TISAtalks…RDR

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PARTNERING IN DISTRIBUTION – THE WAY FORWARD?

With the arrival of the new year, advisory distribution firms are taking their first tentative steps under the new RDR regime.

In the past, outsourcing has tended to be associated with large companies, however, with the onset of RDR business models, the advisory market is witnessing a growing trend towards outsourcing amongst all financial advisers as they seek to lessen the burden of regulation and reduce costs to maintain sleek business models which serve their clients on a cost justification basis. This has been particularly noticeable in the area of investment recommendations and selection.

These outsource solutions can take many forms, from traditional multi-manager funds through to model portfolios and onto bespoke full discretionary services. From an adviser's perspective, the advantage appears to be tackling the increased costs of providing specialist portfolio management services which take the form of higher fees by the client rather than the adviser.

Amongst advisers post-RDR, there is also a perception that there is less risk for the adviser role as underperforming portfolio managers can be replaced whilst retaining client loyalty. However, outsourcing has its drawbacks for both the client and the adviser. This has become an issue for the regulator as highlighted by the FSA paper "*Replacement business and centralised investment propositions".* In this, the regulator wants to ensure clients are not shoe-horned into standardised solutions and outlines three main concerns regarding risk, cost and oversight. The first considers third-party risk profiling tools and whether the results lead to a significant mismatch between a client's attitude to risk and the returns they actually get. Secondly, the FSA wants to ensure additional costs associated with the implementation of a centralised investment proposition (CIP) are incurred in the best interests of the client. Lastly, the oversight of advice given must be robust and demonstrate processes and controls which fit client expectations and profile.

The drawbacks of outsourcing for advisers are slightly more difficult to pinpoint – initial concerns centre on the due diligence and suitability undertaken by the outsource partner and questions whether the business will continue to exist in its current form over the lifetime of the clients' investment cycle. There will, following RDR, be undoubted transparency on costs and pressure on management fees, which continue to fall therefore exerting additional pressure on the smaller discretionary management and fund management firms, posing possibly severe financial difficulty. Others will no doubt merge or combine businesses in order to achieve the requisite economies of scale required to drive those businesses in the new RDR world. These developments will sever relationships that may have been built up over a long period of time and, most importantly, the introduction of an outsourced partner who subsequently fails will reflect on the adviser who introduced them, potentially damaging those client relationships.

In addition, in this scenario the adviser is typically excluded from the investment process, which can add to pressure on explanation of their fees in the post-RDR world and the justification for them when cost for the consumer is likely to be squeezed.

The FSA paper once again places an emphasis on the individual receiving the advice and is subtly different to that characterised as *Treating Customers Fairly* (TCF). The FSA is encouraging advisers to be fully involved in the investment of their clients' capital, which presents operational challenges for advisers who are keen to improve the efficiency of the advice process and reduce unnecessary costs to provide the right customer outcomes.

Furthermore, the distribution advisory market is seeing certain advisory businesses building their own CIP. This is a potential route which reduces the drawbacks of outsourcing and allows focus on cost, performance, flexibility and business value. In particular, this method can focus specifically on cost with the exclusion of outsourced portfolio manager costs, reducing the total expense ratios. Invariably these business models will select a 'Restricted Adviser' route to market in order to control costs, due diligence and risk requirements for the firm's oversight from a regulatory compliance perspective. An in-house CIP does not have to be tethered to a particular platform and will not require clients to transfer from one platform or wrapper to another, making use of the existing advisory businesses infrastructure.

There has been a 'Dear CEO' letter on outsourcing to asset managers recently which focuses on effective recovery of resolution plans to avoid client detriment in the event of a third party outsource partner failing or getting into trading difficulties.

In order to succeed, the advisory business will need to demonstrate suitability, a coherent and fully implemented investment process for the client and where it adds value other than traditional investment models. This market will start developing at a pace into 2014 and beyond.

TISA's view is -

1. We believe that there is good evidence that CIPs can deliver decent, cost effective, consumer outcomes. We wish to support and encourage development of Propositions which deliver this.
2. We think that CIPS also deliver more consistent approaches to investment for homogenous consumer groups by following a structured and transparent process.
3. We believe CIPs can deliver both good value for consumers and more sustainable business models for advisory firms.

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