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THE HEATH REPORT 2

THE ABANDONED 16 MILLION

A report on the consumer detriment caused by the introduction and continued prosecution of the Retail Distribution Review

HEADLINES

- Historically, 23m consumers have accessed advice via IFAs and Banks.
  - **Since RDR was announced 16.5 Million Consumers no longer have that access**

- Just in the last 4 years, IFAs have lost 7.6m of their consumer capacity and Banks have lost 6.2m of theirs.
  - **That's a total of 13.8m**

- The FCA claimed RDR was needed to remove mis-selling which they claimed was costing the consumer £223m pa.
  - **RDR will cost the consumer £340m pa**

- Since RDR was announced 13,500 advisers have left the Industry along with a similar number of administrators.
  - **Initial Job Losses of over 25,000**

- If Trail Commission is banned in 2016:
  At best: The IFA sector will lose another 7,260 advisers (22%) with a current capacity of 1.4m consumers.
  At worst: the IFA sector will lose 15,510 advisers with a current capacity of 3m consumers.
  - **Potential total job losses after Trail could total 55,000**

- THR2 found no evidence of any overall spare capacity.
  - **We did find a willingness to accept more profitable clients at the cost of less profitable ones.**

- There is no evidence of any new entrant on the horizon who will have the scale to start filling the advice gap left by RDR.
  - **Until there is regulatory certainty over "Simplified Advice" those that have been disenfranchised by RDR are unlikely to find advice anytime soon.**

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THE HEATH REPORT TWO

The Heath Report Two (THR2) has been created to examine the consumer detriment caused by the regulator's actions in introducing the Retail Distribution Review.

It does not seek to be a learned academic document but to assemble in one place a clear description of what RDR has created and suggest lessons that might learnt.

It also wishes to explain the social value of the IFA sector and present the arguments for making changes in regulatory accountability to ensure that RDR represents the last time the regulator can abuse its power.

THR2 has been created for the consumption of the financial services industry, its regulator and in particular the politicians who created an Act which has created a regulator over which they have no control - which in a democratic country is totally unacceptable.

The Heath Report does not seek to be a learned, academic document, but to assemble in one place a clear description of what RDR has created and suggest lessons that might be learned.

THE METHODOLOGY

The Interim Heath Report was created from a mixture of our first IFA survey and the combined results of both IFA and consumer facing surveys. The creation of the Interim Report also clarified a couple of other issues.

Firstly, in launching the Heath Report; it was expected that THR would need to receive a wide selection of survey results directly from the sector. We are now clear that RDR is one of the most over-surveyed areas of the industry. We have been given access to a number of reports and surveys, which when combined with our own, give a solid statistical picture of the current effects of RDR.

The Heath Report Two has the benefit of a much more detailed survey designed and collated by Action Consulting with questions informed by the original Interim Report survey. Most of our questions had the option of "other" with room for additional commentary. Some of these answers are the most revealing we received.

One detail THR sought to identify was the different business types covered by the IFA banner. As THR was based on the availability of advice; it has not tried to differentiate between Restricted and Independent as THR looks at those labels as transitory as the regulator keeps changing the definitions.

As RDR seeks to corral the IFA sector into a high service labour intensive ghetto encouraging it to abandon the mass market it has serviced so well for so long. It has become clear that the final THR report needs to also include a clear picture of what the IFA sector offers to consumers and the social benefit of the sector.

Finally in attempting to provide answers to some of the issues identified above; other issues present themselves as matters worth of mention and debate. RDR can easily be seen as a counter-productive regulatory initiative which shows the lack of accountability experienced by the current regulator.

But it is also a symptom of a far larger issue; namely the need for a wider debate on the balance between Government provision and private provision which THR2 now seeks to instigate.

THE PURPOSE OF THE HEATH REPORT TWO

The Heath Report (THR) has been created to examine the consumer detriment caused by the regulator's actions in introducing the Retail Distribution Review.

In particular, it seeks to identify the number of consumers that have lost access to advice due to:

- **The banning of commission**
- **The exit of advisers from the industry and**
- **The contraction of how many clients each adviser is willing to service in a fee based environment.**

From these statistics, THR seeks to instigate a discussion on the accountability of the current financial services regulator – the FCA and by extension how best the IFA sector can be represented in the future.

It also seeks to stop any further damage RDR might do to the sector and the wider public by further implementation of its principles such as the removal of Trail commission.

Despite paying European Economics £147,000 for a report in praise of RDR – they received a report which clearly opined that there was "no evidence of consumer benefit" – We agree

Whilst the FCA cannot demonstrate any consumer benefit from RDR's introduction; The Heath Report can easily demonstrate that RDR has created solid consumer detriment by disenfranchising over 16m consumers from their advisers - a number that will increase if Trail commission is removed.

The Heath Report seeks to instigate a discussion on the accountability of the current financial services regulator – the FCA and, by extension, how best the IFA sector can be represented in the future.

PROGRESS SO FAR

This journey started with a Panacea Conference in January 2014 at which the effects of RDR were discussed and in particular the way the loss of Trail commission might compromise a significant sector of the IFA community.

Panacea completed a comprehensive survey in late 2013, 92% of respondents thought the removal of trail would be "catastrophic to the future of their businesses". This survey has been repeated at the end of 2014 & the new catastrophic figure is 94%.

In April 2014; the Panacea Team and Garry Heath met the FCA which dismissed the survey of 1,752 advisers, representing over 50% of the direct authorised IFA firms, as "unimportant". As is shown under its own heading; the removal of Trail will cause a further significant loss of advisers.
[See page 10]

At the April meeting, the FCA informed us that it would issue an internal review early in the autumn which we expected to be in praise of RDR. In the end, the FCA employed European Consulting and Towers Watson to produce and issue 2 lacklustre reports which were smuggled out in the week before Christmas to a distracted media - hardly the action of a confident regulator.

These reports suggested that there was "no evidence of consumer benefit" leaving the FCA to opine that RDR's "longer journey will benefit consumers". This is reminiscent of Mr Micawber's hope "that something will turn up". Or perhaps more accurately suggesting that the Luftwaffe's bombing of Coventry was a great act of Town Planning.

The Interim THR Report was issued in September and gave ammunition to politicians on the Treasury Select Committee, to ask some uncomfortable questions of Martin Wheatley. It also found considerable traction in Europe and Canada; both of whom face regulators keen to follow this latest dangerous regulatory fashion. Interestingly, the RDR infection which started in Australia is now waning there. There will be a point at which RDR in the UK becomes untenable.

RDR – AN ABUSE OF POWER

The regulator is tasked by The Financial Services and Markets Act 2000 to:

- **protect the consumer,**
- **promote effective competition in the interests of consumers in the markets**
- **protect and enhance the integrity of the UK financial system**

In an attempt to remove perceived imperfections in the market; the regulator has forcibly divorced millions of clients from the advice they have historically accessed.

How this can be seen as consumer protection is a mystery, as also is how the loss of over 30% of the adviser establishment promotes effective competition or enhance the integrity of the UK financial system.

Until The Retail Distribution Review (RDR); clients and advisers decided the basis of their relationship. Between them freely agreeing the amount of advice required and the methodology of payment. RDR has arbitrarily removed commission as a payment option and by doing so has created a paradigm shift in financial services distribution.

The FSA/FCA has had 2 clear opportunities to put a stop to RDR.

1. A FSA Board meeting held on 25 March 2010 discussed whether RDR should be pulled at a time when it had already cost £430m. (Its current cost is £1.7bn). The FSA was not particularly proud of the RDR but it didn't want to lose face. So 25,000 lost their jobs and 16m have lost their adviser to save the FSAs face.
2. Martin Wheatley joined the FCA in 2011. Again he had an opportunity of burying this turkey – he refused to do so.

Commercially: The removal of Trail commission will remove the method by which most IFA practices are valued and sold. The accepted valuation methodology was a multiple of trail commission. On that basis, the IFA sector was valued at circa £9bn pre RDR.

Whilst much of this value can be resurrected by moving clients on to contracted on-going service agreements; our research demonstrates that there is a hard core of heritage policy clients who cannot be moved without costing the client money.

This could as high as 40% - if so £3.6bn has been struck off the value of the sector by regulatory whim.

The removal of Trail has impacted particularly older advisers and rendered many of their practices worthless. This is the destruction of private property by arbitrary action of unaccountable regulators exactly what the Common Law has evolved to prevent.

- **THR would suggest that the wilful destruction of wealth is an abuse of power. Similarly once the principle of regulators having an interfering role in every aspect of a commercial relationship is established, the spectre of arbitrary price control, perhaps applied in retrospect, becomes apparent.**
- **Such interference will kill incoming investment and new distribution models as investors cannot trust the regulator not to destroy the wealth that such a new distribution might have created.**

PARLIAMENTARY ACCOUNTABILITY

In a democracy we must have our elected representatives exercising control and oversight over the bodies their legislation creates. The whole Select Committee system exists to call ministers and their departments, as well as the quangos they sponsor, to account.

In a democracy, we cannot accept that the executive can demand Parliament passes legislation which gives draconian powers to a quango including the power of taxation, immunity from civil law and most worryingly the relief from meaningful Parliamentary oversight.

THE FSA/FCA demonstrates that once released from the normal strictures of accountability; the body can fill its committees with fellow thinkers and close its ears to any external criticism in the sure fire knowledge that Parliament has no power even to demand answers to its questions.

Similarly when the Coalition Government took power 5 years ago it decided to cut the costs of many Government departments including HM Treasury by 35%. In same timescale the FSA/FCA has increased its budget by 32% - a gross swing of 67%.

The regulator has also funded the Money Advice Centre which MPs agreed was "unfit for purpose" with a budget of £80m. The Chancellor has also decided that rather than fines being used to cut down the regulatory fees of those un-fined that the money should be appropriated back to the Treasury.

Whilst the funds are initially found by product providers and advisers; the costs are actually visited on the shareholders, investors and policyholders of the UK who have no recourse through the regulator or the Parliament that created it. Who speaks for them?

The FCA can continue to grow its role and its funds without any control. For many advisers the cost of regulation and compensation is over 25% of their total overhead. The RDR debacle demonstrates the danger of this structure. The FSA/FCA was set up by New Labour to have a particular left of centre mind-set. Despite a change of Government it still does.

As an example: Its consumer panel has 13 members, five of which are ex civil servants, a Labour Party councillor, some "poverty" campaigners and a couple involved in social engineering. The majority of this panel have

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For many advisers, the cost of regulation and compensation is over 25% of their total overhead.

The Heath Report estimates that in the last year alone, 7,656 banking advisers have been removed: A loss of 88%.

Since the announcement of RDR, independent adviser numbers have dropped by nearly 6,000. However, the cull is not over…

drawn their income from the public purse and nearly all would come from the political left.

They may represent the thinking of the metropolitan big government chattering classes but they do not represent consumers, particularly the SME and self-employed people who have had their financial advice removed by RDR, so that the FCA's social engineers can have their "clean" market.

We need a change of legislation to bring accountability back to financial services regulation. Otherwise we live in a democratically sponsored dictatorship run by bureaucrats for the benefit of themselves and a political elite - none of whom have any practical experience of the industry being regulated and both of whom are susceptible to unproven fashions such as Behavioural Economics.

In the interim we also recommend that advisers and providers identify separately the costs of regulation so that clients can identify how much this half a billion industry is costing them and how much of their advisers' charges are not under their (or anyone's) control.

ACCOUNTABILITY: THE TREASURY SELECT COMMITTEE

One line of accountability that the naïve might think would be available is the Treasury Select Committee which should have power to oversee the actions of a body created by the Treasury. But as the Treasury Select Committee discovered on 9 March 2011, thanks to Financial Service and Markets Act 2000, the FCA was above influence from either the TSC or the Government.

Hector Sants's attitude to the TSC in 2011 was both disgraceful and disrespectful in committee by regularly failing to provide it with information reasonably requested. There were a number of examples of apples being deliberately compared with pears with some adviser numbers being flooded with non-RDR insurance agents, others not.

RDR was created by the FSA to remove from the industry what it claimed to be an annual consumer detriment of £223m from "miss-selling". The FSA suggested that the 5 year costs of RDR would be 600m now upgraded to £1.7bn. This is an annual cost of £340m.

The cost of RDR is now 50% higher than the problem it sought to cure.

In the same meeting Sants suggested that RDR might create an adviser cull of 10 - 20% which he found "acceptable". Quite apart from the appalling authoritarian arrogance demonstrated by that statement; since the announcement of RDR Independent advisers have dropped from 38,743 to 32,845 - **a loss of 5,898 IFAs 15%.**

However, the cull is not over. Thanks to the planned removal of Trail Commission in 2016; between 7,000 and 15,000 advisers are in danger. **So, if Trail goes ahead, the actual IFA losses will be between 33% and 54%**

In their evidence, the FSA missed out the banking sector which has dropped from 8,656 to a January 2014 figure of 3,556 - **a loss of 60%.**

THR estimates after looking at press releases that 2014 has been a year of redundancies for banking advisers. In the absence of up to date figures the THR estimate is less than 1,000 banking advisers have survived. If correct 7,656 banking advisers have been removed - **a loss of 88%.**

The combined adviser losses are currently 31%. A peak of 48,250 dropping to a current 34,000. Three times the lower Sants estimate

Let us be clear: There are no unforeseen RDR circumstances. Each and every issue was identified to the TSC before the outset and before the Sants meeting. If anything the TSC contributors underestimated the scale of the issues. RDR is the deliberate action of an over confident regulator determined to bully both Parliament and the Industry into its view

When the FCA/FSA disrespects the Treasury Select Committee, it disrespects its elected members and by doing so it disrespects the British People.

By rejecting the TSC and its suggestions; the FCA pressed on with this piece of social engineering in a bizarre view that regulators know more than the industry they regulate and the preferences of their consumers were inferior to the house view of the regulator.

Employment: In their desire to be seen to be exercising the power Parliament unwisely gave them and driven by their need to create their view of what constitutes a perfect, if unwanted, market:

The FCA has led to 6,000 IFAs and 7,000

banking advisers losing their jobs and as they each had least one administrator, we are talking about the employment of over 25,000 people being removed by these over mighty beings for - as European Economics reminds us - “No evidence of consumer benefit.”

If Trail is actioned in 2016 the potential employment losses may rise to 55,000.

A TIMELY DEBATE

The Financial Services Industry exists to provide a long term commercial solution to the vagaries of life in order that clients can maintain their independence when subject to unforeseen misfortune or foreseeable events like retirement.

If private provision is to be made it will have to last over most of the life of the individual and therefore cannot be exposed to political fashion or the continuous battle between those politicians who believe that the state should be the first port of call for such provision and those politicians who look at the state as the place of last resort.

If this is to achieved there needs to be a wide ranging debate on what citizens should reasonably expect from the Welfare State and what they need to provide for themselves. Such a debate has not happened since the Atlee Government.

If one just takes pensions as an example; there have been piecemeal initiatives such as stakeholder pensions, auto enrolment, and the change in the retirement age and the liberation of pensions - all of which have been taken against the background of a considerable improvements in the expectancy of life and the certainty of an increase of those needing long term care.

Currently the Pension Minister wishes both to increase the numbers savings for their pensions but also to relax the restrictions on current pension pots to allow consumers more flexibility in their use. However laudable such a relaxation; it will inevitably require those involved to seek advice as to the options available. Advice that the Chancellor said would be forthcoming.

At the same time the regulator, over which the Chancellor and his Treasury are believed to have sway, have removed 13,500 advisers from the industry – a figure that could double if Trail Commission impacts in the way THR2 believes it will.

We need far more joined up Government.

This has all the makings of the 1990s Pensions Review.

Such a debate will go to the very essence of our political process. How much can the citizen rely on government provision and if private provision is to be made – will the citizen on average income benefit from saving?

RDR has removed that option from most of the families of the UK making far more dependent on the state which some conspiracy theorists might suggest was the real purpose.

If politicians really want to see an improvement in the Savings Gap and the Protection Gap We need this debate immediately via the provision of a Royal Commission.

NEW ENTRANTS

The FCA now realises the void in advice that the RDR has created will need to be filled. Their problem is that new entrants are not finding the current climate conducive to starting new distributions.

The twin issues are uncertainty and mistrust.

In the RDR preamble; the regulator was actively suggesting that much of the transactional advice would be achieved by “simplified advice”. Unfortunately the FCA has been not able to define what it might be or how it might work; this was the central plank of the TSC’s RDR report published on 16th July 2011. 4 years later no definition exists as the regulator wishes to keep its options open.

Additional complexity is created by the Financial Ombudsman Service (FOS) which maintains an “arm’s length” position from the FCA. There is no guarantee that any process agreed by the FCA would be upheld once FOS started to receive complaints.

This presents a nightmare scenario for new entrants. The creation of a new process which may be deemed “Simplified Advice” at outset could be deemed to be full advice by the FOS many years later; once thousands had been advised via that route. Hence the uncertainty and mistrust.

Equally disconcerting is the way the Trail issue has been handled. Trail was a regulatory imperative 10 years ago and advisers were encouraged to restructure their businesses in that way. Values were created on the back of it and some of those

The FCA now realises the void in advice that RDR has created will need to be filled. Their problem is that new entrants are not finding the current climate conducive to starting new distributions.

There is no evidence of any new entrant on the horizon who will have the scale to start filling the advice gap left by RDR in the forseeable future. Those disen-franchised by RDR are unlikely to find advice any time soon.

values have been destroyed by regulatory action.

The FCA, in its current unfettered and unaccountable position, is not only an affront to Democracy but is a major disincentive to new investment and distribution development. The THR's editor has had the opportunity to discuss new distributions with private equity houses and similar and whilst all see an opportunity; few wish to commit client's money in an industry whose fundamentals can be changed so quickly by regulatory diktat.

In terms of potential new entrants; there are two broad approaches being deployed by mostly embryonic companies. One seeks to create a new type of distribution by attempting to lead the definition of "simplified advice" in the hope that the regulatory bodies will eventually agree. Some of these approaches include decision trees or a form of "self-advice". Names like Nutmeg would come to mind here.

The other approach is to take the full advice and make it more efficient by removing adviser travel, using Skype and other electronic face to face media, both to speak to the client and help with regulatory proof, using the adviser to solely do the advice part of the process with others completing the rest. This approach has the advantage of not needing a "Simplified Advice" definition as it would be judged to be an IFA or restricted player. The "Smart Alex" portal through Alexander House is an excellent example of what might be done.

Both approaches have an issue; as discussed elsewhere, commission filled an important role in giving access to advice to those who could not afford to pay for it at the time. Interesting Malcolm Kerr of Ernst and Young recently suggested that a quasi-commission model would need to be invented to fulfil this problem.

There is no evidence of any new entrant on the horizon who will have the scale to start filling the advice gap left by RDR in the foreseeable future and whilst business abhors a vacuum unless there is regulatory certainty it is unlikely that vacuum will be filled quickly and as a result those disenfranchised by RDR are unlikely to find advice any time soon.

THE HEATH REPORT'S DEFINITION OF IFA BUSINESSES

Informed by the results we received by the Interim Survey; we created these definitions for the larger survey. Each respondent was asked which definition best described their business.

Descriptor	Definition
Boutique	My firm only takes on a limited number of clients from a clearly target market, and for whom our service is specifically designed.
Segmented	My firm pro-actively seeks as clients people from one or more specific target markets, but will accommodate other types of clients.
Generalist	My firm provides financial advice to a wide range of potential customers and is continuously trying to engage with new clients.
Other	Other

The interim survey indicated a straight 33%/33%/33% split across the three descriptions. We now have a more sophisticated split which generally agrees with the first finding but gives better detail. These statistics are given with the warning that businesses are moving generally from Generalist towards Boutique. The Generalist descriptor was called "Transactional" in the THR Interim Report.

The "Other" nomenclature was put into the survey to sweep up any new methods of distribution. Nothing new was found but many of the "other" respondents are in transit between one of the main 3 descriptions with some restricting their business to existing clients only.

A cross section of the comments received:

RDR forces me to be more specialised and only deal with clients who can afford to pay the necessary rates to cover the ever rising cost of compliance. For the FCA to complain our reports are too long and detailed, while simultaneously insisting more information is provided is, to put it mildly, unhelpful.

I am only interested in HNW.

We don't have a specific market for our clients, but do not actively seek too many new clients as most business comes from our existing client bank and referrals from existing clients.

We have not taken on a new client family for four years and currently have no intentions of doing so. We continue to add occasion clients as the children of our existing families become clients in their own right.

HISTORICAL CAPACITY

64m represents The UK population but that includes children who generally do not seek financial advice. ONS

40.6m are consumers are either working or retired making them potential consumers of financial advice. ONS

17.6m have never accessed advice from the IFA sector or the banks. Some may self-advise, some may have been traditional "Industrial Branch" clients which is now defunct, some have funds but lack the drive to invest or protect. The largest number however are probably regularly dependent on the state benefits and entitlements and therefore cannot generate sufficient disposal income to buy the market solutions that the industry offers. ONS minus BBA & Gfk

23m represents the rest who have accessed advice at some time or another. This number can be further split down into: BBA & Gfk

7m have used advisers employed by banks. This regularly quoted number is believed to have come from the BBA. There may be an element of double count between the IFA sector and the banks as it possible that over the years a single client may have accessed both. We have no way of quantifying this. BBA

16m represents those who have used the independent sector. This figure emanates from consumer attitude surveys and is backed up by the ABI Statistics Dept. which places the number of clients assessing Insurance companies via the IFA sector as 12m. It is not unreasonable to suggest that an additional 4m have accessed non-insurance based products such as Unit Trusts and Investment Trusts via the IFA sector. Gfk

It is important to understand that the 23m represents all the clients accessing the two sectors. The majority of both sectors' historical client banks have not wanted or needed constant handholding; indeed many consumers only want to be involved with their sector on a transactional basis when they face a life event that needs advice.

Typically these events may be marriage, divorce, house purchase, child birth and the receipt of money from relatives, compensation or company pension schemes. Most life events are a time of great expense and therefore commission offered a painless way to pay for advice at a painful time.

In a unique action; the FCA used RDR to remove this option from millions of clients. Traditionally most regulators have satisfied themselves with demanding clear written disclosure between the parties.

We cannot find another example of a regulator from any market who has stipulated the payment method that consumers use for their goods and services or has sought to insert itself as a third party in a commercial relationship.

The adviser's first job is to challenge the client to start protecting and investing. The price of RDR's commission free world is the removal of that challenge from the common man and with it any independence from the state when in need. This is RDR's true dichotomy.

RDR forces me to be far more specialised and only deal with clients who can afford to pay the necessary rates to cover the ever rising cost of compliance. For the FCA to complain our reports are too long and detailed, while simultaneously insisting more information is provided is, to put it mildly, unhelpful.

[THR2 See Appendix One = "The Social Benefit of an IFA"]

POST RDR CAPACITY

THE IFA SECTOR

The Post RDR capacity is defined by two elements.

1. The number of clients disenfranchised from access to advice by virtue of their adviser exiting the industry
2. The number of clients disenfranchised from access to advice by virtue of their adviser cutting down the numbers of clients that can be serviced.

	IFA	BANK	TOTAL
Peak IFA Numbers was June 2005	39,500		
RDR was announced on November 2008	38,750		
Treasury Select Committee on Nov 2010	36,250	8,750	45,000
Currently Adviser Numbers	33,000	1,000	34,000
Adviser Loss since RDR was announced	**5,750**	**7,750**	**13,500**

BANKING AND BUILDING SOCIETIES ADVISERS

Unlike the statistics issued every month by the FCA on the IFA sector; the number of banking advisers is only published occasionally - usually in FCA speeches.

We have 2 reliable dates:

November 2010 **when the number of banking advisers was given at 8,750**
January 2014 **when the number of banking advisers was given at 3,500**

We do not know the current number of banking advisers; but given the number of redundancy announcements since January 2014 - THR believes to be the number to be less than 1,000.

The quoted banking advice consumers was 7m so each adviser had an average 800 consumers.

From November 2010 to January 2014; the loss of 5,250 advisers creates a loss of 4.2m consumers.

If THR estimates are right 6.2m banking customers have now lost their adviser.

REDUCING THE NUMBERS OF CONSUMERS HAVING ACCESS TO ADVICE

	Advisers at the time	Source	Consumers	Loss
Number of Consumers who have used the IFA Sector	39,500	Gfk	16,000,000	
Number of Consumers who have used the Banking Sector	8,750	Bba	7,000,000	
Total Pre-RDR adviser Capacity	**48,250**		**23,000,000**	
TOTAL IFA SECTOR LOSSES IN CAPACITY				
IFA Sector Capacity as at November 2010	36,250	THR2	8,400,000	7,600,000
Current IFA Sector Capacity	33,000	THR2	6,400,000	2,000,000
Total IFA Sector losses				**9,600,000**
Current IFA Sector Capacity	33,000		6,400,000	
TOTAL BANKING SECTOR LOSSES IN CAPACITY				
Banking Sector Capacity as at November 2010	8,750	FCA	7,000,000	
Banking Sector Capacity as at January 2014	3,500	FCA	2,800,000	4,200,000
If THR Estimates is right	1,000	THR2	800,000	2,000,000
Total Banking Sector losses	**7,750**		**800,000**	**6,200,000**
Consumers who have lost their adviser			**15,800,000**	
Consumers who have lost their adviser			**69%**	
Remaining Consumers				7,200,000
Remaining Advisers				34,000

THE REASON FOR ADVISERS TO CUT DOWN CLIENT NUMBERS

RDR has pushed advisers towards particular advice model and away from the way many used to trade.

THE TRADITIONAL ADVICE MODEL

There is an accepted myth, currently promoted by the Towers Watson RDR Report, that consumers need perpetual advice and servicing. Much of the RDR concept is based on this myth, as is the whole concept of universal 'financial planning'. This is certainly one part of the market but it wasn't even the majority of the market.

Information given to the Heath Report shows that the majority of the sector's historical client bank have not wanted or needed constant handholding; indeed many consumers only want to be involved with the sector on a transactional basis. It is from this group that the majority of disenfranchised clients will come.

The traditional advice model was based on giving advice which lead to the purchase of solutions in which commission formed part of the cost of the product. Since the late 1980s both the overall costs of the product and the cost of the commission has been specifically declared to the client.

It is also the case that IFA Clients are not one homogeneous mass nor are they universally spread across the UK. Whilst there are geographical areas which deliver quantities of wealthy clients capable of fee paying; there are other areas where clients are less wealthy and IFA sector services lower income families.

The commission system allowed such clients to access good advice in an affordable manner. This has now been removed by RDR and, as a result, there will be some areas who have no IFA coverage at all.

Research completed by Impartial Media in late 1990's revealed that the average transactional client was triggered to seek advice from IFAs once every 7 years. If the IFA had a regular marketing regime including quarterly newsletters that trigger was shortened to 5 years.

In terms of social benefit this model worked very well. It pushed advisers to find new customers, to challenge these consumers to confront their futures, to advise them and to complete the process with a sale. This lead to more families being protected and more people saving for their future. Whilst there were a hard core of 17m UK working or retired citizens who did not seek advice; between the IFA sector and the banks 23m had access to advice via this method.

In contrast, once RDR has run its course, the maximum number of consumers in receipt of advice will have dropped to 7.2m and that presumes that the removal of trail commission will not create a further loss of advisers and that there will be no further rationalisation of clients per adviser.

THE EFFECTS OF REMOVING TRAIL COMMISSION

The loss of trail commission and its consequences was the first reason for the existence of the Heath Report. Panacea ran a comprehensive survey in late 2013 which said 92% thought the removal of trail would be "catastrophic to the future of their businesses". This survey was repeated at the

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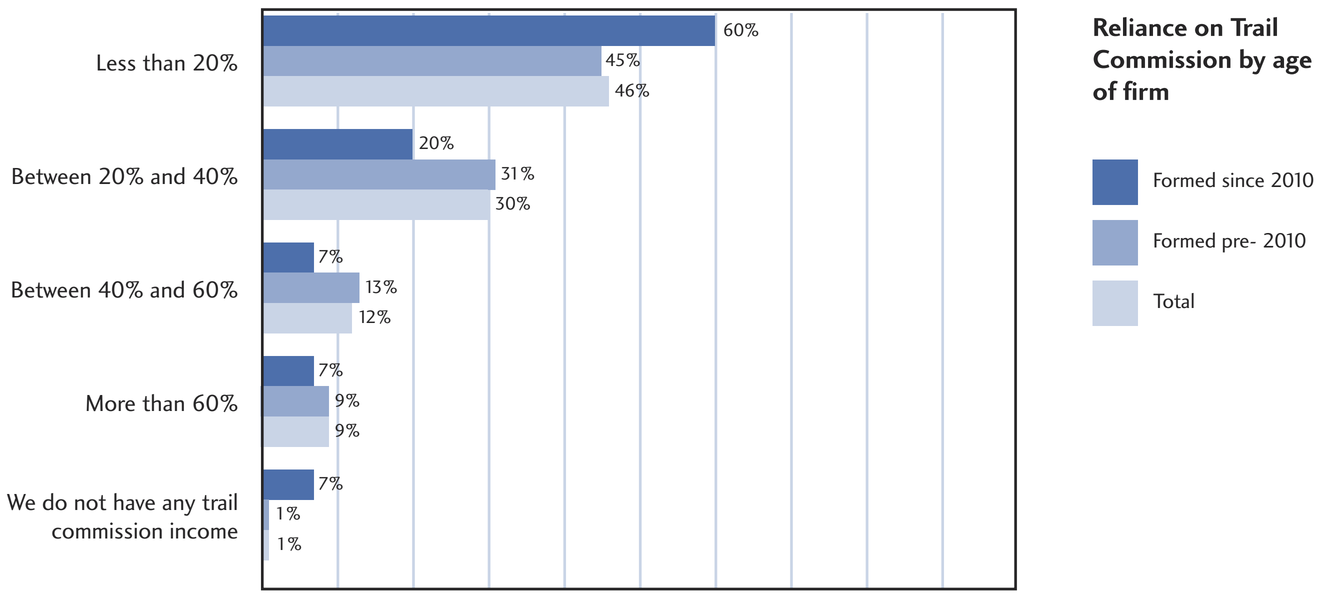

Reliance on Trail Commission by age of firm

> **RDR sought to create a commission free market in which the cost of the product was separated from the cost of advice. The FCA also wants to back date the process by moving funds invested before RDR. If they insist on this another round of adviser exits are guaranteed.**

end of 2014. The new catastrophic figure is 94%.

RDR sought to create a commission free market in which the cost of the product was separated from the cost of advice. The effect that this idea has had on the provision and availability of advice is discussed elsewhere However not content with creating a new regime for future advice, the FCA also wants to back date the process by moving funds invested before RDR from heritage funds into "Clean Post-RDR Funds". If they insist on this, another round of adviser exits are guaranteed.

The Interim Heath Report used the information then available to suggest that Generalist (Transactional) IFAs would be most exposed by the removal of Trail. The latest THR survey concentrated on the effects of trail and we now have more information and a wider view. All business types are exposed with smaller companies and Generalist advisers most exposed.

The THR2 survey shows that: only 1% of advisers have no trail commission, 51% depend on Trail for between 20% and over 60% for their turnover. 46% of advisers depend on Trail for less than 20% of their turnover. Clearly these numbers demonstrate that the removal of Trail will compromise the future of many advisory firms.

THE EFFECT OF LOSING TRAIL ON ADVISER NUMBERS

Action Consulting has attempted to rate our responders by their vulnerability to the removal of Trail, through a combination of a firm's dependency on Trail as a percentage of overall turnover and the degree to which the firm is addressing the issue of converting Trail to some form of explicit on-going service charge:

		by Firm %	by Adviser %
Very high risk	5	4.96	2.51
High risk	4	18.44	19.63
Medium risk	3	32.62	24.89
Low risk	2	25.53	33.56
No risk	1	13.48	14.16
Other		4.96	5.25

- If the tipping point is High Risk and above; we can expect to lose another 7,260 advisers who are currently servicing 1.4m clients. A loss of 22% of current adviser capacity.
- If the tipping point is medium risk and above; we can expect to lose 15,510 who are currently servicing 3.02m clients. A loss of 47% of current adviser capacity
- Panacea's survey suggests that the removal of trail would be "catastrophic to the future of their businesses" for 94% of respondents. That would equate to everything above "Very Low Risk" being the tipping point. If correct the sector would be destroyed as the surviving companies could not support the regulatory and compensatory overhead.

Despite the long lead time that RDR has given for this conversion; only 15% have achieved 100% circa 50% have converted more than half with 27% still needing to convert more than half.

These conversion figures will be further compromised by a glass ceiling created by Heritage products. 56% of IFAs have in excess of 10% Heritage clients. 8% have over 71%. Every heritage client is by definition untransferable and this is unlikely to change.

It follows that with 12 months to go further conversions may be hard to achieve. The THR Survey also identified that 14% of advisers are confused about the Trail deadlines with 62% confused on definition. Generalist advisers are the most confused.

TRAIL'S PRACTICAL ISSUES

In essence, the regulator wishes to unravel a complex group of intermediated contracts in which the client is paying for investment management, financial collection, administration, provider profit as well as a commission to the adviser which over time has been stipulated as being deferred Initial commission and/or a servicing fee.

Each of these charges are applied at different times and in different levels during the life of the policy with much of the provider's profit "back loaded" to the final years of the policy. The issue is similar to the recent "closed book" scandal. Providers are very wary about losing the sole ownership of these funds and down value the client's holdings in order to maintain that control. However the design of each product is based on an intermediary filtering client queries.

RDR seeks to encourage all parties to break this contract in favour of a "clean fund" but to do this the adviser has to prove to the client that it is in the client's financial interest to do so. Our research shows that in up to 40% of cases no such proof exists.

This approach has a number of attendant issues.

1. There is a significant legal issue. There is considerable doubt that the regulator has the power to instigate retrospective changes in existing contracts between providers, clients and advisers. As with many recent regulatory initiatives; the FCA declares it has the legal power in the confident hope that they are unlikely to be challenged.

2. There is the practical issue of how such changes might be administered. Each product has a fixed charging structure embedded in the provider's systems which makes change complex. The FCA has declared that all trail payments are "a servicing fee" whatever their original status and then insists there must be evidence of such servicing. However this judgement is not made by the regulator but by the paying provider.

   The provider has a vested interest in not finding any evidence of servicing as it will then keep the 0.5% charge. Not surprisingly, there is no adviser confidence that this would be applied properly.

   Some providers have already arbitrarily removed such payments claiming that the regulator's wishes are too complex to administer. Either way the provider is making more money out of the product – at least until they realise their heavy overhead for servicing will absorb any perceived benefit.

3. The client is left in a particularly unpleasant situation. His adviser is no longer paid to service his policy. The adviser may service pro-bono, but in a world of advisers jettisoning non-productive clients, there is no guarantee. The client cannot move his investment without loss. His provider is not set up to handle unfiltered servicing.

4. Each adviser faces a number of issues which impact differently; dependent on how the business has been run over the years.

   Longer established advisers such as generalists, are likely to need to contact a significant number clients; usually with smaller investments per adviser, more of whom are likely to be heritage policyholders. Each of these clients have to be appraised to see if their funds can be moved - at the cost of the adviser. It is this group who are likely to be adversely effected by the loss of trail commission as they were probably transactional advisers too.

   Less established advisers are likely to have fewer clients probably with more investment per client. They may have found this transfer easier but the THR survey shows even this group has issues

   5.Finally, there is a major issue of confidence in the regulator. In the 1990s, adviser were put under considerable regulatory pressure to move more funds over to Trail. As a result advisers businesses have been valued principally on a multiple of trail commission that being a funding stream which was contractual and unlike new advice was less impacted by an adviser's retirement.

   As Trail Commission was worth £2.8bn pa and the multiple was at least 3 times – RDR has put in doubt the residual value of the sector of around £9bn which has been compromised by the regulator's actions. On the basis that 40% of trail is trapped in heritage policies; the FCA has removed around 3.5bn from the value of the sector by a stroke of a pen.

   The FCA is desperate to show that there will be new forms of distribution to fill the advisory void that RDR has created. There is very little evidence of anything of scale on the horizon. It may be that potential investors will be reticent to support a new firm that is so exposed regulatory whim.

> **Less established advisers are likely to have fewer clients, with more investment per client**

SPARE CAPACITY

This subject must be looked at alongside the drop in adviser capacity. Essentially we have 2 trends running in opposite directions.

The THR2 Survey shows that in the 2010 – 2014 period; 36 clients per adviser or 108 per firm have been disenfranchised by current advisers seeking to cut the numbers of clients they service. It is clear that this process is not over and that some of the clients currently included in the numbers have yet to be told that they are no longer welcome.

> **The Heath Report Two survey shows that in the 2010-2014 period 36 clients per adviser or 108 per firm have been disenfranchised by current advisers seeking to cut the numbers of clients they service. It is clear that this process is not over.**

However we also asked the question of how many new clients the firm could take on the next 12 months without compromising the services received by existing clients.

The IFA sector is likely to face a spiral of decline, not created by its own commercial viability, but by regulatory interference.

The answer was 54 per firm - bizarrely half the number of those clients already jettisoned between 2010 – 2014.

It is likely that any new clients offered adviser capacity will receive it by advisers dropping less attractive existing clients. In this way advisers will upgrade their client banks but the overall number of clients serviced by the IFA will continue to drop and clients who have lost access their adviser are unlikely to find another.

The only way the 16m disenfranchised clients will regain advice is to agree to a high service high cost plan and become more attractive than an existing client.

THE SPIRAL OF DECLINE

One of the major costs which have become an increasing factor for IFAs is the regulatory and compensatory cost which many IFAs define as being over 20% of their costs.

These costs are fixed by the authorities and then the cost distributed across the relevant number of advisers in each sector. The numbers of adviser in the IFA Sector has dropped from an all time high of 39,500 to the current level of 33,000 which in itself increases costs by 20%

THR2 has defined two levels of loss expected by the removal by Trail.

The best that can be expected is a drop of 7,260 advisers which will create a cost increase of 28% from the current advisers numbers or 43% from all time high

The worst shows a drop of 15,510 advisers which will create a cost increase of 47% from the current advisers numbers or 55% from all time high.

There is a severe doubt as to whether the surviving advisers or more accurately their clients can fund this level of cost. The average adviser would face an annual bill for their direct costs around £25,000.

The IFA Sector is likely to face a spiral of decline, not created by its own commercial viability, but by regulatory interference in a functioning market in an attempt to improve it's idea of transparency.

In addition, the total sector cost of the regulatory burden is increasing exponentially. At a time when the Coalition government was attempting to decrease departmental spending by 35%, the FSA/FCA has increased its budget by 32%. These costs are passed onto the client via higher product or advice costs.

THR2 believes that it is now time to expand the concept of transparency to disclosing the cost of regulation as a separate item, perhaps based on the firm's previous year's regulatory cost.

In this way clients can discriminate between the value they receive from their adviser and the cost of regulation over which the adviser has no control.

THE HEATH REPORT TWO - FINDINGS

RDR'S EFFECTS

16.5m consumers who have historically accessed advice, either through the IFA sector or the banks, will no longer have access thanks to RDR.

The most important part of an adviser's job is to challenge consumers to make provision for their future.

The price of RDR's commission free world is the removal of that challenge from the common man and with it any independence from the state when in need. - This represents the long term cost of RDR.

Advice will never be available at times of a client's poor cash flow under fees only regime - only commission can do that.

The FCA has deliberately reduced the numbers of advisers and its failure to define simplified advice has compromised the widespread development of radical solutions.

Despite paying European Economics £147,000 for a report in praise of RDR – they received a report which clearly opined that there was "**no evidence of consumer benefit**".

THE ABUSE OF POWER

THR2 cannot find another example of a regulator from any market who has stipulated the payment method that consumers must use for their goods and services or has sought to insert itself as a third party into commercial relationships.

When the FCA/FSA disrespects the Treasury Select Committee, it disrespects its elected members and by doing so it disrespects the British People.

The FCA has created a £340m pa solution to a £233m pa problem.

REPRESENTATION

It is very important that the IFA sector finds the voice to define, with its own clients, the limits of its own sector rather than allowing regulators or competitors to do it for them.

TRAIL COMMISSION

THR2 believes that if FCA continues with its Trail Commission plans; the best result will be that another 7,260 advisers who are currently servicing 1.4m clients will leave representing a loss of 22% of current adviser capacity.

If there is a larger impact the sector can expect to lose 15,510 advisers who are currently servicing 3.02m clients. A loss of 47% of current adviser capacity.

REGULATORY COSTS

The IFA Sector is likely to face a spiral of decline, not created by its own commercial viability, but by the regulator's fixation with transparency and its effect on adviser numbers

The regulatory and compensatory costs faced by the sector are divided by the number of advisers in the sector. Therefore the more adviser numbers decrease the larger the cost per adviser.

Notwithstanding any increase in the total sector costs; the current drop in adviser numbers mean that there is a 17% surcharge since the announcement of RDR.

If our estimates on Trail commission are correct this could increase between 42% and 52%.

Such increases are likely to compromise those left in the sector.

NEW ENTRANTS

There is no evidence of any new entrant on the horizon who will have the scale to start filling the advice gap left by RDR.

Whilst business abhors a vacuum unless there is regulatory certainty on "Simplified Advice" it is unlikely that vacuum will be filled quickly and as a result those disenfranchised by RDR are unlikely to find advice anytime soon.

The Heath Report Two believes that, if FCA continues with is Trail Commission plans, at least 7,260 advisers who are currently servicing 1.4 million clients, will leave. If there is a larger impact, nearly 50% of advisers could leave, affecting more than 3 million clients.

PROPOSALS

- **THR2 is calling for legislation to restore proper Parliamentary accountability** to Financial Services regulation. This is required to prevent consumer detriment by unaccountable & unfettered regulation.
- **THR2 demands that FCA eradicates the planned removal of Trail Commission** in 2016 immediately, so that further damage can be avoided
- **THR2 believes that it is now time to expand the concept of transparency** to disclosing the cost of regulation as a separate item. In this way clients can discriminate between the value they receive from their adviser and the cost of regulation over which the adviser has no control.
- **THR2 believes that RDR should be seen as the abuse of power that it is.** It is a clear demonstration of what unfettered and unaccountable regulation can do to an industry and a lesson to other industries facing similar issues.
- **THR2 proposes that a Royal Commission should be set up** to define what citizens should reasonably expect from the Welfare State and what they need to provide for themselves.
- **THR2 believes that RDR could have been prevented by a more rigorous and robust representation by the IFA trade association** which was criticized by the Treasury Select Committee's report on RDR. This will be further explored in a paper THR3 written primarily for an IFA audience to be issued 2nd March.

APPENDIX ONE: CONSUMER PROFILES

Clients can be assessed in four categories. They are not born into these categories but elect to go to them by virtue of the amount they have to invest and seriousness of thought that they apply to their financial future. There are some investors on reasonably modest incomes that attain considerable wealth by good advice, maintaining modest out goings and wise investment.

The Seriously Advised: These are the clients who have a regular and planned meetings scheduled with their adviser. They take the planning of their financial future seriously and will be aware of issues such as Inheritance Tax. They are also likely to run their day to day finances in a sensible manner.

Typically, they would have at least 6 figure amounts to invest, are almost certainly higher rate taxpayers. In industry speak - these clients are labelled "High Net Worth" but most are actually Mass Affluent. They are also likely to be the group that are most likely to accept fees. This is the group that may have benefitted from RDR. They will be the clients that advisers, seeking to cut down their numbers of clients, will want to keep.

The Regularly Advised: These clients take their financial future reasonably seriously and expect regular updates from their adviser. They probably expect their adviser to initiate contact. They may not have significant capital to invest but are likely to have a healthy income which they will wish to use for savings, pensions and protection. Typically, they have been happy to pay their fees through the commission route and now face paying for their advice via fees, probably less happily.

This group will face a decision. Either they will upgrade to the level of service of the Seriously Advised, which for them may be an over provision, or be in danger of being dropped by their adviser.

The Transactionally Advised: These clients do not seek regular contact but are triggered to seek advice by an event. They may be getting married, buying house, receiving an inheritance, having new children, seeking a divorce or approaching retirement. They will look at the advice as a specific answer to a specific situation and do not want or expect a holistic service so do not appreciate (or warrant) full 'financial planning' services.

This group are most likely to object paying fees as they view advice as a distressed purchase and probably perceive commission based advice as "free". This group will be the most compromised by RDR. They will not wish to have a regular relationship with an adviser but their adviser is likely to fill the available capacity with the Seriously Advised who will provide high levels of regular income. So when the Transactionally Advised wants advice there may be no capacity for them. This group is the most likely to attempt self-advise but is poorly equipped to do it successfully.

This is the largest group to be disenfranchised by RDR.

The Unadvised: The majority of the Unadvised are unlikely to have the excess income to save much and many will not protect their families unless the benefit is provided by their employer or Government.

Historically advice for this group was advised by "Industrial Branch" advisers who were employed by the likes of Pearl, Refuge, and Prudential etc. These clients were the first victims of the wholesale loss of advice as a consequence of previous failed regulatory interventions.

In theory, this group now has access to 'advice' from the Citizens Advice Bureau and the Money Advice Service as well as casual advice from their personal networks. This group has not been affected by RDR as they were not consumers of advice, except perhaps via Banks.

THE SELF-ADVISED

There is also a small but increasing group of consumers that believe they can arrange their investments on their own, thanks largely to availability of information via the internet, who along with those basing decisions on guidance from MAS, CAB, etc., will not have the protection of FOS that advised consumers do." This emphasises one of the major advantages of getting advice and therefore the significance of loss of advice capacity.

MOBILITY

Whilst there are few investors who down size their advice type; there are many investors who wish to upgrade in the light of new developments in their lives; retirement, lottery wins and inheritances being good examples. The post RDR world will make upgrading far more difficult as there will be precious little advisory spare capacity to allow advisers to accept new members of the Seriously Advised.

Clients can be assessed in four categories. They are not born into these categories, but elect to go to them by virtue of the amount they have to invest and seriousness of thought that they apply to their financial future.

APPENDIX TWO: THE SOCIAL BENEFIT OF AN IFA

The least discussed, but most important aspect, of an adviser's day is the challenge. It appears twice in any client relationship. Firstly, when a client is challenged to seek advice. And secondly, when the client is challenged to accept the solutions that are suggested.

Most IFAs give little thought to the social benefit of their activities. They get on with what each day holds for them. This section seeks to explain what IFAs do and what is the social benefit of each of their activities.

1. Finding New Clients

Each generation of newly qualified advisers needs to find a new generation of clients. Traditionally many new advisers arrive in the industry as a second profession in their 30s – 50s just at the time when many consumers realise the need for advice. New advisers tend to advise clients of their own age.

In terms of social benefit; it is important that there is a significant degree of job mobility across industries. Past generations of advisers were able to join the industry easily by accessing employment through insurance company's direct sales forces or Industrial Branch. Once there, they were exposed to heavy degrees of training and supervision as they established their own banks of clients.

Currently, Industrial Branch has been regulated out of the market and Direct Sales Forces are a fraction of their former size. Thanks to significantly increased and compulsory academic qualifications, the current regulatory system has created such a high entry level that few advisers are now joining the industry as employers cannot afford to train them in the interim.

As a result, the number of younger consumers being introduced advice is already being severely restricted. The IFA sector is currently enjoying a small recruiting drive from ex banking advisers but this will be a one off benefit as the banks are no longer recruiting advisers.

Unless a commercial & regulatory solution is found to dramatically increase the number of adviser recruits, the numbers of advisers will reduce further by dint of age. The numbers of adults being advised will drop and with it the other benefits of advice. By failing to have the new advisers finding new clients, the next generation will not be challenged to consider their futures.

The Social Benefit: 60% of each generation has sufficient funds to make private provision for their savings, pensions and family protection. Unless there are enough advisers in the market to promote that provision our children and grandchildren are unlikely to make the right decisions.

2. The Challenger

This is the least discussed but the most important aspect of an adviser's day. The challenge comes twice in any client relationship. Firstly when a client is challenged to seek advice and secondly when the client is challenged to accept the solutions that are suggested.

If the world was logical, the vast majority of families would already have adequate protection as the cost/benefit equation is so clear. They would also invest in order to provide their families with some independence.

Sadly many people are perverse - doing the opposite to the logical. Others seek to prevaricate avoiding making a decision or prefer the immediate satisfaction of consumer goods, holidays etc. to protecting their families or investing in the future.

By far the greatest impediment to greater responsibility is the mantra that the Welfare State is able to give sufficient support to protect all citizens from cradle to grave. This is now being exposed as both untrue and unsustainable. Personal provision might improve expedientially if politicians of all parties were able to declare that those making private provision are always going to be in a superior position to those who haven't. Currently citizens of modest means may well find that they are saving themselves into penury as many benefits are means tested. This is true of many after retirement benefits as well as care homes and other social costs.

Every professional financial adviser, however well qualified, has to be able to sell both himself and his solutions. This is true of all professionals. Doctors have to sell their prescriptions to their clients. Solicitors sell their conclusions. Whatever the professional niceties and snobberies involved; unless a professional adviser can persuade the client firstly to meet to discuss needs and then to sell to that client the solutions made; there will be no positive outcomes or value to their actions.

In terms of social benefit every successful challenge creates someone, maybe a group of people, who are trending towards self-sufficiency and away from government dependency. This may not suit some of the more progressive elements of the political establishment but is welcomed by taxpayers and families alike.

The price of RDR's commission free world is the removal of that challenge from the

common man and with it any independence from the state when in need. - This represents the long term cost of RDR.

The Social Benefit: If you believe that it is right for citizens to protect their families and provide for their financial future by investing in private provision: It is important that, as each generation takes on their responsibilities and that there are advisers available to challenge individuals to make provision for their future.

Failure to do so exposes that generation to accepting whatever help an already overspending government is willing to provide.

3. The Prioritiser

Once a client has been challenged to address their financial future; the next step is to understand their needs and their ability to fund the same. It is very rare for a client to afford everything that is needed, so along with discovering the client's facts and opinions, the adviser needs to agree priorities with the client.

In some cases clients get hung up on an issue which they value but may not represent the most serious problem facing the clients and their family. The purpose of this process is to establish a plan to satisfy the real needs of the client and a budget to satisfy those needs.

The Social Value: The social value of an adviser using his expertise to prioritise his clients spending ensures that money is spent on the areas of most risk and avoids the danger of clients losing state benefit by saving themselves into penury.

4. The Client's Expert Purchaser

Once the needs and budgets are established the adviser needs to match the plan with the best solutions available. This may require finding a product provider with the right plan at the right cost or more recently the adviser can assemble solutions in house using platforms or other technology. The dual drivers are value for money and flexibility. The adviser will have access to significant comparison systems and the ability to use them. The benefit to the client is access to someone who has experience of buying financial solutions and does so on a daily basis.

In the 1990s, a major re-insurance company created a report of comparing the costs of life assurance across the EU. There was a solid and unavoidable link between the impact of Independent advice within a market and low costs. Term Insurance was chosen as it is not compromised by variations in taxation as would be the case with savings products. To avoid currency variations the figures were based on a factor with the cheapest country (The UK) factored at 100.

The EU has two different types of market.

The Broker/IFA based markets

The UK	100
Ireland	105
Netherlands	117

The Bank dominated countries

France	230
Germany	215
Greece	540

The average Greek's life expectancy is almost identical to the average UK citizen so why are they expected to pay 5 times the amount for their term insurance?

The Social Benefit: The IFA sector acts as the experienced purchaser for what was historically 60% of the number of policies created in any year and significantly more by value.

The IFA sector acted as a major depressant of provider charges not only for its own clients but for consumers as a whole as other distributions such as bankers and direct sales forces could not afford to be too far removed from the prices attained by the IFA sector.

The IFA sector acted as a major depressant of provider charges, not only for its own clients, but for consumers as a whole as other distributions, such as bankers and direct sales forces, could not afford to be too far removed from the prices attained by the IFA sector.

5. The Client's Facilitator

Once the decisions have been made it is important that the solutions are created and completed. Provider's administrations are complex and where tax advantages exist it is important that he relevant forms are completed. The same is true of trust documents and wills.

Similarly, clients need to understand that forms must be completed correctly to ensure that the solution can be depended upon and the taxation can be claimed

The Social Benefit: It is important that clients are not only challenged but also complete the process. Advisers and their staff have daily contact with providers and have the expertise needed to ensure that solutions are delivered.

APPENDIX THREE: THE HEATH REPORT'S ADMITTED BIAS

If I had my way, I would write the word "insure" upon the door of evry cottage and upon the blotting book of every public man, because I am convinced, for sacrifices so small, families and estates can be protected against catastrophes which would otherwise smash them up forever.

Sir Winston Churchill

The Heath Report admits it has a strong viewpoint and is best summed up by Winston Churchill:

"If I had my way, I would write the word "insure" upon the door of every cottage and upon the blotting book of every public man, because I am convinced, for sacrifices so small, families and estates can be protected against catastrophes which would otherwise smash them up forever.

It is the duty to arrest the ghastly waste, not merely of human happiness, but national health and strength, which follows when, through the death of the breadwinner, the frail boat in which the family are embarked, founders and the women and children and the estates are left to struggle in the dark waters of a friendless world"

- Churchill's quote demands that social policy should be concentrating on foreshortening the savings gap at in excess of £300bn and protection gap which is currently estimated at £2.4 Trillion.
- If this is to be achieved there must be more sector activity, both more advisers and more radical solutions.
- Unfortunately, the current attitude of the regulator looks upon commercial solutions as inherently dangerous. It seeks to create a perfect market even if the price is millions of our fellow citizens failing to make an provision
- The FCA has deliberately reduced the numbers of advisers and its failure to define simplified advice has compromised the widespread development of radical solutions.
- That most of the solutions created by IFAs are both for the benefit of the client and for the social benefit of society as a whole.
- Whilst the Churchill quote speaks of insurance; clients may well require solutions from outside the insurance industry
- The biggest hurdle to being protected from the vagaries of life such as death and major illness is apathy i.e. not facing up to, confronting and insuring against such vagaries before they happen.
- That private provision is infinitely superior to state aid for the majority of citizens as long as they can find a way of funding it.
- That citizens, independent of the state, are of far more social benefit to themselves, their families and their fellow citizens than those who must by necessity access benefits from the state.

APPENDIX FOUR: BUSINESS TYPES

Boutique Adviser Model 8,250 Advisers – Current Capacity 1,311,750 Clients

The most RDR compliant model is the Boutique Advisers who represent what the authors of RDR would like the whole sector to become. Boutique advisers have probably never had a large number of clients.

However; it is very clear that clients who pay fees expect a high level of service which is very labour intensive and impacts on the number of clients each adviser can handle. A third of the advisory force has adopted the "New Model Adviser" business model or its derivatives; top slicing their client banks to those most willing to pay fees and receive high levels of service.

For the purposes of this report; we have named them "Boutique Advisers" and their clients are likely mostly to be "The Seriously Advised". Some Boutiques enjoy a per adviser range between 10 and 120 although the current average is 159.

The commercial reasoning for the Boutique Adviser is strong. A small number of clients are relative inexpensive to administer and fee levels are strong so many advisers have seen an increase in overall profitability accompanied by the less stressful existence.

There are 2 commercial downsides.

Embedded Value: the business is not scalable and therefore difficult to sell to others. The business is a provider of income not capital.

Replacement Clients: There is no ready pool of clients in the business accessing lower levels of service who may be upgraded if other clients leave.

It is this model that will represent the fall-back position for the whole sector as long as each adviser can find enough clients willing to pay fees for advice.

If all the current IFAs became "Boutique Advisers" the sector capacity would settle at 5.2m.

The Segregated Adviser Model – 9,900 advisers. Current Capacity 1.89m

The Segregated Adviser wishes to advise as many clients as possible by segregating them into different levels of service. In general, there are two basic levels advice on offer. The high service level of the Boutique Adviser and a more arm's length model in which paraplanners and staff members do as much of the work as possible; enabling the high level skills of relatively expensive adviser to be used more effectively. The average Segregated Adviser is probably more driven by emotion than commercial necessities and does not want to abandon clients if at all possible.

There are strong commercial reasons for this; however the Segregated model is not established, is heavily system dependent, requires increased working capital to fund increased support staff and may prove less profitable per client than the Boutique version.

If this model settles down to be effective and profitable, the Segregated Adviser will be the way forward for the adviser who wants more than a lifestyle business as it can offer a capital exit in the future. The current per adviser average is 191.

The current commercial downsides are principally access to capital and the development of systems and processes. The sector has historically drawn its capital from product providers, which following the RDR, is a method is no longer available to it. More traditional sources of capital such as Venture Capital and Private Equity houses are expressing interest but not investing much.

The Generalist Model (Transactional) 11,550 advisers - Current Capacity 2.39m

This Group is the most compromised of the three business model types; as many advisers in this group are in great danger of leaving the industry. This group also has the largest number of clients per adviser at 207. It also has the biggest number of ex clients.

"Generalists" will face a troubled future – unless they can persuade a significant number of their previously Transactional clients to pay fees otherwise to survive this group needs to upgrade either to Boutique or Segregated.

This group does most for the social good as it drills down to customers who cannot afford more expensive forms of advice such as SME owners. Generalist clients are more likely to be the sector's less wealthy clients.

This model was perfectly commercially viable until the RDR rules were imposed. The demand that clients pay fees disproportionally impacts on this group due to its lack of ready cash. Many of these clients baulk at paying fees for new advice so post RDR the undefined adviser sector are already experiencing a downturn in new business.

The costs of maintaining contact with such a large pool of clients requires a regular income to pay for the regular cost. Trail Commission is invaluable to this group and represents a disproportionately high percentage of its income.

"Other" 3.300 advisers - Current Capacity 537,900

The other grouping appears to represent those who fall between the descriptions shown above rather than being a fourth type of distribution.

The most RDR compliant business model is the Boutique Adviser who represent what the authors of RDR would like the whole sector to become. Boutique advisers have probably never had a large number of clients.

The group most at risk are the Generalists, with 11,550 advisers and a capacity of 2.39 million. Prior to RDR, this business model was perfectly viable. Unless they can persuade a significant number of their clients to pay fees, this group of advisers faces a troubled future.

APPENDIX FIVE: IN PRAISE OF COMMISSION

It is fact that Post RDR truly independent advice will never be available at times of a client's poor cash flow – only commission can do that.

The issue of commission has always suffered from criticism usually from outside the industry and with that criticism comes a number of conspiracy theories which are rarely based on fact. Many media members project what they would do if put in the advisers' position of trust. Such remarks say more about the moral code of the commentator than the profession on which he comments.

Critics fail to understand that advisers are totally dependent on personal recommendation for business growth. An adviser who consistently abused their position of trust would not last long. To that extent the market is self-regulating.

The first theory is that IFAs prefer commission. They don't. In a perfect world advisers would prefer to run fee based businesses. There have been many IFAs who have been running fee based businesses for decades. The benefit of fees is that advisers can expect and predict their incomes, plan the development businesses better and provide a better quality of life to both adviser and client. The only downside is the resultant business become unscaleable.

The problem, which this report clearly defines, is that many IFAs do not have the quality of client banks to deliver a sub set of clients who can support the transition to a fee based only business. In addition, current advisers have inherited a long established market where advice was "free" at the time it was given.

In time, more consumers may be prepared to pay for advice in cash but we may need to wait a generation for it to become apparent.

It is a fact that Post RDR truly independent advice will never be available at times of a client's poor cash flow - only commission can do that.

The second theory is that commission creates widespread IFA provider bias. If there was widespread provider bias; the providers with the largest market share would be paying the highest commission. The opposite is the case. Historically, Standard Life had the highest market share and the meanest commission structure.

Over the years various regulators have attempted to "prove" this theory by spending a fortune on hired gun consultants. THR has yet to see any report which shows that there is any widespread commission bias. As there are always the odd rotten apple; there may be discreet examples that can be identified. The regulator has the power to take action against such individuals which includes removing them from the industry.

The third theory is that commission creates a bias between product types. The argument is that faced with 2 solutions with different commission structures the adviser will choose the one with the biggest commission.

There is no evidence of this, Not only would such an action compromise an adviser's reputation but also expose them from attack from the regulatory authorities and their own Profession indemnity insurers.

It is more likely that fiscal differences and advantages are likely to lead to bias between 3 different solutions.

APPENDIX SIX: LIBERTATEM

Libertatem – the association for Impartial Advisers and Wealth Managers

Latin: for Independence (or Liberty or Freedom). Interestingly Magna Carta's real title is **Magna Carta Libertatum** (The Great Charter of the Liberties"). We believe a new association should avoid the alphabet soup that previous versions have endured.

Structure

Libertatem is a company limited by guarantee with its membership being firms drawn from the current Independent, Restricted and Wealth Management sectors. It will draw its elected directors from its membership. We see board members being drawn from a regional election process on the basis of One Firm = One Vote.

Libertatem is a trade association. Its members are commercial entities, sole traders, partnerships, limited companies and Llps. It will work on improving the commercial activities of the sector by concentrating on the policies regulators, product providers and Government pursue. It will also want to expand the influence of the IFA sector in the financial services markets.

Objectives

Our prime objective is to protect our members and their clients and ensure both prosper.

The current regulatory climate is not conducive to delivering this objective. We need the different regulatory elements FCA, FOS and FSCS to be properly accountable to the Parliament that created them and to work to the same agenda so that compliant advice does not trigger a FOS payment as currently.

In order to avoid any further loss of numbers in the advisory sector; Libertatem will immediately campaign for the end of any further attacks on Trail Commission from both regulators and providers.

This is likely to need primary legislation which should not just cover accountability but seek to control the overall costs of regulation. That is both actual and deadweight costs.

Libertatem's relationship, both with regulation and Government, must be based on mutual respect. The current relationship is that of master and servant with the government or its regulatory servants acting as master. This is entirely unacceptable in a free, democratic, society since government, and its employees, are by definition the servants of the people.

Libertatem will use all legally available tactics to further its aims and policies but will not restrict itself to a fixed group of passive tactics. It will, of conduct itself in a manner as befits an association of professional companies.

For example, we will seek to use our members to contact their MPs to ensure that the sector can bring current issues into the public arena.

We particularly wish to encourage more synergy between Government Policy and existing Regulation. It is bizarre that at a time when the government needs skilled advisers to help clients with complex pension's liberation issues; the regulator has been responsible for 13,500 skilled advisers leaving the industry. Similarly whilst the regulator wishes to see increased qualifications in the sector; auto-enrolment is being conducted by completely unregulated, relatively unqualified and likely inexperienced individuals.

In order to avoid any further loss of numbers in the advisory sector, Libertatem will campaign for the end of any further attacks on Trail Commission, from both regulators and providers.

APPENDIX SEVEN: GARRY HEATH MCIM

Garry Heath was Director General of The IFA Association, 1989–1999, which enjoyed a membership of over 60% of UK IFA Practices. At its height; the IFAA had 16 staff and a turnover of nearly £2m.

Garry was a central player in the introduction of regulation into the financial services industry and was instrumental in the reform of FIMBRA and the creation of the PIA. He also was a witness to four Parliamentary Select Committees and the Joint Parliamentary Committee that created the Financial Services & Markets Act.

He has been awarded "Outstanding Contribution to the Financial Services Industry" for eight concurrent years and awarded five other Financial Services industry awards. He created the Financial Services department of BIPAR which still thrives as the EU body for advisers as well as the Financial Adviser 5 Star awards.

He represented the Association as its public face including promoting members' interests to Government, the civil service, and regulators and made numerous media appearances which included all four breakfast television stations, *The Money Programme, Watchdog* and *Working Lunch*.

More recently Garry established and sold two national financial services businesses valued at £40m and currently acts as a consultant with expertise in Financial Services distribution.

The publication of the Interim Heath Report lead to Garry being asked to address the national IFA conference in Toronto as well as being given a spot on lunch time Canadian Television. More recently, he was the speaker at the FECIF Conference in Brussels.

In 2015 he is already booked to give key note speeches in Vienna, Monaco, Berlin and Prague.

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LIBERTATEM

Knowledge | Integrity | Innovation | Equity

The Impartial Advisers Association

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