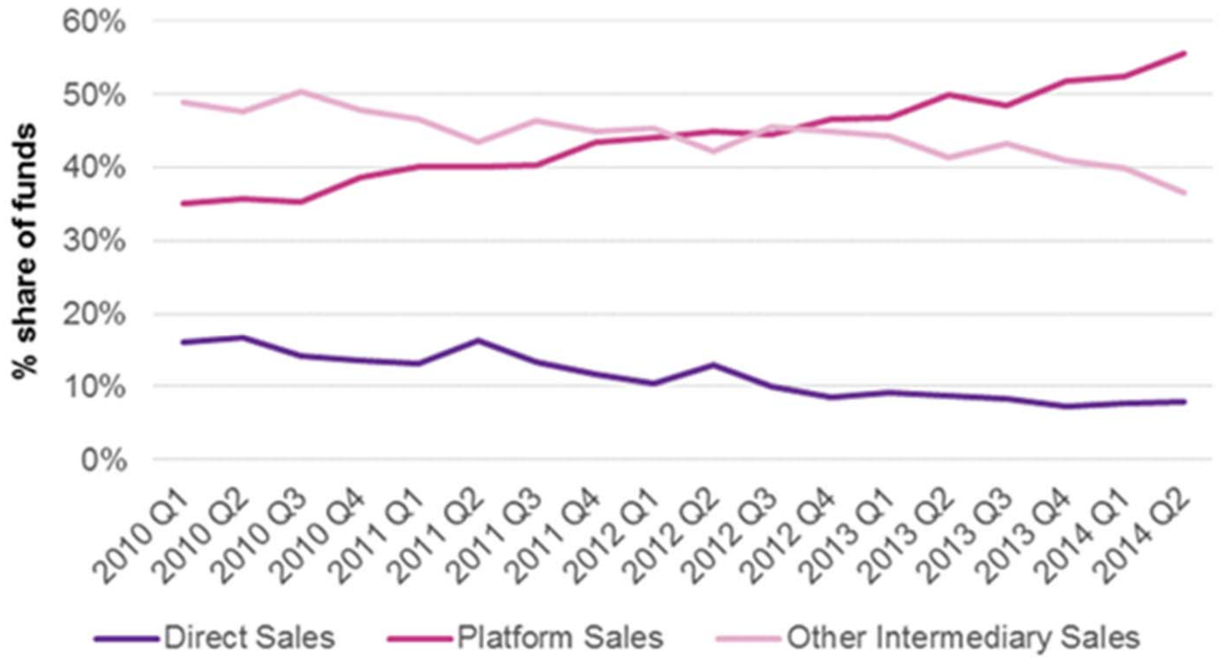
How has the advisory industry coped?

Are consumers better off after the RDR?

The UK retail investment market and the RDR

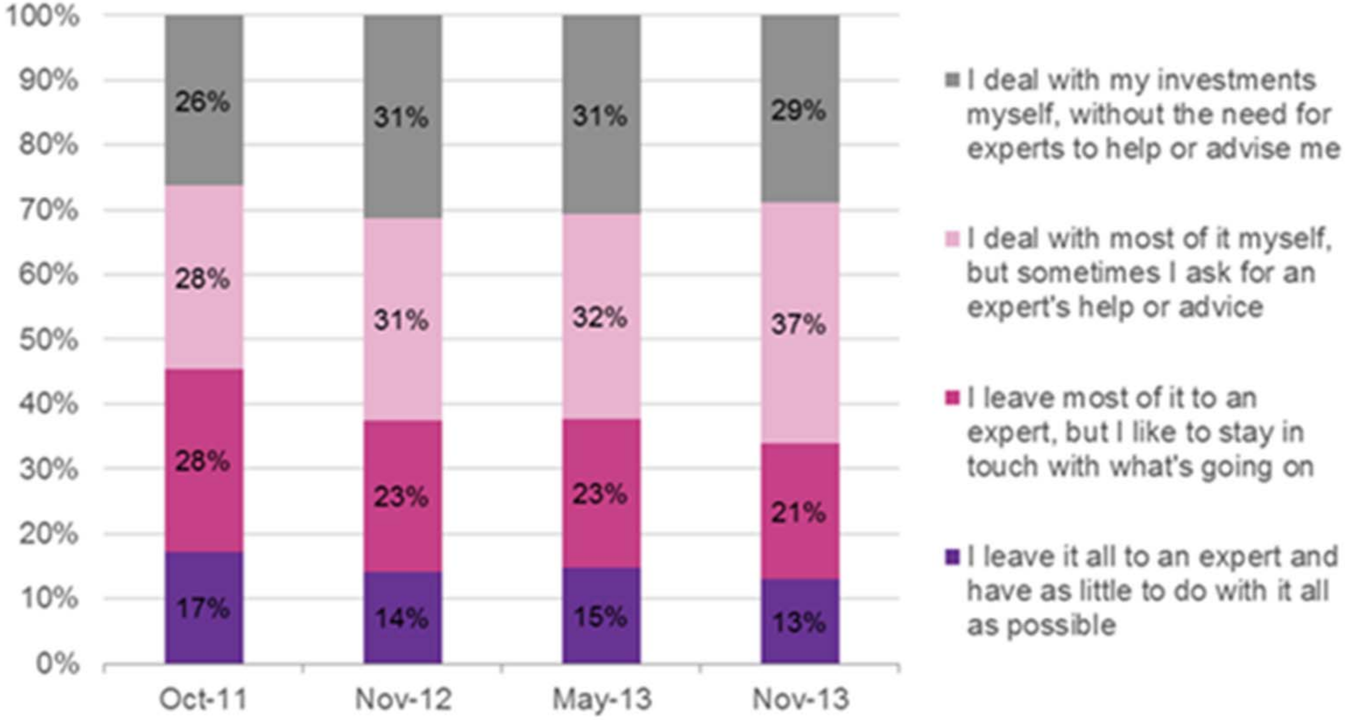
Europe Economics

An estimated 15 million in the UK with a retail investment. Intermediaries are the traditional distribution channel, but platforms are increasing in importance



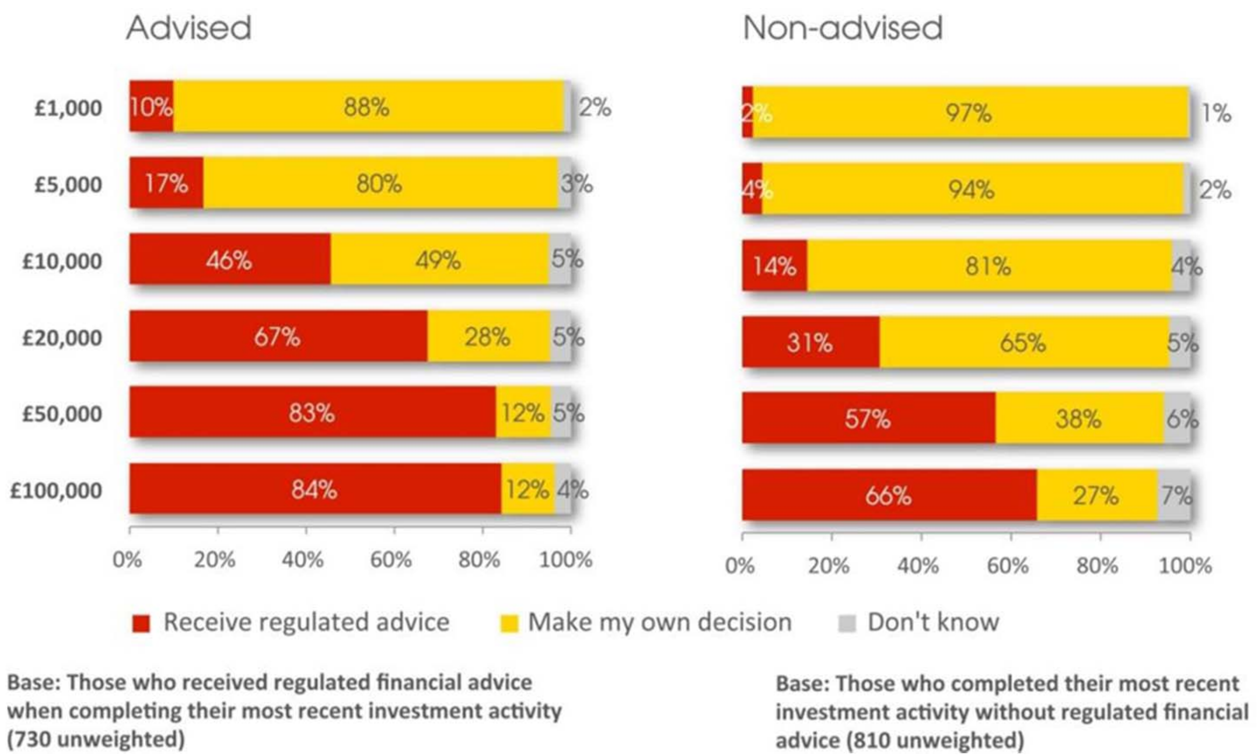
Source: Investment Management Association (IMA)

Increasing interest in self-direction reflects growing (over-) confidence by consumers – facilitated by B2C platforms - and also degree of cynicism about adviser motivations



Source: Platforum

Those who do not regularly get advice more likely to when over £50k involved (or if pension related); tipping point £10-20k for those with advisers



Source: NMG Consulting, Impact of the RDR on consumer interaction with the retail investment market, September 2014

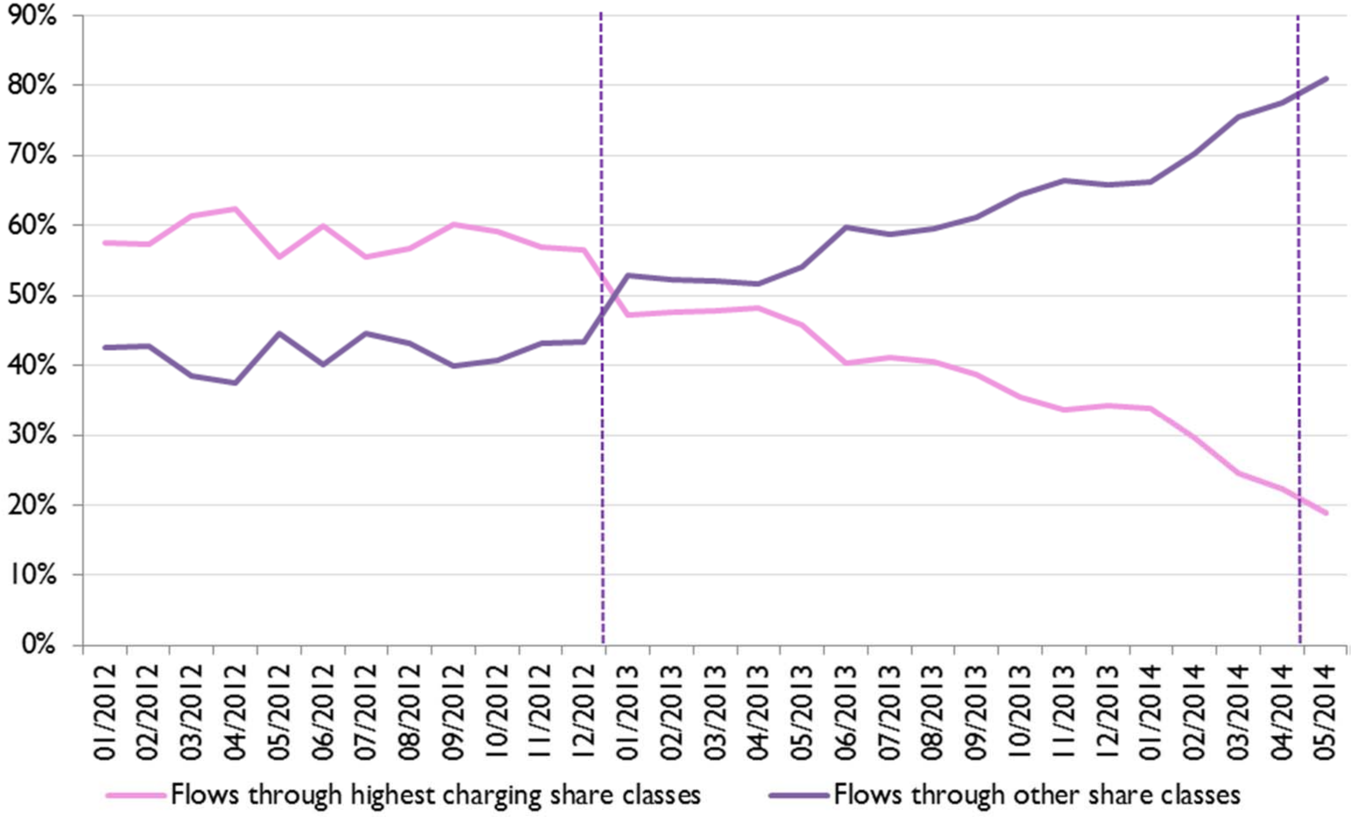
The RDR was designed to re-establish trust and to re-construct the interaction between consumers and advisers in order to align incentives

- The required level of professional qualification was increased from QCF3 to QCF4 with effect from December 2012
  - QCF3 = EQF4 ≈ La Matura
  - QCF4 = EQF5 ≈ first year of a Bachelor's Degree
- Third-party commissions payable to advisers were prohibited from December 2012
  - This was the dominant remuneration model, accounting for 85-90 per cent of revenues for the typical firm. However, small minority of firms had switched to various 'customer pays' models in advance of what was seen as the regulator's clear direction of travel
- Payments by product providers to platforms and cash rebates by providers to consumers were banned from April 2014

Was there bias in the UK retail investment market and what impact has the RDR had on it?

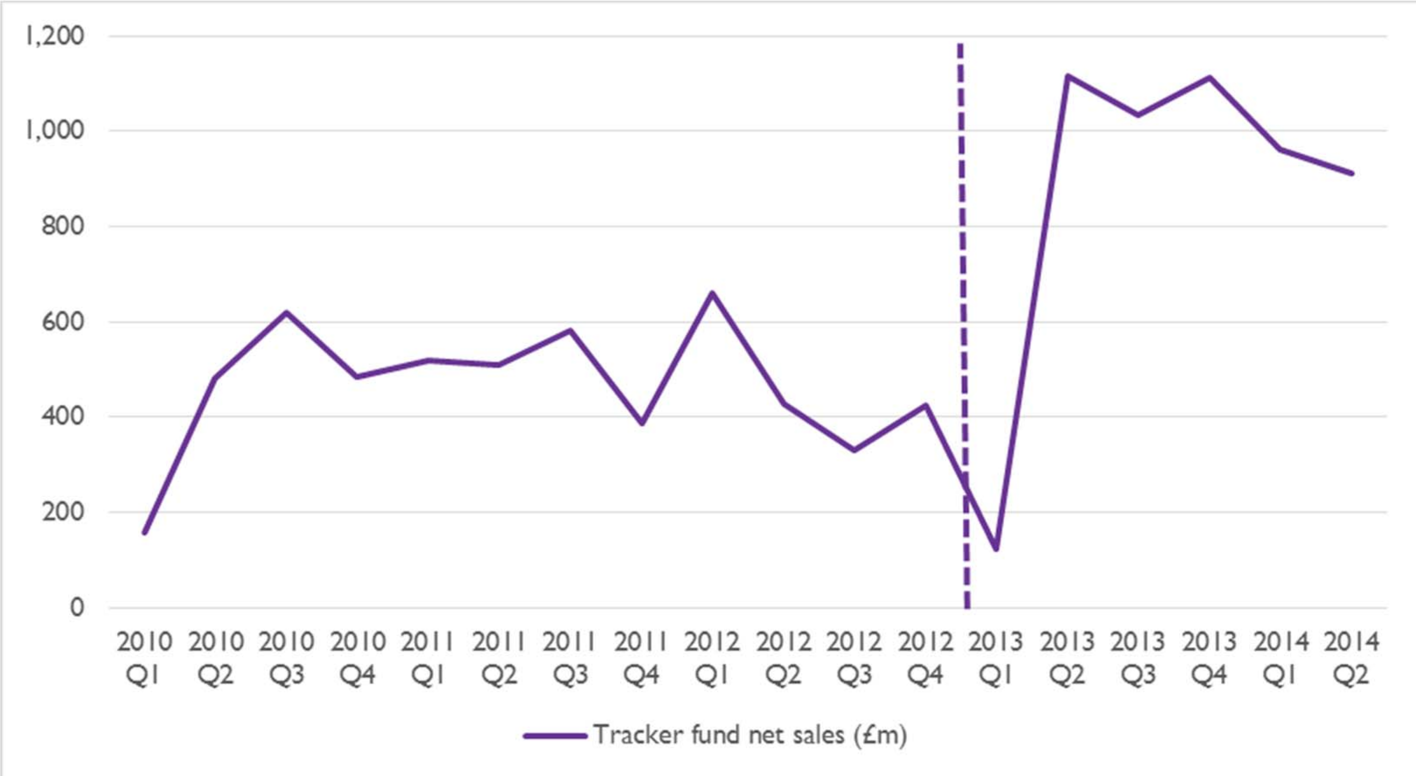
Europe Economics

Gross retail flows through highest-charging class shares and other shares show marked shift around onset of adviser rules



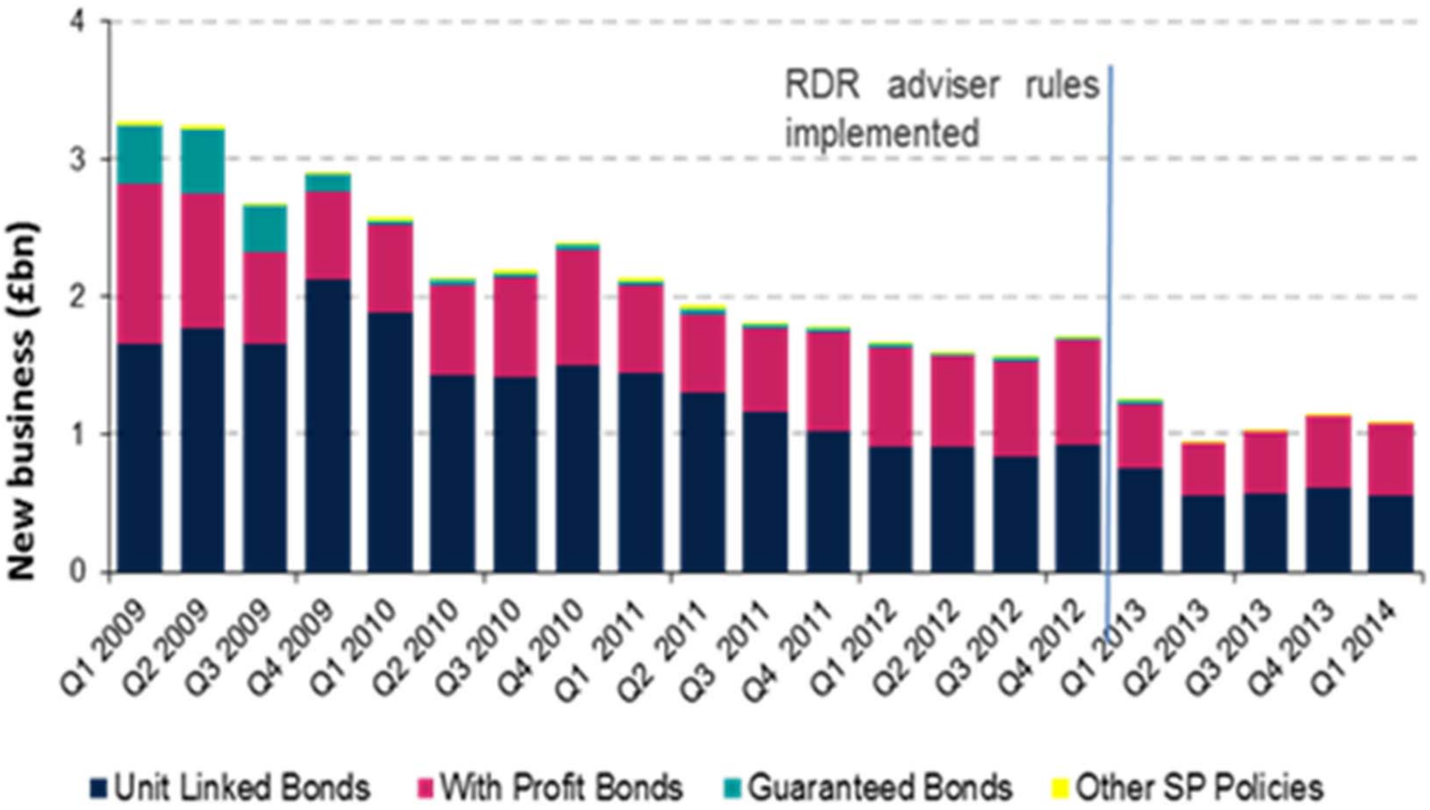
Source: Investment Management Association

Tracker funds typically attracted lower commission levels pre-RDR. Upward trend since 2010, with sales jump after RDR rule implementation



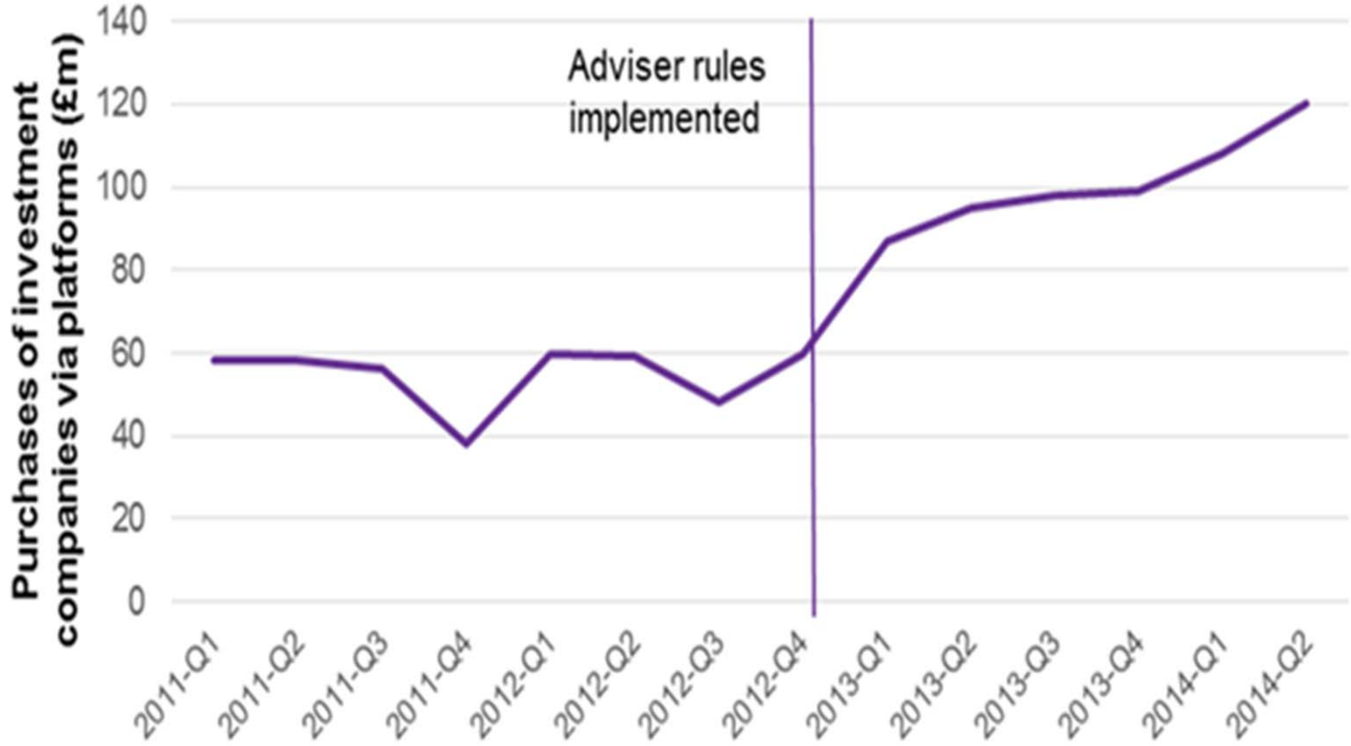
Source: IMA

Investment bonds typically attracted above average / high commissions pre-RDR. Secular downward trend, but step change around RDR implementation



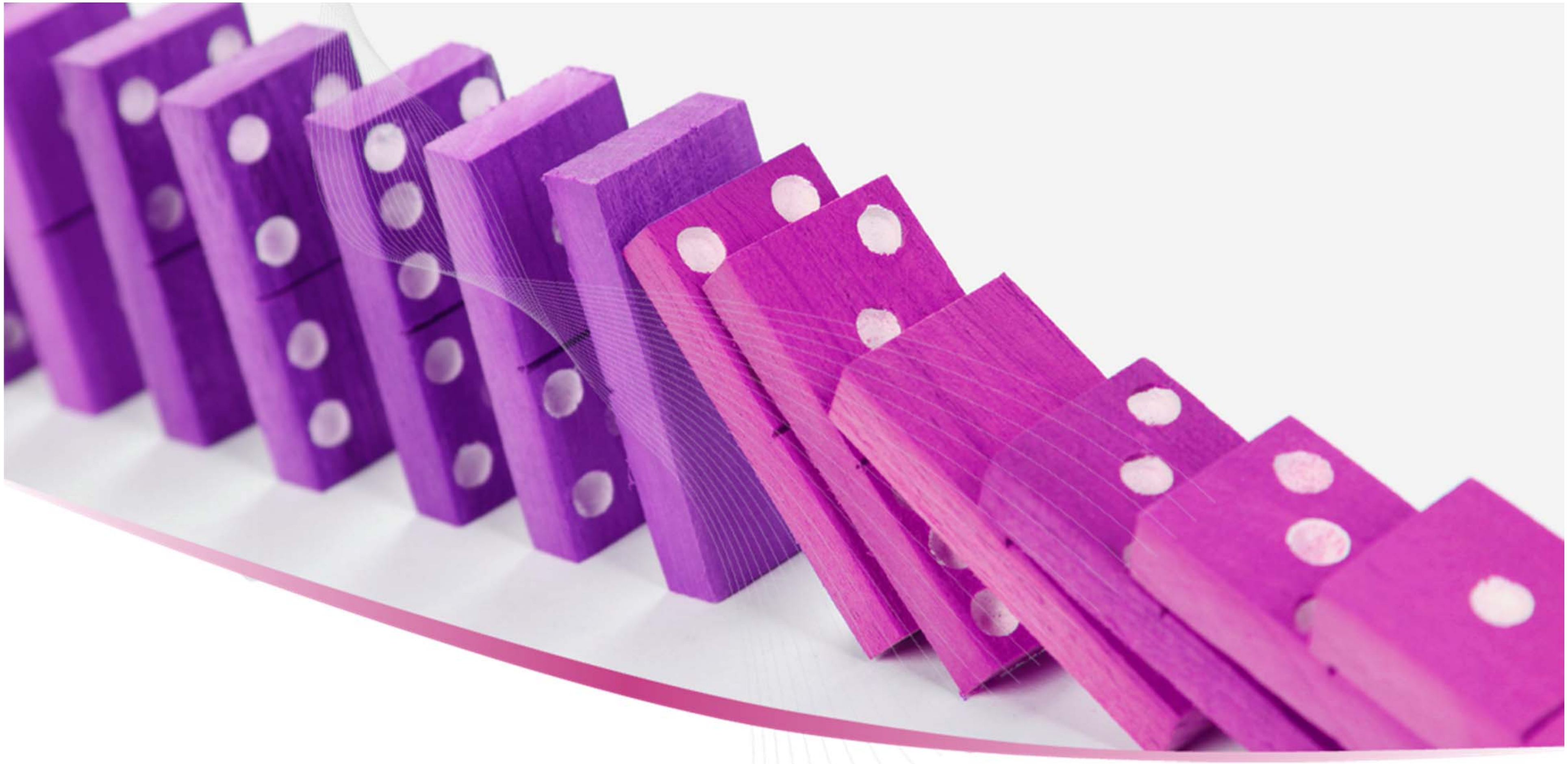
Source: Association of British Insurers

Shares in investment companies ≈ packaged products within a corporate wrapper. Third-party commissions never permitted, i.e. RDR levelled playing field. Sales now double



Source: Association of Investment Companies

Before the RDR there was bias in the UK retail investment market and the ban on third-party commissions reduced it



How has the advisory industry coped?

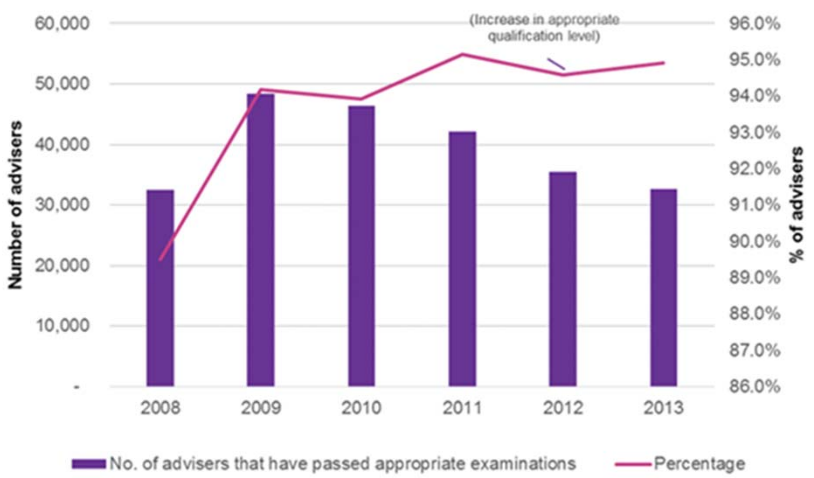
Europe Economics

Firm and adviser numbers declined in advance of the RDR, concentrated in tied "advice" networks of banks. Adviser numbers are relatively stable (outside of banks)

Source: Europe Economics, RMAR

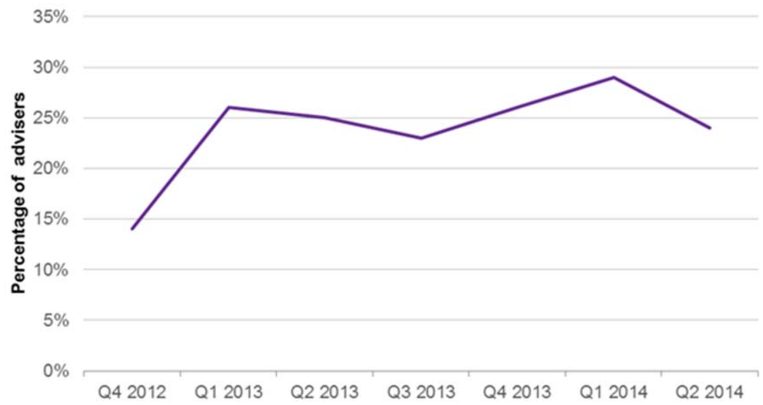
Professional qualifications have increased (alongside decline in adviser numbers). Some evidence of voluntary competition on qualification levels

Massive effort made by industry to transition from QCF3 to QCF4 in time



Source: Europe Economics, RMAR

Advisers with Chartered/ Certified status is up

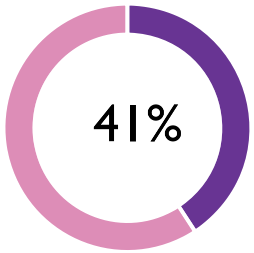


Source: NMG Consulting (2014), "Financial adviser census – business trends report"

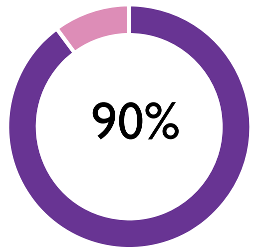
- …but professionalism is a broader concept than training and qualifications

Firms are experimenting with different forms of charging structure, offering consumers a choice (i.e. charts sum to > 100%). Charts show % of firms offering initial fee structures based on:

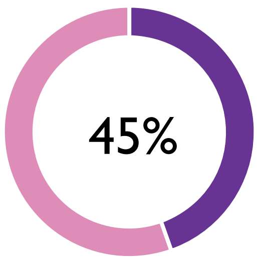
Time-based charging



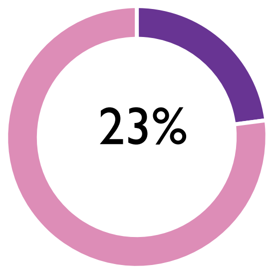
Charging % of investment (NB typically contingent on investment being made)



Service-based fixed fee



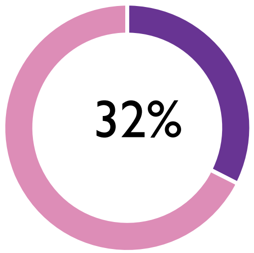
Combination of these models (for any given customer)



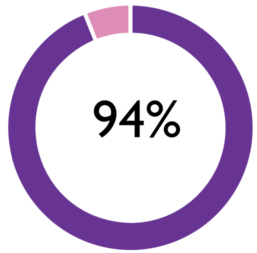
Source: Europe Economics, FCA's RMAR dataset

Similar position on ongoing charges to consumer, although % of investment more clearly the market "norm"

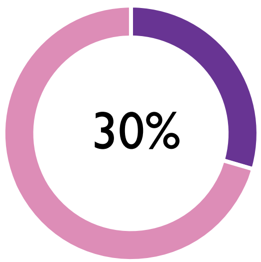
Time-based charging



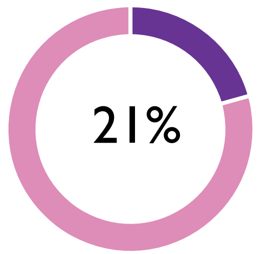
Charging % of investment (NB typically contingent on investment being made)



Service-based fixed fee

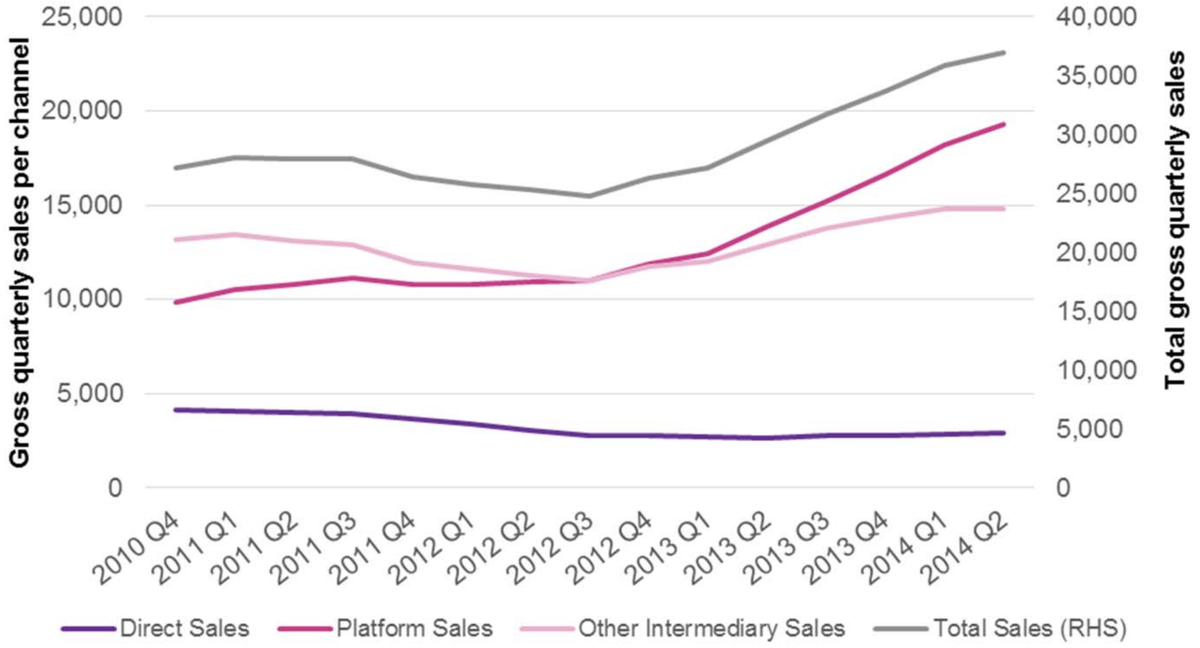


Combination of these models (for any given customer)



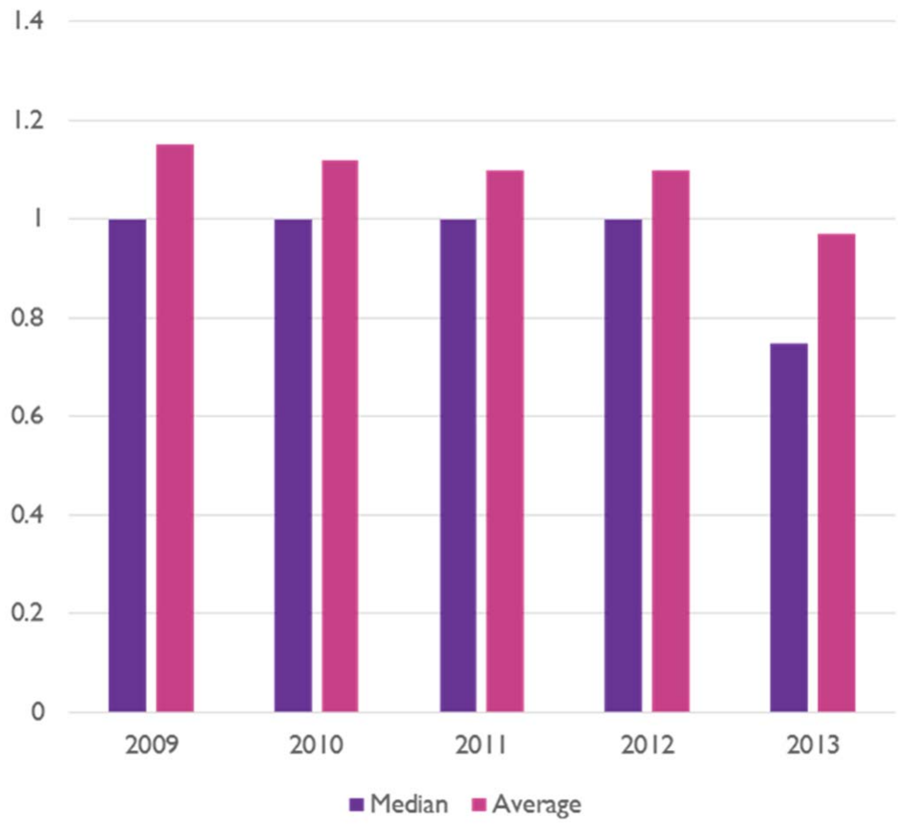
Source: Europe Economics, FCA's RMAR dataset

The RDR was well-timed, largely coinciding with an uplift in investment appetite



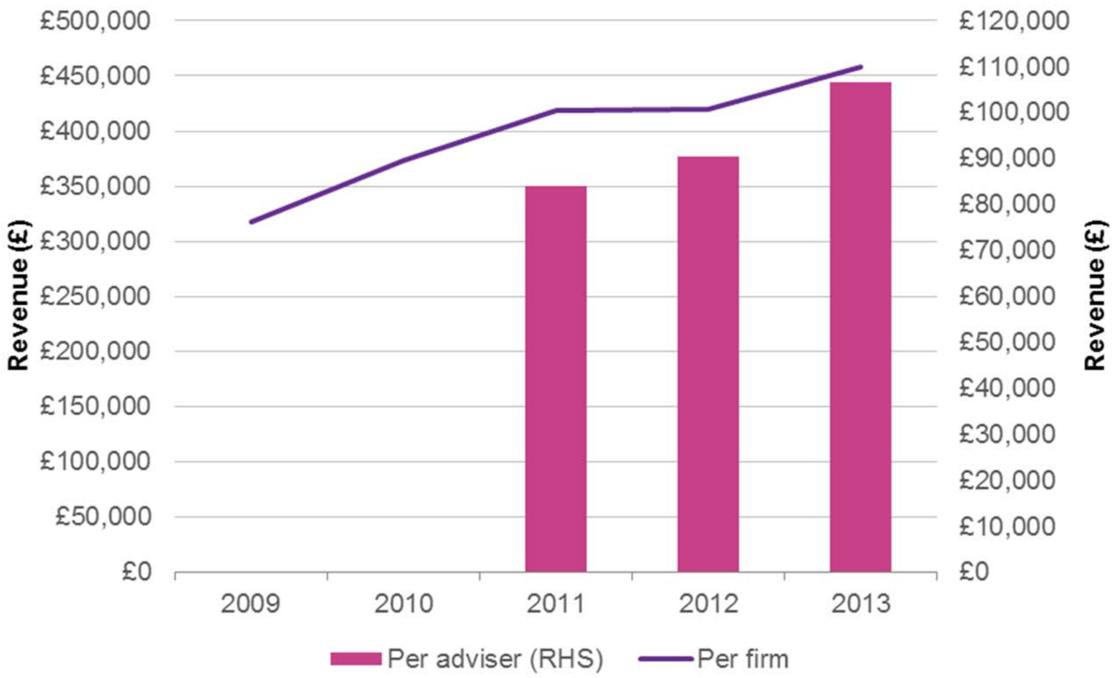
Source: IMA, annualised moving average of quarterly data

Operational efficiency has improved with greater use of paraplanners to support advisers. The average firm has fewer advisers (4.3 in 2014 against 5 in 2012)



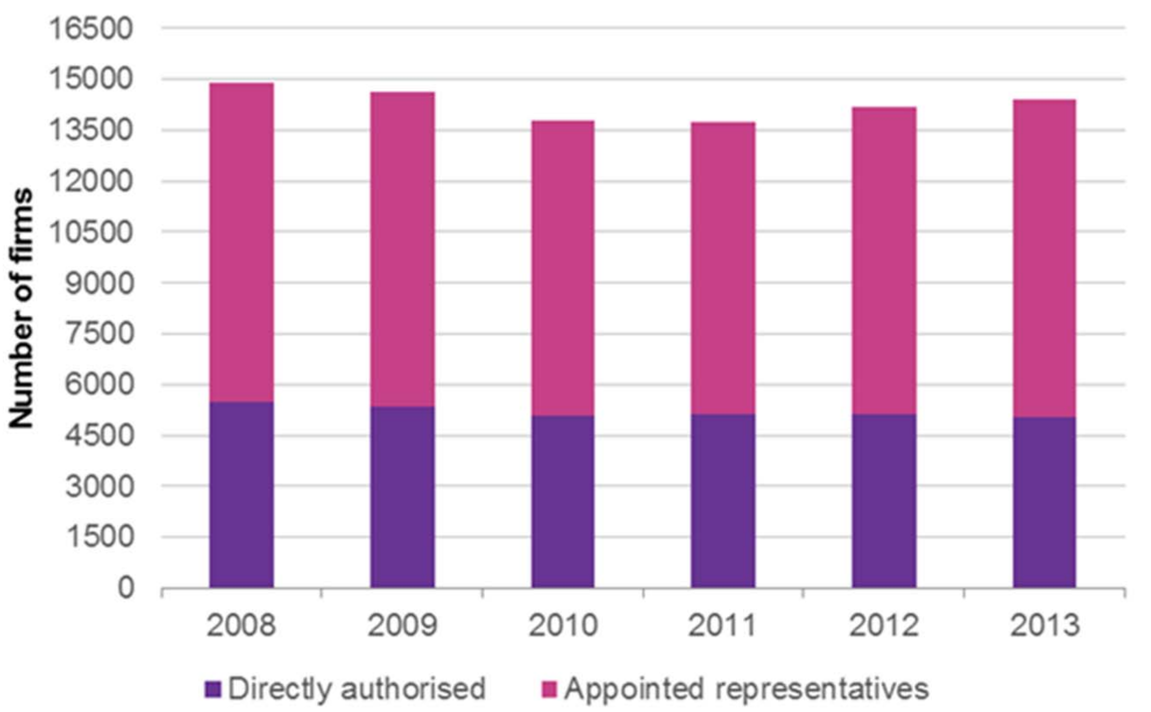
Source: Europe Economics, RMAR

Revenues per adviser have increased by about one-third from 2011 to 2013. Profitability has improved, as weakest firms have left, and the market has recovered



Source: RMAR, APFA

Advisory firms have coped, and at least some are doing very well. The number of advisory firms has risen slightly since the RDR (NB mostly ARs, which are likely smaller, not DA)



Source: RMAR

The advisory industry is in better shape now. This is only partly due to the RDR.

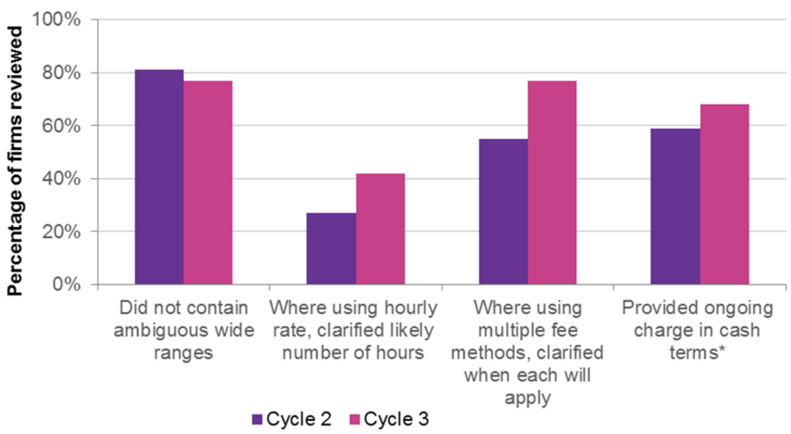
NB This does not mean all advisers/ firms are better off – the RDR "encouraged" exit by specific types of market participant

Are consumers better off?

Europe Economics

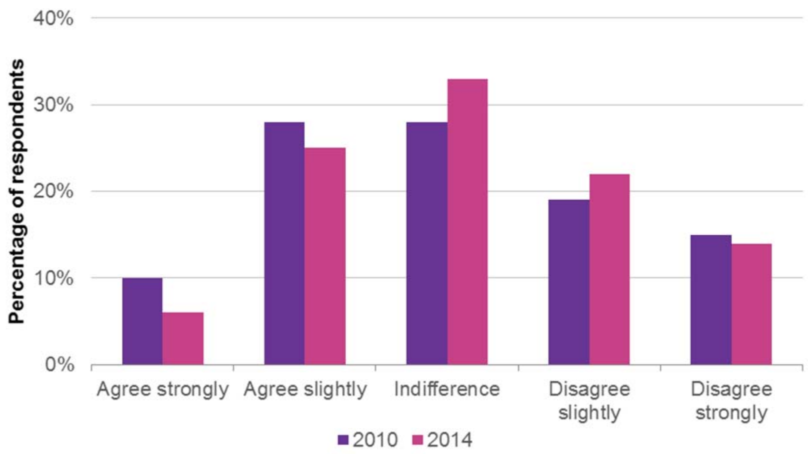
Bias has reduced, and the clarity of disclosure to consumers has also improved. However consumer trust remains an issue

Post-RDR advisers are meant to disclose more information (and are largely doing so)



Source: FCA Thematic Reviews, Cycles 2 and 3

Trust is almost unchanged from before the RDR was introduced (and is arguably less now)

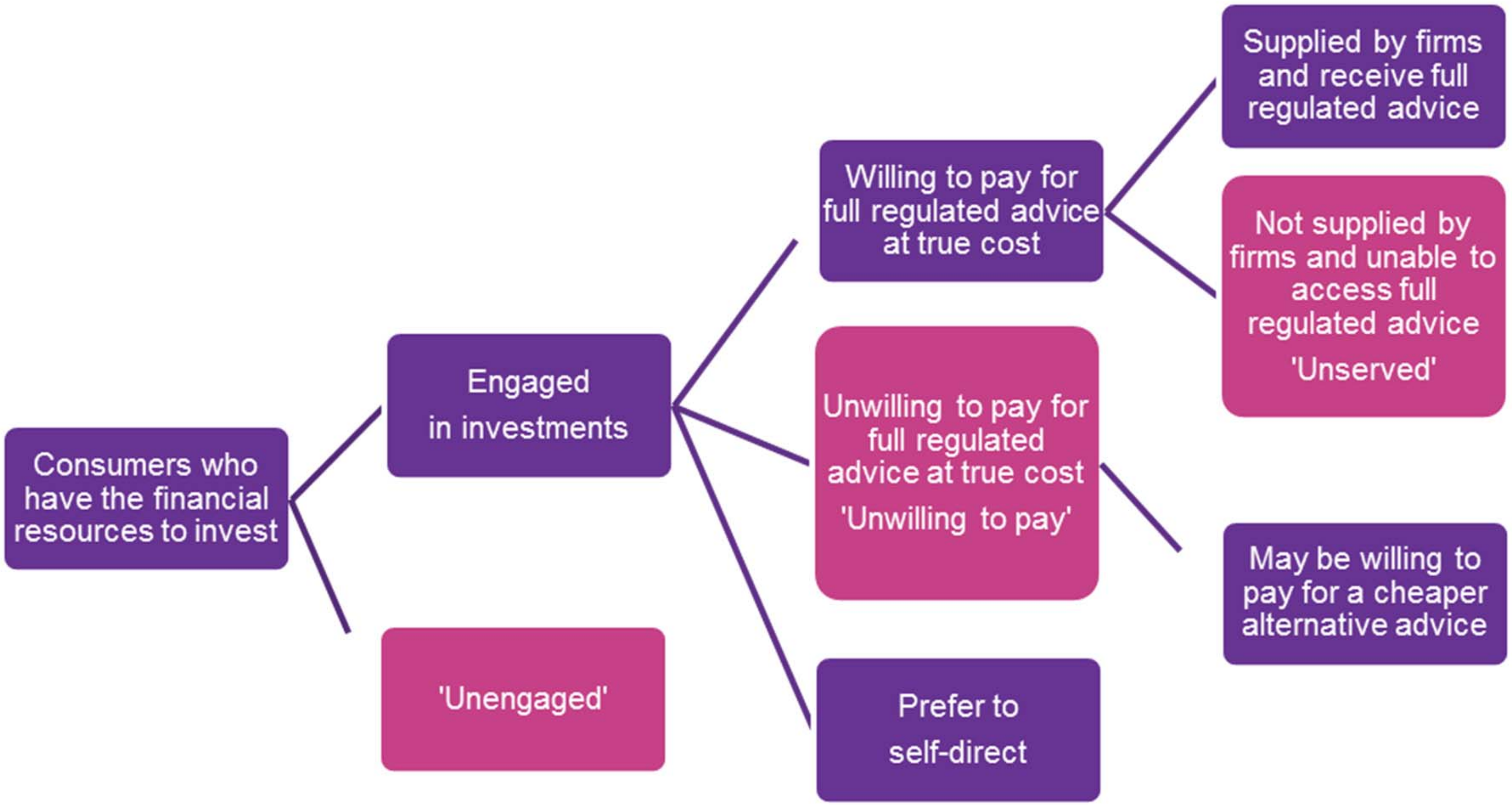


Source: Omnibus surveys in 2010 and 2014

The cost of advice has not reduced

- The indications are that product providers are facing increased competition on fees, at least in part due to the greater visibility around these. Ongoing product charges are lower, but this simply reflects the stripping out of adviser and platform charges as part of the transition to 'clean' share classes. The net to product providers (about 50–75 bps) are similar to the pre-RDR position. The sense amongst product providers of increased competitive pressure may reflect changes in product mix.
- The charges by platforms, both B2B and B2C ones, have become less opaque and look to have reduced post-RDR.
- However, the cost of advice has not fallen — if anything it does seem to have risen, at least for customers with relatively less to invest.
- Implies the marginal incentives to go non-advised (at least on more "straight-forward" investments) have increased

Do consumers have access to advice?



The impact on consumers is mixed – signs of better quality, but also of raised costs. The UK has an advice gap, albeit only partly attributable to the RDR

Conclusions

Europe Economics

Three answers:

There was bias in the UK retail investment market and the ban on third-party commissions reduced it

The advisory industry is in better shape now. This is only partly due to the RDR. NB This does not mean all advisers/ firms are better off – the RDR "encouraged" exit by various players

The impact on consumers is mixed – signs of better quality, but also of raised costs. The UK has an advice gap, albeit only partly attributable to the RDR