Thinkpiece

1912–2012 A CENTURY OF PROFESSIONALISM

CII

Number 82 June 2012

INDEPENDENTLY PROMOTING DEBATE AND FRESH THINKING IN THE FINANCIAL SERVICES INDUSTRY

Plugging the "Financial Advice Gap": Bringing Good Advice to the Mass Market

Nick Hurman FCII, MBA, Chartered Insurer

Summary

- The implementation of the FSA's Retail Distribution Review (RDR) will deliver a suite of reforms on how packaged retail investment products are sold. However, many commentators suggest that the RDR will leave behind an increasing 'advice gap' for those who cannot afford or are unwilling to pay the higher fees for regulated advice when considering their financial needs.
- This Thinkpiece is based on a research project undertaken by the author and Ian Costain for the Financial Services Consumer Panel to look at the advice market and the potential future developments in advice coverage and delivery models in response to market changes such as the RDR. Its main finding is that there appears to be a disconnect between public policy on savings and the regulatory execution of consumer protection in this market.
- In the mass market, there is likely to be a continued shift for commercial providers from advised to non-advised services. The Treasury will need to determine what role it sees the FSA/FCA playing in addressing the savings gap issue and what this means for the FCA objectives. Meanwhile the FSA/FCA should be mindful of distortions as activity is driven out of the investment regime into other areas, and from advice to financial promotions.
- The research suggests that the focus of new development is around designing advisory models that provide value to mass market consumers and which have lower costs. Integrating distribution models as a value-add proposition around banking and insurance services gives them a potential edge.
- Despite all these efforts, all stakeholders must realise that these other propositions such as guided non-advised will still be regarded as "advice" in the mind of consumers.

CPD

Qualified CII members: reading and reflecting on this Thinkpiece can count as *Structured CPD* under the CII CPD Scheme. See the second to the last page for details.

CII Introduction: a long-standing review led by the FSA of how investment advice is given to consumers in the UK is reaching its conclusion with a number of major reforms around adviser professionalism, how their services are labelled and how advisers are remunerated coming into force at the end of this year. There has been much debate over whether these reforms would restrict access to all but the wealthiest consumers, and the very people who will most need assistance with how to best save will only be able to afford non-advised solutions. In this article, Nick Hurman returns to the Thinkpiece series with a timely examination of options around making good advice accessible to the mass market.

With the implementation of the Financial Services Authority's Retail Distribution Review (RDR), most stakeholders predict major changes in the market for advice on packaged investment products such as ISAs, Bonds, Pensions and Annuities. This is unsurprising, as the main drive of the RDR has been to increase significantly the levels of skill and professionalism in this market. The RDR delivers a suite of reforms such as the raising of qualification standards, the introduction of a professional code of conduct and the adoption of Adviser Charging to separate out the cost of advice from product charges and to replace product commissions.

Our main finding was that there appears to be a disconnect between public policy on savings and the regulatory execution of consumer protection in this market.

However, there are also questions over what the RDR programme will do to access to advice - especially for those in the mass market. The debate applies to advice in the wider sense, covering all forms of generic financial advice, as well as regulated advice as defined by the Financial Services and Markets Act. Many commentators suggest that there will be an increasing 'advice gap' for those who cannot afford or are unwilling to pay an adviser charge for regulated advice when considering their financial needs.

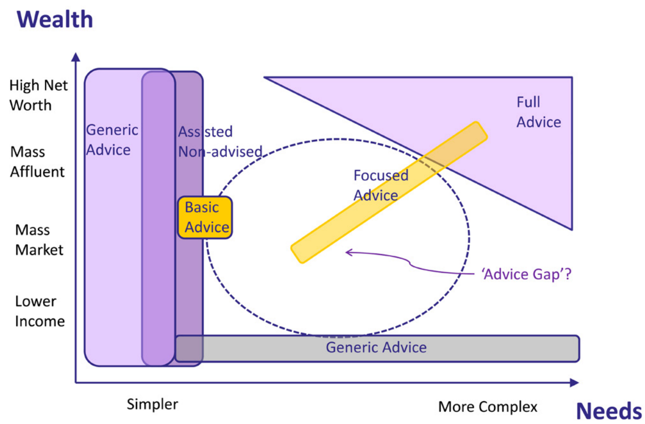
'Advice Gap' Research

The Financial Services Consumer Panel (FSCP) have been heavily engaged in the RDR debate and are strong supporters of the RDR but are concerned over the 'Advice Gap' issue.

To advance this debate, they commissioned a short piece of qualitative research from the author and a colleague, Ian Costain, to look at the advice market and the potential future developments in advice coverage and delivery models in response to market changes such as the RDR.[1]

In this research, we mapped out the potential advice gap (see Figure 1) and summarised views from Stakeholders and Case Study providers.

Figure 1: Mapping the 'advice gap'



FSCP Advice Gap, Nick Hurman and Ian Costain, 2012

We concluded, importantly, that there appears to be a disconnect between public policy on savings and the regulatory execution of consumer protection in this market. Contributing factors could be:

- the lack of agreed quantification or specification of the savings problem;
- the lack of clarity over the use of the word 'advice';
- an unresolved policy debate over whether the cause of the savings problem was an 'advice' or an 'engagement' gap; and
- a current lack of any organisations operating or about to operate in the simplified advice space as defined by the FSA.

---

[1] See Financial Services Consumer Panel, Advice Gap…. March 2012. This research was published at the end of March 2012 http://www.fs-cp.org.uk/publications/pdf/advice-gap.pdf .

We also made observations about the market and the continued reduction in advisory businesses' capacity and reach, with most new development being in assisted non-advised models. In these models, providers seek to provide information and guidance to assist a client to purchase a product, where this assistance leaves the assessment of suitability to the client - such as Hargreaves Lansdown do with their online ISA and SIPP products. There is, however, a risk that consumers may see these new non-advisory models of this type as 'advice' in the regulated sense of the word, seeking to rely on the provider to assess the suitability of the product for their needs.

But policy also recognises the need for consumers to have improved resilience to future economic shocks – savings, investments and insurances are a key component of the solution.

From this we concluded that in the mass market, there is likely to be a continued shift for commercial providers from advised to non-advised services, leaving only generic advice to try and fill the gap.

Addressing the issues

In the FSCP's foreword to our research, they called for policy makers and providers to get back around the table to debate how the advice market could be opened up to secure engagement with customers. So the question this Thinkpiece will address is 'what could the players around such a table do to address the issues highlighted by this research?'

Public Policy on Savings

As HM Treasury hold the brief for the issues of savings, they have a key role in framing the debate. HMT have a policy goal to increase savings but as observed in the research, the scale and causes of the problem have not been set out by government beyond the work specifically on pensions.

There are competing agendas here as government is also relying on consumer spending to help drive the economy out of the recession. But policy also recognises the need for the consumer sector to have improved resilience to future economic shocks – savings, investments and insurances are a key component of the solution. It might also consider the spread of assets held by individuals and what risks to resilience lie in a focus on residential property as the dominant asset class.

Policy needs to drill down into these issues and establish what really is the problem, and its nature and scale. With this precision, solutions can then be properly tested to see if they can deliver the outcomes desired.

The second key for HMT is the role it sees for the FSA and the FCA in delivering outcomes. If HMT wants financial conduct regulation to deliver consumer access outcomes, it needs to task them to do so. Otherwise, conduct regulation will tend to focus on the elimination of mis-selling rather than the promotion of beneficial advice. There is a risk that the classical economic view that delivery of a competitive market will axiomatically result in good outcomes for consumers will prevail. But there is now a realisation, through the finding of behavioural economics[2] that the market for financial services does not necessarily work this way. Consumers do not respond to pricing signals in this market in the same way they do in conventional consumer markets. Rather as prices and margins drop, consumer demand tends to drop rather than rise.

Conduct Regulation

The FSA have already cast the environment going forward through the RDR. Their focus may now need to be in two areas.

The FSA should look for distortions as activity is driven out of the investment regime into other areas and driven from the advisory process to financial promotions, with the expected move to assisted non-advised models.

The first is to look again holistically at consumer risk across the markets for financial services, across all four broad areas of business (investment, protection, mortgages and banking). It should look for distortions

[2] *For example, see FSA Consumer Research Paper 69*

as activity is driven out of the investment regime into other areas and driven from the advisory process to financial promotions with the expected move to assisted non-advised models.

The second should be to ensure that the good outcomes expected from increased professionalism, skills and remuneration clarity are delivered. FSA projects that consumers, after a period of adjustment, will respond positively to the new market. The FSA have a part to play in this by promoting the benefits of the RDR and how they meet consumers' demands for a higher skilled and more transparent market for advice.

Commercial providers

Commercial providers are currently responding to the immediate needs of RDR compliance but they need to look beyond this to secure new opportunities in the post-RDR world. The research suggests that the focus of new development is around designing advisory models that provide value to mass market consumers and which have lower costs, as Figure 2 illustrates.

Figure 2: Direction of new advisory model developments

	Holistic ➡	Specific
Higher Depth ⬇	• Full advice	• Focused advice
Lower Depth	• Simplified advice • Basic advice • Generic advice	• Assisted non-advised

FSCP Advice Gap, Nick Hurman and Ian Costain, 2012

Assisted non-advised models need to find ways, as the likes of moneysupermarket.com have done, to empower consumers to make their own choices...

Banks are most obviously placed to benefit from simplified models, but in practice have not found a way to do this economically and securely in an in-branch context. So they have to move to remote selling models using phone and internet. Here they find themselves in direct competition with brands who have built their franchises as consumer champions in this area: particularly the on-line financial supermarkets. Assisted non-advised models are an obvious response to this. But they need to find ways, as the likes of moneysupermarket.com have done, to empower consumers to make their own choices or they risk consumers holding them accountable for suitability regardless of the fact that it is not regulated advice.

Integrating such distribution models as a value-add proposition around banking services gives them a potential edge, but there is a cultural challenge to move from a product sales to a relationship model, especially where the relationship is principally based on virtual rather than face-to-face contact.

The challenge now is in reframing the debate so that it is all about achieving common goals for the consumer. Our research suggested that there are opposing forces operating on mass market advisory coverage

Other providers, such as insurers, advisers and fund managers, are finding their world changing fast as conventional packaged products are replaced by platform offerings and wraps. Providers need to respond to the simplified advice debate either with simpler products that are more focused on end-consumer needs and/or more sophisticated products that come with focused advice packaged as part of the product proposition - to offer in partnership with introducer brands and platforms. The key challenge is to forge new alliances with distribution that accesses the space left by traditional advisers and distributors.

Generic Advice Services

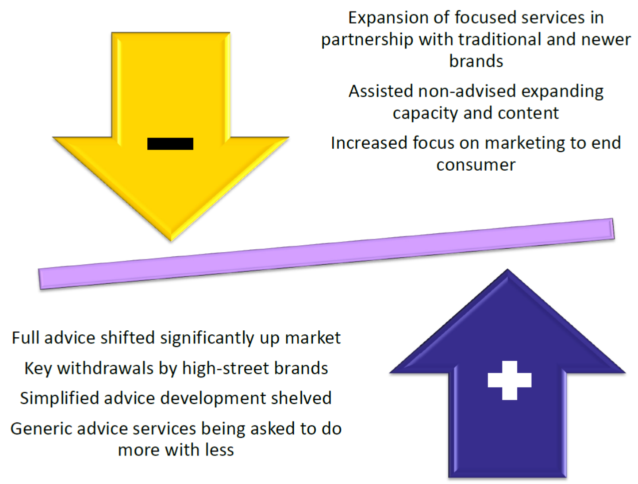
The other key players in the market are the generic advice services and, in particular, the Money Advice Service (MAS). The research suggests that generic advice has been left as the only developing model in the lower depth holistic space. But it needs a partner model for fulfilment, as generic advice cannot, by regulatory definition, deliver a regulated product sale.

But only generic advice currently has the potential to engage on a wide scale in this space and the MAS has a significant budget to deploy. The industry has shown signs of schizophrenia in its attitudes to MAS: on the one hand it sees the MAS as a potential competitor rather than potential lead generator; on the other hand, it criticises the MAS programme as not being of sufficient scale to match the wider engagement challenge. Commercial providers perhaps need to get more closely involved in the development of MAS, to ensure that it can deliver better outcomes for consumers and industry in bridging the engagement and advice gaps.

Moving forward

So all parties can bring something new to the table. The challenge now is in reframing the debate so that it is all about achieving common goals for the consumer. Our research suggested that there are opposing forces operating on mass market advisory coverage as depicted in Figure 3.

Figure 3: Opposing forces acting on 'mass market' coverage



FSCP Advice Gap, Nick Hurman and Ian Costain, 2012

There is a risk that developments will continue on their current course, increasing the gap and excluding more and more of the 'mass market' from engagement in this market. We would suggest it is the interests of all Stakeholders to look closely at:

1. how public and regulatory policy could frame developments based on a more detailed statement of policy for the savings, engagement and advice gap issues;
2. what is needed to expand the development of focused advice services, particularly as a significant activity for larger brands;
3. how assisted non-advised models can be best partnered with products for consumers who have engaged with their needs - for example through generic advice processes; and
4. how new mainstream products designed around end consumer preferences could then be safely partnered with simplified advice models.

If you have any questions or comments about this Thinkpiece, and/or would like to be added to a mailing list to receive new articles by email, please contact us: thinkpiece@cii.co.uk; +44 (0)20 7417 4783.

Nick Hurman FCII, MBA, Chartered Insurer is an independent Strategy and Change Management consultant and has worked with commercial and public interest clients such AEGON UK, Hewitt, the Resolution Foundation, the Financial Services Consumer Panel and the Equity Release Council over the last seven years. He has a particular research interest in consumers' engagement with financial services, developed over 25 years' experience in executive roles within the financial services industry. He holds an MBA from City University (now CASS) and is a Fellow of the Chartered Insurance Institute.

The CII is the world's leading professional organisation for insurance and financial services, with over 100,000 members in 150 countries. We are committed to maintaining the highest standards of technical expertise and ethical conduct in the profession through research, education and accreditation. In 2012 we are celebrating our Centenary as a Chartered body. For more information on the CII and its policy and public affairs function, including examples of the range of issues in financial services and insurance that we cover, please see: www.cii.co.uk/policy.

The CII Thinkpiece Series

The CII Thinkpiece series consists of short 1,500–2,500-word articles on subjects of interest to the insurance and financial services profession and stakeholders, and are written by a range of contributors. If you wish to be added to a mailing list to receive new articles by email, please contact us at thinkpiece@cii.co.uk

Recent and relevant articles in the series:

No.81: **The Insurance Regulatory Regime in Hong Kong**, by Ann Leung (22 June 2012).

The last few years have seen major changes to financial services regulation in many jurisdictions, mainly in response to the global financial crisis. Some markets particularly the US and Europe will be dealing with significant reforms over the coming years. Hong Kong which has over the years enjoyed a light-touch approach to regulation generally, and self-regulation in the broker market is no exception to these reforms.

No.80: **Climate Change: Implications for the UK and the Rest of the World**, Professor Sir John Beddington CMG, FRS (18 June).

The UK Government's Chief Scientific Adviser discusses the potential implications of a two-degree warming of the climate. Possible negative consequences include a rise in sea levels, increase in prevalence of heat waves and an increase in the number of extreme weather events.

No.77: **The Money Myth?**, by Alex Davidson (18 May).

With technological advances and ever more complicated investment vehicles, it is easy to forget that financial markets are driven by humans and human nature. The author offers up examples from classical mythology that show human nature has changed little in 2,500 years and provides five rules to help would be investors bear this in mind.

No.75: **Converging Ideas: Building a European-Wide Supervisory Culture in Insurance and Pensions**, by Gabriel Bernardino (4 May).

The European Insurance & Occupational Pensions Authority (EIOPA) was formed in January 2011, at a time when many in the industry were still wondering how a pan-European insurance "supervisor-of-supervisors" could operate in practice without compromising the work of the national authorities. In this article, Gabriel Bernadino, Chair of EIOPA provides a perspective on the Authority's first year of operation.

No.74: **From Brussels with Love: A Perspective on Developing Insurance Regulation at the EU Level**, by Karel van Hulle (4 May).

With EU insurance regulation landscape more relevant to individual firms than ever before, Karel van Hulle, the European Commission's lead official on insurance & occupational pensions, and author of many of the proposals under discussion in these areas, offers his own strictly personal view of insurance regulation in the post-financial crisis world.

No.71: **The Challenge of Age: Global Longevity Trends and Economic and Social Implications**, by George Magnus (23 March).

George Magnus ("the man who predicted the financial crisis") argues that the current economic turmoil is colluding with rising longevity to severely depress returns for the elderly. Governments, societies and industries must take robust action now in order to ensure that rising longevity is celebrated rather than feared over the decades to come.

No.68: **Who Saves for Retirement? Analysing Incentives for Saving Using the Wealth & Assets Survey**, by James Lloyd and Timothy Fassam (26 Jan)

James Lloyd of the Strategic Society Centre and Tim Fassam of the Prudential summarise the results of an extensive survey exploring public attitudes driving pension saving, and draw conclusions in the context of the Government's new workplace pension auto-enrollment system starting this October.

No.62: **The Role of Professionalism in Securing Consumer Trust and Confidence**, by Adam Phillips (31 August 2011).

Why are regulators and firms suddenly taking staff professional standards so seriously? Will this make a difference for the end consumer? Adam Phillips, Chairman of the FSA's Financial Services Consumer Panel, offers his personal perspective on why professionalism plays a role in improving public trust and confidence.

No.61: **Back to Basics: Rethinking Risk Management**, by Simon Ashby (9 August).

The global financial crisis has sparked considerable debate and analysis of its causes and of the lessons to be learned. This paper seeks to make sense of the crisis in terms of its implications for the management of risk. It reflects on the future for the practice of risk management, and provides some recommendations for financial institutions, and their regulators. Many of the recommendations are built around the notion that mangers and regulators should place more emphasis on the micro-level human/social aspects of the crisis.

Reflective Questions

Reading this Thinkpiece with respect to the learning outcomes below can count towards *Structured CPD* under the CII CPD Scheme. The questions are designed to help you reflect on the issues raised in the article in relation to these learning outcomes. Please note that the answers to the questions are not meant for CPD records purposes.

Learning Outcomes

- To gain an understanding of the issues underpinning the development of financial advice propositions in the wake of the regulatory changes under the FSA's Retail Distribution Review.
- To be able to appreciate the policy responses to the savings gap, and how these translate into public policy goals, regulatory objectives and commercial realities.
- To be able to summarise the complexities around delivering an appropriate investment distribution system that meets the needs of the mass market.

1. How could public and regulatory policy frame developments based on a more detailed statement of policy for the savings, engagement and advice gap issues?

2. What is needed to expand the development of focused advice services, particularly as a significant activity for larger brands?

3. How can assisted non-advised models be best partnered with products for consumers who have engaged with their needs - for example through generic advice processes?

4. How could new mainstream products designed around end-consumer preferences be safely partnered with simplified advice models?