RDR: Remuneration for financial planning

The proposals for intermediary remuneration focus on achieving greater clarity in terms of the types of activities which make up advice, intermediation and outsourced services including on whose behalf the services are rendered.

Remuneration for advice will be based on two criteria. The first is that it will be calculated based on the ability to define the various activities comprising the delivery of the service. Secondly, it will take into consideration who the individual or entity is that will benefit from receiving the advice.

The FSB has set out certain principles for remuneration. For example, remuneration should not contribute to conflicts of interest, it must be reasonable and in line with the actual service provided and all fees which are paid by customers must be motivated, disclosed and explicitly agreed to by the customer. Remuneration structures should also strike a balance between the upfront advice and intermediary services and any ongoing support or advice given. The intention is to ensure that the remuneration structures promote level playing fields and to ensure that customers can easily compare the different types of services and fees.

In this article we explore the FSB's proposed remuneration structures for services/activities delivered to customers, with a specific focus on financial planning advice.

Financial planning is about providing advice and helping customers plan for and meet their life goals - for life and investment advisors. Inherent in this is a financial plan. It may also include ongoing reviews of the plan. For most advisors, this will be nothing new. For short-term insurance advisors one can define this as risk planning, including risk finance consulting, loss control advice and surveys and risk management advice. Specific fit and proper standards will be set for entities or individual who provide financial planning, upfront and ongoing product advice.

In the case of delivering financial planning services, the ***advice fee will be negotiated with the customer***.

As mentioned in last week's article, designing your value proposition is **step number one**. This is a wonderful opportunity to reposition the services you deliver to existing and potential customers. No longer is the financial plan part and parcel of what you do, thrown in for free in order to make the sale of a product. ***It is now the process and service which results in the financial plan that should be analysed, understood, itemised and costed in order to ensure from the customer's point of view,***

that they will be willing to pay an advice fee for it.

A value proposition should support the types of services you have identified as those you will be delivering to customers as it is the foundation upon which your remuneration will be based. Activities need to be clearly defined and you need to take into account which resource is best positioned to deliver these activities in the most efficient and productive manner – and most importantly to what extent these activities will add value to the customer because that is the one who will benefit from the receiving the advice and who will be paying for it.

Furthermore ***the value of your financial planning services as experienced by the customer will be influenced by the type of advice, expertise and support services your business can provide***, e.g. the advisory proposition for a FSP who focus on high-net-worth investment advice which only supplies a financial plan and no execution is likely to be very different from the advisory proposition used by a FSP who provides financial planning and execution focusing on retirement planning for mass-market clients.

What are some of the questions you should be asking yourself?

1. What services do your customers understand and value the most or the least? Importantly, it's what THEY value, not necessarily you.
2. Consider the profile of customers that your business currently attracts. Are they the types of customers you would like to attract, if not, what does the profile look like that will appreciate the value your financial planning advice?
3. Is the profile of customer (current and proposed) likely to be profitable for your business
4. What is the type of advice you could best offer, given core areas of competence and resources you have?
5. What are the skills, attitudes, experience and spirit in the business? What makes your FSP different to competitors? Why should they do business with YOU?

Areas that could further influence your value proposition are whether you are a small or larger FSP. Does the business have the ability to deliver the value proposition and therefore deliver on promises made? FSP's often serve many different client types and possess a range of areas of expertise. It might be worth considering whether a diverse range of client types and activities can provide the business with income streams that a narrow or specialist business may not be able to do – and, at what cost?

Research conducted by Harris Interactive on how consumers value advice shows some interesting results. Customers rated the following points as the most valued aspects of financial advice received:

1. The advisor's recommendations are based on the understanding of my needs - nearly half the face-to-face respondents rated this as the most important.
2. They help me better understand my options
3. Their expert opinion
4. Impartiality of advice
5. They save me time by researching options on my behalf
6. Personal relationship

7. They keep me on track with my financial goals and objectives
8. They proactively monitor my investments and keep me informed
9. They let me know about opportunities as they arise
10. They provide me with written reports

The most valued attributes of independent financial advisors:

1. Professionalism of the adviser – almost 50% of face-to-face respondents rated this as the most important.
2. Independence of the advice
3. Adviser's reputation
4. Adviser's qualifications
5. Strength of personal connection with the adviser
6. What they charge

RDR : Services Connecting Customer and Product Supplier

The RDR proposals seek to give retail customers confidence in the retail financial services market.

The key structural changes are to make sure that customers receive fair treatment by placing greater responsibility on product suppliers, to address a variety of conflicts of interest by defining the type of remuneration which can be earned and from whom and to ensure greater understanding by clear, transparent and fair disclosure.

For this reason, the activities which make up a financial service to a customer need to be clearly defined so that the remuneration for an activity can be paid for by the person who is benefiting from that activity.

As we discussed last week, the 3 broad activities set out in the RDR Discussion paper are:

1. Services to customer;
2. Services linking the customer and product supplier;
3. Services to product supplier.

There are many activities which an advisor performs, some of which are prescribed by legislation. In the current structure, remuneration for the different types of activities is often combined and it is not always clear who is paying for what. Advisors will need to be able to classify the different types of services that they give to their customers so that their value provided at each point in the process of rendering a financial service to a customer is clear and defined. Masthead already provides support to its members by running seminars and workshops regionally that provide guidance to advisors in defining their value propositions.

Looking at some of the services which connect product suppliers and customers, the FSB separates the activity of sales from ongoing product maintenance/servicing as follows:

- **Sales Execution** relates to the activity of "selling" a product which can be done with or without advice. Where it is done with advice, the ***remuneration for the advice is separate*** from the remuneration for the actual "selling" of the product which is where an advisor truly intermediates between the product supplier and customer. "Sales Execution" will be defined in the regulatory framework and standards set regarding the provision of this service.

- **Ongoing Product Maintenance/Servicing** relates to the after-sales maintenance and servicing which an advisor provides to a customer in relation to the financial product which has been sold. This is where an ***advisor acts as a go-between*** to facilitate post-sales transactions such as:

    - Product related communication
    - Routine administrative queries by customers in relation to a product
    - Execution of product changes such as beneficiary alterations, exercising benefit options
    - Collection of insurance premiums
    - Claims and disbursement management such as receiving and submitting of claims or helping a customer to access funds.

    These services are separate to any ongoing product advice that may have led to or be provided together with the administrative service concerned.

An advisor needs to always distinguish between advice giving activities and those which are more administrative in nature and are performed as a go-between. Those ***services which link the product supplier and the customer must be paid for by the product supplier*** (except in the case of investments) as they could have been performed by the product supplier in the absence of the advisor. The activity of selling would take the form of sales commission, while remuneration for ongoing product maintenance or servicing would take the form of a service fee – both paid by the product supplier to the intermediary.

<u>Importantly</u> however, it is proposed that product suppliers will be prohibited from remunerating advisors in the form of commission or fees for the sale or servicing of investment products. This means that ***only advice fees may be charged by an advisor in respect of investments***, further details of which will be dealt with in a separate article.

Turning to life insurance risk business, ***long-term insurers will be able to remunerate an advisor directly for selling life risk policies*** as well as for certain types of ongoing servicing or maintenance of such policies. However, because commission payable under current regulation presupposes that this will cover both the cost of advice and other intermediary services, by separating these services, advice to be paid for by the customer and intermediary services to be paid for by the product supplier, the amount of commission payable should be reduced as this will now only remunerate intermediary services and not fees for advice. One of the principles discussed is that an advisor should not be paid twice for the same service.

As a result there will be changes to the maximum commission levels allowable but these have not been defined as further work is required before these can be determined. As always, Masthead will gather input from its members and make submissions to the Regulator as it will be important that maximum levels support the objective of sustainability.

This does not mean that an advisor will have to earn less. It means that ***the way in which the advisor will be remunerated will change***.

Consideration was given to the case against full as-and-when commission and it has been proposed that a ***balance*** be struck ***between up-front and ongoing commission with 50% upfront and 50% ongoing commission***. This will be 50% of a lesser maximum amount which is still to be determined.

The proposals also point to a ***prohibition on any form of commission payable by a product supplier on replacement business***. This means that any activity in regards to a replacement policy which connects a product supplier and a customer cannot be remunerated by way of commission. However, an advisor can still charge a client for the advice, both upfront and ongoing. This proposal may need to be carefully considered to ensure that unintended consequences do not prejudice the customer. Masthead will be considering feedback from its members to ensure that constructive comment in regards to this proposal can be included in the formal response to the Regulator.

PREPARING FOR THE LONG-HAUL: In unpacking a small section of the RDR Proposals, the important question is what can advisors do to prepare for the changing environment. Advisors will need to first decide what their long term goals are and whether remaining in the industry forms part of these goals. If they are in for the long haul, then it is imperative that early preparation begins so that they can drive the change in their own business which will be needed to adapt to the new environment. Advisors are able to earn and be remunerated for all the activities which they perform both for their customers as well as for product suppliers.

Being absolutely clear about the types of activities which are performed, the value offered, what they can charge and who is responsible to pay will form the groundwork for an action plan to ensure a safe transition from the current business model to a completely overhauled model.

The FSB has given assurances that there will be a phase-in period and from our interaction with advisors in the UK, it is clear that those advisors, who begin sooner rather than later to prepare their businesses for the change, will have a greater chance of success.

The end of SIGN-ON bonus

The "sign-on bonus ban" has become reality as Board Notice 146/2014 was published on 4th December 2014, incorporating its provisions into the General Code of Conduct (the Code) and amending the Code. Although this was dealt with separately, the issue of sign-on bonuses was addressed in the RDR discussion paper, and supports the objective of addressing conflicts of interest and promoting fair competition.

The amendment provides that:

- A Category I provider that is authorised or appointed to give advice may not receive **a sign-on bonus** from any person.
- No person may offer or provide a sign-on bonus to any person, other than a **new entrant**, as an incentive to become a Category I provider that is authorised or appointed to give advice.

Masthead, along with other commentators, submitted comments in response to the draft amendments and the FSB addressed several concerns raised by the industry regarding the draft amendment released earlier this year.

The amendment defines:

- **"sign-on bonus"** as any financial interest offered or received directly or indirectly, upfront or deferred, and with or without conditions, as an incentive to become a provider; and includes, but is not limited to, compensation for potential or actual loss of any benefit including any form of income, or part thereof; or cost associated with the establishment of a provider's business or operations, including the sourcing of business, relating to the rendering of financial services; or a loan, advance, credit facility or any other similar arrangement.
- **"new entrant"** as a person who has never been authorised as a financial services provider or appointed as a representative by any financial services provider.

The Registrar, as regards **providers who are not new entrants,** recognises that industry may have to restructure remuneration arrangements to provide for basic salaries. Therefore the prohibition does not restrict a provider from structuring its **remuneration arrangements** in such a manner that it provides for a basic salary. However, such remuneration arrangements must be equally available to all employees and not only a select few.

Whether or not a remuneration arrangement amounts to a sign-on bonus is a factual question that will be considered against the provider's normal remuneration arrangements, the extent and equivalence of participation by all employees and whether the arrangement is commensurate to the services being provided.

Please click here to download BN 146 of 2014 and click here to view the Response of the FSB to Comments Received.