Society of Actuaries in Ireland

RDR, PRIPS and IMD2 – Overview of developments

09.04.13

Agenda

1. Retail Distribution Review (RDR)
2. Coming Legislation Changes in Europe and elsewhere
    - PRIPs
    - IMD2
    - MIFID 2
    - Sample other country developments
3. UK market environment post-2012
4. Irish market implications

Retail Distribution Review (RDR)

1

The RDR is about bringing the customer to the heart of the retail investment market

The FSA identified two key issues...

1. Poor outcomes for consumers and firms

2. "Inherent conflict" in an inefficient market

...to address with the following key initiatives

1. ***Address the potential for adviser remuneration to distort consumer outcomes***

- Receipt and payment of **commission** from product providers is banned.
- Ban on allocation rates greater than 100%

2. ***Improve the clarity with which firms describe their services to consumers***

- Advisers are required to make a clear distinction to consumers between **restricted advice** and **independent advice**
- The government provides free financial information through the Money Advice Service

3. ***Increase the professional standards of advisers***

- Financial advisers must be qualified up to the newly developed **QCF level 4**
- Advisers must maintain a **Statement of Professional Standing** and meet requirements around ethics and conduct

Issues with the pre RDR sales process

Free Advice

Bias

Potential for Churning

Inappropriate advice

Product Selection

The regulator's vision

"The utopia is people will see the value of financial advice, much as they see the value of going to the doctor or the dentist, and understand they are talking to someone who is qualified as a professional who they can trust is giving completely unbiased and unconflicted advice. That is what the RDR is about and that is where we want to get to."

Martin Wheatley – CEO Financial Conduct Authority – October 2012

Key features of the RDR legislation

1. Banning Commission

- For investment products, product commission replaced by adviser charging
- The adviser charge is agreed upfront and reflects services given to the consumer
- Providers can facilitate the payment of the adviser charge.
- For vertically integrated firms (i.e. those with in-house IFAs, tied agents or own sales force) adviser and product charges must be separated.
- Commission can continue to be received on a product sold before the implementation of this legislation.
- Product providers will not be permitted to make payments to the financial platforms that offer their products to retail investors.
- Ban on cash rebates from advisers to consumers from 31 December 2013, subject to final rules.

Key features of the RDR legislation

2. Clarity of advice

- Advisers are required to disclose services under two categories; independent advice and restricted advice.
- Leading to increased customer awareness of options considered.

3. Professional Standards

- Higher Minimum qualification required (QCF Level 4)
- Advisers must also complete 35 hours of Continuing Professional Development (CPD) each year
- Must maintain a Statement of Professional Standing (SPS), which can only be issued by a recognised professional body

Other features of the RDR legislation

Products not in scope

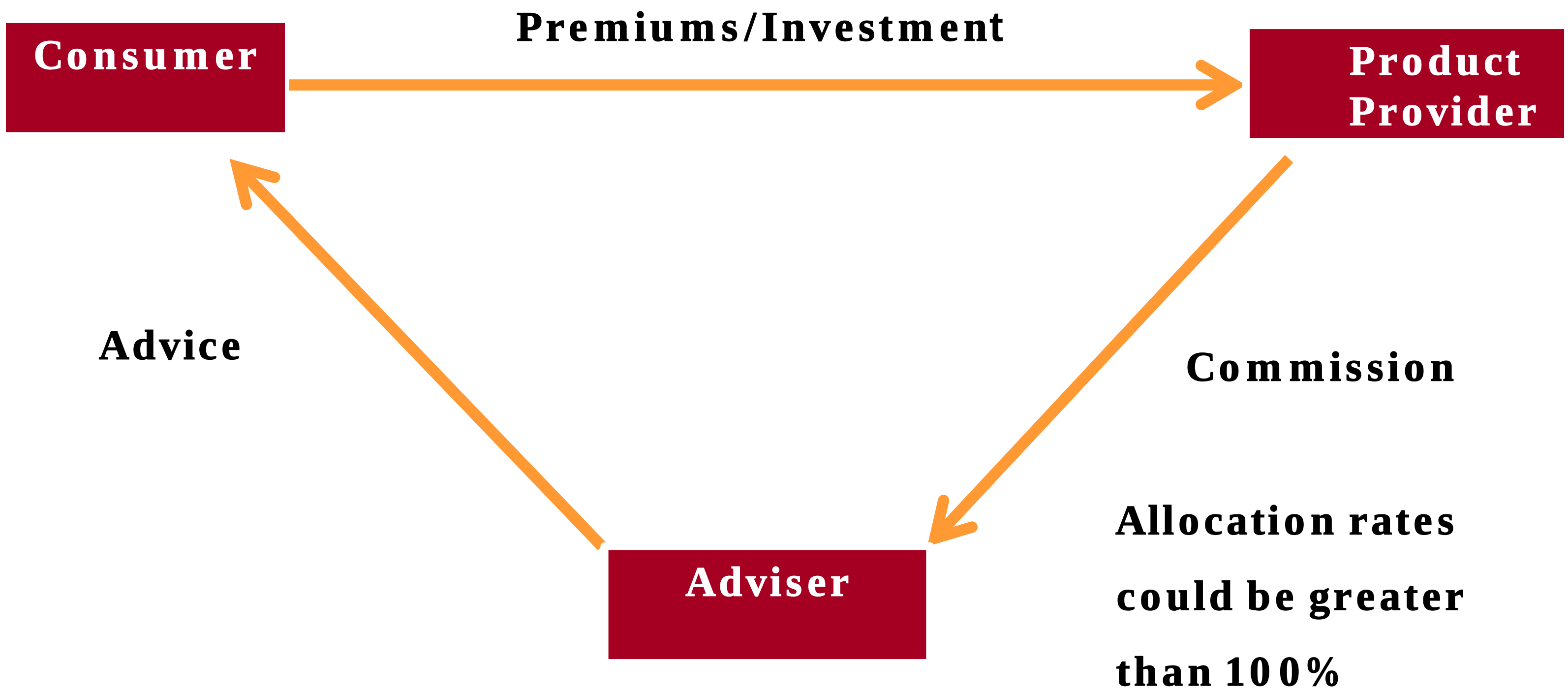
- Pure protection products where benefits under the contract are payable only on death or in respect of incapacity due to injury and the contract has no surrender value.
- Structured products where there is a capital guarantee
- Execution only (non advised services)

No Allocations > 100%

Watch BIK

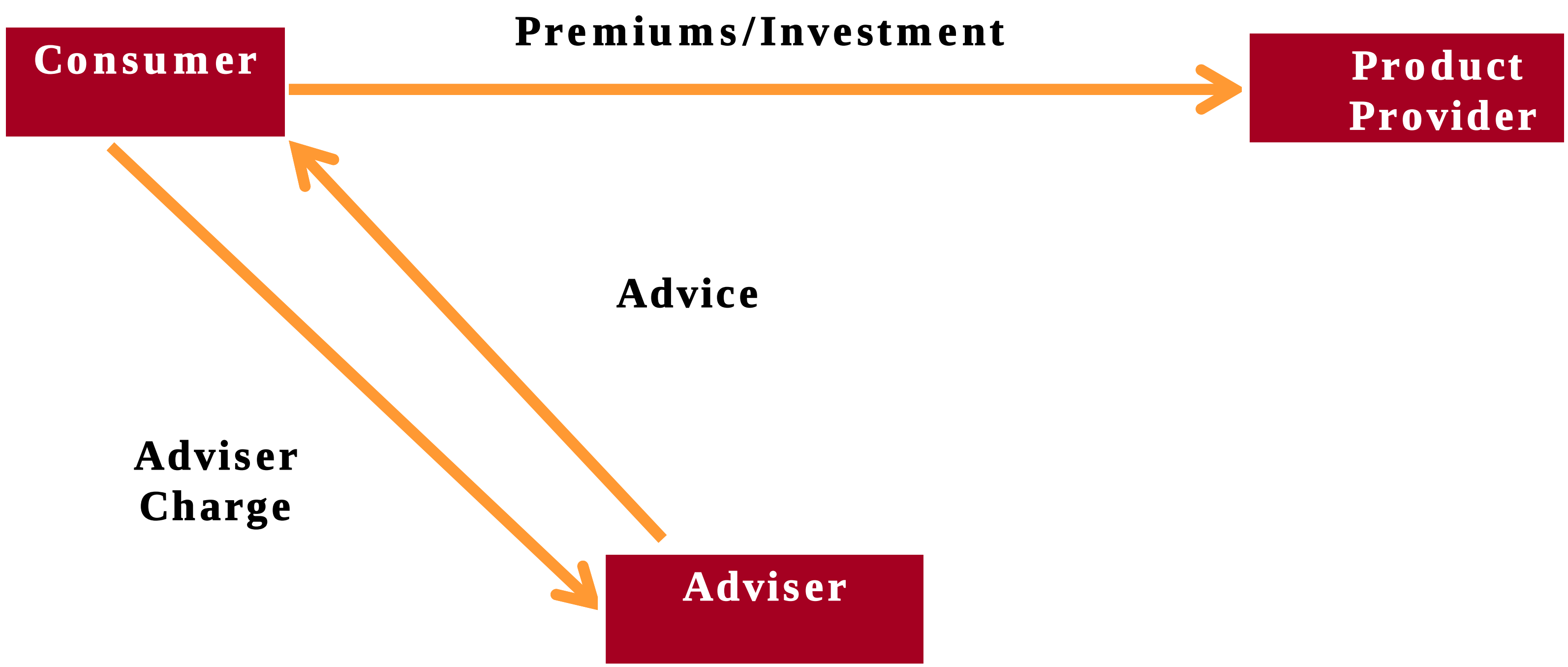
- Non-cash remuneration being clamped down on by FSA
- Payments that work around commission ban also banned

Pre-RDR advice/sale process



Commission disclosed to consumer at point of sale in the disclosure document. The amount of the commission payment is factored into the product provider's costs and annual charges.

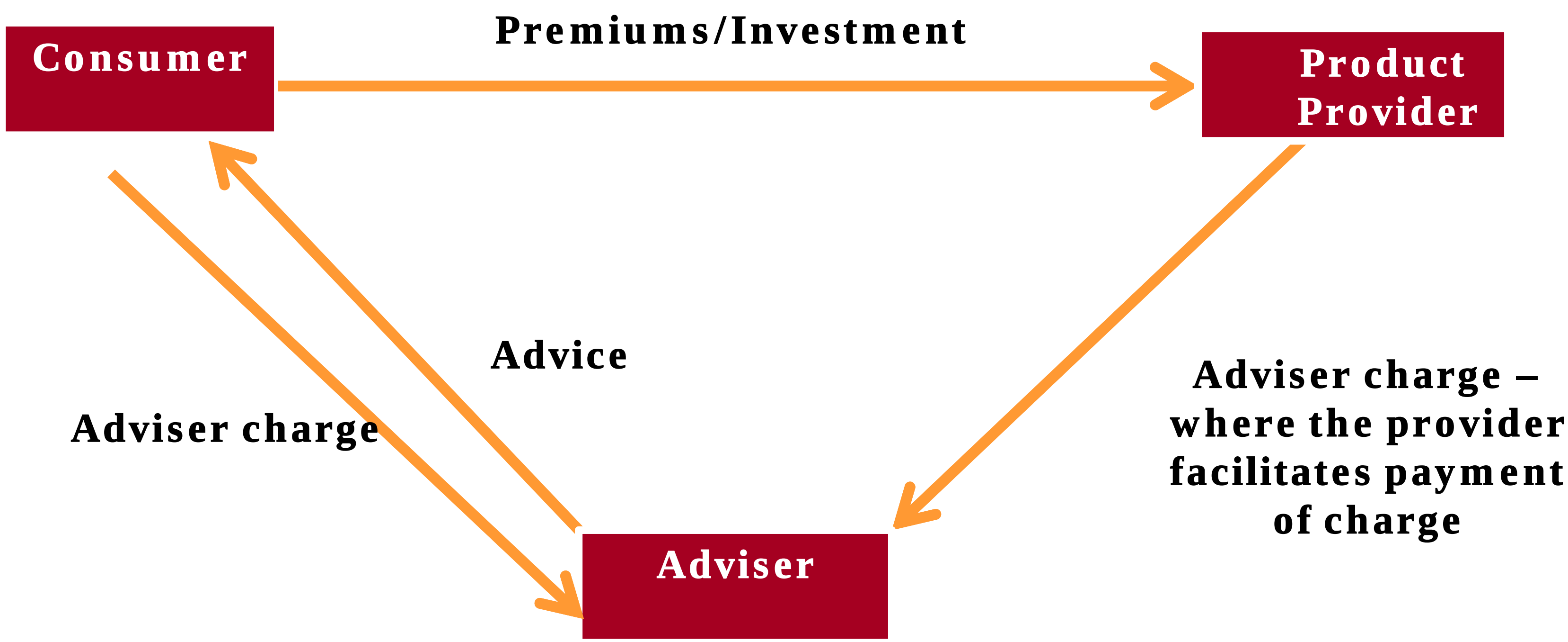
Post-RDR advice/sale process - Without the facilitation of Adviser Charging



Adviser charges and product charges are separately disclosed.

Advisers are required to give clients charging structures in advance.

Post-RDR Sales Process - With the facilitation of Adviser Charging



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Impacts of the RDR

The impacts of the RDR on the market can be best understood by considering the impacts on the various stakeholders:

Consumer

Adviser

Product Provider

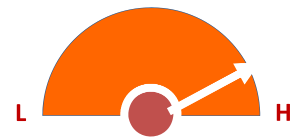
Regulator

The intended impact of the RDR on consumers is to:

- Increase confidence in financial advice
- Increase understanding of advice charges
- Remove provider bias

Impacts of the RDR

Adviser

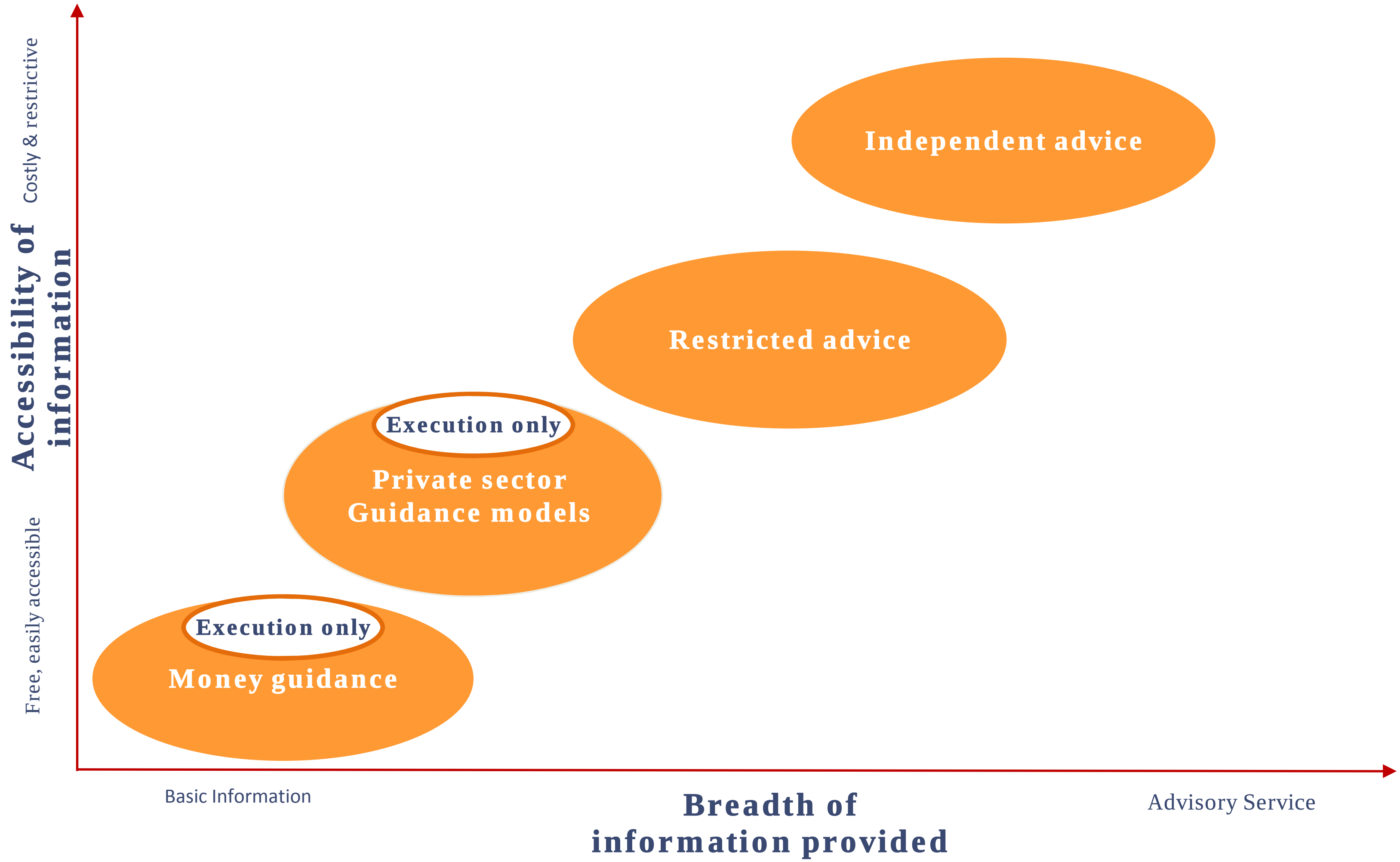


Impact

- Ban on commission
- Restricted or Independent advice proposition
- Advisers will have to be qualified and maintain their Statement of Professional Standing (SPS)
- CPD - 35 hours per annum

Impacts of the RDR

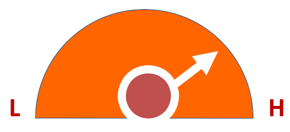
Advisers – The Post-RDR advisory landscape



Impacts of the RDR

Product Provider

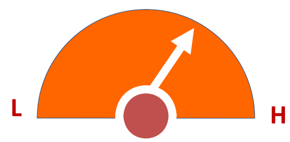
Platforms



Impact

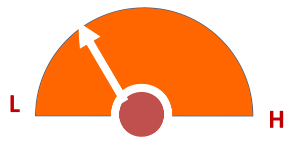
- Adviser Charging
- Execution-only capabilities
- Cash rebates
- Transparent charges

Life Companies



- Commission ban
- Facilitating charges
- Advice and professional standards rules, particularly those with tied sales forces
- Transparent charges

Asset Managers



- Commission ban
- Facilitating charges
- Cash rebates
- Transparent charges

Impacts of the RDR

Regulator

- ensure compliance with the new legislation
- clarify or amend legislation where necessary, e.g approaches to facilitating adviser charging on guaranteed products, consultancy charging
- Complaints reporting and ongoing notification
- Competence notification
- Surveys of consumer outcomes and post-implementation reviews. Four thematic reviews in 2013 to cover professionalism, charging structures, description of services and market distortions.
- Focus on viability of each component for vertically integrated firms

Coming Legislation Changes in Europe and elsewhere

2

Introduction

On 3rd of July 2012, European Commission proposed legislation changes to improve consumer protection in financial services.

PRIPs	• Packaged Retail Investment Products • **Aim:** Consumer protection and understanding of products • **Timeline:** Expected end 2014
IMD 2	• Insurance Mediation Directive 2 • **Aim:** Consumer protection through regulation of selling practices • **Timeline:** Expected 2015
MIFID 2	• Markets in Financial Instruments Directive • **Aim:** Make financial markets more efficient, resilient and transparent and strengthen the protection of investors • **Timeline:** National implementation 2014

PRIPS, IMD2 AND MIFID 2 - interaction

PRODUCT TYPE	Manufacture	Distribution
	PRIPS (preparation)*	PRIPS (delivery)*
Asset-linked investment	MIFID**	IMD
Guaranteed investment	MIFID**	IMD
Protection		IMD

*PRIPS covers all retail, i.e. including non-insurances. IMD relates just to insurance.
**MIFID does not apply to insurance or pension products.

Introduction to PRIPs

- Proposed EU legislation for European retail investors
- “Packaged Retail Investment Products" (PRIPs) which provide retail investors with easy access to financial markets, but can be complex for investors to understand. Distributors potentially exposed to conflicts of interest.
- Asymmetries of information may lead to higher prices and consumer detriment
- Include investment funds, retail structured products, investment-focused insurance products, private pensions which expose investors to fluctuations in asset values
- Pure protection and non-life products excluded.

Aim of legislation changes:

1. Increase transparency and the comparability of packaged products sold to retail investors
2. Place all retail investment product manufacturers on a level playing field in terms of product disclosure.
3. Increase consumer confidence in purchasing insurance and investment products through standardised look and feel of documentation and plain language.
4. Level playing field across the EU.

What issues is PRIPs regulation addressing?

Information made available to investors is complex and often includes jargon

Complexity of products

Conflicts of interest in sales process

Lack of awareness of the scale or nature of the risks

Comparability of products

Purchase of unsuitable products

Consistency across border and sector

The new PRIPs - KID must contain the following information:

Identification of the product and its manufacturer

What is this investment?

Could I lose money?

What is it for?

What are the risks and what might I get back

What are the costs? (direct & indirect)

How has it done in the past?

What might I get when I retire?

PRODUCT MANUFACTURER RESPONSIBLE FOR PREPARATION

DISTRIBUTOR RESPONSIBLE FOR DELIVERY PRE-SALE

Insurance Mediation Directive (IMD) 2

- IMD, introduced in 2002, aimed to create a Europe-wide market for insurance intermediaries by imposing minimum standards of regulation and consumer protection on insurance product selling practices throughout the EU.
- IMD's provisions have not been applied in a consistent manner throughout the various Member States, leading to fragmentation of markets, inconsistency of information provided and consumer misunderstanding of risks etc. Also, IMD requirements are less onerous than MIFID and IMD does not cover direct selling.
- Reform of the IMD is intended to
  - improve consumer protection in the insurance sector through increased information provision and advice;
  - create common standards for insurance sales;
  - Ensure the provision of honest, professional advice
  - Ensure the provision, in advance of sales, of clear information about the status of the person selling the product and the remuneration they receive.

IMD2 changes

1. Expand the scope to all sellers of insurance products including direct writers. Currently, only agents and brokers are covered by the IMD

2. Identify, manage and mitigate conflicts of interest, including disclosure of remuneration by intermediaries

3. Improved requirements for life assurance products with investment elements , covering sales standards, conflicts of interest, and a ban on commission for independent advice

4. Mutual recognition of professional knowledge and ability

5. Special requirements for bundled products

6. Effective sanctions in respect of breaches

IMD 2 - key outstanding issues

- Specifics and extent of commission disclosure, eg intermediary v direct seller

- Details of any ban on commission

Market in Financial Instruments Directive (MiFID) 2

MiFID (introduced 2007) governs provision of investment services in financial instruments by banks and investment firms and the operation of stock exchanges and alternative investment venues. Financial crisis exposed shortcomings.

Key elements of proposed MiFID 2

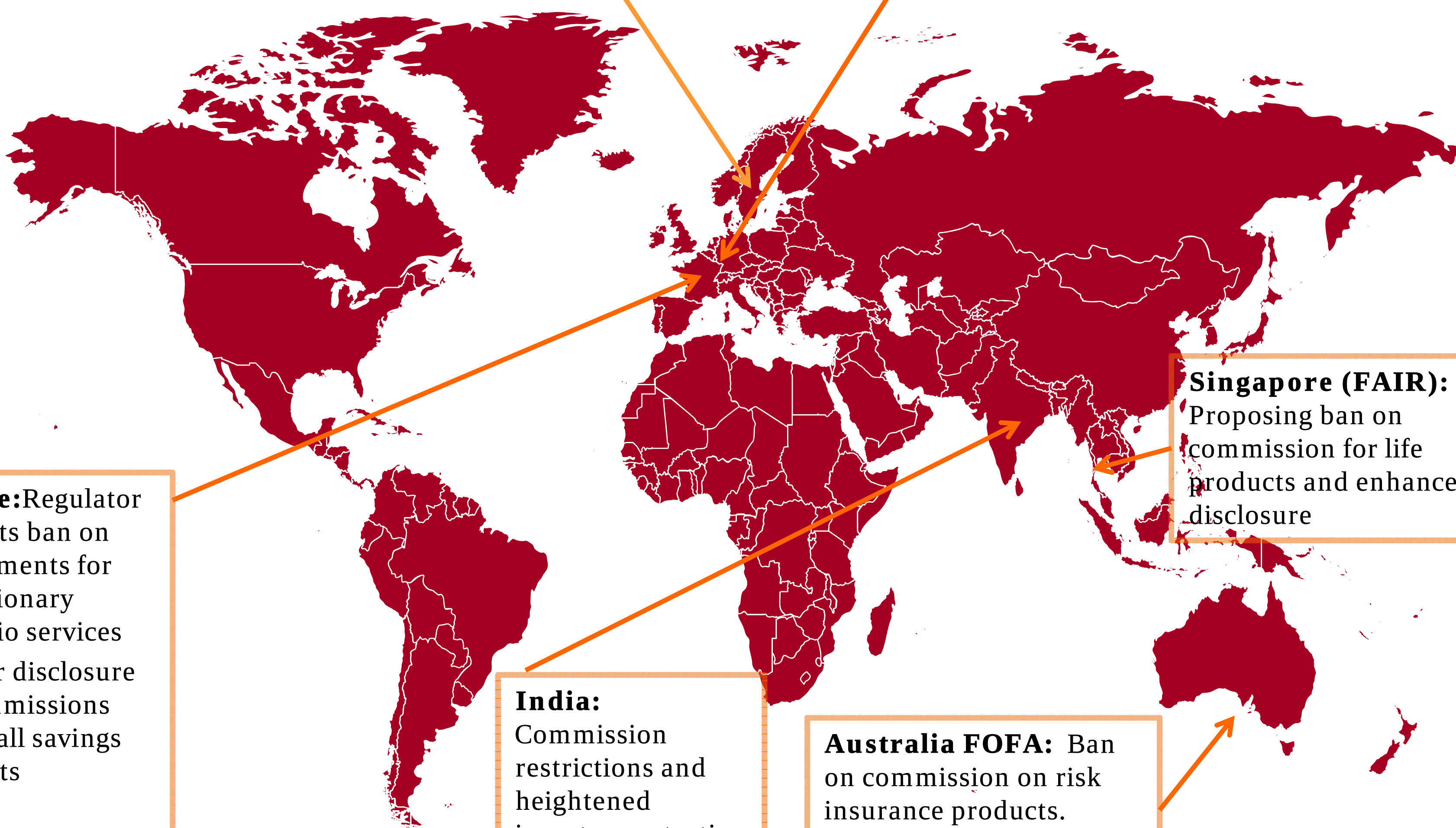
- more robust and efficient market structures
- Take account of technological innovations
- Increased transparency
- Reinforced supervisory powers and a stricter framework for commodity derivatives markets
- Stronger investment protection – focus on distribution of investment products The proposals restrict the receipt of monetary inducements, for both portfolio managers and providers of independent advice.

Insurance, pension and certain banking products are excluded.

Sample other country developments

Scandinavia: Finland and Denmark commission bans. Sweden “fair value” pricing”.

Netherlands: Ban on commission on retail investment products from 2013. New disclosure and competency requirements.



Singapore (FAIR): Proposing ban on commission for life products and enhanced disclosure

- **France:** Regulator supports ban on inducements for discretionary portfolio services
- Greater disclosure on commissions across all savings products

India: Commission restrictions and heightened investor protection from 2013.

Australia FOFA: Ban on commission on risk insurance products. Annual disclosure statements.

UK market environment post -2012

3

Impact on UK market - Distributors

IFAs

- A number of adviser charging models possible
- Some move from up front commission to ongoing charging
- IFA networks being established to pay ongoing charge and provide support
- Reduction in numbers

Banks

- Establishing separate protection and investment teams
- Execution only on line solutions to lower net worth customers
- Significant IT investment
- Establishing links with manufacturers

Wealth Managers

- Up skilling advisers
- Split between initial and ongoing advice
- Investing significantly to upgrade proposition

  Risk classification

  Suitability control

Direct sales

- Some manufacturers refocusing on this area
- Up skilling advisers
- Creating suitable new charging models

Impact on UK market - Manufacturers

Insurance Companies

- Considering direct distribution strategies
- Must establish strong customer propositions and distribution partnerships
- Less well positioned moving out of retail
- Significant spend on rationalisation, facilitation of new regime and customer proposition upgrade

Fund Managers

- Concern around distribution
- Engaging with platforms
- Focus on end customers and direct distribution
- Seeking opportunities for differential pricing with distributors

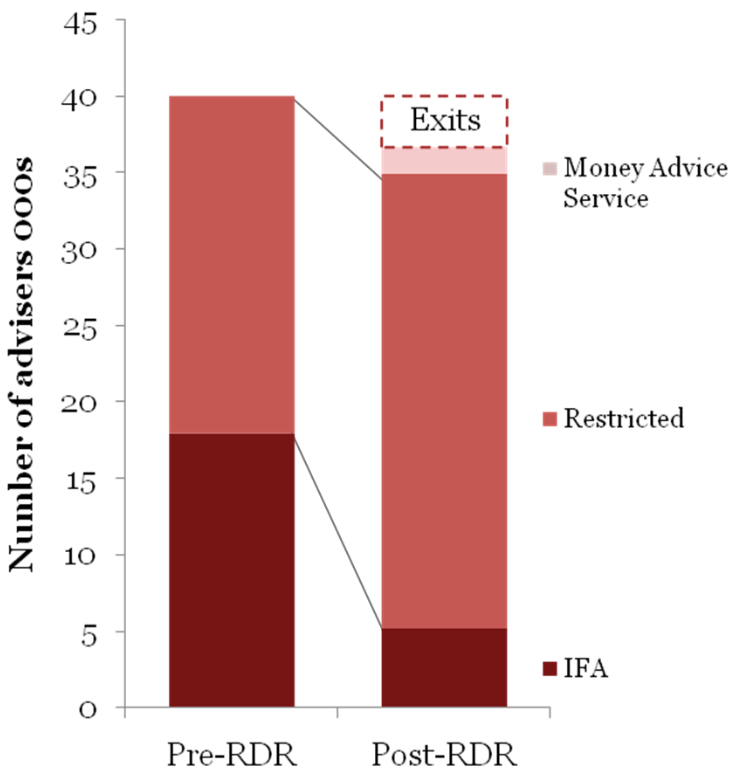
Platforms

- Increased transparency required
- Developing direct to customer proposition and strategic alliances
- New entrants based on technology solutions

Source: FSA, PwC analysis

Restricted advice is likely to be the predominant advisory model

Estimated adviser reactions to the RDR



Adviser numbers (late summer 2012)

There were 35,899 RIAs - a fall of 11.5% since summer 2011; IFAs largest group at 58% of population, followed by bank / building society advisers at 19%.

Intentions (late summer 2012)

- Approx 90% of RIAs will remain RIAs;
- 6% expecting to be early leavers;
- Only c15% likely to remain fully Independent focusing on HNW consumers
- Auto enrolment may attract consumers and advisers to the corporate channel, where advice could be paid for by employers

Source: FSA, distributor interviews, PwC research and analysis

Distribution models in new environment

Bank Manufacturers	Broker Oriented model
Advice only for mass affluent and HNW	Broker networks to provide distinctive proposition
Guided execution only for lower end	Platform based
	Re-energise direct sales
Focused on: Reduced cost & Owning Customer	

IFA views of new banking approaches

"With the regulatory focus on risk assessment and capacity for loss, firms have to increasingly question whether a pure sales model works any more."

"No bank is going to make advice work compliantly if it insists on using incentives and performance management measures in the way the banks have in the past."

"It is not that these big firms have decided that they cannot make advice work post-RDR, but more that the world has changed and they do not want to change with it."

Financial power moving to distributor

- Change in the financial dynamic
- Adviser charge – no one charging strategy
- Unlikely to be a significant reduction in total product-based adviser remuneration; providers still paying bulk of adviser remuneration
- Ownership of customer increasing driver of share of available margin
- Most advisers intend to continue providing advice to mass market clients (FSA survey November 2012)
- Some banks scrapping sales targets for retail staff

Product Charging Comparison - Single Premium Product

	PRE-RDR			POST-RDR		
	Product	**Adviser**	**Aggregate**	**Product**	**Adviser**	**Aggregate**
UK (Sample IFA)						
Initial	0.7%	Up to 4%	Up to 4.7%	0%	0%	0%
Recurring	2.1%*	0.5%	2.6%	1.8%*	1%**	2.8%

***Includes charge for platform, fund manager. manufacturer.**
**alternative broker adviser charge structure 3.5% initial, 0.5% ongoing

	PRE-RDR			POST-RDR		
UK (Sample Bank)						
Initial				0%	£500 per plan plus 0.75%-1.25%	.75%-1.25%
Recurring				1.8%*	0.5%	2.3%
UK (Sample Direct Sales Force)						
Initial				0%	6.5%	6.5%
Recurring				1.8%*	0.5%	2.3%

Source: Various, including Money Marketing and PwC research.

Sample manufacturer strategy changes

- Away from retail toward at-retirement and workplace savings
- Away from face to face advice for mass market toward execution only
- Taking stakes in adviser firms
- Purchase of platform
- Building direct sales
- Cost reductions
- Out of provision of advice

What is the RDR bill?

Aspect of RDR	One-off costs (£m)	Ongoing costs (£m)
Legacy commission ban	460	N/A
Adviser charging	600-750	170-205
Cash rebates and fund manager rebate bans	17-43	4-11
Professionalism	155-225	3-4
Data collection/complaints	7	3
Total	1,239-1,485	180-223

Source: Money Marketing

Early outcomes of RDR regime

- Anecdotal evidence of enhanced customer risk analysis leading to product replacement
- Adviser business not flowing but early and may be complicated by Gender Directive
- Customers placing limited value on independence badge?
- Strategic position adopted leading to real differentiation – winners and losers
- Quality big issue in advice market
- Big spend continuing on business understanding, “guided self serve”, platform

Irish Market Implications

4.

Current Market Characteristics

Area	Ireland	Implication of difference
Population & Average Wealth	lower	Less scope for market segmentation
Level of financial advice & persistency	Reputation: better? Persistency : worse Manufacturer brand: ✓✓	Superficially less obvious need for reform but poor persistency pointing to need for fundamental change
Commission payable	lower	Less obvious need for reform though persistency is a driver for change
Platforms	less developed	Less mouths to feed in the value chain in Ireland Opportunity for manufacturer to get closer to customer
Manufacturer profitability and returns on capital	lower	Less scope for manufacturer margin squeeze or another player in the value chain

Charging structure comparisons – Single premium product

	IRELAND	UK post-RDR samples		
	Broker/bank	IFA*	Bank	DSF
Initial (adviser)	Up to 3.5%	3.5%	Planning fee plus 0.75%-1.25%	6.5%
Recurring (aggregate)	0.75% -2.25%	2.3%	2.3%	2.3%

* Alternative UK IFA model 0% initial, 2.8% recurring

Irish market implications - macro

- Increasing regulatory focus on commission and disclosure – already evident from CBI statements
- Move away from volume based payments
- Investment platforms becoming key means of transacting and servicing investment business
- Changes to product design to curb incentives to switch
- Introduction of execution only models
- Greater focus from CBI on broker professionalism, compliance capability and financial models – leading to reduction in broker numbers?
- Opportunity for strategic differentiation
- What happens to charges?

Irish implications – some possible consequences

Impacts	Directional	Comments
Persistency / Retention	↓	Manufacturer profitability ↑
No. Of Advisers	↓	Less brokers with enhanced professional standard
“New Business” Volumes	↓	Less movement of new business among providers
Product Providers	↓	Small no of players writing less ‘new business’ on more profitable terms

Thank you for your time

Any Questions?