TISAtalks…RDR

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OH FOR A CRYSTAL BALL: DISTRIBUTION DILEMMAS

What often seems a great idea can with hindsight become a far more challenging millstone and the assistance of a crystal ball could be most useful on these occasions. This is probably true when reflecting on control and investment in advisory businesses.

In my time as National Sales Director of a FTSE 100 provider, with stringent financial and compliance controls, we often looked anxiously at other providers investing in distribution with assumptions around how to capture new business scale and market share as payback for their investment. My provider employer had canny financial minds, which, no matter how differently I constructed a potential business case, could not always appreciate the long-term profit and dividend return to shareholders on such an investment idea.

My crystal ball is becoming clearer now as those providers continue to relinquish their majority or minority shares in advisory businesses. It seems the realisation has dawned that capital invested has continually failed to gain control over distribution and grow market share.

The situation has been exacerbated with the arrival of RDR and can be seen in the ownership of Sesame with Friends Life and Positive Solutions with Aegon changing hands as the provider seeks to focus on those core activities which can deliver a return and profit margin with some certainty. It would seem to suggest that life company ownership of advisory firms, both large and small, could soon be a thing of the past. It is becoming apparent that provider owned advisory networks and nationals are unlikely to last into the future. These advisory firms in a post-RDR world now require a different ownership structure and the purchase of Positive Solutions by Intrinsic will be watched with interest. The model here has so far done well as it is vertically integrated through ownership of the asset management company (Crillium) and has created momentum with advice and assets.

Prior to the implementation of RDR, impetus was given in the FSA "Dear CEO" letter which outlined with some certainty those perils of circumventing the commission ban through distribution agreements and marketing packages. Whilst these arrangements are not illegal the FCA will require robust and detailed evidence from both parties of a convincing joint venture business and marketing plan strategy with absolutely no detriment to consumers. The financial mechanism of networks particularly are changing due to the original FSA's rules on marketing allowances and payments which some networks have been very dependent on.

Additionally, a number of networks have consistently posted large losses whilst at the same time accumulating an increasing number of complaints against their sales and compliance process. This makes the model very expensive to operate where these costs need to be controlled.

The main driver from a provider's perspective for a change of tack is that owning an advisory business as a parent shareholder does not result in control over distribution. Whilst a provider may have total ownership or a stake in an advisory business the parent probably had the aim of controlling product sales uppermost in their minds. With best advice panels and advisory businesses sticking to the mantra of independence, this never materialised apart from a number of small exceptions.

Exercising control and effective management is indeed a very real challenge for the networks themselves. Many have grown rapidly, often by acquisition and amalgamation, arriving at a period when the RDR has increased the cost in addition to regulatory pressures. The current FCA input into the recent TISA project on suitability highlights a number of issues which would undermine provider control of advisory businesses.

The network structure included inadequate processes which failed to identify and monitor suitable sales, file reviews, supervisory visits and management information systems which were not fit for purpose together with problematic recordkeeping. Thematic reviews studied in the TISA project and breaches of Principle 9 in the Keydata saga have highlighted this. In part this emanates from networks originally offering shelter to independent small advisers who are used to doing things in their own way whilst the networks' core focus was

to leverage their entrepreneurial instincts and keep constraints on costs as minimal as possible. It's true to say that in the past processes, technologies and management competencies were acquired for a less demanding regime.

Post-RDR it makes more sense for providers to be attracted to restricted propositions where they have a chance of control and the independent tag is less relevant.

It is clear many life companies and providers are removing non-core functions and focusing on their central profit lines as they readjust to their position further back in the distribution chain. This will include in the future, building direct to consumer businesses as proven recently with Royal London, Standard Life and Aviva all proposing to build execution-only propositions for their legacy and non-advised customers. Indeed the Prudential have gone one stage further with a return to a modern direct sales force model.

TISA is working closely with the FCA to clarify the operation of distribution structures for direct to consumer, execution-only and simplified advice models for the benefit of not only the consumer but also those providers and advisory firms seeking to develop new world models and harness it to the digital revolution. Let me now reach for my crystal ball again…

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