

AEGON's response to the FSA's review of retail distribution

Retail Distribution Review 6

December 2007

Introduction

This review looks at key issues such as adviser status, payment options, advice quality and customer access. Here are the main points we raised in our response to it.

Our response represents the views of AEGON Scottish Equitable, Guardian and AEGON Scottish Equitable International.

In its Review of Retail Distribution, the Financial Services Authority (FSA) outlines a number of problems and urges the industry to identify the best ways to serve its customers and address these problems itself. The FSA notes there's significant appetite for change and that we should take advantage of this.


AEGON agrees that change is necessary and that distributor sustainability, remuneration, advice quality and access are the right areas for the review to focus on. In our response, we've made clear that changes to how advisers and providers operate isn't the complete answer. How consumers engage with our industry is also important.

We'd like to see:

- more ways for customers to engage with an industry that's better trusted
- enhanced competition between providers giving customers better value, and
- regulation that rewards well-run businesses and penalises those that aren't

The key points of our response

- Independent advisers must continue to look across the whole market.
- Customer agreed remuneration (CAR) should be the default option for independent financial advisers, encouraged for all other advisers above primary, and deferred for primary until that model is clearer.
- All advisers should be required to join a professional body.
- A change is needed in minimum and desirable qualifications.
- Primary advice wouldn't be called advice. We also think the terms 'basic' or 'basic product' are better than 'primary' at reflecting the limited product set available in this model.
- The review needs to consider specific features of the corporate market.
- The review needs to strengthen commission disclosure in the protection market.
- The FSA could offer regulatory encouragement for advisers to move away from front-end remuneration to flatter shapes.

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- New adviser models with a more 'retail' feel should be allowed to develop.
 - The FSA should review incentives in all distribution channels to eliminate bias.
 - We need to measure progress towards objectives.

The adviser model

Adviser labels

Some have criticised the discussion paper for proposing three layers of regulated advice, further complicating an environment which customers already find hard to understand.

To simplify this, we recommend some basic rules. Any model that doesn't meet the product suitability standard in the Conduct of Business (COB) rules shouldn't be called advice. We don't think the term 'primary advice' is right. Any labels need to be tested with consumers, but we think 'basic' or 'basic product' are better than 'primary' and something other than 'advice' is essential to make this concept clear to customers.

The question of whether general financial advisers are a permanent feature of the market or a transitional state doesn't arise under our proposals. They would continue for as long as customers value their services. We think a move to phase out general financial advisers by regulation would run a major risk for customers and the market. It would force advisers to choose between professional financial planner, basic, and market exit. We think exit would be the choice for many advisers, so cutting supply, access and competition in the market.

Advisers who are qualified to chartered level would be able to use 'chartered' – or the equivalent designation – to differentiate themselves in the market. 'Professional' shouldn't become a regulated term.

We need to make clear to customers the differences between 'advice' and any new models in the 'primary' area.

The importance of qualifications and professionalism

We think the FSA is heading in the right direction on qualifications and professionalism, but any proposals need to be practical. We also need to take into account consumer expectations of qualifications, which would mean a higher level across the market, and incentives to go beyond the minimum qualification level.

Professionalism is about standards of conduct, integrity and maintaining knowledge and skills. Qualifications are about acquiring and demonstrating knowledge.

We recommend that all advisers join a professional body and be required to attain diploma-level qualifications, including evidence of financial planning skills, during a six-year period. Any adviser failing to do so will either leave the market or operate under the supervision of an adviser who is chartered, or equivalent. This timescale is stretching, but achievable with determination. The FSA could further encourage advisers to reach diploma and then chartered status using regulatory incentives.

For the 'primary' role, we recommend a review of the required qualifications once the FSA has clarified the sales process and product range. This may mean qualifications below or above the current Certificate in Financial Planning (CertFP).

Independence

As part of a wider AEGON study on what customers want from financial services, we asked what they understood by 'independent'.



Our view, drawing from the research conclusions, is that adviser independence should mean:

- having a whole-of-market product range
- predominately operating customer agreed remuneration (CAR)
- being a member of a professional body
- holding qualifications to at least CII Diploma standard, including demonstrating competence in financial planning

If the FSA takes this approach, independence would be closer to what consumers want it to be and general financial advisers would be able to call themselves independent. It would also give advisers an incentive to adopt CAR.

We believe consumers are more likely to trust an industry that uses language they can relate to. All labels should be rigorously tested to check consumers understand them.

Incentives, remuneration and CAR

Improving trust and removing bias

As adviser incentives have a major impact on consumer trust, we believe that adviser remuneration must be part of the reform agenda. We support the concept of CAR. It should reduce product and provider bias by allowing clear comparison between charges for products. It can also incentivise advisers to provide ongoing services, improve persistency, and lead to improved financial results for advisers as well as providers.

However, we need to be sure it does improve consumer trust and confidence. CAR must demonstrate that a firm is managing incentives in its business and aligning adviser and customer interests. And it shouldn't require customers to understand significant or complex disclosure, or require them to negotiate every deal with their adviser.

CAR should include a broad range of current commission structures, including fund-based trail.

Payments between customer, adviser and provider


Payments for advice may be fee-based, if the customer pays the adviser direct, or financed through the provider from product charges. In the latter case, product charges may or may not be deducted at the same time as the provider makes the payment to the adviser. If deductions are at the same time, the review calls this 'matching'. If not, meaning the provider pays the adviser ahead of when it deducts charges, the review calls this 'factoring'.

We don't think matching need be a strict condition of CAR, but should be adopted for all ongoing service charges as well as initial advice for single premium business. Matching for single premium business is transparent, and wouldn't be complicated by factoring terms. For modest regular premium contracts, strict matching could produce heavy up-front deductions, because of the impact of initial advice, and so would be less suitable.

To avoid bias, we'd support an FSA rule obliging advisers using CAR not to vary the amount or timing of remuneration according to which provider they recommend.

Adviser models and CAR

Turning to which advisers should adopt CAR, AEGON believes CAR should be the default indicator of freedom from bias for those who wish to trade as 'independent'. We also think CAR should be encouraged for all other advisers above primary, and deferred for primary until that model is clearer.



Firms might prefer to use other means to demonstrate freedom from bias, and so qualify as 'independent', but we envisage CAR being the predominant approach.

We recommend a FSA-led approach where advisers must be operating CAR, or an equivalent model for eliminating bias, within six years. Appropriate risk-based capital requirements might encourage this.

However, before the FSA takes any final decisions on the scope of CAR or accompanying regulations, it needs to thoroughly review incentives across channels and business models.

Other considerations

CAR could apply to the protection market, but the high proportion of premiums that account for advice costs might discourage customers from buying these products. Further work in this area is required.

We're asking the FSA to consider the merits of requiring all corporate advisers, whether or not independent, to adopt CAR when the employer is the customer.

Regulation and supervision

Firms should be able to show they're moving towards the outcomes the review wants to deliver. At the same time, the FSA has to be able to spot emerging issues quickly. We suggest it does this by measuring against a number of key indicators on progression towards the outcomes. This would need to be simple to avoid unnecessary burdens on firms.

Measurement would allow the FSA to introduce clear incentives into the market by rewarding good outcomes with regulatory dividends. These dividends need to be chosen carefully, possibly after consultation, if they're to change behaviour, but we suggest it focuses on capital requirements, fees and levies, and relief from specific COB requirements.

Widening access

We believe widening access to advice and products is key to this review. All the ideas need to fit into a world of generic financial advice and more confident and capable consumers.

Earlier this year, AEGON carried out consumer research where we asked 'How would you like financial advice and the distribution of financial products to look?'

The research gave us five concepts of advice access, showing consumers want more choice in the advice and sales process. They want to be able to use different types of adviser and that the process should have a more 'retail' feel than the current one. We labelled the five concepts as:

- financial guru
- life coach
- personal shopper
- drop-in centre
- financial superstore

We believe an advice-and-sales process that operates around the above concepts may allow consumers to choose the points in the advice-and-sales process where they're willing to take responsibility and when they should rely on advice. These could be around the stages between financial plan and implementation of the plan. We'll be doing more work on this in the coming months.



What next?

The review covers a wide range of complex issues. We'd like the FSA to reach prompt conclusions on some areas, to reduce the number of 'moving parts', and make it easier to advance debate on others.

We expect an interim report from the FSA in April, with a full feedback statement in October. This is a welcome response to our call for early clarity on some issues such as the definition of independence, the scope of CAR, how regulation itself will adapt to monitor, report on progress, and the scope for new models to widen access.

This clarity would allow for research and a more focused debate in 2008 on adviser labels and the detailed operation of CAR (including related disclosure questions). This could then lead to a fuller review and debate about incentives and businesses that CAR might not cover, the products that might be sold through the primary label and the detailed approach to monitoring progress.

We should aim for the end of 2008 to agree on the basic elements of change and to have a timetable for introduction. But even once that timetable is complete, change won't stop. A successful market-led review will include further industry reform to meet and exceed customers' expectations, more advisers attracted by the improved reputation of the sector and better economics, more highly qualified advisers, and a greater separation between advice and transactional services in line with customers' wishes.

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One of the ways the team regularly shares its thinking is through the industry lobbying blog on the AEGON UK website. To find out about the latest developments, go to www.aegon.co.uk/how/industryblog.htm

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