FAMR: Feast or famine for IFAs?

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Intelliflo

Content

1. Introduction

The financial advice industry has always been dynamic. The introduction of the Retail Distribution Review at the end of 2012 shook the framework of the industry to its core, affecting how providers structured their products and the way advisers could service clients and meet their advice needs while running a profitable business.

In 2015, the introduction of the new pension freedoms further challenged the industry and brought into sharp focus the differences between 'advice' and 'guidance', with fears that doors were being opened to unscrupulous opportunists, keen to part people from their pension savings.

Fears were also raised about consumers not seeking advice and cashing in their pension pots to fund a better lifestyle.

Indeed, there is evidence of both these things happening, although many of those who have cashed in their pension pots are recognised to have had small amounts that are insignificant in terms of providing a useful supplement to the State pension.

Hot on the heels of the new pension freedoms came the announcement of the Financial Advice Market Review (FAMR) – not a coincidence considering what I've just highlighted. The government is clearly worried about the finances of low to middle income people and wants to find a way to encourage them to save more and become less reliant on the State in the future.

As the time for the FAMR panel to reveal their proposals approaches, we wanted to give advisers an opportunity to say what they think of the review and express their hopes and fears for the future.

Will the FAMR deliver a new dawn for existing financial advisers and encourage more to join the profession? Only time will tell.

Nick Eatock
Executive Chairman, Intelliflo

2. What is FAMR?

In August 2015 the UK Government announced the Financial Advice Market Review (FAMR) to examine how financial advice could work better for consumers and address the 'advice gap', defined as those who cannot or will not pay for full regulated advice, which the government believes is affecting consumers with modest income and ability to save.

Co-chaired by Tracey McDermott, Acting Chief Executive of the FCA, and Charles Roxburgh, Director General of Financial Services at HM Treasury, the review involves an external expert advisory panel led by Nick Prettejohn, Chairman of Scottish Widows Group plus senior figures representing financial services providers, financial advisers and consumer representatives.

The objective of the review is to find out:

- whether there's an advice gap for those people who don't think they can afford to get financial advice
- the regulatory or other barriers firms may face in giving advice and how to overcome them
- how to give firms regulatory clarity and create the right environment for them to innovate and grow
- the opportunities and challenges presented by new and emerging technologies to provide cost effective, efficient and user-friendly advice services
- how to encourage a healthy demand for financial advice, including addressing barriers that put consumers off seeking advice

The review included consultation with the financial advice industry which closed on 22 December 2015. It is reported to have attracted 280 industry responses.

A set of proposals for how to meet the objectives of the review is being produced and is expected to be announced as part of the 2016 Budget in March 2016.

3. What prompted the review?

The government is concerned that mid to low-resourced consumers do not have access to financial advice and with the introduction of the new pension freedoms the need for advice has been pushed into the spotlight.

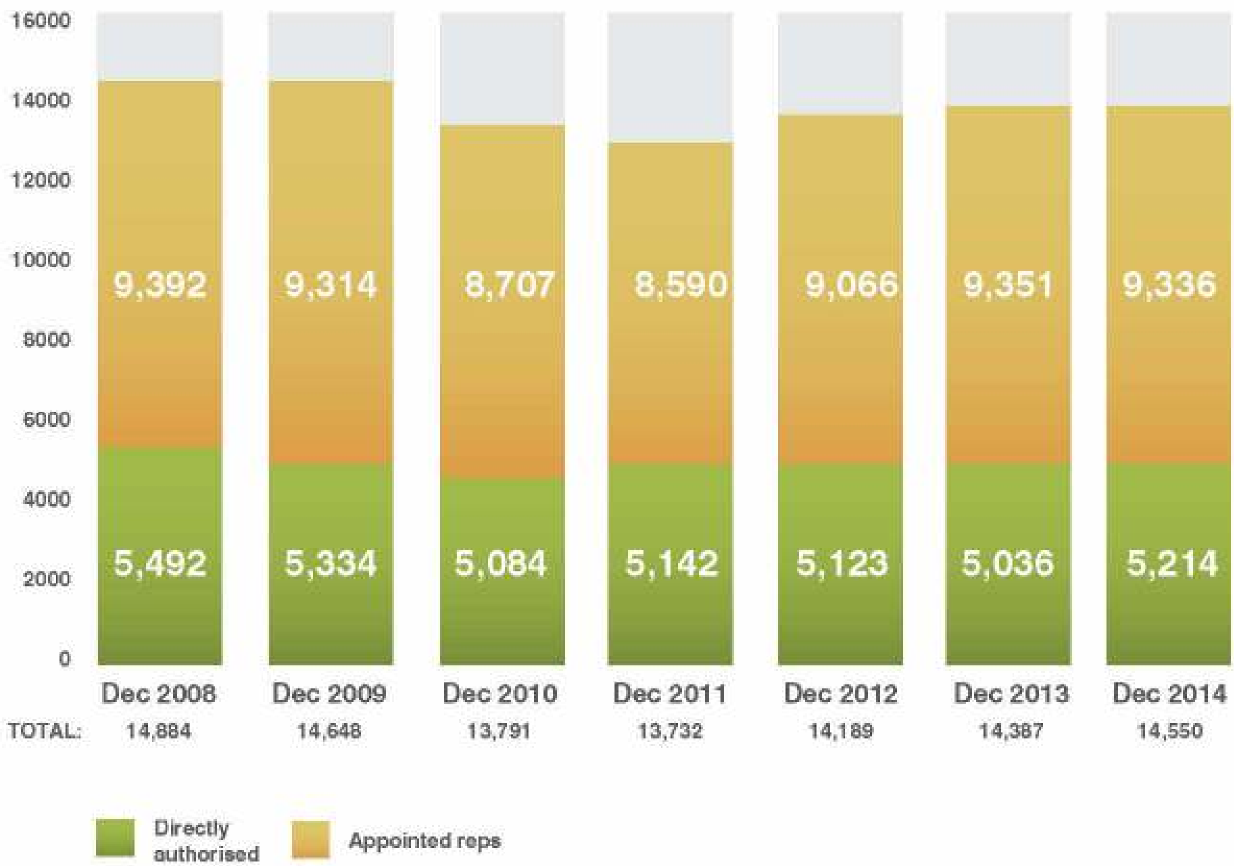
Although there is concern that the number of financial advisers is falling, figures published by the FCA to end of December 2014 show a slight increase between 2010 and 2014.

In spite of the available statistics not recording a drop in numbers among independent advisers, it is widely accepted that there is a gap between the number of ageing advisers who are likely to retire in the near future and new entrants choosing financial advice as a career.

The reasons for fewer people choosing financial advice as a career and the 'advice gap' opening up are, arguably, a result of the Retail Distribution Review (RDR), which came into effect in December 2012.

The RDR radically changed the way advisers could deliver advice and how they are remunerated. The fee-based model and abolition of commission-led saving and investment products resulted in many advisers focusing on clients who are able – and perhaps more importantly willing – to pay for advice with fees.

With the UK advice industry being highly regulated and compliance-focused, many advisers have found it is more profitable for them to target clients with significant investments, rather than working with those with relatively modest amounts and a reluctance to pay the costs associated with delivering the advice they require.



Source: Association of Professional Financial Advisers 'The Financial Adviser Market: In Numbers report

4. What might the FAMR proposals include?

There is much speculation about what the FAMR proposals will include but little clarification. Key issues include:

- what robo-advice, or digital simplified advice, can and cannot deliver
- a return to commission-based products
- how 'advice' and 'guidance' are delivered

4.1 What is robo-advice?

Robo-advice is one of the hottest topics to have emerged over the past couple of years. A recent Google search delivered almost one million articles that use the term.

But what is robo-advice and does it present a threat or an opportunity to UK financial advisers?

This is how Wikipedia describes the term 'robo-adviser':

> **"Legally, the term "financial advisor" applies to any entity giving advice about securities. But most robo-advisors limit themselves to providing portfolio management (i.e. allocating investments among asset classes) without addressing issues such as estate and retirement planning and cash-flow management, which are also the domain of financial planning.**
>
> **Other designations for these financial technology companies include "automated investment advisor", "automated investment management", "online investment advisor" and "digital investment advisor."**

In the UK, robo-advice is mainly used to refer to a form of simplified advice that is delivered digitally, providing clients with automated selections that lead them to a product that meets their needs without the involvement of a qualified financial adviser to guide them through the process.

In essence, this form of robo-advice has been around in the UK for years, with investment providers, for example, giving access to equity ISAs via an online selection process. Such products include baskets of pre-selected funds that meet risk-rated criteria that match the risk appetite of the investor, determined through a series of online questions.

So what's new?

The digital revolution has led to two significant developments:

- cost-effective technical solutions that make delivering digital simplified advice (robo-advice), possible for organisations of all sizes
- an increased consumer appetite to engage digitally with financial services

How might robo-advice feature in the FAMR proposals?

According to reports from an FCA exploration event on robo-advice held in autumn 2015, the government sees technology as having the potential to help stop consumers being put off saving for their future by the cost of advice.

As such, it's expected that the FAMR will propose a way to regulate robo-advice to make it 'safe' for consumers yet make it simple to use and lower cost than the traditional advice route.

What is clear is the UK Government is a big fan of financial technology (fintech): it appointed a special envoy, Eileen Burbidge, in July 2015 to promote it regionally and abroad.

4.2 Commission-based products

Perhaps one of the most controversial topics to come out during the FAMR process has been the suggestion that the review may lead to the reintroduction of commission-based investment products.

Tracey McDermott introduced the idea in an interview with BBC Radio 4's Money Box programme in January 2016 when she said that while the FCA did not want to overturn the RDR, it was revisiting its outright ban on commission linked to investment products.

The RDR banned commission payments to financial advisers as a way to stamp out mis-selling.

> *"Millions of people will benefit from a right to free and impartial guidance on how to make the most of the new pensions choices..."*
>
> **George Osbourne** Chancellor of the Exchequer

4.3 'Advice' and 'guidance'

The issue of 'advice' versus 'guidance' came to the fore with the introduction of the new pension freedoms in April 2015.

When he announced the new freedoms in his budget speech in April 2014, the Chancellor, George Osbourne, stated that each and every defined contribution pension saver would get "free impartial advice on how to get the most of their pension".

This caused a furore which focused on his definition of advice and resulted in the government announcing in July 2014 that, "Millions of people will benefit from a right to free and impartial guidance on how to make the most of the new pensions choices..."

While the FAMR is all about examining advice, the government is also reviewing how providers of guidance, including the Money Advice Service and Pension Wise, can be made more effective.

One of the issues the FAMR will be considering is how many people who currently fall into the so called 'advice gap' actually need advice and who could benefit from guidance instead.

5. FAMR and the banks

The growth of robo-advice, the government's decision to drop its review into banking culture and its desire to see affordable advice channels available for consumers have opened the door for Britain's banks to re-enter the advice market.

HSBC and Santander have both announced they will launch simplified investment advice to consumers with less than £50,000 to invest during 2016, although HSBC has said this will not take the form of robo-advice. Lloyds and the Royal Bank of Scotland are also reported to be planning to launch robo-advice during 2016.

There is speculation that the FAMR proposals will play to the banks' strengths, allowing them to step in to service the low to middle income consumers who currently don't receive any financial advice.

How this will be charged for and whether consumers will trust them with their investment money after years of fines due to mis-selling scandals remains to be seen. Certainly issues such as Lloyds' £28 million fine for the incentives it offered to retail investment staff, or the £10.5 million HSBC was fined for mis-selling investment bonds to elderly clients are ones the government will not want to see repeated.

"I don't regard the banks as a threat. If the correct controls are put in place they are in a good position to meet the needs of people with small amounts to invest."

Alan Moran Interface Financial Planning

"Banks have proved for decades how inefficiently they have dealt with advice. There is a real need for rules - don't leave it in the hands of the banks' marketing departments."

Paul Dodd Paul Dodd Asset Management

6. The advisers' view

So what do some of the UK's financial advisers make of the FAMR and how do they think it may impact on them and their businesses? We asked 200 advisers* who use our Intelligent Office business management software for their views.

Here is what they said:

> *"I can see why the government wants to open up advice but the people they are targeting aren't likely to seek advice, even though they need it."*
>
> **Paul Dodd** Paul Dodd Asset Management

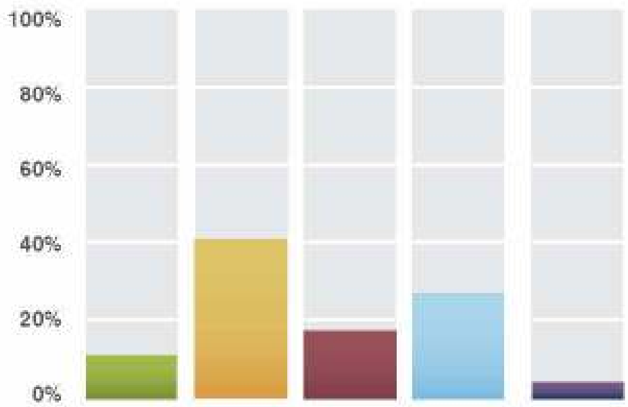
1. How do you feel about the government/the regulator getting involved in trying to open up the advice channel for people with relatively small amounts of money to invest?

One in 10 (11%) of those surveyed wholeheartedly welcome the review, while one in five (41%) welcome the review but are concerned that it is being rushed.

Over a quarter (27%) are unhappy at the way the government/the regulator keeps changing the rules about how advisers can run their businesses.

One in 6 (17%) don't welcome the review and think it should be left to commercial businesses to decide what sort of clients they want to attract. It's not something the government should get involved with.

> *"I never cease to be amazed by the regulators of the financial services industry. As soon as they introduce changes they start to question what they've put in place."*
>
> **Peter Harrington** Hodge Bakshi Financial Services



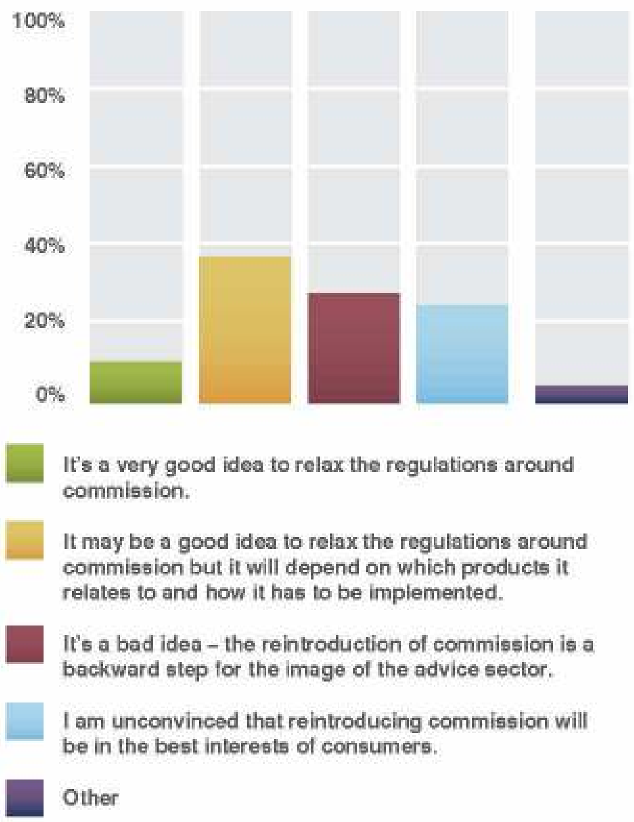
- I welcome the review and think it is being carried out in the best way.
- I welcome the review but I am concerned that it is being rushed and I worry about the decisions that may be made as a result.
- I don't welcome the review. I think it should be left to commercial businesses to decide what sort of clients they want to attract. It's not something the government should get involved with.
- I am unhappy at the way the government/the regulator keeps changing the rules about how advisers can run their businesses.
- Other

2. There is speculation that regulations around commission for investment products may be relaxed to allow advisers to help open up the advice channel for the less wealthy. What is your view of this?

Just over a quarter (27%) of the 203 advisers who took part in the survey said they thought it was a bad idea for commission to be reintroduced and would be a backward step for the image of advisers.

More than a third (36%) said they thought it may be a good idea but it would depend on which products it relates to and how it has to be implemented.

Almost one in 10 (8%) said they thought it was a very good idea. Around a quarter (23%) said they were unconvinced the reintroduction of commission would be in the best interests of consumers.



"Clients will be charged for the level of advice provided and what we decide to call the method of settlement of those charges is missing the point. Clients have to be charged for the advice provided and those charges need to be settled, whether we decide to call that settlement fee or commission is irrelevant."

Richard Wheatley OneLife Wealth Advice

"Commission has a place for the lower net worth client who can't pay what it costs me to carry out a review. If commission is brought back it must be capped – the old days of 7% is too high."

Peter Harrington Hodge Bakshi Financial Services

"The RDR has left us with a broken system. It introduced one model that favours those with significant amounts to invest and has left those on low incomes and small savings out in the cold. Bringing back some form of commission may help to redress the balance."

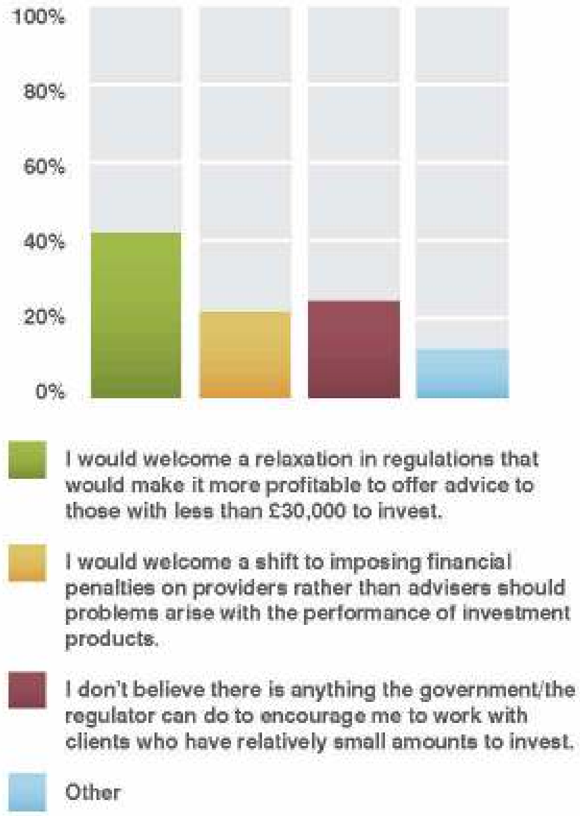
Peter French Integrity Wealth Management

3. What could the government/the regulator do to encourage you to do more business with clients with relatively small amounts to invest?

Almost a quarter (24%) don't believe there is anything the government/the regulator can do to encourage them to work with clients who have under £30,000 to invest.

Around two in five (43%) would welcome a relaxation in regulations that would make it more profitable to offer advice to those with less than £30,000.

Around one in five (21%) would welcome a shift to imposing financial penalties on providers rather than advisers should problems arise with the performance of investment products.

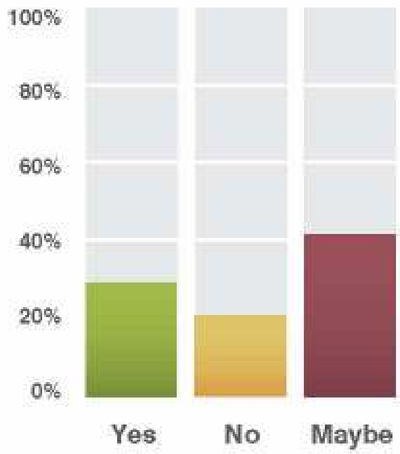


> *"For advisers to be able to give advice to anyone it has to be profitable. Less red tape would make it cheaper. Use of smart technology also helps to reduce costs. People expect to have more digital interaction so a mix of options to suit different people's requirements – priced accordingly – is the way forward."*
>
> **Richard Wheatley** OneLife Wealth Advice

4. Are you prepared to adapt your business model to provide investment services to people with relatively low amounts to invest?

A third (33%) would be prepared to adapt their business model to provide investment services to people with relatively low amounts to invest.

Around one in five (22%) would not be prepared to adapt their business, with the majority (44%) open to considering adapting depending on the outcome of the review.



"I would consider adapting if the review creates opportunities for offering advice to people with less than £50,000 to invest in a profitable way. Robo-advice is interesting, as is the ability to charge commission for certain products."

Peter Harrington Hodge Bakshi Financial Services

5. What are your biggest hopes for this review?

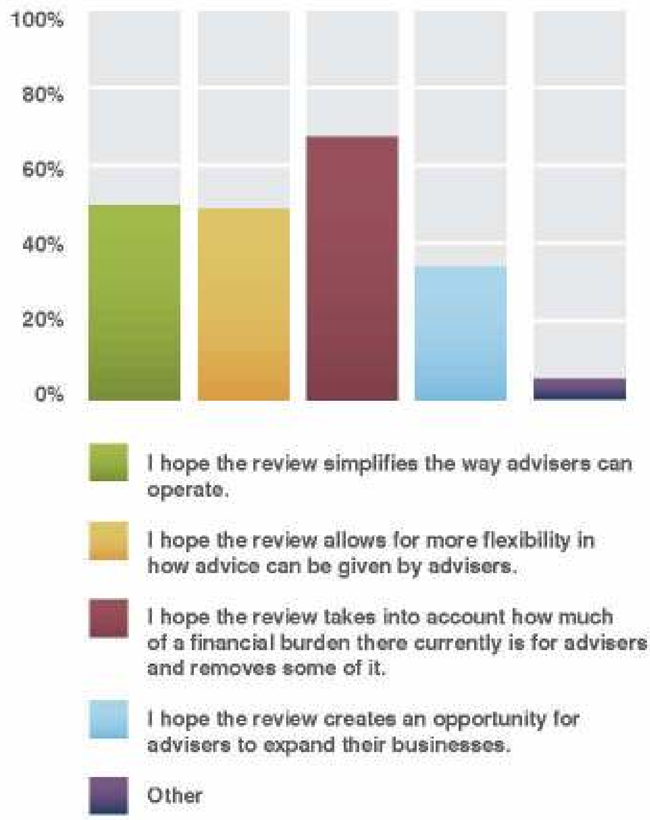
Two thirds (66%) of respondents hope the review takes into account how much of a financial burden there currently is for advisers and removes some of it.

Over half (51%) hope the review simplifies the way advisers can operate and allows for more flexibility in how advice can be given by advisers.

Almost a third (31%) hope the review creates an opportunity for advisers to expand their businesses.

"I passionately believe that everyone should have access to professional advice regardless of assets or income level – if the FAMR can help by simplifying and reducing costs this would be a great achievement."

Alan Moran Interface Financial Planning



6. What are your biggest fears for this review?

In terms of fears, over half (55%) are worried that all the hard work required for the RDR will be wasted should a return to commission be announced in the review.

Two in five (40%) are worried that the review will make it harder for advisers to run profitable businesses.

Almost two in five (39%) are worried the review is being carried out too quickly.

Around one in 25 (4%) fear that the review may be the last straw for them and will make them decide to give up being an adviser.

"I am concerned about the amount of work that might have to be done to run a simplified advice offer and the impact it might have on professional indemnity insurance. If we're not careful an environment that opens the door for claims chasers could be created."

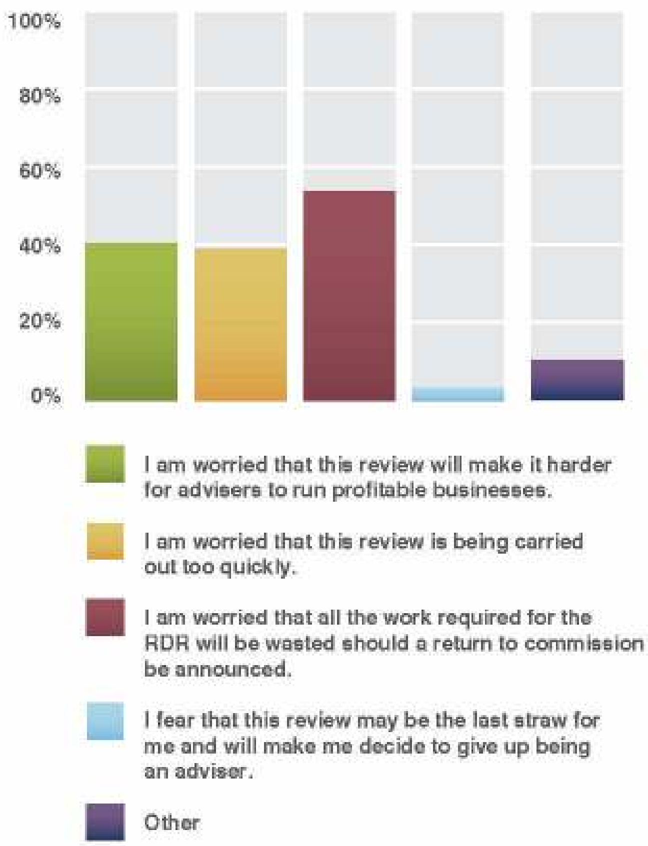
Peter Harrington Hodge Bakshi Financial Services

"I fear the review will impose rules that will backfire in the future. It seems to be being carried out in a bit of a rush but we will have to see what timescales are set out in the proposals."

Paul Dodd Paul Dodd Asset Management

"I fear that a relaxation in the commission rules could lead to a return of the bad old days of commission-hungry sales people."

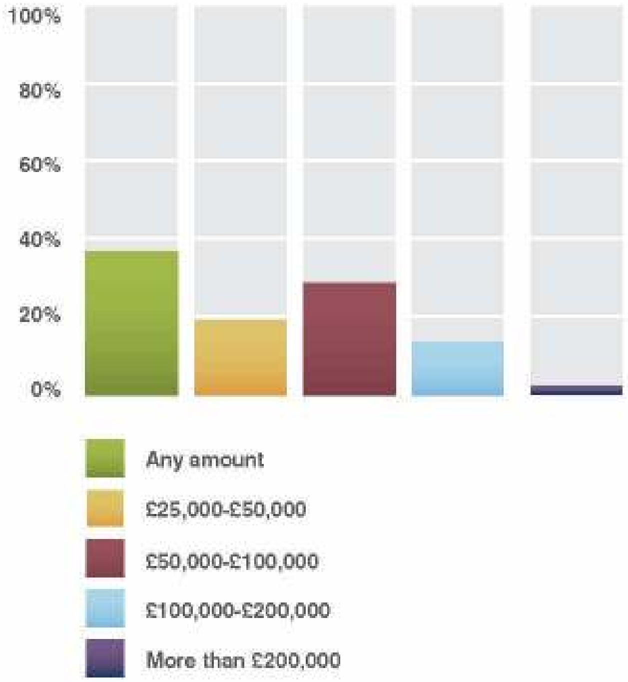
Richard Wheatley OneLife Wealth Advice



7. Currently what is the amount a person needs to have available for investment before you will accept them as a client?

More than half (56%) will accept clients with less than £50,000 available for investment, with over a third (37%) saying there is no minimum amount before they would accept someone as a client.

More than two in five (44%) require a minimum of £50,000, with almost one in seven (15%) requiring in excess of £100,000 as a minimum amount.



*Survey carried out with 203 adviser users of Intelliflo Intelligent Office between 18-29 January 2016