Libertatem was alerted by the media to the FCA's request from the TSC to comment on *The Heath Report 2*.

In the interests of process and for public record, Libertatem needs to respond.

For ease of use, we have interspersed our comments in blue within the FCA document. To achieve this, we have converted the original FCA .pdf document provided into a Microsoft Word document. That conversion experienced some formatting issues and a couple of FCA graphs did not survive the process.

Our commentary should be read alongside our letter to Andrew Tyrie, Chairman of the Treasury Select Committee of the 14th of June 2016.

FCA’s response to The Heath Report Two

Introduction

1. At the TSC hearing on 20 January 2016 we were asked to consider The Heath Report Two[1] (THR2) and provide comments on the numbers and methodology used in respect of the impacts arising from the Retail Distribution Review of the market for retail investments.
2. The FCA welcomes the opportunity to provide written evidence to the Committee on the issues raised within the Report.

1 Mr. Garry Heath is the former head of the Independent Financial Advisers Association and in 2015 launched a further trade body called Libertatem aimed at adviser firms.

2 Page 6, Retail Distribution Review proposals: Impact on market structure and competition, Oxera (2010). http://www.fsa.gov.uk/pubs/policy/oxera_rdr10.pdf

Executive summary

3. This response sets out our views on the conclusions of THR2. These are set out in detail later in this response. However, in brief, they are as follows:

Conclusion 1: Since RDR was announced 13,500 advisers have left the industry.

4. We recognise that there has been a decline in the number of advisers over recent years. Before the RDR was implemented it was anticipated that there would be a fall since the increased minimum standard of qualification was expected, inter alia, to act as a catalyst for earlier retirement among some older advisers.

Libertatem:

The increase in standards announced in 2008, which included a mandatory, no grandfathered increase in academic standards, did act as a catalyst for earlier retirement among some older advisers. We agree.

The FCA seeks to say that RDR can only be judged when it was implemented. We disagree.

Advisers started making their business decisions from 2008 when RDR was announced so it quite reasonable to look at the numbers from the announcement through implementation and beyond.

To do otherwise presumes that nothing happened until implementation and clearly the figures do not indicate that. It appears that the regulator underestimates the import of its actions on business planning, development, capital raising and staffing of adviser businesses.

By suggesting that RDR Implementation is the base date from which all statistics and arguments should be made, the FCA is attempting to move the dispute on to more favourable ground.

5. However, THR2 measures the change in the number of advisers from 2008 whereas the RDR took effect at the end of 2012. Measuring changes from a long time before RDR implementation makes it difficult to isolate the changes due to the RDR as opposed to other market changes.

   There are a number of reasons why adviser numbers fell in that period including: banks withdrawing from parts of the market for wider commercial and strategic reasons; and the consequences of episodes of mass mis-selling (in terms of redress and reputational damage).

Libertatem:

Again the FCA is attempting to rewrite history. The major regulatory change between November 2010 and March 2015 was RDR. It was announced in November 2008. It became a certainty after the TSC meeting of November 2010. THR2 came out in March 2015.

In November 2010; there were (according to the FSA) 8,750 retail banking advisers. By January 2014 Martin Wheatley (former FCA Chief Executive) announced those numbers had dropped to 3,500. In March 2015 THR2 estimated the numbers of retail banking advisers to be 1,000. We note that the FCA has not sought to argue with that estimate – until now.

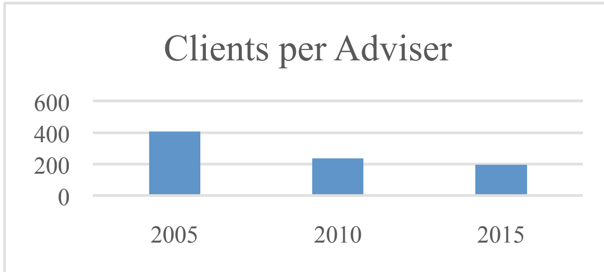
For the FCA to claim RDR did not have a significant effect is risible and invites the question that if RDR did not have the major effect intended, why did the FCA persist with it?

6. Also, it is important to note that adviser numbers on their own do not tell the whole story, since the issue is not solely the number of advisers, but the number of clients those advisers service which determines capacity in the market. There is evidence that points to advisers having adequate capacity to meet demand. Please see paragraphs 19 to 32 of this note for more detail.

Libertatem:

THR2 existed to look at the loss of the availability of advice to the consumer. There were two factors. The number of advisers lost to the industry; and the remaining advisers rationalising their client banks, due to the commission ban.

The average number of clients per adviser can be extrapolated from *THR2 Printed Version Page 8 Table 2*. Unfortunately, between the digital version of the original document and the printed version, one table was lost (see below):



The average client/adviser ration has dropped from 405 in 2005 to 235 in 2010 to 195 March 2015. The 405 figure is created by dividing the historical capacity of 16m by the historical high point of adviser numbers. Both the 235 and 195 figures are derived from the THR2 survey of 1,300 advisers in which respondents were invited to look at their client numbers at March 2010 and again in March 2015

We intend to carry out this survey again in March 2017. We believe that we will see a further ratio decline.

Conclusion 2: Historically 23m consumers have accessed advice via IFAs and banks. Since RDR was announced 16.5m consumers no longer have that access.

7. We have reviewed THR2's analysis and do not recognise the figures which are presented, as the sources of the data are not always referenced. From a methodological perspective, the analysis is likely to significantly overestimate the number of "abandoned consumers".

Libertatem:

THR2 *Printed Version Page 8 Table 2* clearly shows the source of the 16 million as being provided by Gfk.

Gfk is a worldwide research company with a turnover of £1.5 billion Euros and a staff of 13,485. Their figures are derived from interviewing consumers.

As part of our research THR2 was told by ABI Statistics that 12 million consumers had accessed the products of their member companies via IFAs. That left us with those consumers who have sought advice for products outside the ABI membership, such as Unit Trust and collective investment companies.

In order to assess that number and to find a "sanity check" for the numbers as a whole, we approached Gfk who were happy to share with us the research they had carried out for clients on the basis we only used it generically. Their number was a total of 16 million, or a 4 million supplement on the ABI numbers for non-ABI providers

The FCA may not like these numbers but they are credible, moderate and conservative.

In addition to the adviser numbers, we also quoted a figure of 7 million consumers who have accessed advice via banks. This figure is often quoted in articles – and even FSA speeches – but its true parentage is unclear. We have been told it may have originated at the BBA but have not been able to confirm that. We do, however, note that the FCA does not seek to challenge that figure. Combined with the 16 million, it placed the IFA/Bank advice universe at circa 23 million.

> This is because it takes the number of consumers who have received advice *at "some time"* and then subtracts the estimated capacity for advice based on the number of clients THR2 estimates the advisers in the market at a *particular point* in time can service.
>
> It would seem unreasonable to expect the stock of advisers at any one point in time to be able to service all individuals who have ever had advice at some time. Equally it would seem unlikely that all of these individuals would want, or need, advice over the same period.
>
> Consumers are likely to want advice with different degrees of regularity, depending on their circumstances. Some may seek advice frequently through the year; others may

seek advice on a transactional basis, say once every few years.

Libertatem:

As is clearly set out in *THR2 Printed Version Page 19 Appendix 4*, there were three major forms of distribution pre RDR: Boutique, Segregated and Generalist (Transactional).

RDR favoured the Boutique model, which was already fee-based, against the Segregated and Generalist models which were more commission reliant.

RDR removed paying commission for investment advice as an option for any potential or returning client and, by so doing, compromised the Generalist Model. As this was historically the largest of the three models handling Middle England and the self-employed. It is this group who have been disenfranchised.

The FCA is missing the point. Historically advisers had some clients requiring regular attention and a far wider number who appeared when advice was needed – an average cycle of 5-7 years. This is well documented in *THR2, page 9*.

Post-RDR pushed advisers into giving fee-based advice which has led most of them to reduce their client banks and give more service to a smaller number of clients. Clients returning for new advice after their normal cycle will, therefore, find their access "bed-blocked" by existing fee-paying regulars. The quotes on *THR2, page 6* identify current adviser attitude.

In making this argument, the FCA misses how the public uses the professions. Some, such as doctors, may experience regular patient contact, primarily because that contact is provided free of charge at the point of need. That said, there may be long periods between visits for many patients.

Solicitors may also have a few regular clients but, once again, they will have clients that they do not see for long periods of time. In both examples, patients and clients will go and see that practice when they need to access that expertise, and they will expect advice to be available.

RDR has attempted to corral advisers into a world of fee-based, regular contact advice of mainly High

Net Worth (HNW). Consultants Towers Watson have then been commissioned by the FCA to report that – having defined the market in those tight terms – there is capacity.

8. We set out a more detailed analysis of the methodology, and our views in paragraphs 33 to 39.

Conclusion 3: If trail commission is banned in 2016 then the IFA sector will lose between 7,260 advisers and 15,510 advisers with an associated consumer capacity of 1.4m to 3m consumers.

9. We have not banned trail commission to advisers relating to pre-RDR advice on investments. The final rules on trial commission, which were published in November 2011, confirmed that commission for pre-RDR advice can continue to be paid and that it can be transferred to a different adviser.
10. There may be some confusion in THR2 between adviser trail commission on pre-RDR business and the sunset clause in relation to payments to investment platforms.4 Our rules require platforms to stop retaining payments from providers at the latest by 6 April 2016, and to be paid for their platform service only through platform charges agreed with clients. But these rules do not affect commission paid to advisers for advice on pre-RDR business, including pre-RDR advice on investments held on a platform. It is correct that when platforms move clients to 'clean' share classes, there may no longer be a facility for commission to be paid to advisers, but this change is not required by our rules. This is covered in more depth in paragraphs 40 to 46.

Libertatem:

There was no confusion. THR2 looked at both the rule change for platform charges *and* the potential for providers using that rule change as an excuse to stop paying trail commission on Pre-RDR business.

The rule change for platform business was not seen as major issue, not least because, for established firms, it was relatively new business which could be easily converted to service contracts.

The perceived danger was if providers pulled trail payments on the older pre-RDR business. The FCA Conduct of Business sourcebook puts the onus on providers to assure themselves that the client is being serviced before paying this form of trail commission.

The fear (which was initially identified by IFA information supplier Panacea and was instrumental in creating both the interim *Heath Report* and *THR2*) was that providers had a vested commercial interest to use the rule change on platform business as an excuse to stop paying Pre-RDR trail. There were a number of articles in trade media at the time that suggested the same thing.

Commercially, it would provide them with an extra 0.5% on their bottom line which would not be given back to the client in reduced charges. Such an action would again strike the Generalist firms disproportionately compromising the existence of between 22% and 44% of existing businesses (*THR2 Printed Version Page 9*).

Standard Life Investments (SLI) took this action in March 2016 So far they are the only ones to do so.

Libertatem could stand accused of screaming before being hit. We would counter that *THR2*, which was heavily distributed to providers, may have stopped other providers taking this action once they had recognised its long term effect on the sector.

The removal of Pre-RDR trail still hangs over the sector as providers could yet decide to follow SLI's example. We also have Markets In Financial Instruments Directive (MIFID) II, which may reintroduce this as an issue.

Conclusion 4: RDR will cost the consumer £340m pa (with no associated consumer benefit).

11. The estimated costs presented in the Cost Benefit Analysis included high costs to the banks of changing their systems. In reality, however, many of the banks left the market for advice for a range of reasons, many of which were unrelated to the RDR. These costs therefore are unlikely to have been incurred by the industry on this scale.

12. Europe Economics were commissioned by FCA to conduct the first stage of an RDR Post Implementation Review. In their report, they made clear that it was early days since the implementation of the RDR (less than two years) and so definitive evaluation of all of the impacts and benefits was not possible, as some impacts were still to be fully realized. Even so, Europe Economics identified a number of very positive impacts, which are explored in more detail in paragraphs 47 to 54 below.

Libertatem:

The “raison d’etre” of RDR was to stop an annual £223 million consumer detriment due to “mis-selling”. This was a much-challenged figure at the time with many suggesting it was an over-estimate.

Even if you accept the FSA’s original cost of £600 million, that would create a 3-year payback period. The FSA then upgraded the 5 year cost to £1.7 billion, extending the payback period to over 7.5 years.

All this makes the huge presumption that RDR had completely cured the problem, which seems unlikely. We believe it is reasonable to ask whether in cash terms the cure was worse than the disease.

Financial Advice Market Review (FAMR)

13. We will continue to monitor the impacts of the RDR and developments in the sector. As the Committee is aware, we have been looking, alongside HMT, at ways of increasing access to advice through the Financial Advice Market Review (FAMR).

We remain of the view that the RDR is delivering some very positive impacts such as improving adviser professionalism and reducing product bias. FAMR, however, recognizes the challenge that those without significant assets or income may have in obtaining appropriate advice or support with their decision.

Libertatem:

FAMR exists principally because of the damage that RDR did to the availability of advice for Middle England. This came to Treasury's attention after the Pension Freedom idea came into the public domain.

We need to be clear that there were no unforeseen circumstances in the implementation of RDR. The TSC did an excellent job in inviting views and identifying issues which lead to the rejected suggestion of a delay in implementation of RDR which the FSA refused. Everything that was suggested to the TSC came to pass. Some of it more damaging than was originally identified.

The completion of RDR became both an example of regulatory machismo and a demonstration of FSA/FCA "Independence".

Libertatem believes that the FCA should apologise to Parliament, the TSC, and to the 25,000 people who lost their employment for the way RDR was introduced. But we are not holding our breath. To paraphrase the line from the film *Love Story*. "Regulation means never having to say you're sorry."

14. The recommendations from FAMR were published on 14 March 2016 (https://www.fca.org.uk/your-fca/documents/financial-advice-market-review-final-report). The report sets out a series of recommendations intended to tackle the barriers to consumers accessing advice.

Background

15. THR2 sets out the views of Garry Heath (Director General of Libertatem, a trade body

representing advisers, planners and wealth managers) in relation to the impact of the Retail Distribution Review, along with some wider views on regulation and government policy generally. The Retail Distribution Review (RDR) was introduced by our predecessor (the Financial Services Authority) at the end of 2012 as a package of measures to address the root causes of some of the problems that had persisted in the retail investment market over a number of years. The RDR sought to improve the level of professionalism within the intermediary sector and enhance consumers' understanding of the service they were receiving, and also to remove the potential for bias in the advice market where advisers were remunerated by product providers through commission.

16. The FSA recognised the potential impacts of the very significant changes which were being introduced and so not only set about one of the widest reaching consultation exercises it had undertaken, but also committed to review the impact once the changes had been implemented. As part of this post implementation review (PIR) Europe Economics were commissioned to give an independent, objective and robust assessment of the impacts that the RDR had made as of December 2014 (Phase 1 of the longer term post implementation review project). We continue to believe that it is the most thorough and methodologically robust study into the RDR that currently exists and draw on the evidence it presents in this response.

Libertatem:

Europe Economics is the consultancy firm who initially received £147,000 from the FCA to deliver an opinion favourable to RDR and the regulator's place in it. Anything that was critical of RDR was unlikely to find favour with the FCA, who was their client.

So the Europe Economics report is neither independent nor objective and it is only as robust as the FCA will allow it to be as they define the parameters of the work. In our opinion, it was commissioned too early in an attempt to silence criticism.

Its significant quote is: *"In relation to total cost of investment - or indeed the benefit to consumers from the advice received - the evidence does not yet enable us to draw firm conclusions as to whether this has changed post-RDR."*

At the same time Towers Watson was hired to research whether RDR had created an advice gap. By defining the Professional Advice sector as HNW only, it found that there wasn't a gap. This completely ignores transactional advice and the adviser market's previous role to 16million consumers.

Libertatem does not seek to criticise either of these firms. It is the nature of consultancy that firms are often hired to support their client's prejudices. We therefore believe that it is not possible to suggest that either of these reports could be considered as being "independent" or "objective".

For Libertatem, perhaps the most revealing part of both reports was the date they were issued – just before Christmas 2014. Consequently, much of the media had either started their Christmas break or did not take issue with the reports until January 2015. By then, the two reports were old news.

Had the FCA had real confidence in these reports it would have issued them with maximum press coverage either earlier in December, or in the January of 2015. The fact they were issued at a time they would not be picked up on by the media we believe is significant. And it worked: Press coverage was minimal and didn't occur until at least two weeks after the reports were released.

17. The next phase of the PIR is planned for publication in 2017, allowing us to draw from at least three years of evidence. A subsequent, third phase of the review will consider the longer-term implications.

Purpose of this report

18. This report gives our response to the conclusions of THR2, including our view on both the numbers given and the methodology used. We also provide a summary of the findings from the first stage of the RDR PIR, which found that, although it was early

days since implementation, there was evidence of some very positive effects for consumers, such as: greater adviser professionalism; a reduction in product bias; and falling prices in some areas.

THR2 Conclusion 1: Since RDR was announced 13,500 advisers have left the industry

19. THR2 states that since the RDR was announced in 2008, 13,500 advisers have left the industry, made up of 7,750 bank advisers and 5,750 IFAs.
20. As previously set out in the RDR Post Implementation Review, there has indeed been a fall in the numbers of advisers in the sector. This is shown in the diagram on Pg. 54, Retail Distribution Review: Post Implementation Review, December 2014, Europe Economics http://www.fca.org.uk/your-fca/documents/research/rdr-post-implementation-review-europe-economics:
21. This chart shows that there were approximately 40,000 advisers in 2011, falling to 35,000 in the summer before the RDR came into force. In November 2015 the total number of advisers stood at 30,600. This has remained stable since 2013.

Baseline for measuring RDR impact

22. The THR2 baseline against which it measures the number of IFAs leaving the industry is 2008. We do not believe the impact of the RDR should be measured from this point. The changes were not finalised until 2010 and did not actually come into force until 31st December 2012, and so while there may have been some departures in anticipation of the RDR, not all of the exits will have been directly as a result. The number of advisers had been falling steadily for many years against a backdrop of falling demand for advice which predated the RDR – not just advice on investments but in respect of all financial products. FCA data shows the proportion of the population who had sought advice across all products (not just investments) fell from 25% in 2008 to 13% in 2012.
23. We consider that it is more appropriate to take the total number of advisers in the market in the year before RDR implementation (35,000 in Summer 2012) as a more relevant baseline from which to measure the changes caused by the RDR. By going back further in time it becomes more and more difficult to identify the changes directly attributable to the RDR as opposed to other changes happening in the market.

Libertatem:

Once again, the FCA is moving the timeline in the hope of finding better ground. Essentially, the long term figures show a loss of 6,000 as posted in *THR2* and the FCA agrees – they have to as they are the source of that statistic.

However as this is inconvenient, the FCA wishes to only consider figures from RDR's implementation date. This argument is so poor we would suggest it to be beneath a regulator set up by an Act of Parliament. Allow us to demonstrate the issue and the timelines required to achieve it.

RDR came with two big ideas:

Firstly, a mandatory increase in examination to level 4 with no grandfathering and secondly, the removal of commission as an option for clients to pay for advice.

As a concept it has existed since 2004. It was properly announced in November 2008. The TSC asked for comments on November 2010 and at the notorious "Sants" TSC meeting 9th March 2011. It became clear there would be no turning back and that the introduction of RDR was going to happen whatever the arguments of the TSC and others. It was finally implemented December 2012.

RDR gave each advisory firm the same two questions to ask.

1. Do I want to pass the new level of exams?

If **Yes** an adviser needed a lead time of around 24 months to successfully complete the process.

If **No** alternative questions came into play. Who do I pass my clients to? Are others in the business going to continue to run it? Can I sell my business now and get a good price rather than waiting for implementation date when there may be a fire sale?

2. Can I configure my business so that my clients pay fees?

This presumes that the adviser has decided to advance to the new examination level. If they haven't, the question becomes academic. But if the adviser is unable to find clients willing to pay fees, there is no point taking the exam.

However, this impacts each adviser business model in different ways.

Boutique Advisers were already charging fees. They may already have had Level 4 qualifications. For them, the disruption caused by RDR was relatively small and as they already had a small number of clients, there was little need to decide which ones to keep and which ones to stop actively advising.

Segregated Advisers had a lot of work to do dividing their client banks into those who wanted a full service who might pay fees, those who required less attention, and those that needed to be dropped. This group then had to create a new service for those who were paying less. This was potentially five year's work.

The Generalist Adviser was the most compromised by RDR. Their model was based on a large number of clients who needed advice infrequently. This advice was mostly paid for by commission. This model generally had clients from a lower income, lower investment level background who were not used to paying fees.

Some of this group have downsized their client banks, but have managed to find enough clients willing to pay fees to allow them to continue. Others have left the industry, or have chosen to just continue servicing the policies of their existing clients.

Sadly, one of the features of those who left the industry at this time is our inability to contact them now to ask them the factors behind their decision to leave. But, from occasional conversations with now retired IFAs, the major hurdle seems to have been the exam. Not just the time it took to qualify for level 4, but the belief that it was yet another regulatory demand and pressure that impacted on those nearing retirement age.

For this group, now was the time to retire and 6,000 of them did just that. As many were also Generalist advisers with extensive client banks, leaving large numbers of clients without a financial adviser.

RDR represented the largest change in regulation and distribution in a decade. It required a huge amount of work for the entire adviser community and resulted in a large number of major decisions being made that impacted on the future of the industry.

The suggestion that advisers were not making business decisions in preparation for RDR until the implementation date of December 2012 is laughable. Indeed, wise advisers started planning from 2008 onwards.

Factors contributing to a fall in adviser numbers

24. The RDR is not the only reason for a fall in adviser numbers. It is important to look behind the numbers to understand all the drivers of any reduction:

Demographics of adviser population

25. A decline in the number of advisers was expected before the implementation of the

RDR since the requirement for a higher level of qualification and professionalism would mean that advisers who were not able or willing to meet those standards would naturally leave, particularly those close to retirement.

26. Similarly, in 2011, 8% of Retail Investment Advisers stated that they expected to cease being an adviser after 31 December 2012 because of non RDR reasons, including planned or early retirement or a switch to another role within the industry.

Libertatem:

The FCA is now agreeing with us. Advisers left because of RDR's academic demands before December 2012. So surely they left because of RDR. No RDR = No Exam = No Exit.

As Point 26 suggest, surely if 8% of advisers left the industry for non-RDR reasons, it follows that 92% left because of RDR.

Majority of fall due to exit of bank advisers

27. The majority of this decline in adviser numbers (58 per cent of the advisers who left the industry in the period 2011-2014) 12 can be attributed to banks withdrawing from some parts of the market for advice. While the requirements of the RDR may have played a part, there were a range of other important factors at play. These include the commercial realities of maintaining a viable advice model based around geographically disparate, 'bricks and mortar' branches in the face of growing competition online and the impact of a number of significant mis-selling episodes.

Libertatem:

The FCA can seek other causes if it wishes, but the major drivers for the banks was broadly similar to those of professional advisers. The logistical issue and expense of marshalling 8,750 bank advisers through Level 4 was massive. Selling advice on a fees basis was also contrary to the banks' business model, which was to use advice as a way of selling products.

We suspect that the banks faced similar issues to Generalist advisers. Neither found servicing that level of client profitable at a cost the client would accept. This was even worse for banks, who carry a high overhead cost.

THR2 exists to examine the loss of advice availability – not advice quality. There are few who would bemoan the loss of banks' advice on quality grounds. Sadly, the unwillingness of successive regulators to bring a halt to a number of corrupt and dubious banking practices continues to this day. Indeed, FAMR is in great danger of being used by the banks to sell products via "guidance" which may well be advice in all but name. To this end, the sudden removal of the Banking Culture Review is a retrograde step.

Growth of non-advised market

28. At the same time we have seen a growth of the non-advised market, particularly now that the cost of advice is made clear to clients. As an example of the costs, a typical pre RDR commission taken on a £100,000 investment into an Investment Bond was 3% of the investment upfront with a 0.5% trail commission payable each year. This meant that the total amount received by the adviser over the first ten years was approaching £9,000 or 9%.

Libertatem:

£9,000 (or 9%) over the first ten years equates to less than 1% of the investment per annum. For advice and service provided over a ten year period, this does not strike us as being overly excessive.

29. These costs, coupled with an increasingly computer literate society, have meant that consumers use and transact on the internet more often than before and are more willing to by-pass advisers with self-directed investing via web-based services to save time and

money. NMG Consulting consumer research found that a significant proportion of consumers, particularly when investing smaller amounts, were happy to direct their investments themselves.

30. These impacts are summarised in a Cass Business School Report which states that "even without the RDR, the landscape for the advisor sector would have begun to change; technological advances have been making the creation and delivery of investment products more accessible and cheaper to a wider audience, whether guided by an advisor or not," and that "the industry was already shrinking pre-RDR". This is supported by data showing that the demand for advice in respect of *all* financial products (not just investments) has been falling since before the introduction of the RDR.

Advice Capacity

31. As THR2 suggests, adviser numbers on their own do not tell the whole story, since the issue is not solely the number of advisers but also the number of clients those advisers service which determine capacity in the market. The fall in adviser numbers does not mean a corresponding decrease in the capacity for advice. In fact, the evidence points to advisers having adequate capacity to meet demand:

    - Existing advisers in the market have taken on more clients — research by NMG Consulting shows that each adviser took on, on average, a net increase of 26 clients in Q2 2014.

Libertatem:

This coincided with the Chancellor's announcement of Pension reforms in March 2014. THR2 is happy to trade the back office records of over 1,000 advisers over 5 years from 2010 and 2015 for an odd quarter in 2014.

- There is also evidence that advisers are making greater use of technology (e.g. adviser — i.e. B2B — platforms and social networking sites) and paraplanners to grow their businesses and increase efficiency.
- Towers Watson's model estimates that the aggregate supply of full regulated advice outstrips demand.
- THR2 reports that in their survey firms felt they could take on an additional 54 clients on average in the next 12 months without compromising the services received by existing clients.

Libertatem:

This may be correct, but the commentaries we also received noted that advisers sought better (more profitable) clients, while continuing to rationalise their overall client banks so *THR2* also suggested that while the overall client ratio would not increase, client quality might.

THR2 identified the drop in the client ratio between March 2010 and March 2015 as 40 clients.

Whilst statistically correct, it downplays the drop in Segregated and Generalist sectors. Many Boutiques have a static number of clients which serves to dilute the overall change in ratio in other types of distribution.

If we repeat the survey as planned in March 2017. We expect another overall drop with some boutiques remaining static but those who had larger ratios rationalising vigorously.

32. In summary, there has been much comment on the absolute number of advisers in the market, which have fallen for a number of reasons, but capacity in the market is not determined by the number of advisers alone. The evidence suggests that there is still adequate capacity in the market to meet demand for full regulated advice.

Conclusion 2: Historically 23m consumers have accessed advice via IFAs and banks. Since RDR was announced 16.5m consumers no longer have that access.

33. We have reviewed THR2's analysis in this area and do not recognise the figures presented as the sources of the data are not always referenced. However, we have made some observations on the methodology as follows:
34. THR2 suggests that 23m consumers have historically accessed advice via financial advisers and banks. This suggests a greater number than corresponding data from the Personal Finance Society (PFS), which has consistently found that around 34% of the population had received financial advice at some time, equivalent to 16.5 million people.
35. Similarly, the size of the group of consumers "abandoned" appears high. This is because it is calculated by taking the figure for consumers who have received advice historically (23m) and then subtracting the estimated capacity for advice based on the number of clients THR2 estimates the advisers in the market *at a particular point in time* can service. Methodologically, it is not comparing like with like. Regardless of the RDR, it would seem unlikely that the stock of advisers at any one point in time would be able to service (even on an infrequent basis) all individuals who have ever had advice. It is also unlikely that they would need or seek advice at the same time. THR2 figures seem particularly high when one considers that in the 12 months to summer 2012, research estimates that investment advisers gave advice to 2.65m people.

Libertatem:

We picked this point up on Page 3 of this document.

36. The banking example in THR2 illustrates this point. The average stated client base for a bank adviser is calculated by taking the total number of people who have received

advice via a bank at any time (7m) and dividing by the number of advisers in November 2010 (8,750). This gives an average client base for a bank adviser of 800, however research from 2012 shows that the mean number of clients advised by bank and building society advisers per year was 110, so an active client bank of 800 appears on the high side.

Libertatem:

If the average return rate for banking clients matched the UK generalist rate at 7 years, then the figures quoted in THR2 are correct.

The FCA suggests we are not comparing like with like. But *THR2* is a study of advice availability, not how many consumers are advised annually. However, the whole RDR project, the FCA and Towers Watson seem to believe that every client should be what *THR2* calls "The Seriously Advised".

It is a nice aspiration, and if the British consumer took their finances as seriously as this group then the nation would not face many of its current problems. Sadly, THR2 has to live in the real world with real consumers, most of whom have to be challenged even to give an hour's thought to their financial future in any given year.

This is unlikely to be much improved by Money Advice Service (MAS), "guidance", or internet wizardry, as none of them can deliver (see *THR2 Printed Version Appendix Two Page 16*) the same as an adviser does for his client. Perhaps the most important task is to challenge the client to take their financial futures seriously.

THR2 Printed Version Appendix One Page 15 defines the different types of client. RDR has compromised the transactional and some regularly advised current clients. It will also adversely affect younger generations who may get to middle-age without ever being challenged to consider their financial futures.

The report then goes on to assume that the number of advisers has fallen by 7,750 (in the report bank advisers are estimated at less than 1,000 when there were actually approximately 3,700 in November 2015 - and in addition several of the banks have announced that they are re-entering the advice market). The report concludes that the number of bank customers left without advice are 7,750 bank advisers x 800 customers = 6.2 million. This would appear to us to be a high estimate.

Libertatem:

The November 2015 figure is both new and welcome. However, again avoiding mis-comparison, are all these banking advisers employed in advising clients full time?

37. It also assumes that clients of advisers (both financial advisers and bank advisers) who have exited the market are completely excluded from the market. In reality the exiting adviser might sell their bank of clients to another firm or the client may look for a different adviser. Similarly, those advisers who left the banks may have joined an independent or restricted financial adviser firm.
38. Europe Economics point to NMG Consulting's research which implies that 820,000 clients were gained by advisers in the twelve months to Q1 2014 (some of whom would have been previously serviced by advisers who had since left the market). Even taking account of some advisers stopping servicing some existing clients because they might be unprofitable (about 310,000 in the year to Q1 2014) and advisers refusing to take on clients for reasons of insufficient profitability (about 60,000) the positive net increase in customers serviced suggests that consumers looking around for an alternative adviser were largely successful. Europe Economics concluded that "we cannot rule out the existence of a residual group of consumers denied service in this way. However, these data do not speak to a significant issue here.
39. This said, the recently published FAMR report sets out our belief that steps need to be taken to make the provision of advice and guidance to the mass market more cost-

effective, particularly for those seeking help in relation to smaller amounts of money or with simpler needs. The report finds that there are a number of consumers who would be willing to pay something for financial advice but not the cost of full face to face advice. FAMR therefore makes a number of recommendations intended to deliver real improvement in the affordability and accessibility of advice and guidance to people at all stages of their lives.

THR2 Conclusion 3: If trail commission is banned in 2016 then the IFA sector will lose between 7,260 advisers and 15,510 advisers with an associated consumer capacity of 1.4m to 3m consumers.

40. It appears that much of the concern behind THR2 stems from a belief that trail commission on contracts set up pre RDR will be banned this year (April 2016). The concern expressed in THR2 is rooted in the impact on the advice community and a potential negative effect on the value of IFA businesses rather than on the outcomes for consumers.
41. We welcome the opportunity to clarify the situation We have not banned continued payment of trail commission to advisers in relation to pre-RDR advice on investments provided that the conditions in Section 6.1A of our Conduct of Business sourcebook are met.
42. The final rules on trial commission, which were published in November 2011, confirmed that commission for pre-RDR advice can continue to be paid and that it can be transferred to a different adviser if appropriate. This can take place either through a bulk transfer of business (e.g. on retirement of the original adviser) or where the client chooses to move to a new adviser, and the new adviser decides to seek transfer of commission payable in relation to the client’s existing products. In the latter case (but not in the case of bulk transfers), the new adviser must make certain disclosures to the

client and provide an ongoing service to the client.

43. Separately, there has been some confusion between commission payable to advisers and the ‘sunset clause’, which relates to payments received by *investment platforms* from product providers. Under the sunset clause referred to in THR2, platforms must stop retaining payments for their service from product providers by 6 April 2016. Platforms are already banned from keeping such payments for new business, and will also have to stop retaining them for product transactions executed on or before 5 April 2014 (when the rules came into force). Instead, they can only be remunerated through platform charges agreed with clients. The ban on keeping payments from product providers can be implemented either by the platform moving clients to ‘clean’ share classes or by the full amount of the payments being rebated to clients in the form of small cash rebates or unit rebates.

44. This sunset clause does not stop advisers continuing to receive commission in relation to pre-RDR advice, even where the advice related to assets held on platforms.

45. However, we are aware that some platforms/providers have chosen to move to ‘clean’ share classes which remove commission payments to advisers as well as payments by providers to platforms. This is a consequence of the platform/provider’s own commercial decisions, not a requirement of FCA rules. Interestingly, we have noted that the annual management charge to the consumer has been reduced by up to 50% or even more in some cases.

46. Moreover, as we have seen above (paragraph 28) trail commission can hide the true cost of advice from the consumer. The example in that paragraph shows that the adviser received a total of 9% in commission payments over the life of the product in essence for providing the initial advice, since pre-RDR there was no requirement to provide any ongoing service funded by trail commission.

THR2 Conclusion 4: RDR will cost the consumer £340m pa with no consumer benefit

47. The estimated costs contained in the Cost Benefit Analysis of complying with the RDR were revised (as highlighted in THR2) with the present value of the first five years' costs ranging from £1.4bn-£1.7bn. THR2 obtains the £340m pa cost figure by taking the upper end of this range and averaging over five years. However, the increase in estimated cost was as a result of the banks revising their estimates of the costs of the required systems changes significantly upwards during the period of consultation. In reality, many of the banks left the market for advice, for a range of reasons, many of which were unrelated to the RDR. These costs therefore will not have been incurred by the industry on this scale.

Libertatem:

We already picked up all these points – refer to Pages 5 & 6 above

48. As part of the Post Implementation Review (PIR) of the RDR, we asked Europe Economics to examine how the compliance costs that were incurred by firms compared with what we originally expected. They found that "compliance costs to firms of complying with the RDR are likely to have been as expected or lower than originally estimated".

49. THR2 states that "the Europe Economics report clearly opined there was no evidence of consumer benefit". However, from the outset of the report, Europe Economics made clear that it was early days since the implementation of the RDR (less than two years) and so definitive evaluation of all of the impacts was not possible, as some impacts were still to be fully realised. It has always been our expectation that it will take time for the changes to feed through to demonstrably better quality of advice. Even so, Europe Economics identified a number of very positive impacts, which are explored in more detail below.

What were the findings from the RDR PIR?

50. *Reduction in product bias* - the removal of commission paid by providers to advisers and platforms has reduced product bias from adviser recommendations. This is reflected in a decline in the sale of products which paid higher commissions pre-RDR and a move towards lower cost products and those which did not attract high commissions pre RDR. As an example of how product bias has reduced, chart 1 shows sales of low-cost index tracker funds rising almost threefold post RDR.

51. In the same vein, chart 2 shows how the introduction of the RDR at the end of December 2012 saw a move towards the use of share classes that were not the highest charging. The adoption of lower charging share classes has gathered pace ever since. By the end of May 2014, over 80% of flows were being directed into lower charging share classes as opposed to the highest.

52. *Greater adviser professionalism* - the vast majority of advisers are now qualified to the new minimum standards (with the remainder being new entrants undergoing training) and there has been an increase in the number of advisers going beyond these minimum standards. The increase in qualifications, along with greater focus on provision of ongoing advice services, indicates positive moves towards increasing professionalism in the advice market.

53. *Firm sustainability* - among advisory firms, average revenues have been increasing over the past few years, with average profits also up by about 20% between 2011 and 2013. At the same time, the percentage of firms posting a loss has decreased. Capital and reserve levels have remained stable or increased for the majority of those firms with a retail investment focus. This indicates an industry where advisory firms are better placed to meet their long-term commitments, provided they continue to build up capital reserves from greater profits.

54. *Falling prices in some areas* - product prices have fallen by at least the amounts paid in commission pre-RDR, and there is evidence some product prices may have fallen even

further. This is due in part to the introduction of simpler products and funds which have a lower charge and advisers and platforms exerting more competitive pressure on providers, with platforms increasingly able to negotiate lower product costs. The RDR has also made it easier for consumers and advisers to compare platforms, increasing competitive pressure and leading to a significant reduction in Direct-to-Consumer (D2C) platform charges.

Looking forward

55. It should be noted that key concepts contained within the RDR, in particular banning payments from providers to advisers, have been adopted by regulators around the world, for example in Australia, Canada, South Africa and several European member states. In fact, MiFID II, due for implementation in 2018, will prohibit commission payments for independent advisers and portfolio managers across Europe.

56. We will continue to monitor the impacts of the RDR and developments in the sector and have been looking at ways of increasing access to advice alongside HMT via the Financial Advice Market Review (FAMR). The recommendations from FAMR were published on 14 March 2016 and are intended to tackle the barriers to consumers accessing advice. The recommendations are, in part, directed at the FCA and the Government, but, consistent with our belief that this issue can only be tackled through a multi-faceted approach, we also make recommendations directed towards employers, service providers and consumers.