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.

Importantly 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.

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