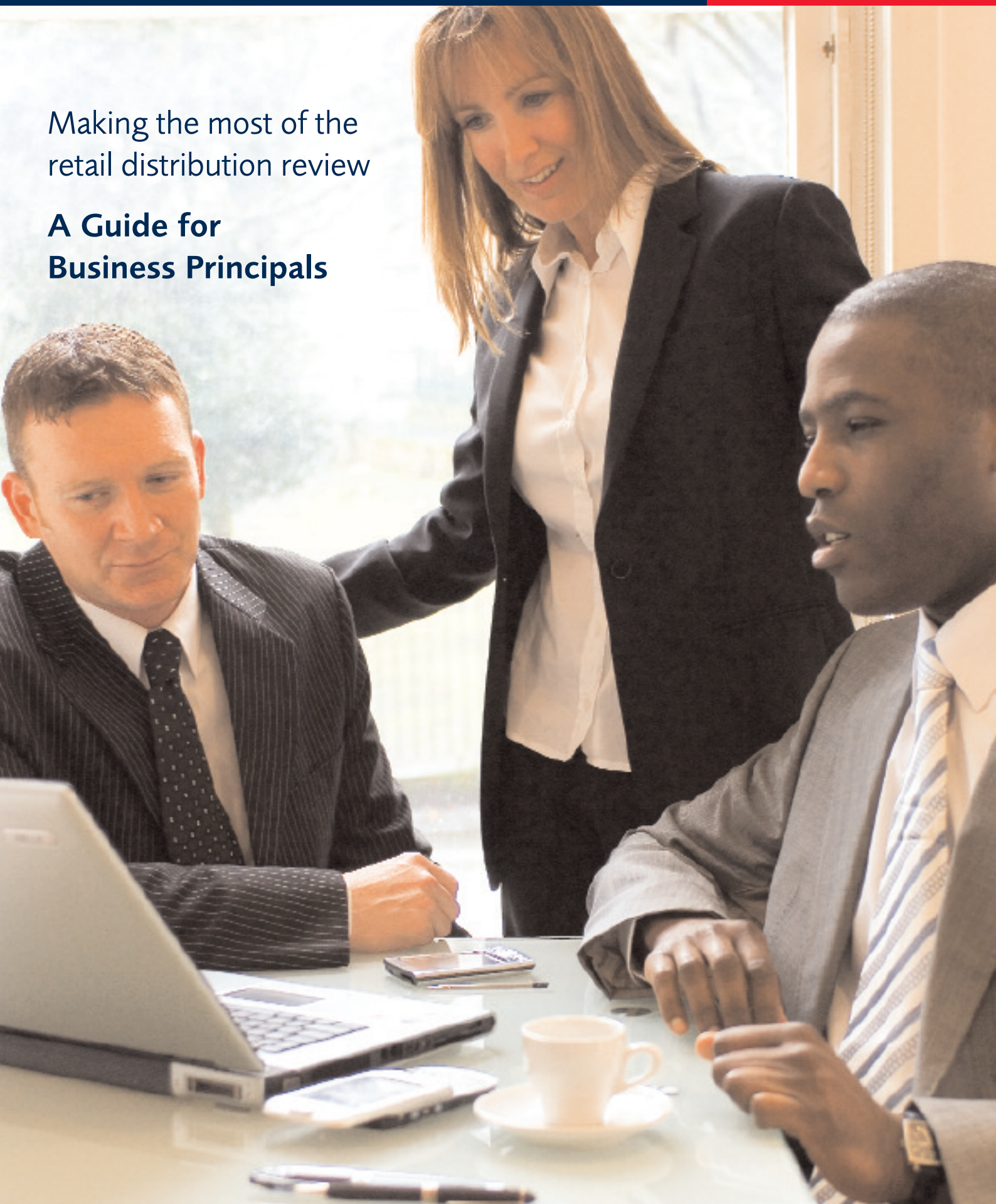


Making the most of the
retail distribution review

A Guide for Business Principals



Retirement has more potential with

PRUDENTIAL



Forward

"With the government's emphasis on private provision, changing demographics and increased occupational mobility, there has never been a greater need for good quality financial advice. We will lobby to ensure that this is recognised and protected.

We will continue to develop factory gate product solutions ahead of regulation and aim to increase our support to advisers who are moving to a 'post RDR' model and put advisers and their clients in control of remuneration for advice.

We hope that you will find this guide useful in helping you to understand the proposals and potential implications of the RDR and enables you to recognise the opportunities these changes create for the industry"

Andy Curran,
Intermediated Distribution Director,
Prudential



Background

A Financial Services Authority (FSA) Interim Report published on the 29th April set out the current thinking on the Retail Distribution Review (RDR).

This report outlined the principle areas of feedback received in response to their discussion paper issued in January 2007. Importantly this gives us a clearer understanding of the major changes that the FSA are proposing to 're-shape' the investment market place and potentially other markets.

The purpose of this document is to outline:

- The key proposals contained within the FSA's report
- To promote discussion with your Prudential account manager about how these changes may affect your business and what decisions you might need to make about your current business model

Key points within the Interim Report on the Retail Distribution Review

The Interim report has identified three main challenges for the industry:

- **Remuneration:** Challenging providers to change their products and processes so that they do not determine how much advisers are paid.
- **Professionalism:** Challenging the industry to develop and implement an agreed common framework for higher professional standards for advisers.
- **A new type of service called 'Sales':** Encouraging firms to present propositions to the FSA for the new non-advised 'sales' service and to make a case for how these deliver a better outcome for consumers.

The FSA has made it clear in the Interim Report that it wants to create a new simpler distribution landscape with new distinctive services which consumers may use to meet their financial needs. How close the FSA gets to achieving this objective will depend on the extent that they consider the consequences of these changes and extent of lobbying by intermediaries and providers.

In the Interim Report the FSA has reaffirmed its intention to have a marketplace with three components:

Advice – importantly the FSA has stated that all advisers will be **independent and 'Whole of Market'** (or operate a representative panel). The FSA has stated again that competency standards will be a condition of independence.

Sales – the FSA has removed the phrase 'Primary Advice' referred to in its original discussion paper and replaced this with 'Sales' which, at this stage, is being describe as strictly a **non-advised service**.

Money Guidance – the Thoresen Review of Generic Financial Advice launched in 2007 recommended that the FSA and the Treasury lead a 'Pathfinder' programme to set up services offering a money guidance and information service. This work is ongoing and potentially creates an opportunity for other agencies to offer this type of service as a 'gateway' to sales/advice.

We are committed to the principal of advice and the advisory sector whether tied or independent

The RDR is proposing that there will be three distinctive services Money Guidance, Sales and Advice. The introduction of the three tier approach in dealing with customers will mean that you will need to decide what level of service or combination of services you will wish to offer. This will be largely influenced by how you segment your client base and how your clients' needs may be best satisfied.

The following questions may help you to consider the how these changes may be implemented within your business

- › What level of services would you potentially want to offer/be able to offer your clients?
- › What changes might you need to make to your current business model?
- › What changes will you need to make to stay in the 'advice sector'?
- › Could the introduction of money guidance and/or sales service into your business enable you to engage with more clients at lower cost and potentially help to grow your business?

What does the FSA want the market to do as a result of the RDR?

The FSA has made it clear that product providers should change their business models to allow advisers to decide how much they will be paid for the advice they are giving.

The FSA has said that there will be a 'transitional period' to limit any impact on advisers. There is still some debate to be had on the future of the tied and multi-tied sector since the FSA has indicated that a condition of being able to give 'advice' is independence and offering a 'Whole of Market' service.

The FSA did not invite responses to the interim report, however, any responses may be sent to them at rdr@fsa.gov.uk

What does the FSA expect in terms of non-advice sales?

The FSA has outlined that there could potentially be two types of non-advice sales:

- › Execution-only: customers know exactly what they want.
- › Guided sales: customers provide information which would lead them to select a product.

The FSA has said that since this change is as a result of the need of a simpler financial services market place, not the historical quality of advice in this sector, the door is being left open for sales services with an element of advice in this sector. Clarity is needed from the FSA on this point although it is likely that the FSA would want to create a very clear separation between advice which will be independent and sales service which will not.

The FSA is therefore being pragmatic as to how the market separation will work in practice and also will consider how the market responds, effects of European and UK law and how regulatory incentives would work in practice.

Money Guidance

The recommendations set out in the Thoresen Review of Generic Financial Advice have been agreed by the government and the FSA has indicated in the Interim Report that they see this as potentially a national service (although this may not be the only service of its type and potentially private sector providers could emerge). You may decide not to offer this service in its current form, although as the distribution market changes there may be joint venture opportunities.

Incentives for good outcomes

The FSA has considered many suggestions concerning how it can reward good customer outcomes and is exploring monetary and non-monetary options.

Recommending products from across the whole market

As mentioned earlier the FSA has stated that for a firm to be referred to as 'independent' it should be able to advise on a 'Whole of Market' basis or a 'representative' panel. It has gone further to state that an adviser must be able to advise on other designated investments in addition to packaged products. These changes, for example, could also affect private client investment managers.

Consumer Agreed Remuneration (CAR)

Under the FSA's latest proposals, independent advisers will need to agree with their clients the cost of the advice being given and how clients are paying for it – either by way of fees (outside of product related charges) or product based remuneration (initial, renewal, level or fund based) or a combination of these. These need to be clear and not influenced by the product provider. Therefore it will not be possible to assume that the product provider will pay a 'standard' remuneration per product.

A clear separation within a product of advice based and product based charges should make it easier for you to analyse the 'real cost of the product', compare products and measure value for money.

In addition to indicating that they wish to remove 'provider influence' over adviser remuneration, the FSA has stated that it is not seeking to end the practice of providers paying indemnity commission to advisers and recognises that many firms would not want to or would be unable to move to a pure 'fees basis'.

Some advisers are likely to embrace CAR and others may find it a challenge. Taking commission disclosure a step further, the FSA intends to introduce CAR to ensure

that consumers see a clear separation between any product charges (which are there to pay for manufacturing costs) and any remuneration linked charges. This could improve customer relationships and ultimately make the advice process simpler. However, some advisers may need to adapt their sales process to accommodate this change – for example, you may decide to offer your clients a 'menu' of payment options.

This may also lead to some clients wanting to challenge the 'shape' of remuneration received by their financial adviser. For example, some clients may prefer for their financial adviser's remuneration to be based upon the funds that they manage as opposed to an indemnified lump sum taken from initial product charges, a flat regular remuneration or possibly a combination of all of these.

Any change in the timing of commission payments could have financial implications for the adviser's business and your advisers and therefore when building your remuneration menu this needs to be considered.

Professional standards

Feedback received following the FSA's Initial Discussion Paper has suggested that advisers should attain the equivalent of a QCA level 4 qualification. The FSA has stated that it recognises that competence is also about having and maintaining skills, knowledge, expertise, ethical behaviour and application of knowledge. It has also indicated firms might be required to become a member of a professional body. On all of these points, the FSA has fallen short of outlining any mandatory requirements since it expects the industry to make its own decisions about what minimum standards need to exist. It is the FSA's current view that 'grandfathering' should not be part of industry change.

For many IFA firms ensuring their advisers are able to obtain further qualifications in order that they retain their independent status could create financial and time strains on their business. Although it is likely that advisers will be offered several years to attain these new standards, firms need to consider how they plan to meet these. For example, is additional training required, how will this be implemented and assessed?

Liability management

The FSA has indicated that it is considering whether a 'long stop' (time limiting liability) would be of benefit to the consumer and the industry as a whole and also requires further considerations of the legal position in this area.

Legal constraints

The FSA is still considering the influence of UK legislation and EU Directives on the RDR:

- › Whether it can limit the market for advice to only firms meeting the changes.
- › How far the FSA can go towards influencing advisory remuneration.
- › How a new regime would operate in relation to MiFID.
- › Requirements for mandatory membership of a professional body (the FSA is presently in discussion with the OFT in this area).
- › What will happen to the initial intention of introducing 'Basic Advice'.

The next stages in the process

The FSA has indicated that they want to consider further the effect of the impact on consumers and firms of its desired outcomes. The FSA has also made it clear that they want to ensure that the potential long term impact on the economic viability of advisory firms will not be detrimental to consumers and therefore the FSA has not yet made any decisions on the implementation of the changes.

Before publishing the Feedback Statement in October 2008, the FSA will:

- › Further analyse responses to the initial Discussion Paper.
- › Consider how close they can get to a simpler landscape and the extent to their intended outcomes can be delivered by economically sustainable firms that treat their customers fairly and how they tackle any legal implications.
- › Consider what changes required in the standards of advisory services.
- › Consider what short term solutions could be introduced to meet demand whilst providing appropriate consumer protection.
- › Consider the extent of potential risk of regulatory action or successful consumer complaints on firms in relation into any new sales processes.
- › Look further at incentives for firms to deliver good customer outcomes.
- › Consider transitional arrangements.

Our view

We are pleased by the commitment from the FSA to improve consumer confidence to increase savings and we believe strongly in the value of 'advice'. We also feel strongly that independence should mean genuine independence – whole of market and free from potential remuneration or ownership bias.

We also agree that the remuneration for advice must be agreed with customers and determined without input from product providers

We think that a Diploma qualification or equivalent should be a 'baseline' professional standard for advisers.

We see the need to both retain the many good advisers in the industry as well as encouraging new entrants.

We feel that the FSA has taken some positive steps towards a sharp distinction between "advice" and "sales".

The RDR enables firms who have already segmented their client base to take the opportunity to operate a three step model to create additional revenue and reduce operating costs.



Our products

We are committed to supporting all business channels through the changes that may come from the FSA's Retail Distribution Review. We believe only through product transparency are we treating customers fairly and Prudential is one of the first product providers to offer products which are 'factory gate priced'.

Flexible Retirement Plan

Prudential's Flexible Retirement Plan (FRP) is a product wrapper incorporating Personal Pension and Income Drawdown, both with SIPP options. Having these products in one wrapper means that as clients move from pre to post retirement they can transfer between products without changing contracts and allowing them to maximise annual management charge discounts that are applied for fund size and loyalty.

The FRP also offers a flexible and transparent remuneration structure which can be tailored to the desired remuneration model agreed between yourself and your client. Importantly product and commission related charges are clearly identifiable and separate.

Portfolio Account

The Portfolio Account from Prudential International is a single premium investment bond that provides your clients with the opportunity to invest in over 2,000 funds, creating their own unique portfolio and giving you the opportunity to choose the charging option and commission structure to suit each client's situation.

The Portfolio Account has features such as:

- › 4 charging options so you can discuss the structure that best suits your clients' needs
- › The opportunity to give up remuneration to reduce charges and/or increase allocation (see examples below)
- › Annual Management Charge rebates, which are accrued daily and credited to your clients' Deposit Account on a quarterly basis, which effectively increases the investment returns for your clients
- › New preferential terms with Fund Managers, to provide your clients with competitive fund terms
- › As well as virtually tax free growth, it also offers for UK residents the potential for tax deferral which can help you and your client control the amount of any future tax liability and when this will be paid.

Prudential Investment Plan

The Prudential Investment Plan offers a flexible remuneration structure allowing you to discuss with your clients the appropriate mix of charges and commission with a very broad range of benefits for your clients. Our product helps to provide a transparent investment solution which gives you the freedom to shape the product charging structure, so you can:

- Negotiate the level of commission to be paid
- Confirm when the commission is to be paid

This approach will allow you to reflect the type of service model you wish to provide to your different clients. For example, you can control, vary and adapt:

- Initial Commission – Initial Charge or Establishment Charge options
- Trail Commission

This means that you can negotiate with your client the charging options related to your commission and allow for a discussion around the scope of your advice and support on an individual basis.

We hope that you found this guide useful and rest assured that we will be keeping you informed as things develop. In the meantime please speak to your account manager to discuss these proposed changes.

Nick Hunt
Markets Development
Manager

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