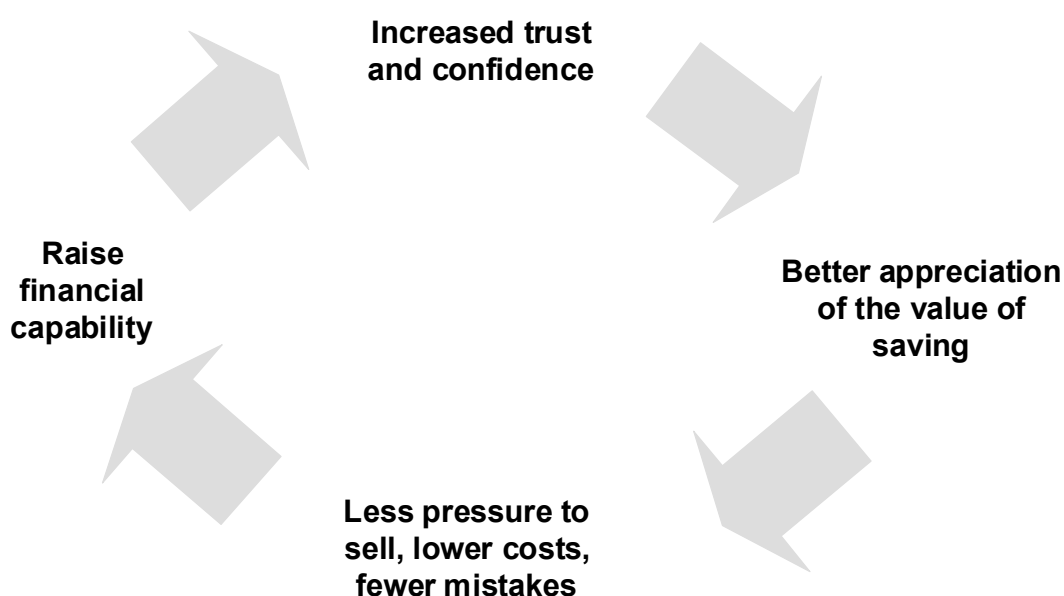


THE ABI'S RESPONSE TO DP 07/1: A REVIEW OF RETAIL DISTRIBUTION

Executive Summary

1. The ABI and its member companies recognise the importance of reform of the distribution of retail investment products. We believe that reform should seek to create a virtuous circle started by raising financial skills and increasing trust in the market.

Figure 1 Importance of reform of the distribution of retail investment products



Source: ABI

2. To address the challenges we face in the market, we must focus on the needs of consumers, but recognise the value added by advisers and other service providers and provide incentives for this work to take place. In our response we outline the steps we believe are necessary to ensure the market is trusted by consumers and profitable for providers and intermediaries.
3. Proposals must avoid developing unnecessary complexity in the market and will need to be properly tested with consumers, intermediaries and providers before they are introduced. We should also avoid stifling competitive developments within the market where competition can deliver for consumers. Proposals must seek to build on areas where the market currently works well and on areas where the market is already starting to innovate.
4. We are convinced that reform is necessary and timely. To ensure success the FSA must focus its efforts at the next stage on a small number of key issues where it can deliver real change. These should build on the FSA's existing financial capability strategy and the emerging proposals on generic advice.

5. The priority for the industry must be to meet consumer needs, thereby raising demand for the products that the industry offers by:
 - *Giving customers clear services that they can understand (sales and advice):*
 - A single regulated category of advice, with qualifications and specialisms allowing advisers to differentiate themselves rather than regulatory titles.
 - A new regulated sales process “Assisted Purchase” helping people get affordable access to basic products.
 - *Developing simple products that consumers can understand.*
 - *Helping future generations access the market through improved Financial Capability and Generic Advice.*

6. If we can raise demand we must then ensure that the market can deliver a service to match expectations. To do this we believe that it is necessary for:
 - *All advisers to be able to demonstrate their professionalism:*
 - A new minimum qualification of Diploma for advisers;
 - Compulsory membership of a professional body;
 - A new Professional Standards Board;
 - Improved consumer information on qualifications, charges and services.
 - *Remuneration to be transparent, set at fair levels and linked to clearly defined and understood services:*
 - Customer Agreed Remuneration for all firms offering products from a range of providers;
 - Where intermediaries are not offering a choice of providers they should be able to demonstrate how they have addressed the potential for bias and clearly disclose the services they are providing.
 - *Effective supervision of all firms:*
 - A balanced scorecard approach taking into account a range of factors such as qualifications and remuneration to be used to target firms for enhanced regulatory supervision;
 - The level of capital held by the firm to be included within such an assessment.

7. We believe that the objective must be a market that treats customers fairly as well as being sustainable and profitable for intermediaries and providers. But, if additional costs, through for example increasing minimum qualifications, are the accepted price for a market with better outcomes for consumers, there must be a regulatory dividend for firms in the market. Regulatory support is required, in particular to develop a new Assisted Purchase route to market, supporting the take-up of CAR across the advice market and improving the supervision of intermediaries.

8. We believe that our proposals would make a significant difference to the market. They cannot be delivered overnight and more work is required to determine feasibility, practicalities, transition issues and therefore an appropriate timetable. But, they can be delivered by the industry within an overall framework of principles enforced by the FSA. The industry faces many similar challenges in the protection market and we propose that in 2008 we test which solutions for the investment market should also apply to the protection market.

Introduction

9. The ABI accepts that the distribution of life and savings products can be improved for the benefit of consumers, distributors and manufacturers.
10. Working together with the FSA, the industry can develop reforms that help consumers understand their needs, and get the right products and services. We believe that more people could get savings and investment products while new business models are developed by the industry. Regulation should encourage new distribution channels to develop, and expand consumers' access to, and understanding of, financial products.
11. Reform should increase consumers' confidence and raise professionalism but we must be realistic about the degree to which customers can or, in the future, could understand the market. We therefore recognise that there is a need to improve regulation to protect consumers and ensure the development of a more efficient market. We believe that this vision can be delivered by the industry within the FSA's desired principles based approach.
12. In facilitating the required changes the FSA should seek to coordinate their retail strategy, ensuring that the priority themes are aligned and complementary, allowing the industry time and resource to implement any changes.

Scope of response

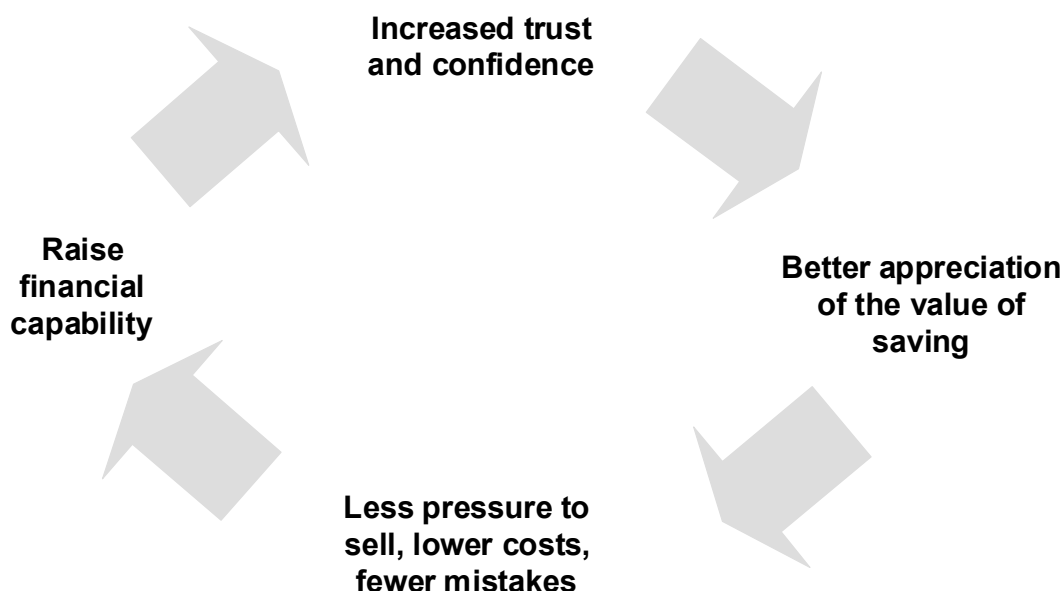
13. Our response is limited to comments on the retail market for investment products. We outline the destination for market reform and also the potential steps on this route. Our ambitious set of reforms will take time to implement and at this stage we have insufficient evidence to develop a definitive timetable. That said, it is certain that reform is essential.
14. We will use the time between the end of this consultation and the publication of the FSA's consultation paper in 2008 to consider further the likely challenges we face.
15. Our response is split into five sections:
 - Section 1: Creating better outcomes
 - Section 2: Key perspectives on the challenge
 - Section 3: Increasing demand
 - Section 4: Increasing consumer confidence
 - Section 5: Delivering reform
16. While this response is limited in scope to the retail investment market, we acknowledge that the industry faces many similar challenges in the protection market. Many intermediaries selling investment products also sell protection products. Can the solutions we are proposing be applied only on one part of an intermediaries business?
17. As in the investment market, consumers should expect transparent products and services that meet their needs. Is the protection market delivering this? Persistency of protection sales and therefore their profitability is also a concern.

18. We are proposing a new sales process – Assisted Purchase – which would match consumers with products that meet their basic needs. Simple protection products must be included in such a process.
19. Protection is outside the scope of this review. But in 2008 we must test which solutions that we propose for the investment market are equally appropriate for the challenges we face in the protection market.
20. Responses to the individual questions raised in the Retail Distribution Review are attached separately.

Section 1: Creating Better Outcomes

21. We believe that reform should seek to create a virtuous circle started by increasing trust and confidence in the market. By focusing on the needs of consumers, we can address the challenges we face.

Figure 2 Importance of reform of the distribution of retail investment products



Source: ABI

22. At present regulations governing disclosure of relationships, the sales process and qualifications seek to give consumers confidence in the market. The Retail Distribution Review recognises that the current mix has failed to deliver satisfactory outcomes for consumers, intermediaries or providers. Regulation needs to be rebalanced towards better qualifications and professionalism and away from regulatory interventions that add cost without promoting the choices that consumers need or securing their trust.
23. We must ensure that the market is simple for consumers to access, giving them the choices they need in a form that they understand. A new route for consumers to access the market is needed – we call this Assisted Purchase – providing an option between execution only sales and fully regulated advice. Consumers in future would access financial products through any number of these channels at different times to meet different needs, just as they use a number of different channels when buying other products or services.
24. Coming pensions reforms, including auto enrolment and Personal Accounts to be introduced from 2012, provide additional impetus for the need to improve financial capability. As consumers seek to engage with financial services the market will need to develop the products and services that meet their needs.
25. Discussions around Generic Advice envisage a service focused largely on the needs of people with lower than average incomes. Many who do use Generic Advice will not need investment or savings products. Many consumers of investment or savings products will not need Generic Advice.

26. As we develop channels that are better understood by consumers, we also need to ensure that we deliver the professional services they expect. Where they want assistance, it must be backed up with systems and processes that ensure that they are given clear information, from professional staff with simple products and providers demonstrate a commitment to Treating Customers Fairly. Where they want advice, it must be backed up by a clear demonstration of the professionalism of service.
27. The market is already making rapid progress towards greater professionalism – research from IFA Promotions (IFAP) demonstrates the rise in the number of advisers attaining additional qualifications¹. We argue in this paper that all advisers should demonstrate their professionalism (both through qualifications and ongoing demonstration of competence), not just those who currently choose to take additional qualifications.
28. Where advice is being provided we do not believe that the current minimum level of qualification provides the minimum level of skills (or examined competence) that a consumer should be able to expect. The Diploma represents a more appropriate minimum. To achieve this, the industry must find ways to support advisers who choose to demonstrate their skills, either through financial support for exams or providing access to training. New routes to qualification are required, not just the traditional exam based.
29. Professionalism means more than simply having the right qualification. Consumers accessing the market in future also have a right to expect advisers' behaviour to match their qualifications and professional standing. Membership of a professional body with a strong professional code of ethics provides reassurance in other professional services. Such ethical standards should equally apply in this sector.
30. As consumers become more engaged we will need to work harder to demonstrate the value added by advice. Greater transparency of the services they are receiving and its cost are essential. Consumers should be confident that the advice is free from bias, with a transparent cost of advice set by the adviser and not by the product provider.
31. Regulation will remain as the back-stop for consumers. Those firms who demonstrate their professionalism should expect to see the burden of regulation fall. Higher standards and greater consumer engagement will lead to a larger market for financial services and higher demand for our products and services. As demand increases, understanding will continue to increase, reinforcing the virtuous circle.

¹ "State of the IFA Nation", IFA Promotions, growth rates Sept 05-Sept06

Section 2: Key Perspectives on the Challenge

The Consumer

32. The financial services market provides products and services that meet a wide range of consumer needs. Many consumers are well served. Yet many consumers have little understanding of the products we provide. For instance, around a quarter of consumers who hold stocks and shares state that they don't want any risk in their savings². Lack of understanding, and at times the behaviour of those in the market, has led to mistrust³.
33. Low trust has been re-enforced by consumer confusion about the way the market operates. Incentive structures within the industry are seen as boosting sales rather than enforcing independence and impartiality.
34. Consumers' expectations are changing; they want products that are more flexible. As a result, the length of time savings and investment products are commonly held has fallen significantly⁴. Consumers now regularly switch many products they hold, and savings products are not excluded from this trend. Many consumers are benefiting from this greater flexibility.

The Intermediary

35. Intermediaries have thrived despite constant change and pressure on their business model, both from regulators and external commentators. Despite this, commission remains the main way consumers choose to pay for advice. Remuneration by commission can bring benefits to both intermediaries and their clients. Clients can choose to pay for advice only if they make a purchase; and they can spread the cost over time, increasing affordability and access. While up-front and indemnity commission allows intermediaries to be paid when they do the work.
36. Many firms within the market do operate on a fee basis (around 11% charging fees without commission offset⁵). But it is most common in relatively niche markets e.g. group pensions and high net worth individuals.
37. The interaction between means testing, Personal Accounts, debt and other forms of saving (such as housing equity) together with new tools allowing intermediaries greater flexibility in financial planning is making financial advice more complex to deliver. These changes, together with high regulatory burdens are impacting on the availability of advice, particularly with lower income consumers. IFAs are reacting to the need for higher skills by gaining more qualifications but this is tending to push them further up market and away from the mass market.

The Provider

38. The industry has been making changes and improvements in distribution over a number of years. Research commissioned on behalf of the ABI, firstly from Charles

² "Levels of Financial Capability in the UK: Results of a baseline survey." FSA CR47

³ "Survey of consumer attitudes to financial services and their experience in buying them." Financial Services Consumer Panel, March 2006

⁴ "Understanding Switching" ABI Insurance Market Study no.2

⁵ CRA International Intermediary survey

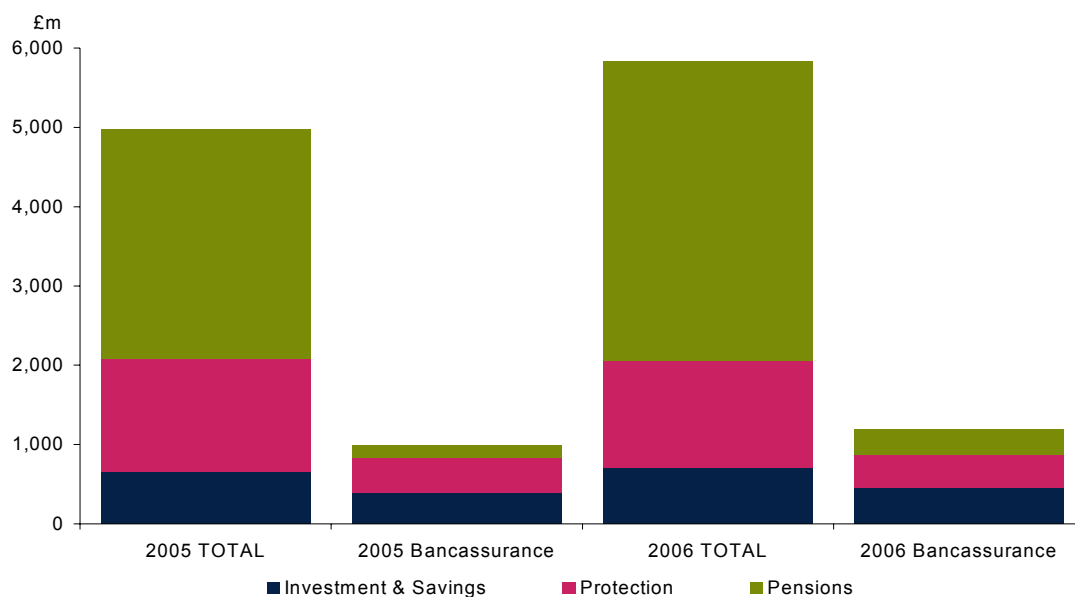
River Associates then Deloitte helped develop an evidence base highlighting the challenges we all face. In particular:

- Consumers do not adequately understand what advisers do and how they are paid for it.
 - The quality of advice received by consumers is variable.
 - There is evidence both of a perception of bias and actual bias.
 - The economics of the products are not working well for many advisers and many providers.
 - The regulatory environment leaves many consumers without access to help buying the financial products they need.
39. Individual firms making changes to their terms of business or remuneration risk losing market share if others do not adopt similar reforms. For example, a provider moving to factory gate pricing risks seeing their customers move to other firms where the advice still is described as “free”. In effect there is a first mover disadvantage. That said there have been significant changes in the market over recent years that have produced benefits for consumers (see paragraphs 42-47).
40. The impact of the reduction in persistency on consumers and advisers is uncertain. But, for providers, the reduction in persistency has, at the least, changed the economics of the market. Products must now be profitable over a shorter time period or share the persistency risk with the customer.
41. Market developments for example in professionalism, bancassurance, Wraps and new charging structures all point to a market that is embracing the changes we wish to see. The challenge is to speed up the reform to meet the changing needs of consumers.

Bancassurance

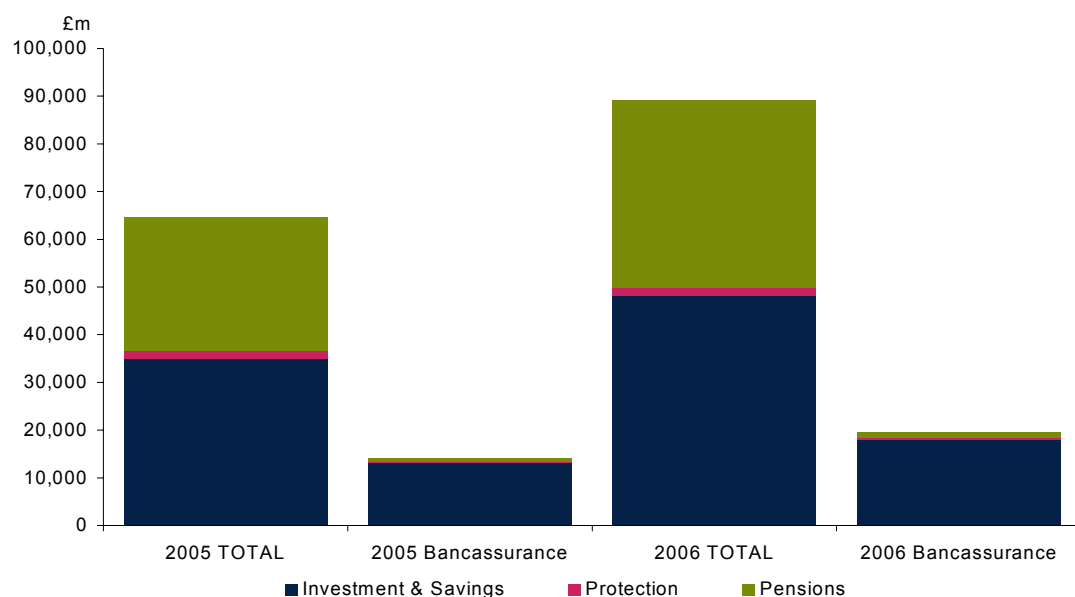
42. While IFAs dominate sales of protection products and pensions, banks play a large and growing role in sales of investment products. This is not surprising; high street presence with strong brand awareness and large existing customer base make an attractive market proposition. Significant recent investment in IT systems and controls by high street banks are leading to more reliable consumer outcomes and expanding the access of middle income consumers to financial products.

Figure 3 Regular Premium Sales



Source: ABI Statistics (previous data not available)

Figure 4 Single Premium Sales



Source: ABI Statistics (previous data not available)

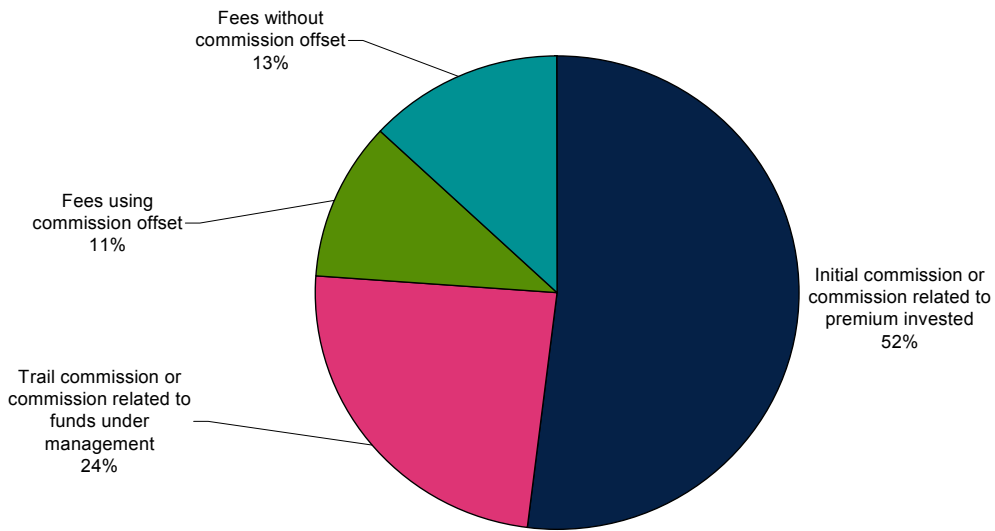
Wraps

- Wraps provide consumers with a consolidated view of their overall financial portfolio. They also support advisers, helping them provide holistic advice. The increased flexibility of the software in Wraps can lower the cost of providing ongoing advice making it more affordable to many consumers. An ongoing stream of income also helps advisers move their business model to a more sustainable basis. If delivered well, Wraps should add value for consumers and help generate a more professional advice market.

Charging Structures

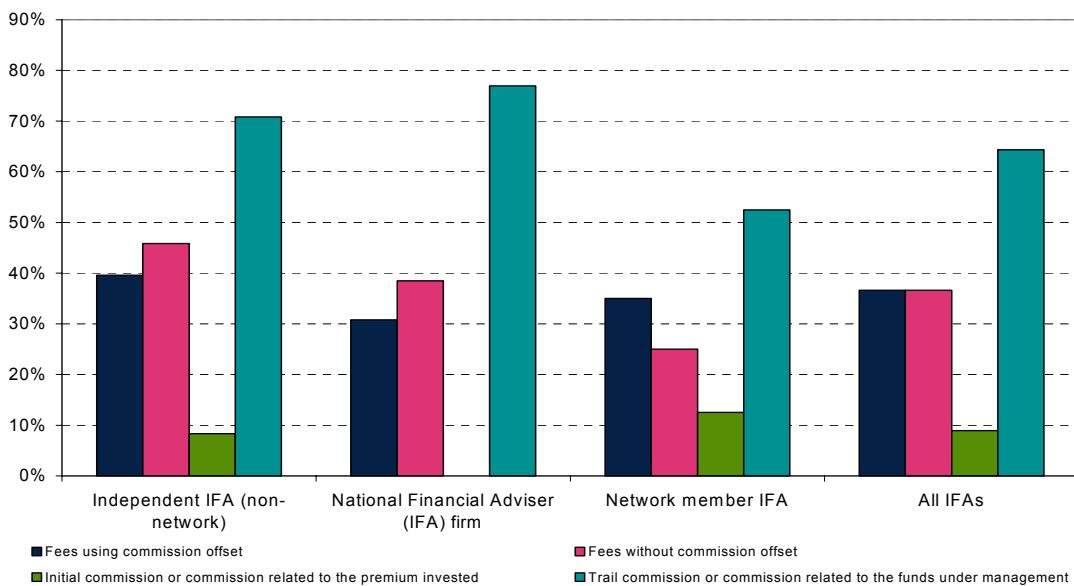
44. There is little data available on how remuneration paid to intermediaries has changed over time. To develop an understanding of the market we must rely on trends seen in individual companies. Such anecdotal evidence indicates a shift away from up-front commission in the market (Figure 6 gives the proportion of intermediaries indicating an increased use of different remuneration structures). That said, despite these trends, up-front and initial commission continue to dominate the market.

Figure 5 % of Remuneration by Category



Source: CRA International

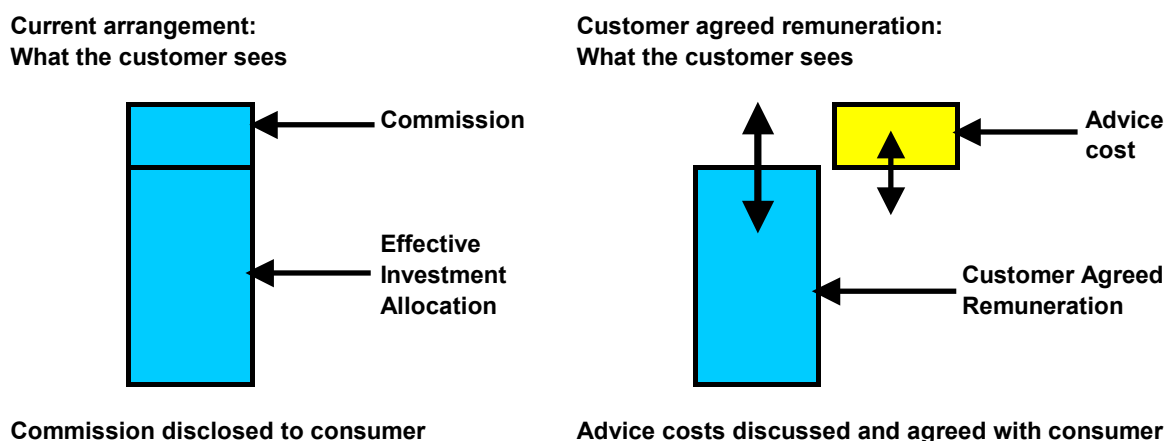
Figure 6 Change in remuneration over last three years



Source: CRA International (Advisers were allowed to state a range of remuneration methods likely to increase.)

45. *Trail commission* – in part driven by the developing Wraps market, intermediaries are seeking to develop business models where they can build greater value within their business.
46. *Fees* – there is a detectable shift up-market among many intermediaries to clients with larger portfolios who seek a greater variety of services. This is often accompanied by an effort from the intermediary to develop a greater understanding and explanation of the value of their service with payment by fee. In the majority of cases this fee is offset against commission paid on the product.
47. *Factory Gate Pricing (FGP)* – various models of FGP have been developed by companies all with the same basic feature that the provider costs are separated from the adviser's charge. Some models allow complete flexibility of the adviser's charge, others specify a limited range of adviser charges that the adviser may select. In all models the insurance company provides some oversight to ensure the charge rates are fair to consumers.

Figure 7 Customer Agreed Remuneration



Source: ABI

The FSA

48. The regulator's critique of the industry is by now familiar following the key speeches announcing the Retail Distribution Review. In developing the Discussion Paper the FSA grouped its critique into five themes:
 - the sustainability of the distribution sector;
 - the impact of incentives;
 - professionalism and reputation;
 - consumer access to financial products and services; and
 - regulatory barriers and enablers.
49. Retail investments are sold in a number of different ways, with many distributors already embracing changes designed to improve the service they offer consumers. New channels and alternatives to standard commission terms are emerging. But we believe that the pace of change remains too slow. It is possible to raise trust in the industry by raising the minimum standards and we believe that this will raise demand for our products and services. Our proposals aim to raise consumer confidence and increase access for consumers to financial services.

Section 3: Increasing Consumer Demand

50. We believe that many more people could and should be saving in the UK than at present. Significant action is needed to increase demand for saving and investment products. We need to be able to offer a clearer choice for consumers of how they can buy financial products when they do seek to access the market. We propose a clear choice for consumers between sales and advice

Market Structure

51. We believe that the variety of different categories of advice suggested in the Discussion Paper would actually lead to greater consumer confusion, making things worse for consumers not better. Instead the market should promote two categories: sales and advice.
52. Those providing advice would then differentiate themselves by their skills and qualifications. Some may wish to promote their independence by sourcing products from across the market. In the long run we believe levels of skills and qualifications will become more important to consumers than a title of independence. But, first all firms must be able to demonstrate that they act in the consumer's interest and are free from bias.

Assisted Purchase

53. We believe that developing a sales model similar to the Primary Advice model, suggested in the Discussion Paper, can extend access to financial products and help service existing customers more efficiently.
54. To be a success, the ABI believes that any new model must achieve outcomes that encourage consumers who are either doing nothing, or not doing enough, to address their basic financial needs. It should deliver solutions that are appropriate to consumers' broad financial needs, not necessarily suitable to their full individual circumstances.
55. But for any new process to work, it cannot be advice in the traditional regulatory sense. Furthermore to avoid confusion among consumers about the term 'advice', we describe it instead as **Assisted Purchase**. Assisted Purchase presents for consumers a solution to meet either a particular priority or a broader range of financial needs.
56. In its simplest terms the ABI sees the difference between Full Advice and Assisted Purchase as:
- **Full advice:** where consumers' detailed circumstances are considered and advice specific to their needs is given, for which the adviser takes full responsibility, i.e. advice that is suitable to their financial needs (see Section 4). Advice can also be given on specific products – Focused Advice.
 - **Assisted Purchase:** where consumers' general circumstances are compared to those of people in similar circumstances. This process helps a consumer to choose an appropriate solution although not necessarily the most appropriate solution which can only be determined by full advice. i.e. help that is appropriate to people in similar circumstances.

57. The process is more than **Execution only**, which does not provide the interactive reassurance and support that customers require or direct them to specific products. There would still need to be an execution only route for those consumers who are happy to buy directly from providers with no support.
58. The Assisted Purchase model must be:
- simple enough for a consumer to understand.
 - clearly differentiated from the rest of the market.
59. We recognise that our proposals for Assisted Purchase still require more work, perhaps not surprising given this was the least developed of the areas of the Discussion Paper. In particular we need to consider what products would be appropriate and what level of investment risk could be acceptable. Consumer testing is needed to understand how best to label the service. Despite this we believe that a workable model is essential to the success of the Retail Distribution Review. FSA and Financial Ombudsman Service (FOS) support for such a model is vital.

How would the process work?

60. The process may be initiated either by the consumer or the firm, would be very simple, would take a maximum of 30 minutes, and (where appropriate) result in a one-interview sale. It could be delivered by a variety of means: face-to-face, telephone, and on-line.
61. Customer's responses to simple questions would result in structured outputs via a customer driven, filtering process potentially using 'decision trees'. Basic information on consumers – age, income, key life stage, behaviours – would be used to establish a basic financial profile which matches the customer to one of a number of broad customer segments that define lifestyle stage or needs. This solution could result in a product sale, but equally it might signpost the consumer to individual financial advice with an explanation of the difference between sales and advice.
62. When developing an Assisted Purchase model to suit their business model, firms will identify a list of products that can be sold and satisfy themselves, on a Treating Customers' Fairly basis, that they are appropriate for each segment. The products would be selected to ensure that any risks of inappropriate sales were reduced.
63. Each segment will describe a 'type' of customer and the needs that most people in similar circumstances are likely to have. Consumers would be asked to confirm that they recognise themselves in the broad description and that the types of need identified are likely to be appropriate to them. This process would need to be tested carefully with consumers by the firm to ensure that it achieved accurate results before being introduced. (Where firms had initially segmented customers from their own marketing information, this is the point in the process where personal circumstances and attitude to risk etc are verified.)
64. Significantly, the process is not a zero-failure regime and provides solutions that may be regarded as only approximately right. However, the process meets an unfulfilled need, on the basis that doing something is likely to be better than doing nothing.

Products in an assisted purchase model

65. Perhaps the main challenge is the selection of an appropriate product set that creates the balance between consumer choice and consumer protection. The ABI believes that a wide product range should be available, although certain products may be given a higher priority according to the perceived needs of the consumer segment.
66. Products which are likely to be excluded are characterised as those where an understanding of a consumer's individual circumstances are required. Such products would not be ignored, but would need to carry an appropriate signpost to the option of individual financial advice.
67. The most important aspect of products is that they must have outcomes and risks that are simple to explain and to understand. As well as a straightforward process, associated literature should be well structured and simple to understand. Products with significant risk of short term capital loss are likely to be excluded.
68. A basic Primary Advice model may include a suite of simple products such as life insurance, a cash ISA, a guaranteed equity bond and a FTSE100 equity tracker ISA. Other models may be tailored to deliver solutions for particular specific needs e.g. life insurance or annuities. More specific processes could allow for greater help and guidance around specific product features.
69. A successful process will see well informed consumers buying appropriate products.

Appropriateness

70. If the outcome of the process is to deliver solutions appropriate to consumers' broad financial needs, a clear definition of appropriateness is required.
71. The ABI proposes that the test of appropriateness should be based on the consumer's understanding of the process, assessed by questions inherent in the process, and not left to the interpretation of the sales assistant. The absence of sales assistant interpretation makes the test suitable for delivery of the process via the Internet where there may be no human intervention.

Avoiding Bias

72. Many companies believe that to remove provider bias, either real or perceived, providers of Assisted Purchase would either be tied, or initially offer only one product of each type from a single provider (gap filling). Others believe that models could be developed allowing provider choice. Either could be possible so long as any company's model is simple for the consumer to understand and clearly differentiated from the full advice market. Potentially CAR could be used to offset any concerns of bias in an environment with a choice of products from a range of providers.
73. Individual providers would not necessarily have to offer a full product range, but would have to be clear on what products make up a full set of what most consumers in similar circumstances would be most likely to consider, and which of those products they are unable to offer.

One model, but not the only model

74. The ABI would like to work with the FSA to develop principles-based confirmed industry guidance on the features of an Assisted Purchase model. Confirmed Industry Guidance provides consumers not only with consistency, transparency, comparability, and the ability to shop around if desired, but also provides much-needed certainty for firms. If the simplified process for Assisted Purchase is agreed, and firms strictly abide by it, it will remove the fear of retrospection and hindsight FOS judgements.
75. Perhaps most importantly industry guidance allows individual firms to develop their own Assisted Purchase models. These could then be individually approved by the FSA, subject to evidence of their effectiveness. This in turn would avoid the temptation to over prescribe a solution given the variation in consumer needs. It would also allow the market to innovate in developing a successful and financially viable model.

Qualifications

76. Individuals delivering the service would need to be competent and trained in both the process and the products. They would need an understanding of the products on offer and the consumer needs the products are designed to meet. Individual firms operating the process would need to satisfy themselves and the FSA of the competence of their staff. This would not necessarily mean the staff were trained to the same levels as financial advisers but would be able to recognise when a sign post to Full Advice may be required.

What regulatory changes are required?

77. There is nothing in the current regulations that is stopping firms from adopting an Assisted Purchase model now, so long as there is no personal recommendation.
78. But these ABI proposals take the industry further than it has been willing to go to date – fear of retrospective action from FSA and FOS, and concerns around the degree of persuasion allowable have stifled the risk appetite of potential providers. To broaden the take-up, potential Assisted Purchase providers will require certain assurances that can only be provided by regulatory endorsement of the process.

Financial Capability

79. The insurance industry has been a long-term supporter of moves to address the poor financial capability of the UK population. Personal financial education in schools has been a first priority, with the ABI helping to set up the Personal Finance Education Group (pfeg), the leading charity in this area, and insurers backing many of its key projects to promote financial education. The FSA's support has been vital to expanding pfeg and taking its much more widely across secondary schools. The whole industry now supports pfeg financially through the FSA levy.
80. However, school-age education can only ever go part of the way to increasing financial capability, the industry also supports FSA work to increase capability amongst today's adults. Compared to the work in schools, projects in the workplace, universities and with families are less developed. More work is needed to widen and deepen their impact, and ensure recipients take action as a result of

the help they have received. The FSA's Financial Capability Strategy is moving to a stage where it would benefit from clearer targets; for instance on increasing the numbers of people who reduce unsecured debt, start regular savings or protect against a key risk.

Generic Advice

81. In January 2007 the Treasury set out its long-term approach to financial capability, which rightly identified Generic Advice as a missing part of the jigsaw. As currently envisaged it concentrates on delivering basic financial help and guidance to those on below average incomes. The Thoresen Review is making good progress in developing what was just a broad concept into a deliverable plan. However, the big test will be in how this service can engage with consumers, stimulate demand for its own service, sales and full financial advice, and really have an impact on consumer behaviour.
82. The final Generic Advice model may prove valuable, but should not be seen as essential to the proposals emerging from this review.

Section 4: Increasing Consumer Confidence

83. We do not believe that there is a single solution that would increase consumer confidence in the retail savings market. A package of measures is needed to improve the professionalism of advice, make remuneration more transparent, and ensure the regulation and supervision of advice firms is more effective. Clear differentiation is needed for consumers between what they can expect from those providing full advice and those simply providing assistance. The ABI welcomes the direction of the proposals on professionalism and regulatory supervision that were put forward by the working groups and the FSA Discussion Paper.

Professionalism

84. We believe that to improve consumer confidence it is essential to create a clear separation of sales and advice, so consumers know whether an intermediary is analysing needs and suggesting tailor-made solutions to individual financial needs (advising) or finding an appropriate product to buy (selling). The blurring of the line between advice and sales, has led many consumers to conclude that advisers are actually acting as salespeople (and vice versa). This has undermined confidence in existing distribution channels.
85. The different tiers of advice (Primary, General and Professional) proposed in the FSA's Discussion Paper fail to create a simple choice for consumers between advice and sales, as certain tiers continue to have characteristics of both distribution channels. A better understood advice channel should lead to the development of a better career structure for advisers. This in turn could persuade many over time to take additional qualifications to become a qualified planner.
86. All advisers providing full regulated advice should be professional, and should meet the following criteria:
- A higher minimum level of qualification i.e Diploma.
 - Compulsory membership of a professional body, with an enforceable code of ethics.
 - Remuneration that addresses the potential for bias.
87. While the Diploma would be the academic standard required to provide advice, we should not imagine that it would be sufficient to provide advice on all products or in all circumstances. Advisers should be encouraged to pursue higher qualifications both for specialist areas of advice and to demonstrate higher general levels of knowledge e.g. Chartered status.
88. The Assisted Purchase route would rely on regulation of the process, together with a selection of simple products. Providers selling direct to consumers should make it clear to consumers whether they are offering a sales or advice based service and ensure that their staff are adequately trained and qualified for the service they offer.

Minimum Qualifications for advisers

89. Consumers rightly expect that anyone giving advice should be properly qualified, and maintaining high minimum standards of behaviour. Therefore the ABI supports the Discussion Paper proposal to increase the minimum qualification needed to give regulated advice to Diploma level.

90. We believe that greater professionalism, a clearer set of qualifications and a better understanding of the value of advice could encourage more graduates into the sector.
91. Achieving Chartered status is a worthy ambition in principle, but does not reflect the varied needs of consumers. For those advisers who are focused on less complex products, or client groups with less complex needs, moving to Chartered (or equivalent) status is not necessary. As at present, advising on the most complex areas should be restricted to those with the necessary specialist qualifications (such as on pensions transfers or long term care). Such specialist exams can be taken, either as part of a Diploma, or in addition to it.
92. Whilst increasing the minimum qualification to Diploma appears feasible, there are still significant transitional issues to be overcome. Too short a transition could be damaging for the industry and consumers, if it caused a shortage of advisers. There is limited evidence as to what proportion of advisers currently have a diploma level qualification, what proportion have nothing more than the current minimum, and how many are somewhere in between. This data is vital to transition planning and the ABI would therefore call on the FSA, CII and others to come together to produce a full audit of existing levels of qualifications in preparation for the FSA's Consultation Paper in 2008. However the CII's proposal for a 6 year transition period seems a sensible starting point for debate.
93. As well as setting a transitional period long enough to allow advisers to take the new qualifications, the FSA, FSSC also need to look at the content and assessment process for these qualifications.
94. New ways of getting a diploma-level qualification that are less academic and exam-focused need to be developed to ensure good existing advisers are not deterred from remaining in the industry. The ISO standards have opened up this route to qualification, but all awarding bodies need to innovate in this area. On-the-job assessment through analysis of case files or observation of the advice process are valid alternatives to exams. Where companies have well established training schemes professional bodies should consider accrediting these schemes.

Grandfathering

95. We do not believe 'grandfather rights' (whereby existing advisers are permanently exempted from the new qualification requirements) are compatible with moves to increase consumer confidence in the industry. Grandfathering could lead to consumers thinking an adviser is more qualified than he or she really is. Many current advisers were grandfathered when minimum qualifications were first introduced, and doing so again might allow advisers to continue without qualifications. The industry should be able to give out clear messages to consumers about the high standards it has adopted. Grandfathering would undermine this message.
96. For those entering the sector wishing to become advisers, arrangements will be needed to support their training. Potentially a two-year training grade where advisers are supervised by a qualified adviser could help maintain the attractiveness of the sector to new graduates. Providers will also play a significant role in the transition, helping fund the costs of the training and assessment required to raise levels of qualifications.

Encouraging Higher Qualifications

97. In common with the Chartered Insurance Institute (CII) and many others, we are concerned about the 'alphabet soup' of qualifications that currently confuse consumers and employers. Advisers should also be encouraged to achieve additional higher-level or specialised qualifications. But this should be demand led, with the benefits of such qualifications communicated more clearly to consumers.
98. The CII's proposals for a common framework for financial advice qualifications⁶ is a promising way forward, and we would urge the FSA and all qualification-awarding bodies to back this initiative. IFAP have also demonstrated how the existing qualifications can be divided into a simple understandable framework to compare qualification levels.
99. But more is required. We also believe that the qualification levels, if they are to remain consistent with a single framework, will need to be approved by a single qualifications body to ensure consistency. Such a role could be taken on by a professional standards board that we discuss below.
100. As mentioned previously individuals working in the Assisted Purchase model would not be expected to demonstrate the same level of qualification as an adviser. Instead systems and controls, alongside simple products and adequate training would be deemed sufficient.

Membership of a Professional Body

101. We believe that all advisers should abide by enforceable codes of professional ethics. To be effective professional bodies need to be able to stop those who break rules from advising. To do this membership of a professional body needs to be compulsory for all advisers, not just for those who are already committed to achieving the highest levels of qualification.
102. We believe the CII's proposals on professional standards could and should be implemented⁷. Although we believe it would be simpler if there were just one professional body, we recognise this may be too difficult to achieve and unnecessary. Instead a single Professional Standards Board should be created to oversee an industry-wide code of ethics, ensure consistency of behaviour and qualifications. To ensure consumer confidence this would need to be independent, with people from outside the industry taking leading roles on the board.
103. With compulsory membership, it would be essential to ensure good co-ordination between the FSA's supervisory roles and the professional bodies. Both the FSA and the professional bodies should be aware of any action the other is taking against individual advisers. The CII has suggested that the FSA could delegate its approved persons regime to a professional body. We agree. This seems sensible for many parts of the approved persons regime, it would reduce duplication and minimise the costs and administration. There may be legal barriers to overcome but these should be tackled.
104. Professional bodies should also ensure that advisers keep up-to-date with industry developments. The intensity of Continuous Professional Development (CPD) should

⁶ *Alphabet Soup: A new recipe?* CII Position Paper 2 (Retail Distribution Review), October 2007.

⁷ *A professional body for retail financial services?* CII Position Paper 1 (Retail Distribution Review), October 2007.

be linked with level of qualification. But all consumers should expect advisers to be up-to-date with recent developments and some level of CPD should be compulsory. We welcome the CII's recommendation that CPD should be more prescriptive.

Evidence of bias and consumer detriment

105. Commission provides both a reward for distributing insurance products and a potential incentive to favour the distribution of some products over others. It acts both as a payment on behalf of the client for the advice and a payment from the provider for making a sale. While both of these objectives may be legitimate, they are not consistent with independent advice.
106. In both their 2002 report for the FSA⁸ and 2005 report for the ABI⁹, CRA International found some evidence of commission influencing the choice of providers (provider bias) and the choice of product (product bias). The 2002 report in particular linked this to consumer detriment from provider bias of £140m.
107. Further concern surrounds the potential for up-front initial and indemnity commission to incentivise sales of new products where existing products remain suitable (churn).

Addressing bias

108. We believe that the best way to address the potential for provider and product bias is by making advisers entirely responsible for setting the price of their service and linking their charges explicitly to services that they provide. The greater transparency that comes from this approach could also start to address the perception of sales bias. Customer Agreed Remuneration (CAR - see Box 1 below) is the framework we believe best achieves this aim. We believe all advisers offering advice from a range of providers should move to CAR based remuneration.
109. There are strong arguments that CAR should apply to all advice on retail investment products regardless of the distribution channel. This would present consumers with a clear understanding that advice has costs that they must pay. It would also allow a consistent message to consumers that financial advice is a professional service worth buying. This would be a clear and simple underpinning of consumer confidence and would prevent sales models from presenting themselves as free advice.
110. But given concerns about how meaningful an advice cost is, where the provider and intermediary are in effect the same firm, we have concluded that CAR should not be the only way to address the potential for conflicts of interest. For distribution models with no real provider choice, other models that could demonstrably address concerns of conflicts of interest on a principles basis should also be acceptable. The customer should in any case clearly understand:
 - the scope and duration of services to be provided
 - that the advice is not given under an undisclosed conflict of interest;
 - that the advice has a cost which the customer is paying, and that cost is substantial.

⁸ "Polarisation: Research into the effect of commission based remuneration on advice", Charles River Associates, January 2002

⁹ "Study of Intermediary Remuneration", Charles River Associates, February 2005

111. For example, a firm with a tied distribution channel could use a salary independent of product choice to eliminate product bias. If effective, this approach alongside significant improvements in the disclosure of the service provided, (and the fact that the consumer must pay for this service, even if as part of the product cost) should be equally acceptable to the FSA and consumers as CAR in addressing bias.
112. CAR may not be appropriate in the Assisted Purchase channel. The intention of the model is to expand affordable, trustworthy access to the market. But this service is not advice and hence the purpose of separating advisory services from product sales is not relevant. It also may be confusing to consumers to present the cost in the same way as advice, given our wish to clearly differentiate this service from advice. While we are not sure what appropriate remuneration models will look like, remuneration must be commensurate with the level of service provided. In particular we will need to consider carefully whether a commission basis for remuneration could be consistent with the desired outcomes from this model. Disclosure of total charges must be clear enough to allow consumers to move within and between channels. Where products are sold directly to consumers outside of the assisted purchase regime we must also ensure the disclosure documentation is effective.

Box 1 Customer Agreed Remuneration

At the start of the advice process:

- Provider offers products with a fixed charge for paid by the consumer – the factory gate price.
- The adviser discusses the price for their services and agrees with their client the services they want.
- The adviser discusses with their client the payment options, with the client choosing whether to pay by fee, as a deduction from the product or an addition to the premium.

At the end of the advice process:

- The client agrees the cost of the adviser's services, signing a clear explanation of the charges and services provided.
- Where funding through the product, the provider checks the impact of the advice and product charge and sets up an addition to the premium.

The provider begins payment to the adviser or a fee is paid.

113. CAR should increase transparency for consumers, remove perceptions of provider bias and help to address product bias. Ideally consumers should have transparency over the cost of the product and advice throughout the life of the product. In practice to deliver such flexibility in provider systems may not be cost effective. Transparency when the initial advice is given remains the key objective.
114. CAR goes some way to removing explicit incentives that may lead to bias within the current distribution system. We would expect the FSA to continue to police its rules on inducements and other incentives carefully to ensure bias does not emerge elsewhere in the distribution system.

Evidence of effectiveness of CAR

115. The ABI commissioned CRA International to undertake research on the impact of CAR on consumers, intermediaries and providers. During August 2007 eight focus groups were held with groups of consumers; these were used to help design a quantitative face to face survey of 300 consumers which were carried out in October. A series of interviews were also held with intermediaries followed by a telephone survey of 100 intermediaries.
116. There was widespread belief among consumers that commission bias was a problem. Furthermore, 43% of the 200 surveyed who had previously purchased, reported that they had not been told the cost of the advice.
117. Around 45% of IFAs currently use factory gate products (the current remuneration model most similar to CAR), receiving around 11% of their total revenue from such products. 58% believe that regardless of the RDR they will use more factory gate

products in the future, but they believe that it will be largely limited to products such as large single premium investments.

118. Less than a quarter of consumers felt that the complexity of CAR would put them off seeking advice, with 85% thinking the concept was easy to understand. 84% of consumers felt that it would make it clear how much they were paying, 80% believed that it would make them ask what they were getting for the price. Only 40% though would ask to pay by fee.
119. Over half of consumers thought that CAR would make them more likely to shop around for advice. 68% of these consumers felt that they were most likely to use the Internet to shop around. Websites such as the FSA's comparative tables or www.unbiased.co.uk could become vital portals for consumers looking for advice.
120. A full report of this research will be published in January 2008.

CAR – a flexible framework

121. Whether the payment for advice is conditional on a sale or not, is a matter for the individual business model of the adviser. Whether it is set as a fixed fee or a proportion of funds under management is equally a matter for the adviser and their client. The adviser's remuneration should be set to suit their business model and the needs of their clients. For example, if they wish to base their model around ongoing advice, a funds under management charge may be the most appropriate way for their client to pay.
122. Equally, as the remuneration should fit with the adviser's business model and their clients needs, negotiation over the cost of the advice will often be inappropriate. Indeed, our consumer focus groups found that many consumers were unwilling to negotiate over the charge for advice. This should not affect the effectiveness of the model. So long as consumers are fully aware of the charge, services they can expect in return, and have explicitly signed off the charge, negotiation will not always be necessary.

Challenges

123. Two main challenges exist for CAR:
 - Ensuring that it addresses provider bias - we propose that the FSA should introduce a rule that ensures that the adviser's charges do not vary by provider. This will ensure that provider bias is removed.
 - Balancing adviser needs for funding and the desire for clarity – consumers are often reluctant to pay up-front for advice, yet advisers prefer to receive their remuneration up-front. In the past this mismatch has been resolved by providers through up-front and indemnity commission. Introducing any distortions in the funding of the adviser payment risks re-introducing provider bias. Our aim is that eventually all payments to advisers should be matched directly to payments made by consumers. There may need to be a transitional period where providers are able to factor consumer payments for advice into a single up-front payment to the adviser. Additional rules could be required to ensure that such transitional rules do not reintroduce provider bias (e.g. a single industry discount rate).

Ongoing charges for ongoing advice

124. In the more open discussion about services and costs encouraged by CAR clients are likely to want more control over payments for ongoing adviser services. We believe that if consumers choose to pay for ongoing advice there must be measures in place to ensure that ongoing service is available.
125. Where consumers choose to switch intermediary, there would be few arguments that the advice payment should switch to the new adviser. What should happen if they wish to cancel the service altogether is significantly more complex and controversial.
126. Many argue that the consumer should not be able to cancel the service where ongoing advice is essential for the product (e.g. income drawdown) or the firm has committed to providing ongoing support, for example as part of a tied service. A few others even consider that, if the advice is cancelled, the ongoing charge should not be refunded as this would undermine intermediary efforts to develop more sustainable business models. Finally, in many instances the provider will be expected to provide ongoing services where ongoing support from an intermediary is cancelled.
127. Against this, consumer groups could argue that ongoing advice is like any other service and that tying a consumer upfront to a service with no option to cancel at a later date is unnecessarily restrictive. Consumers have the freedom to choose whether they are getting value for money from a service or product – but increased clarity in describing the both the service and costs is required to facilitate this decision.
128. Further discussion is necessary.

Disclosure

129. Effective disclosure of charges is an essential part of efforts to address concerns of bias in the market. We believe that the Menu failed to achieve its objectives as it was simply too complex for consumers to understand. Given this it is perhaps unsurprising that many intermediaries chose not to discuss its contents with their clients.
130. Firms should be free to disclose the key information that is mandatory under European regulations in a form that best suits their client's needs. This principle is best supported by clear guidance for advisers including an example disclosure document. This is an obvious area for an industry based solution.
131. We are aware that the FSA is currently researching the effectiveness of disclosure documents and look forward to discussing the results of this research with the FSA once published. We would welcome the opportunity to work with other stakeholders and the FSA to develop guidance on disclosure documentation that could support a customer in a CAR environment.
132. Further work on the Assisted Purchase model is needed to understand how best to disclose charges in this area of the market. Similarly where products are sold direct to consumers by providers we must ensure that the disclosure documentation is consistent with other forms of distribution.

Independence

133. Many intermediaries find that the term 'independent' is valuable to their business model. We are aware of the importance of the term and feel that it should continue to be used to differentiate advisers that are 'whole of market', but be strengthened to better match consumers' understanding. Specifically we believe that firms should only be able to describe themselves as independent if:
- They select from products from across the whole market;
 - Their advisers are all qualified to a minimum standard of Diploma;
 - Their advisers are all members of a professional body;
 - They accept payment in ways consistent with the CAR framework.
134. One of the key objectives of distribution reform is to enable consumers to fully understand the value of the advice they receive. If successful, this should ensure consumers focus more on the professionalism and qualifications of their adviser, rather than just product range.

Sales Bias

135. CAR does not attempt to address explicitly the criticism that the current remuneration system creates an undue incentive to sell at the expense of actual consumer needs. Previous research has suggested that the bias to sell continues to exist even in fee-based models¹⁰.
136. At present the transactional nature of much of the financial advice available creates an expectation of a sale. We believe that bias to sell can only be addressed as consumers become more aware of the value of advice and its costs, and are presented with alternatives to the existing advice model. A combination of a more transparent price for advice and greater professionalism should help address the current bias to sell in the market.

¹⁰ "Study of Intermediary Remuneration", CRA International, February 2005

Regulation & Supervision

137. Concerns from many commentators that some intermediary firms are under the “regulatory radar” have struck a chord in the industry. The ABI has backed calls for a level playing field, where all firms receive effective and efficient supervision. Measures to increase individual adviser professionalism must be accompanied by enhanced firm-level supervision.
138. A risk based approach would enable the FSA to target limited supervisory resources most effectively, and to reduce the burden of regulation and supervision on well-run low-risk firms.

Collecting data for regulation

139. Retail intermediary firms are currently required to submit electronic returns - called the Retail Mediation Activities Return (RMAR) - twice or four times a year depending on their size. This data is combined with other intelligence to decide which firms require further supervision. However, the RMAR dataset is mostly focused on a firm’s finances and prudential requirements, rather than its compliance with the Treating Customers Fairly principles. The FSA is now proposing to use visits and telephone interviews to widen its information on small firms.
140. The ABI believes a range of different data could be used by the FSA as an indicator of risk within a firm, under 4 different headings (Management, Staff, Financials, Customers - see box 2). These could be combined into a single ‘balanced scorecard’ measure of the firm. As at present, not all this data would come from firms themselves, but also from bodies such as the Financial Ombudsman Service, providers and professional bodies.

Box 2 Possible data for FSA risk assessment of intermediary firm

Management:

- Existing RMAR data on systems and controls, safeguarding of clients assets, ownership of firm etc.
- Proportion of Board with qualifications
- Numbers of complaints about promotions

Staff:

- Proportion of staff with higher-level qualifications
- Staff turnover

Financials:

- Reserve levels
- Complaint costs
- Proportion of income taken as trail
- Amounts of commission clawback

Customers:

- Persistency by product type relative to the rest of the market
- Complaints to sales ratio

141. Indicators of performance would be weighted according to their importance, so all the data is brought together to produce a score under the four areas, as well as an overall risk-rating. This is an effective way of measuring performance against broad principles, compared to a tick-box approach assessing whether a list of rules have been adhered to. Any scoring system should be transparent for all to help leverage improvements in the sustainability of the industry. But the results should only be for the use of the FSA and the individual firms being scored, as the data is only indicative of a risk rather than necessarily showing any material breach of regulation.
142. Firms that gain a low rating, either overall or under specific topic areas, would expect a supervisory visit from the FSA. The industry and FSA may need to consider the sharing data to support this process, but care should be taken not to over-burden providers. For instance, any need to amend provider systems to monitor IFA indicators should be carefully costed to ensure the benefits are proportionate to the costs.
143. The aim should be to make the system of collecting and then analysing data as efficient and automated as possible to maximise the amount of time supervisory staff can devote to acting on the data and visiting firms.

Regulatory dividend

144. Those that consistently score well should expect a 'regulatory dividend' of some kind.
145. Possible incentives could include:
- Reduced supervisory burdens – with reduced risk of a visit and reduced requirements to provide data.
 - Reduced capital requirements – as suggested in the recent Discussion Paper, capital requirements could vary depending on perceived risk.
 - Reduced FSA fee levels – those with lower risk levels could pay less than those with higher levels.
 - Reduced FSCS levy.

Regulatory long stop

146. We support the principle of a long-stop and believe that it could provide greater clarity and certainty for all parties regarding the point at which the right to complain would ultimately expire. But any 'long stop' should not result in a costly requirement being imposed upon insurers to notify policyholders in advance of the right to complain expiring.
147. The ABI also supports the identification of 'post sale' circumstances that would trigger the start of the period during which the consumer becomes aware of a cause to complain, how these circumstances can be triggered and how this can be proved. While we acknowledge that it would probably not be possible to identify every such circumstance, FSA guidance would be useful.

Professional Body Supervision

148. In this paper we have assumed that professional bodies would focus on individual advisers and the FSA on firm level supervision. However, initiatives such as the CII's introduction of Chartered Firm status suggests professional bodies could have

a role in driving up standards at a firm level too. It is too early to say yet whether the CII's initiative has been successful, but the concept clearly has potential to improve self-regulation and prevent the need for regulatory intervention. In the longer term we would envisage the FSA giving some kind of regulatory dividend to firms, which achieve a higher professional status, where there is strong evidence the scheme is rigorous and reduces risk.

Section 5: Delivering Reform

149. We agree with the FSA's desire that the industry should take responsibility for delivering the required reforms. But we do not believe that the industry can deliver without the support of the FSA. Reform, in particular the desire to increase the transparency of advice and its costs, involves significant challenges for the industry. A move to Customer Agreed Remuneration involves both significant efforts to educate consumers about the value of advice and significant investment in systems changes by providers and intermediaries.
150. Assisted Purchase remains to be defined in more detail. Inevitably much of this detail will be developed by individual companies looking to develop a model to take to market. But any model will need support from the FSA and FOS to ensure that it can be both effective for consumers and viable for providers.
151. Without a clear signal from the FSA that the approaches proposed meet objectives, the industry is not likely to make the necessary investments in reform.
152. We believe that the FSA can play a key role in supporting market based reforms in much the same way as it has developed its Treating Customers Fairly programme. By outlining the principles that the FSA believes are necessary and the consequences of a failure to act, the industry can receive the reassurance that is required. The FSA should set:
- Aims – e.g. minimum standards of adviser, addressing bias.
 - Timetable – to be confirmed but potentially up to six years for increased professionalism and CAR across all retail investment products where appropriate.
 - How they will measure performance – e.g. clean pricing terms on all products after three years.
 - What action they will take in absence of change.
153. In the run up to the Consultation Paper in 2008 the industry will need to carry out the work needed to assess a suitable timetable. The ABI research on CAR has started to consider the financial challenges of the greater transparency and flexibility required in product systems. We will continue to work with our member companies to discuss how long a period of transition is needed.
154. We have noted the need to measure the current levels of qualification in the industry. This is no simple task as such an audit would need to take account both of the variety of qualifications available and the levels of credits held towards such qualifications. The benefits of such an audit would be widespread, and we propose that a group consisting of the main awarding bodies, the FSA, and industry representatives be set up to agree a survey design.
155. A key part of ensuring the professionalism of the industry involves the development of a new Professional Standards Board for the industry. The CII have publicly supported such a concept which will only be successful if supported by the goodwill of all within the Industry.
156. We recognise that our proposals are very challenging. But we believe that significant reform is required. To support the changes required in intermediary

models providers are keen to consider what they can do to help intermediaries through the process of transformation.