HOW MUCH BENEFIT WILL THE RDR DELIVER TO CUSTOMERS?

RESEARCH INTO ADVISER CHARGING
Financial Services

BDO

FOREWORD

THE RETAIL DISTRIBUTION REVIEW (RDR) IS PURPORTED TO BE THE BIGGEST SHAKE-UP THAT THE INDUSTRY HAS SEEN IN DECADES. IT IS CERTAINLY EXPECTED TO HAVE A PROFOUND IMPACT ON PRODUCT PROVIDERS, FUND MANAGERS, FINANCIAL ADVISERS, AND NOT LEAST, CUSTOMERS.

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The RDR represents a major regulatory initiative. It aims to remedy perceived problems in the industry that give rise to potential consumer detriment. Given the time and cost devoted to RDR, the Financial Services Authority (FSA) therefore has it's reputation at stake here too.

We commissioned this research, amongst Independent Financial Advisers (IFAs), so that we might better understand how the RDR might play out in practice. We wanted to know whether it was likely to have the desired impact to improve customer outcomes.

We feel sure that, like us, you will find the insights from the research quite revealing. We were particularly struck by the fact that most advisers will operate post-RDR with adviser charging facilitated by the product provider. To some, this may feel like it is commission by another name.

Consideration of where consumer detriment has arisen in the past tells us that "bias to sell" has been a major risk – namely that many financial advisers get remunerated if the customer purchases a product and they don't get remunerated if the customer doesn't. The RDR's focus has been on "product bias" – that is, commission potentially swaying advisers toward one provider rather than another. The "bias to sell" issue has been the elephant in the room. These research findings suggest that the elephant has not been entirely removed from the room.

We hope you enjoy reading this short report. It prompts an important debate whether you are a product provider, fund manager, financial adviser, regulator, or consumer representative.

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1. EXECUTIVE SUMMARY

The research was conducted to understand whether the RDR will in practice deliver the customer outcomes desired by the regulator. The findings suggest that the major – and costly – changes to UK financial services regulation associated with RDR may change very little in terms of direct benefits to consumers either through lower adviser charges or more transparent charging structures.

The research findings indicate that:

- the cost of advice to customers is predicted to increase post-RDR
- most advisers will operate post-RDR with adviser charging facilitated by the product provider – which indicates that, without regulatory vigilance and genuine customer engagement, the current charge for advice through commission payments may simply remain under a different guise.

Cost of advice to customers

In total, over 90% of respondents said that they expected IFA remuneration to be as it currently stands or higher following the RDR.

Pre-RDR, on an investment of £50,000:

- the average initial commission charged by respondents was 2.9%; plus
- an average trail commission of 0.6% per annum.

Post-RDR, the average level of adviser remuneration on a £50,000 investment is expected to be:

- an initial adviser charge of 2.8% of the investment amount; plus
- an ongoing adviser charge of 0.8% per annum of the value of the investment.

Facilitation by product providers

Whilst the RDR will signal the end of commission payments, evidence strongly suggests that these will be replaced by a structure which may operate in a similar way. 70% of IFAs, in considering how they might receive their initial adviser charge, said that the client would make a single payment to the provider, with the provider then paying the adviser.

Hourly rates

For those IFAs who intend to adopt an adviser charging approach based on hourly rates, the responses showed an average charge of £160 per hour.

BDO Comment

The results of our research show that post-RDR, the prominent form of IFA remuneration will feature charges for advice being deducted from the customer's premium by the product provider and then passed back to the IFA. This looks much the same as the way payment by commission works now. If one of the major objectives is for the RDR to make adviser remuneration more transparent, it is questionable whether the subtleties in this change will be appreciated by customers, who will need to pay particular attention to the information provided to them about charging structures operated by their advisers. It is also apparent that most IFAs expect their income to rise. The focus on increased professional standards should lead to a "professionalisation" of the advice industry, with a culling of under-qualified IFAs leading to better quality advice and an overall higher level of service. However, this will also place the focus on firms and the FSA, ultimately the Financial Conduct Authority, to ensure that the clarity over charging structures is definitely delivered to the consumer in practice.

There is talk in the industry about fears of a growing "advice gap", where pricing would prohibit all but the most affluent consumers from seeking financial advice. Responses to our questions about charging levels anticipated by IFAs would seem to lend weight to these concerns and the fees that advisers want to charge for advice seem significantly higher than what we believe consumers are willing to pay. This could however be a case of over-optimistic commercial planning on the part of the IFA, and we may see that transparency and competition will force these down.

The RDR is a major shake-up of the industry and still has the scope to improve the quality and value-for-money of advice. But its effect on the end customer may be muted unless the regulator takes a very hands-on role in the monitoring of adviser charging structures post-RDR and in making sure that advisers and providers make very clear to customers how much they are paying, to whom and in return for what.

2. ABOUT THE SURVEY

The research was conducted by NMG Consulting, on behalf of BDO, in December 2011. All 283 respondents were IFAs.

The research explored a number of aspects of a post-RDR world including:

- the method by which IFAs propose to charge customers for the various services offered
- the likely hourly rate customers will be charged (where this particular charging method was going to be used)
- whether IFAs expect to charge the customer regardless of whether or not a product is purchased
- the method by which the initial adviser charge would be paid by the customer where a product is purchased
- the proposed charging structure for a customer making a specific purchase (lump sum investment of £50,000) – together with a comparison of how the IFA is currently remunerated for the same purchase
- the extent to which IFAs have discussed the forthcoming changes to remuneration with existing customers.

In total, 90% of respondents said that they expected IFA remuneration to be as it currently stands or higher following RDR.

3. FINDINGS

POST-RDR PROPOSED CHARGING STRUCTURES

The proposed method of charging is varied with:

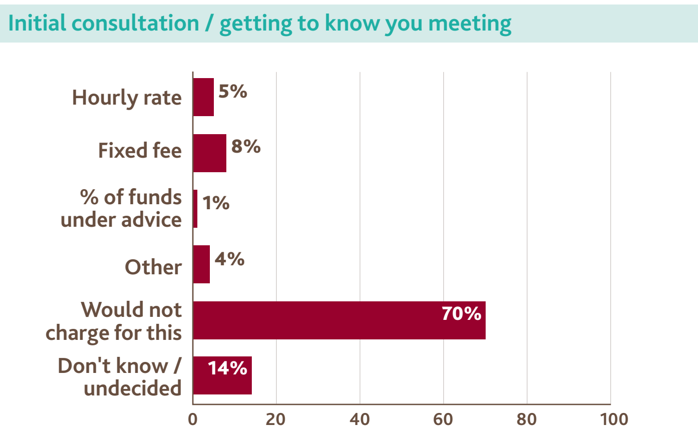
- fixed fees favoured for financial planning
- a fairly even split, on the purchase of a product, between a fixed fee and a percentage of the investment
- payment as a percentage of the investment strongly favoured for ongoing advice.

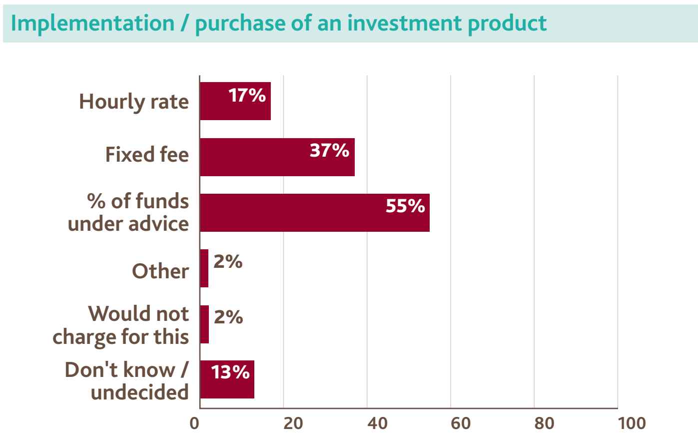
As might be expected, the majority would not charge for an initial consultation.

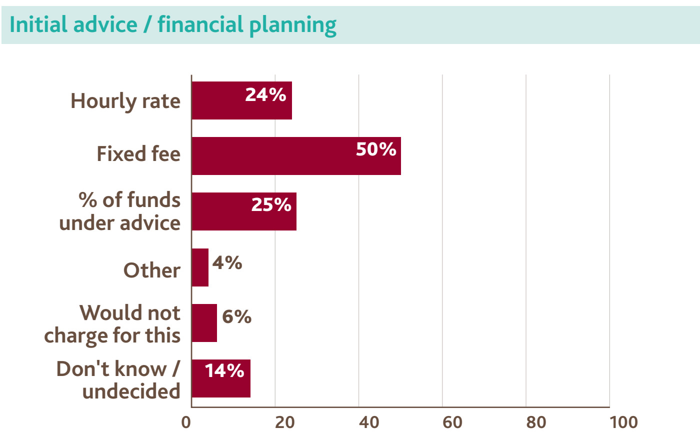
Compared to charging structures utilised today, post-RDR there appear to be significantly more advisers proposing to charge hourly rates and fixed fees. Whether this will manifest itself in practice – and, in particular, whether customers will be prepared to pay in this way – remains to be seen. It may to be somewhat optimistic on the part of advisers.

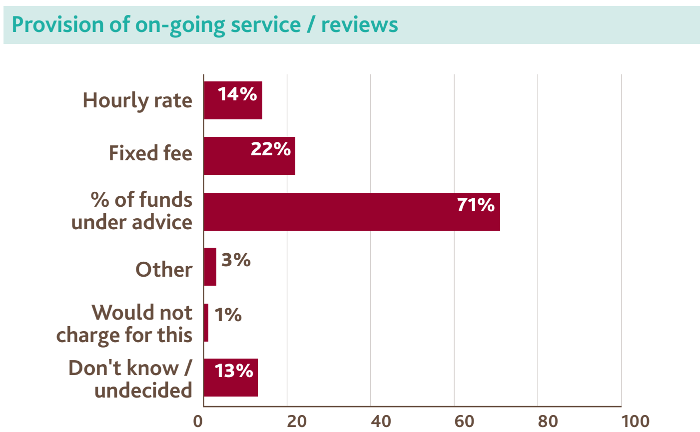
63%

will charge, irrespective of whether a product is purchased









Base: All respondents (283)

Q1: How do you propose to charge for each of the following client services post RDR?

HOURLY CHARGE-OUT RATE

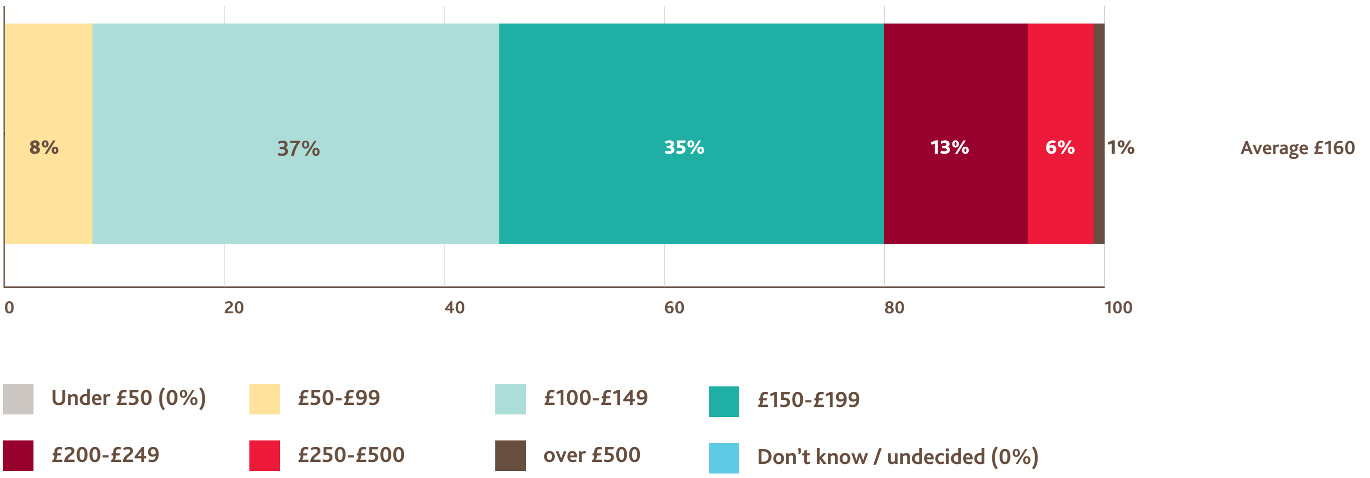
Of those who said they would charge hourly rates for client services post-RDR, the majority estimate the charge will be less than £200 per hour for a fully qualified adviser. The average comes out at around £160 per hour.

Many industry experts have voiced fears of an "advice gap" growing, where pricing would prohibit all but the most affluent consumers from seeking financial advice. The levels anticipated here by IFAs would seem to lend weight to these concerns. The fees advisers want to charge for advice seems significantly higher than what consumers appear willing to pay. Of course, advisers may simply be over-optimistic on the fees they will be able to charge and transparency and competition may force these down.

37%

estimate the hourly charge will be between £100-£150

Hourly charge out rate for fully qualified advisers



Base: All who said they would charge an hourly rate for client services post RDR (93)

Q2: Which of the following best represents the likely hourly rate you would charge for a fully qualified adviser?

CHARGING CUSTOMERS POST-RDR: DEPENDENCY ON PRODUCT PURCHASE, AND FACILITATION BY PRODUCT PROVIDERS

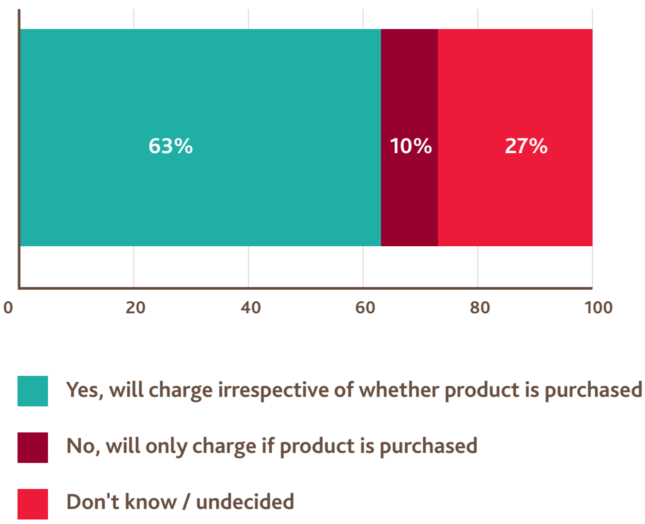
55%

will pay by a single payment to the provider

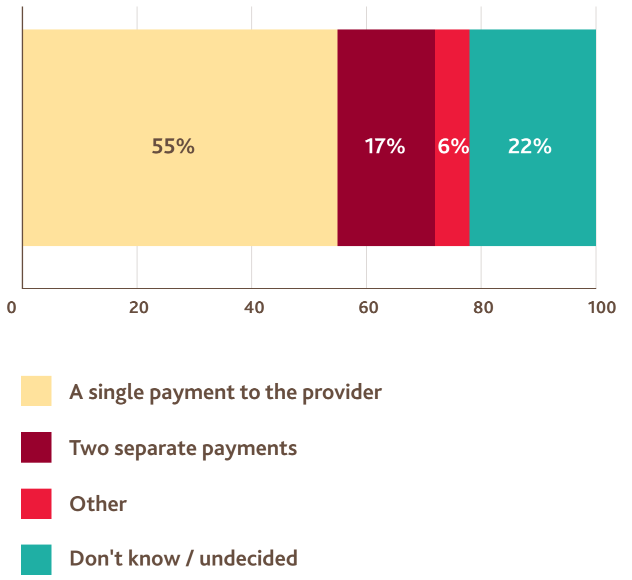
Almost two-thirds of advisers state that they will charge a fee irrespective of whether a product is purchased. Once again, whether in practice this turns out to be the case will fundamentally depend on the willingness of customers to pay.

If a product is purchased, then over 70% of advisers, in considering how they might receive their initial adviser charge, said that the client would make a single payment to the provider with the provider then paying the adviser. And so the most prominent form of remuneration in a post-RDR world will simply be charges deducted from the customer's premium by the product provider and passed back to the IFA, similar to the process by which commission works now. Unless customers take a much greater interest in information shown to them than they do at present, it appears highly debatable that – for all the cost to the industry – the RDR will make adviser remuneration any more transparent.

Whether fee charged if client does not purchase a product



How fee will be paid if product is purchased



Base: All respondents (283)

Q3: Post RDR, will you expect to charge the client a fee if they do not go ahead and purchase a product?

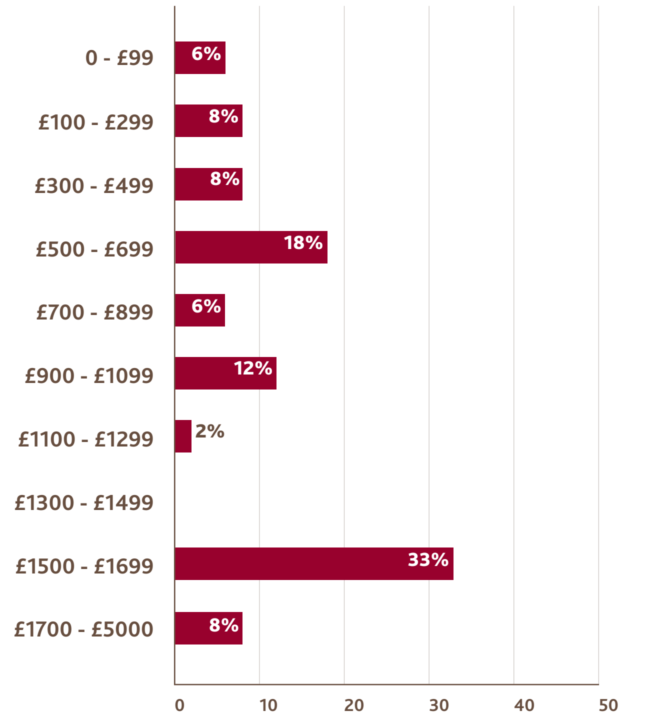
Q4: If the product is purchased, which best describes how you expect the client to pay the initial adviser charge (post RDR)?

CURRENT REMUNERATION STRUCTURE

If a customer were to make a lump sum investment of £50,000, advisers will typically rely on initial commission of 3% and trail commission of 0.5% per annum. The averages are 2.9% and 0.6% respectively.

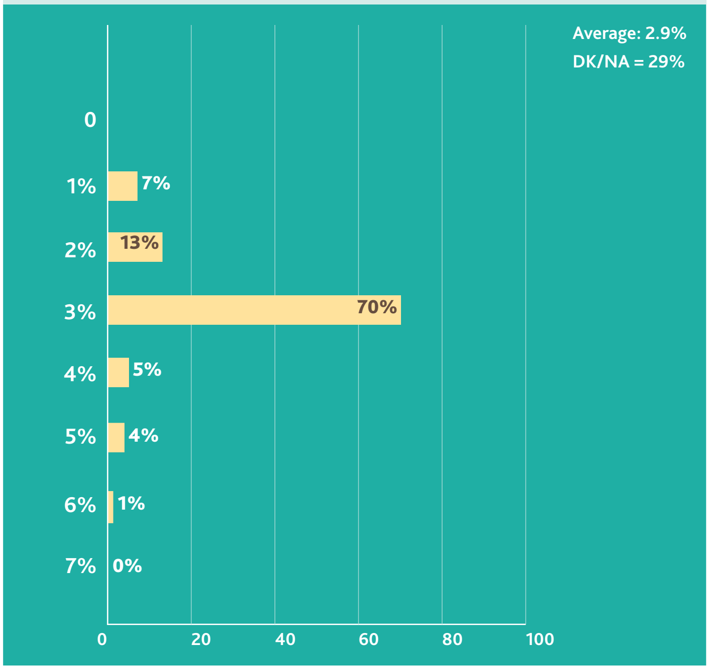
Fixed fees are currently more varied among the small proportion that charge this way. The average of £1,000 represents 2% of the investment amount though there is a great deal of variability around this average.

Fixed Fees (66)

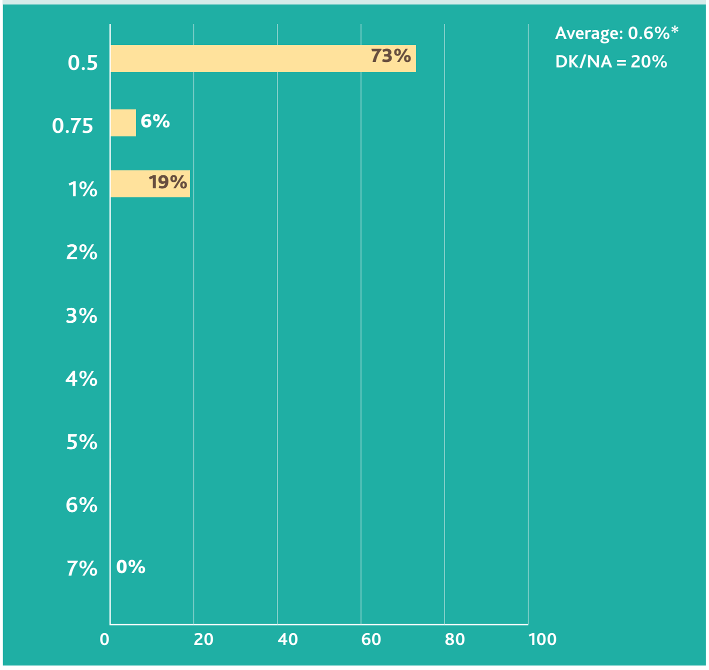


Average: £1,000
DK/NA = 77%

Initial commission (227)



Trail commission (227)



Base: All respondents (see charts for base excluding Don't Know/NA) * 1 outlier removed from average

Q5a: If a client made a lump sum investment of £50,000, how would you typically be remunerated currently?

All who did not give an answer to question have been excluded from % calculations on each chart (20% for initial/trail, 77% fixed fee)

POST-RDR REMUNERATION STRUCTURE

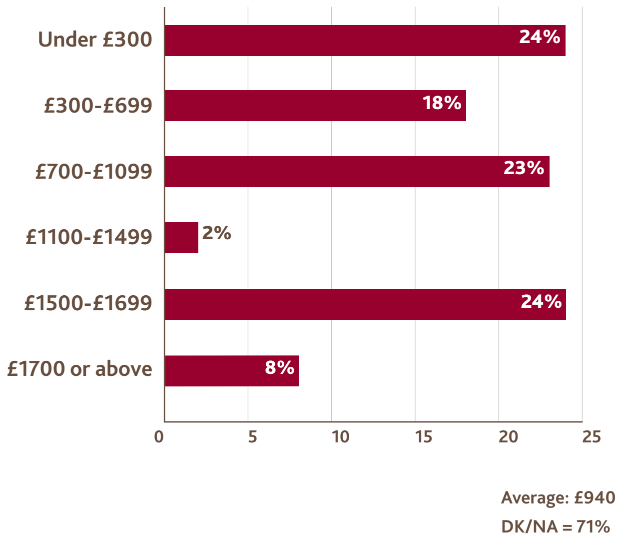
Post-RDR the initial adviser charge is again typically 3%, the average falling slightly from 2.9% to 2.8%. However, consideration of an adviser charge based on the value of the fund shows that many more advisers expect to charge 1% – the average increases from 0.6% to 0.8%.

Consequently, post-RDR IFA remuneration is either as it is now or higher in over 90% of cases.

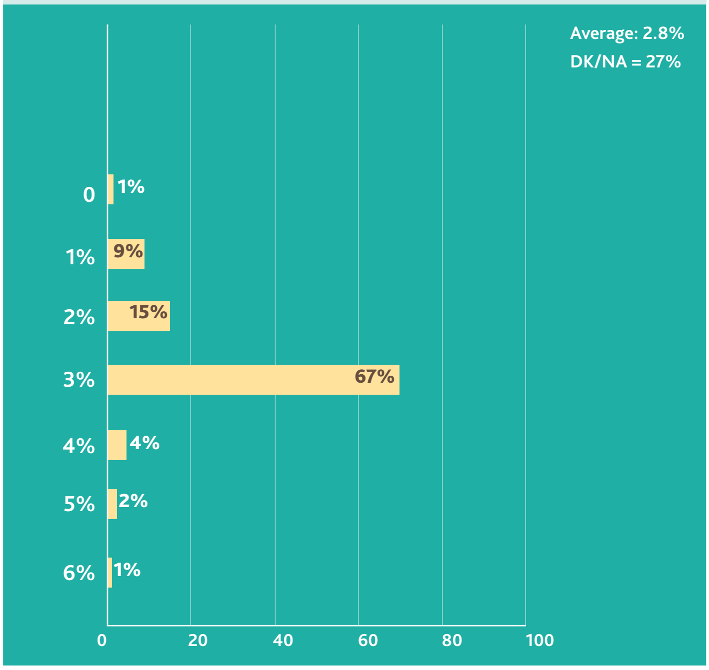
The RDR is the most important shake-up of the industry and still has the scope to develop the quality and value-for-money of advice. But its effect on the end consumer may be muted unless the regulator takes a very hands-on role in supervising adviser charging structures post-RDR and in making sure that advisers and providers make very obvious to consumers how much they are paying, to whom and in return for what.

Whilst RDR will certainly lead to a "professionalisation" of the advice industry, meaning better quality advice, a removal of under-qualified IFAs and an overall higher level of service, it is clear that it will place an extra onus on firms and the FSA, ultimately the Financial Conduct Authority – to provide clarity to consumers over charging structures.

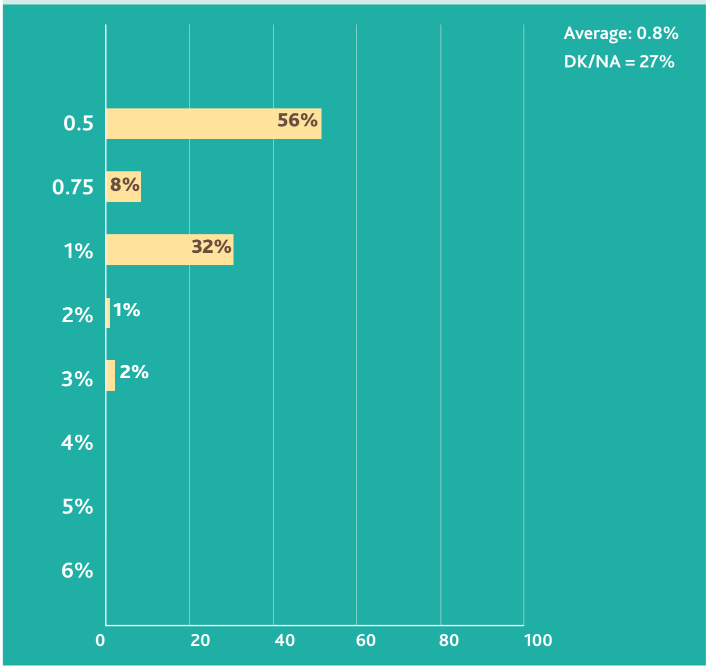
Fixed or hourly charge invoiced directly to the client (83)



Adviser charge based on the investment amount (206)



Adviser charge based on the value of the fund (%) (207)



Base: All respondents [see charts for base excluding Don't Know]

Q5b: And now thinking post RDR, how would you expect to be remunerated if a client made a lump sum investment of £50,000?

All who could not answer have been excluded from % calculations on each chart (27% charge based on investment amount/charge based on fund value)

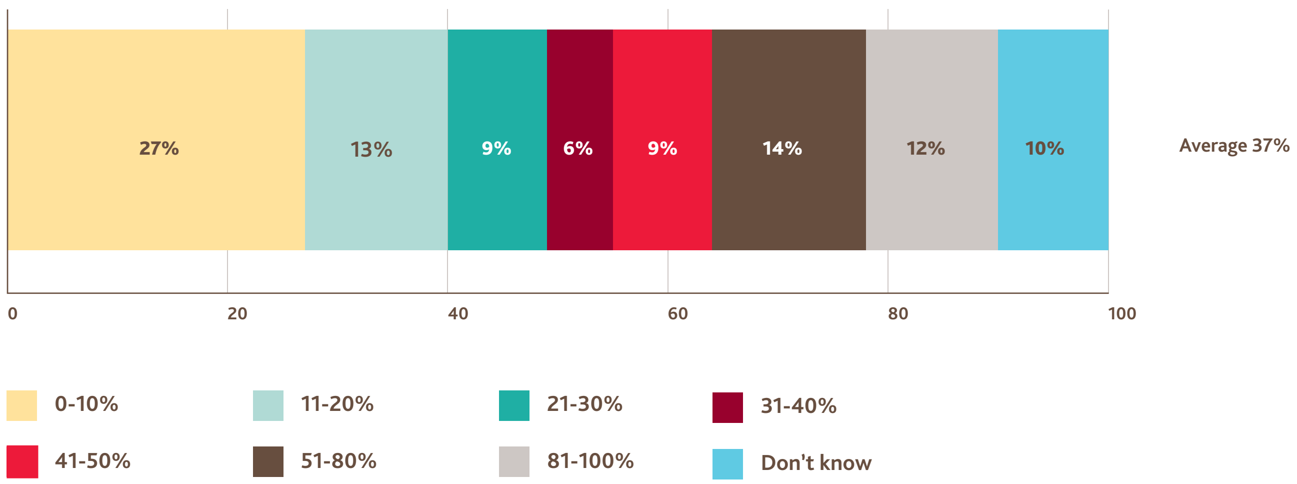
DISCUSSING FORTHCOMING CHANGES WITH CLIENTS

The percentage of existing clients with whom advisers have discussed the forthcoming changes to the way that they will be remunerated varies considerably. When this research was conducted in December 2011 over a quarter of advisers had mentioned it to less than one in ten. This may be a reflection of many advisers not being in regular contact with all of their clients.

27%

discuss forthcoming changes to 1-10% of clients

Discussing changes with clients



Base: All respondents (283)

Q6: With what percentage of your existing clients have you discussed the forthcoming changes to the way you will be remunerated?

Whilst RDR will certainly lead to a 'professionalisation' of the advice industry, meaning better quality advice, a culling of under-qualified IFAs and an overall higher level of service, it is clear that it will place an extra onus on firms and the regulator to provide clarity to consumers over charging structures.

4. CONCLUSION

The research brings into question whether the RDR will in fact deliver the desired consumer benefits. The findings suggest that the major – and costly – changes to UK financial services regulation associated with RDR may change very little in terms of direct benefits to consumers either through lower adviser charges or more transparent charging structures. Of crucial importance, of course, will be how it plays out in practice.

ABOUT BDO

BDO is the world's fifth largest accountancy and professional services firm, providing services to clients in over 100 countries including all major financial centres. Our clients range from global institutions to specialist firms in retail and wholesale markets. We bring a unique view to the issues faced by firms across the whole distribution chain in responding to RDR challenges.

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