



The Retail Distribution Review - RDR

A transparent solution or opaque reality?

**A discussion paper on the real RDR ramifications
and effects on
financial services organisations**

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1. Introduction

The Retail Distribution Review (RDR) represents a unique challenge and opportunity for the UK financial services industry to undertake and complete change management programmes on an unprecedented scale. Such large-scale change in the industry has not been seen for some 15-20 years since the introduction of more vigilant high-level regulation in the 1980's and also commission disclosure in the 1990's.

The FSA regulatory driven move from commission-based product selling to a full fee based service, along with the fact that all retail financial consultants need to be diploma level and product providers and retail organisations need to be completely fair and transparent in their charges, represents a challenge and an opportunity for the industry to take the lead in procurement of 'fair service' to the consumer, which follows the FSA consultancy papers directives on moving the bias from industry to client and builds on the FSA's programme of Treating Clients Fairly (TCF).

Engage Partnership Ltd (EPL) believe the RDR offers the industry a juncture when critical decision's must be made which will define the form of retail based financial institutions for years to come. Threats to practising independent financial advisers (IFAs), retail banks, private banks, wealth management companies (WMCs) and product providers hang on their ability to recognise, understand, structure and implement the changes necessary, not only to survive the RDR new financial world order post-2012, but to thrive.

Whatever we may think about the Retail Distribution Review (RDR), the essential fact that cannot be ignored is, that as a review process, good or bad, it is over and we are now in the Retail Distribution Implementation (RDI) process - or at least we should be.

Like it or not, the industry has been judged wanting in terms of its competency and its approach to the provision of value for money services to the public.

Moving on requires acceptance of this fact. We must not underestimate the degree of change that the industry is being expected to undertake. Neither should we believe that there will be no unintended consequences - there will be - and they may challenge the very survival of retail financial services business models.

1.1 The heart of the change

If you stand back from the day-to-day minutiae of what wealth managers and financial professionals do, and ask "what is the change that we are really being asked to make?", it really is quite profound. They are being asked to deal with the fact that the financial services industry for most of its client base has a huge advantage in the asymmetry of both understanding and information. In the past, where this has existed, the major safeguard has been ethics. Unfortunately, while ethics are still extremely important, society is less willing to give any sector, be they politicians, medics or solicitors, carte blanche on trust; nor are they happy to rely entirely on the guardians of public trust to safeguard their interests, for they have been let down too many times.

The public, in all sorts of areas, are looking to adopt the same philosophy as international arms treaty negotiators, which was "trust but verify". They do, however, face a daunting task. They have access to more and more information yet they have less time available to analyse and process it. We therefore need to be able to redress the problem of asymmetry of understanding and information. We need to look again at the essential processes involved in retail financial services and improve the transparency of each. RDR is most commonly thought to be about competence and commission but we would argue that it goes far beyond this.

With much research on the RDR being prescription- rather than evidence-based, this paper addresses the key areas EPL see as imperative for all parties affected by the RDR to remain as competitive entities after the 2012 watershed. These areas are structured into three parts:

1. Value chain transparency
2. Engaging and maintaining client relationships
3. Efficient and controlled processes

EPL see these three specific areas as critical for all parties affected by the RDR changes and bridge the gap in breadth and quality of current research and the FSA consultancy papers. As we shall see if one, both or all three are ignored, this will result in a regulatory review for non-compliance and the potential loss of client trust and support.

Throughout the FSA's RDR consultancy papers, a theme appears that addresses the need for all parties that come under the RDR radar (Banks, IFAs, WMCs, Product Providers) to ensure their pricing and charging of products and services are fair, understood and transparent to the consumer.

As mentioned the bias now favours the client, and thus efforts need to be made now to ensure business models are aligned to the RDR objectives.

1.2 RDR myths and legends BUSTED:

Major change creates a need for great insights about the environment post-change. Only those with a detailed understanding of the entire value chain can bring really valuable insight. At EPL we observe that a great deal of comment and response to RDR seems to lack, in our opinion, truly valuable insight. In this paper we share our insights, and based on this, we feel it is important to point out the truths and untruths as EPL see the RDR and its implementation over the next two years to the January 2013 deadline:

MYTH and LEGEND	EPL OPINION	MEANING
<p>1. RDR applies only to the IFA community.</p>	<p>Incorrect: The RDR is a regulatory umbrella that covers all retail-related financial services organisations including the wholesale product providers and platforms or wrapper arrangements used as 'trading' platforms.</p>	<p>This means insurance companies, banks, fund warehouses, wealth managers and IFAs have to comply with the RDR rules. There will be continued industry 'noise' regarding changes to RDR such as House of Commons hearings, but currently there are to be no changes to the application of the RDR across retail financial services.</p>
<p>2. Commission will not apply to any service procured that constitutes advice given.</p>	<p>Incorrect: Products that do not fall under the RDR (e.g. mortgages and life products) will continue to pay commissions and renewal commission where applicable, but advice needs to be fee-based and charged as such (see section on financial adviser costs).</p>	<p>This means that fee advice will be separate from any intermediation given. Also, all parties (including the regulator) will need to make the move from a commission (product and knowledge) related mindset to fee (service and competency) based behaviour (see section 5: Consumer engagement).</p>
<p>3. Independence will be difficult to maintain post-RDR.</p>	<p>This depends: The business model adopted by the firm considering costs and restraints that the maintenance of true independence will bring will drive a move to independent or restricted advice.</p> <p>JP Morgan's paper on RDR gives great attention to this issue and cites one third of wealth managers expect to be 'restricted'. Some view this as positive due to a focus on expertise, others view this as a competitive drawback.</p>	<p>IFAs' business models will need to carefully consider the route to independence or employ restricted or simplified advice systems (see section 2.1 point 5). Issues surrounding independent or restricted status will need careful consideration such as 'bias' from other professions and access to relevant markets and RIPs. Many firms see the need for the definition of independence to be revised as different definitions may be applied to banks, IFAs, and private banks (see section 2.3).</p>

<p>4. Fee-based advice will cause industry polarisation.</p>	<p>This depends: Other jurisdictions have made a successful move to fee-based financial advice (most notably, Australia).</p> <p>Thus, although the fact that consumers may choose alternate distribution channels and IFAs may only retain high net worth (HNW) clients, such potential polarisation can only be considered as an unforeseen consequence.</p>	<p>Prospective polarisation is an issue that can be addressed with active planning, e.g. client segmentation, recognise any advice gap (e.g. savings/protection) and hard and soft skill learning and development programmes to address client interaction (see section 2.3).</p>
<p>5. Political and economic change means the RDR will change.</p>	<p>Incorrect: The EU commission is committed to the Packaged Retail Investment Products (PRIIPS) programme of industry transparency and removal of remuneration bias; the Consumer Financial Education Body (CFEB) commitment to consumer focus and UK financial secretary Mark Hoban’s remarks on building trust across the financial service industry and commitment to adviser professionalism: RDR compliance is a given.</p>	<p>RDR is now in its implementation stage and is here to stay. With a morphing of the FSA and The Consumer Protection and Markets Authority (CPMA), and such cross-governmental and industry support, the RDR will form a new benchmark model for other industries and regulatory jurisdictions to note.</p> <p>Despite recent political lobbying, RDR compliance is the new gold standard.</p>
<p>6. Commission style charges may still be built into products and paid as such.</p>	<p>Incorrect: Fee based advice means just that, the client will pay for the advice given and the product provider will no longer be able to employ extra allocation rates, trail fee rebates, charge from their trading account and all parties will stop layering charges.</p>	<p>A transparent value chain should mean healthy competition on fees, fair and understandable pricing for the consumer and charging clarity by the product providers (see point 2.3 and section 6). However, despite what we say, we would point out that the rules as currently written do appear to allow commission style charges provided they are not set by providers. We believe the rules as currently written have not been adequately thought through and remain a trifle opaque as to practicalities.</p>
<p>7. Adviser charging, not qualifications, are the biggest challenge.</p>	<p>This depends: The lobbying of parliament for qualification grandfathering may indicate otherwise, yet the structure level of fees charged by both product providers and advisers is far from clear.</p>	<p>There is no doubt the FSA has created unintended consequences via the RDR. What about the effect of VAT, the I-E insurance taxation system, and the potential attrition of adviser numbers due to qualification standards post-RDR? (See pages 16-18 & 27).</p>

<p>8. Unbundled platform charges will be banned post-RDR.</p>	<p>Incorrect: The FSA has recently reviewed its consultation papers on platform charging and succumbed to lobbying in planning to back down on disallowing unbundling of charges.</p>	<p>This means there may be a place for both bundling and unbundling, which may seek to confuse both the consumer and the industry. Clarification is needed as some platforms argue that unbundling will drive up costs due to fund managers controlling charges not platforms. Our view, though, is that the continued application of Best Execution makes bundled charging very difficult to sustain via an advice channel. (See page 21).</p>
<p>9. RDR applies to the 'hard facts' for business only.</p>	<p>Incorrect: The RDR mantra of transparency and professionalism are applicable across all levels of retail financial services including the communication of services, whether written or verbal.</p>	<p>The RDR brings a hard case for soft facts, where emotional intelligence, articulation of fees and procurement of products and services are integral to the success and competitive nature of the organisation. Communication of fee products and services is integral to successful RDR transition. (See section 5).</p>
<p>10. RDR will only affect front- line value chains of retail financial services.</p>	<p>Incorrect: RDR transparency applies to the whole value chain of product providers and retail financial firms alike. TCF, MPs' expenses scandals and the credit crunch means retail clients will demand value for money at all stages of the value chain.</p>	<p>Transparency, clarity, professionalism and trust are the key words associated with the RDR. This means that any potential blind-spots in the value chain of any product provider, retail or private bank, WMC or IFA, will cause significant damage to their optimal performance post-RDR compliance.</p>
<p>11. Many platforms and products are already RDR-compliant.</p>	<p>Incorrect: The rules require the provider or platform service to go beyond relying on adviser presented authority but to validate the adviser charge.</p>	<p>This goes beyond where we are today and for the most part you may as well be paid directly by the client.</p>
<p>12. Legacy trail is safe provided nothing is changed.</p>	<p>Incorrect: Think about the practicalities of trying to treat customers fairly and explain charging for new investments alongside the old regime for funds or product bought pre-RDR. The practicality is that you will end up re writing the whole basis of the commercial relationship!</p>	<p>Prices being paid for IFA businesses or for books of clients are probably currently excessive given the unsustainability of legacy trail.</p>
<p>13. Many advisers will exit the business and allow someone else to front for them.</p>	<p>Probably correct: BUT if they allow someone else to front for them, they run the risk of breaching FSMA2000. If they introduce "by way of business" and the business is a Pension or a Bond, i.e. any contract that falls within the definition of a <i>contract of life assurance</i>, there is no longer an exemption in the Regulatory Activities Order, and introducers would breach the "general prohibition".</p>	<p>Although the FSA may currently turn a blind-eye to this as soon as a problem arises, they will tackle it with their characteristic practice of bayoneting the wounded – so beware - do so at your future peril.</p>

<p>14. RDR will force more outsourcing of the investment service to Discretionary Managers (DFMs).</p>	<p>Possibly: However although many are going down this route now it will only be sustainable if there is a realistic reappraisal of the value that each party brings. There are also problems about who really runs the relationship and owns the client.</p>	<p>This ultimately means that DFMs who reshape their business model to accommodate this mode of operation may win.</p>
<p>15. Wealth Managers, DFMs and Stockbrokers will be happy to operate with the restricted disclosure.</p>	<p>Unlikely: It may sound OK at the moment but if they keep their advice permission and meet the new competence standards why would they not use this new competence?</p>	<p>The use of the restricted disclosure will be easily attacked by the new independent sector.</p> <p>The ABI have conducted considerable research on effective business models operating under simple, restricted or independent structures. (See page 19).</p>
<p>16. Banks will be the winners in a post-RDR world.</p>	<p>Unlikely: Banks will struggle to provide a ready supply of advisers who meet the higher competence standards. They have a history of being unable to organise to achieve their true potential. Besides, by comparison, they make too much money elsewhere.</p>	<p>There will be plenty of opportunity for advice businesses to prosper in the post-RDR world if they transform further and faster than they currently expect.</p>

2. Executive Overview

RDR Executive Summary:

With current investment advice practices closely allied with existing insurance and mortgage business inevitably the RDR has potentially far reaching implications for all involved in the financial services industry. It is clear that whilst the FSA's intentions maybe well placed the ramifications of such auditions regulatory change may prove difficult to fathom and manage.

A key area that has clearly not been considered is that of behavioural economics (see Section 5) and how such regulatory imposition will affect such a dynamic industry as financial services. Albert Einstein said that a true definition of madness is repeating the same action and expecting a different outcome; thus we would hope the history of UK financial services regulation and its consequences should be noted not brushed under the carpet by the FSA and a different outcome expected when the effects of the RDR are truly felt.

With its launch in June 2006 the RDR wanted to fundamentally reconsider how investments were distributed to retail consumers in the UK. With the FSA now having published their consultation papers with revisions to follow, we are now in the critical final phase and clarity and transparency for the RDR's impact on businesses is crucial to understand.

Through the RDR process, the FSA believes it has identified the various longstanding problems that impact on the overall quality of advice and restrict consumer confidence and trust in the UK investment market. In a world of principles-based regulation satisfactory consumer "outcomes" are all important and the FSA is concerned with eliminating customer detriment. Together with other elements of the FSA's retail strategy (e.g. TCF, financial capability) the proposals are designed to tackle the major shortcomings identified within the existing regulatory framework.

Yet it is on the very objectives of the RDR that confusion abounds, so much so that Hector Sants re-wrote the objectives in November 2010, reducing the objectives from six to three:

- A transparent and fairer charging system
- A better qualification framework for advisers
- Greater clarity around the type of advice being offered

Moving goalposts at this late stage cannot help the considerable unease and discomfort felt by the industry with the gateway to RDR enforced compliance looming ever nearer. With the FSA calling on all investment adviser firms and product providers to consider how they will adapt to these challenging reforms, EPL feel it important to outlay the key areas of contention as we see them by, as ever, pointing to the problems, and providing action points with solutions that if implemented as proposed, the RDR demands for transformation and modernised practices, significantly raised standards and the fair treatment of their customers maybe met and managed.

2.1 Industry inside-out view: adaptability of the current market:

The market structure as viewed from the industry perspective is characterised by six key areas:

1. Clarity of products and services:

EPL find that asymmetric information distorts competition in the market for financial products, making it difficult for consumers to choose an appropriate product. There is a lack of transparency about product charges, with rebating and discounting of stated charges being commonplace. Once products have been purchased, the service levels are reflected in limited evidence of switching if performance is not satisfactory.

The development of holistic long-term services and a clear consistent client proposition is in evidence and is essential for RDR survival.

2. Client needs:

A 'transformational' consumer relationship needs to be developed where flexibility and customer first focus is key. Transactional relations may fade but will also play a role, particularly where simplified advice or execution only is employed.

3. Professionalism:

Advice is and will be driven by transparency and ethics. Advisers are challenged with (QCF) Level 4 examinations, which are now effectively a license to trade 'Specialist' adviser roles already exist in the form of pensions transfer, long-term care and equity release advisers. However these are tied to product advice in their regulatory policing. The future may well see the need for specialist departments in adviser businesses with increased professionalism in their respective areas of expertise. This increased 'professionalism' may mean an increase in the overall price of advice.

4. Remuneration:

See Section 2.3

5. Business model:

Retail investment products in the UK is characterised at the provider level by large numbers of providers and advisers, and a number of different types of distribution channel. Vertical integration, with some providers, particularly life assurance companies, acquiring interests in adviser firms. The structure from the consumers' perspective is one of independent advice given or execution only advice offered by various firms, which is paid for indirectly through commission.

A significant proportion of business competition is aimed at persuading advisers to recommend a particular provider's products, rather than marketing the efficacy of

products to consumers directly. When providers compete with each other directly, this tends to be on the basis of factors such as past performance, reputation and price. At the distribution level, there is a perception that competition between advisers may be limited, as most consumers do not appear to shop around for advice. Any competition that does exist appears to be based on quality of service and access to products, rather than price. Commission bias has been identified as a feature of the market.

6. Market evolution:

Platforms and wrappers are examples of technological developments that have taken place in recent years. These have given advisers the opportunity to offer consumers a more holistic service, involving more efficient portfolio management services. In addition, platforms aimed directly at consumers provide easy access to a wide range of products and enable individual portfolio management. However, aside from the potential benefits of platforms, the Financial Services Authority (FSA) has identified concerns around their charging structures, in particular relating to their complexity and lack of transparency.



EPL ACTION POINT: *Centres of influence such as professional bodies and the Treasury*

Select Committee (TSC) need lobbying with evidence, not emotion, on the key issues about which organisations feel aggrieved by the RDR. EPL are currently presenting the case for their Efficient Transparency Index (eTpI™) and Evidenced Based Practice (EBP) to aid organisational RDR compliance to the TSC.

2.2 Outside-in view: Consumer perspective

The current structure from the consumer's perspective is one of independent advice given or execution only advice offered by various means, which are paid for indirectly through commission.

Which?

Consumers do not understand the market:

- Lack of trust.
- Restricted advice is misleading.
- Concern on cost of advice.
- Independence is preferred.
- Transparency needed.

A commission culture still permeates as 'free advice' and a move to fee-based charging may actually cause consternation in the short-term for clients (see section 2.3).

A contraction of IFAs and advisers in general is expected and quoted by some by as much as 20-50%. This leaves the consumer with a potential gap in the advice market and a

significant loss of experience for the industry.



EPL ACTION POINT: *Consumer awareness education on behavioural finance is integral to RDR acceptance. See EPL's RDR Relational Readiness in Section 5.*

2.3 Impact on the nature of competition:

Factory Gate Pricing (FGP)

A FGP model is already in force and used by some product providers and Intermediaries in the market. This is represented by the provider setting a price for their product and the adviser will then factor this into their charging structure which is then past onto the client in the form of cost for advice.

FGP = Clarity?

A move to factory-gate pricing could answer the Financial Services Authority's concerns about the transparency and sustainability of financial advice, suggests the ABI.

This cost for advice will be paid either by a fee or by inclusion as an additional cost of the product purchased. In both circumstances, the consumer will have to

agree how much they are willing to pay for the advice.

In terms of the impact on competition across distribution channels, an increase in competition would require FGPs to become transparent across channels. Multiple FGPs may be offered across different channels, and survey evidence indicating that some providers will offer multiple FGPs even within the adviser distribution channel. However, other providers expect to offer a single FGP to advisers.

Whether the FGP becomes a focal point for competition between channels or not will depend on whether, for example, networks and larger IFAs start to compete on FGPs and use them to attract clients. This could mean that FGPs become more transparent and could be used by consumers to compare products and prices within and across distribution channels, although this would require consumers to be proactive in this regard. The Association of British Insurers (ABI), believe FGP to be the best way forward for RDR fee transparency for all parties in the value chain.

In their RDR report to the FSA, Oxera consider the impact of the RDR package on competition within distribution channels and mechanisms that might lead to higher or lower FGPs in the IFA channel. IFAs' incentives to impose pressure on providers to reduce FGPs will be weaker than their current incentive to negotiate high commissions (which result in competitive FGPs at present). This is because, under the current regime higher commissions lead immediately to higher adviser incomes, while under the new regime, a lower FGP will not result directly in revenues to the IFAs (although to some extent they may benefit indirectly from negotiating lower FGPs if they manage to attract more customers and/or increase their sales and profits as a result of these lower FGPs).

Consumers could impose competitive pressure on providers (by shopping around for the best product), but are less able to do so than advisers because they tend to be less well informed. However, if the FGPs become a focal point of competition between advisers, or in the direct sales route, end-customers may reassert this competitive pressure.

Adviser Charging (AC)

EPL's view is that FGPs, although important, are generally associated with wholesale products

AC charging

- Charged when clear service agreed up-front with the client.
- Charged when commission is outlawed.
- Product neutral.
- Generated from cash a/c/unit cancellation.
- Ongoing service.
- Applies to all RIPs.
- Trail fees apply to business pre-2013.

and only reflect part of the story. Clear and palatable levels of AC fee pricing are paramount post-RDR and thus, as this will be at the advisory firms' discretion, a price war may erupt, but with adaptive and mimetic behaviour we will see fees find their own level where consumers are happy to pay and advisories are comfortable charging.

Financial Product and Adviser charging is one of the 'elephants in the room' for the FSA's RDR proposals - it is far from clear how this will play out post-RDR:

Could RDR lead to higher charging?

There is certainly a risk of higher charging in the immediate aftermath of the 'scramble' to RDR compliance. Yet in the longer term such higher margins may be reduced.

Increased transparency leading to competition on wholesale prices (e.g. FGPs) via end-customer behaviour may mitigate any upward pressure on ACs. Price is an important driver for competition and the effect of the higher net worth (HNW) clients placing pressure on higher ACs will also see prices come down.

Could RDR lead to price discrimination?

This already occurs with commission rebating. Thus, although there is an existing climate and culture, transparency will aid behavioural change management to a fairer unbiased fee-charging structure. We are already seeing developments where providers are prepared to negotiate price to be charged to the client rather than commission to the adviser. Aviva's introduction of price and risk consultants is a good example of this.

Could RDR lead to inferior product quality?

Providers will want to ensure their services and products offer the best value for the consumer post-RDR. Thus strong competition is expected to offer good service in terms of responsiveness and efficient handling of client support and requests. This will be a direct result of hourly fee billing and saving of costs to consumers with a quick response time. EPL believe clarity on unbundling of fees associated with platforms and 'wraps' (see page 18) will also aid development of quality products within retail financial services.

Provider competition will also increase incentives to improve the quality of their products that again would directly benefit consumers.

Could RDR affect product suitability?

The trade-off between suitability of product and commission payments is removed by the RDR. This means that product providers and retail firms need to take into account their own charging structure before recommendations are made to the consumer. This inevitably leads to a trade off between suitability and time employed to arrive at a solution. In theory there should be more business turned down because the time needed to do it right impacts on suitability. The additional time imposed by poor servicing as traditionally been paid for by cross-subsidy – who pays now?



EPL ACTION POINT: *AC is an elephant in the RDR room and needs to be clarified soonest if product providers, banks and intermediaries are to successfully make the transition to a fee-based structure.*

Value Added Tax (VAT) and advice costs

Joint guidance issued in August 2010 by HMRC and the ABI attempted to clarify the VAT liability of advisers' remuneration. Advice only is taxable, they confirmed, while arranging the purchase of a financial product is exempt. Where clients receive both services, the "predominant" one determines the VAT liability.

However, possible confusion over which service outweighs the other has swayed some businesses toward the 'safety net' of separating their charges for the benefit of the taxman.

This could provide a pragmatic solution that may avoid any retrospective VAT decision by HMRC, but by splitting the cost, this may actually incur VAT on part of the bill and thus this will inevitably be passed-on to the consumer, giving higher potential fees.

VAT charging may become RDR's Achilles' heel. Can the industry find an adequate solution to this issue?

EPL believe the recent self-inflicted problems HMRC have incurred through the new income tax collection system, either taxing individuals too much or too little, may come to haunt the RDR where VAT charging is concerned, as neither advisers nor clients would welcome an event stipulating VAT should have been charged when it was not, and vice-versa.

Although good work is being produced thus far by both ABI and HMRC in the form of guidance notes on the VAT issue, and it seems clear that VAT is to be charged on client receipt of advice only, not on purchase of a product (pension, investment, life or mortgage), EPL is encouraging further work to be conducted on the VAT issue in particular to the clarification on the potential splitting of services and which service predominates where VAT is concerned for the purpose of consistent value chain transparency.



EPL ACTION POINT: *The industry needs guidance and structure for VAT charging. This forms part of EPL's presentation on EBP to the TSC.*

Independent or Restricted advice?

The general view is that currently and more importantly post-2012, independent advice is the “Gold Standard” for firms and its maintenance post-RDR compliance is highly desirable.

Yet, in reality, for most firms independent status is compromised by a process-driven service offered through various distribution channels post-RDR. The internet, telephone, and face-to-face channels will all be utilised to a greater extent, yet it is probable that consumers will tend to want restricted advice as they feel independent advice is for the higher net worth (HNY) clients only. Polarisation of the industry is therefore a reality with the mass market going direct for advice or intermediation and HNY retaining a niche independent advice market.

EPL's Implications of Restricted vs. Independent Advice...

- Impact on outsourcing expertise to professionals.
- JP Morgan's survey of wealth managers = uneven playing field created between 'generalists' and 'specialists' (e.g. GPs).
- Both areas of practice have the same qualification standard.
- Relevant Markets and Retail investment products (RIPs) need clear definition.
- Is it commercially sound to be either?
- Clarification on definitions and significance is imperative.

The ABI have conducted a considerable amount of research on business models and presented simplified advice as a possible solution where clients will start with an automated system of assessment of needs that will then move to a filtering of clients to the offer of restricted or full-blown independent advice.



EPL ACTION POINT: *Intermediaries need to choose whether they will be restricted or independent and prepare financially for this choice. EPL's eTpI™ facilitates such decisions by streamlining the value chain, giving clear ROI for either option.*

Charges and fees

KPMG's July 2010 YouGov survey of over 3,000 consumers found that less than a third would be prepared to pay for one hour's professional financial advice, and that of those who would pay over half would only be prepared to pay £50 or less while only one percent would be willing to pay over £200. The economics of the RDR will therefore be hard for the financial industry to balance, KPMG warns.

EPL believe that, in time, consumers will realise the true value in paying for advice - but only

Consumers - a challenge?

KPMG's YouGov survey:

- Consumers unwilling to pay for financial advice.
- £50 ceiling for majority of those that will pay.
- IFAs are the most trusted source of financial advice.
- Providers will struggle with RDR transition.

when fees and the value chain are transparent and clearly communicated.

ABI research on full advice gives an average time of 7 hours, 40 minutes at an average cost of £670 to the firm to deliver, thus the level of charges and fees needs to be carefully considered from the consumers point of view to ensure a profitable margin is met, and fees are affordable. This then can determine the

restricted or independent and simplified advice route. EPL's position is that intermediaries need to boldly not under-sell themselves. What sits behind the move to fee-charging is the move to 'professionalism' and transparency that pervades the FSA's RDR mantra.

In this case, EPL see a demanding juxtaposition placed on RDR compliance in the increase of industry professional standards and fair and transparent charging. Front line sales advisers will have to promote professionalism at all levels as never before and ensure they are competent and fair in their charging of fees, along with ensuring they remain competitive.

Professionalism in its own right is viewed as a minimum QCF level 4 attainment thus those organisations moving their advisers through to QCF level 6 to chartered qualifications will be recognised and rewarded by the industry, consumers and regulators alike.



EPL ACTION POINT: *The effect of charging structures in organisations' value chains needs to be understood and transparent. Our eTpI™ will provide clarity of all fees and charges and aid consumer satisfaction.*

Platforms, Wraps and Nominee Services: bundling or unbundling

Platforms are the means to which clients and intermediaries gain access to RIPs. With the FSA's recently published paper CP10/29 which embellishes on CP10/2, this area has been targeted as opaque by industry and consumers alike and why so much attention is being given by the FSA on transparency of platform charges post-RDR.

The FSA intends to take a compromise on the bundling/unbundling of charges on wrap, platform and nominee services by allowing unbundling to continue but banning any cash rebate. This may mean higher administration charges and a compromise on transparency.

Bundling:

- Platform and fund managers agree a management fee discount.

Unbundling:

- Intermediary is free to choose funds.

The *Axa Elevate* wrap is a good example - due to some contractual ties with fund management groups they cannot unbundle all charges, which in Axa's opinion will only affect 3% of existing retail customers. Skandia concur in offering both unbundled and bundled charging structures. This may or may not help intermediaries meet RDR requirements.

Intermediaries will be required to select platforms that are no more expensive than any other, and confirm this is still the case annually. EPL believe the FSA's platform directives leave questions that still need to be addressed:

1. Will this lead to price competition between platforms or will they tend to settle to a norm?
2. How will advisers check annually that the platform they use for a particular client is offering best value?
3. Will fund rebates be paid through extra units mean fund bias?

4. There is a requirement for a summary table on charges on client statements, showing for instance the fund cost (AMC or TER), the effective % rebate and the platform admin fees, will this mechanism prevent additional share classes?
5. The FSA's insistence that best execution continues to apply essentially means that the investment process needs to alter to consider which platform could deliver the lowest set of charges for the recommended investments. The big sigh of relieve that many let out in the Platform Papers stance regarding using single platforms will be short-lived.

As there is to be a differentiation between platforms and 'services which are auxiliary to investment management', to which the new rules will generally not apply, EPL believes this creates blurred boundaries. i.e.

1. As fund managers can now pay platforms for admin, will this militate against low cost products (such as ETFs and equities) that do not pay admin fees?
2. Customers will be able to stop payment to adviser firms. A client could then sack the IFA and retain the adviser charges in their account. Could platforms then accept direct clients?
3. Will the investors only pay for the service they require? For example, an investor might pay 1.5% for a fund, the fund charges 0.75% with a platform charging 0.25% for admin and adviser fees of 0.5%. An investor could go directly to the fund manager and pay only 0.75%, alternatively will an adviser and lower up-front product fee be charged which will add to service transparency and client trust?

FSA's platform consultation paper:

- Platform cash rebates to be banned, with rebates made instead in the form of units.
- Fund manager rebates to platforms allowed.
- Platforms to conduct 'timely' in specie re-registration.
- Advisers can use one platform and remain independent provided it is in clients' best interests.
- Regulator has ruled against forcing platforms to host specialist investments like tax-elected funds.
- Providers will not face increased capital adequacy requirements.



EPL ACTION POINT: *The FSA need to be clear and unambiguous in their follow-up*

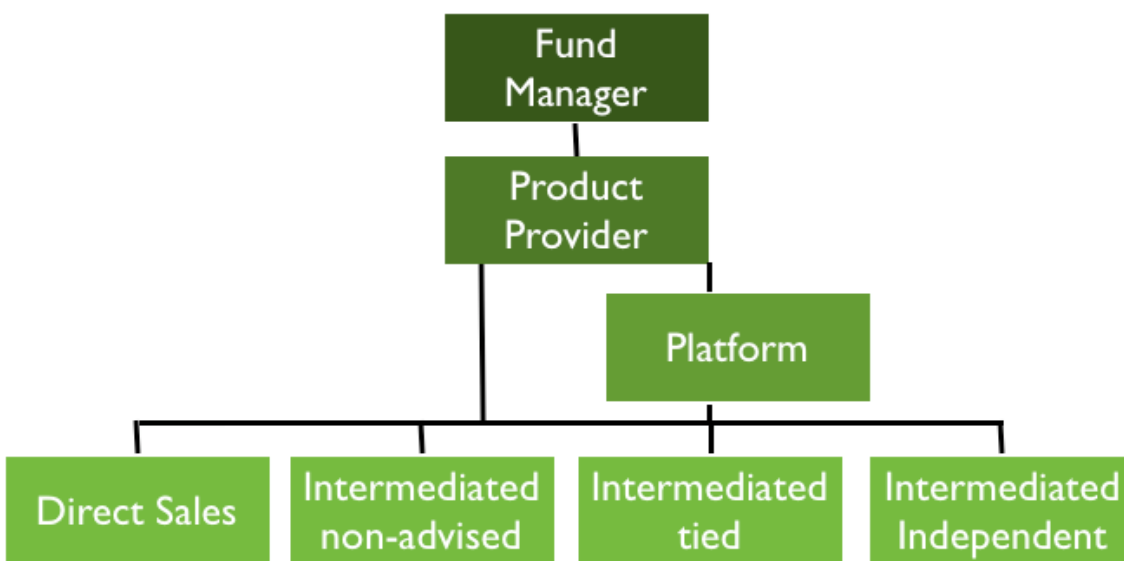
paper to CP10/29

3. Description of the value chain

At present, the retail investment value chain involves several agents (see Figure-1). These range from the fund manager, responsible for managing the underlying assets in a product portfolio, through to the product provider, packaging the portfolio in the most suitable form for a wide variety of investors, via the intermediary, responsible for advising the ultimate purchaser on the suitability of the product to match their particular requirements. The same overall structure applies to both pure savings/investment products as well as those combining an insurance element with investments.

3.1 Value Chain Costs

Figure-1 Value chain costs



Source: Oxera Retail Distribution Review proposals: Impact on market structure and competition

Fund Manager

Costs will arise at all stages along the chain, beginning with the fund manager who will incur dealing and administration costs for the portfolio on which the retail product is based. It is not straightforward to isolate these particular costs for a specific retail portfolio because managers responsible for retail products will tend to combine the assets in a range of funds, both retail

and wholesale, that they have under management. The costs of this fund management will be passed on to the product provider in the form of management fees.

Retail Providers

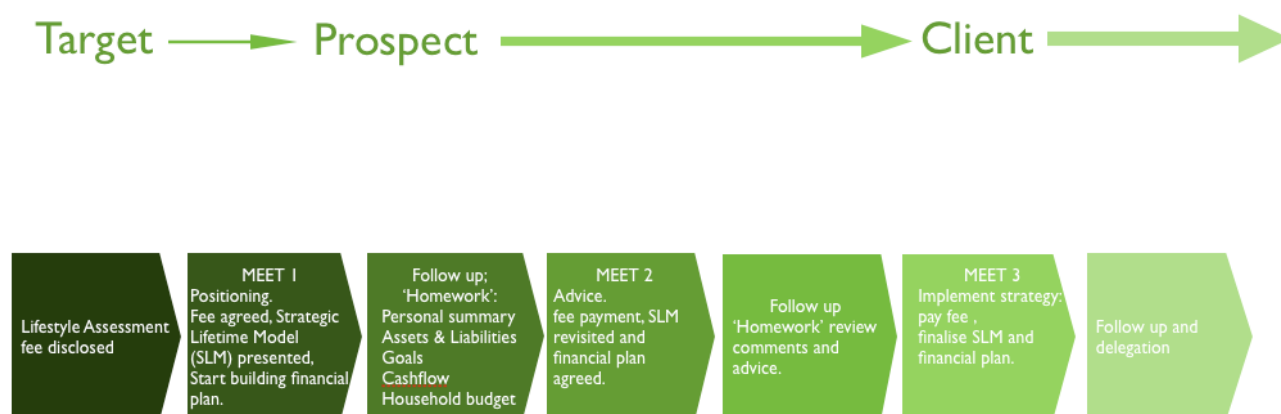
Many retail fund providers will make use of their in-house management operations to undertake such activity. As a result, it may be difficult to separate out the costs of this activity from those incurred in providing a retail product that is in the most suitable form for the consumer.

Product Providers

The product provider is responsible for allocating the assets to a particular (retail) fund and packaging this fund in the most appropriate form. Costs will be incurred in structuring the fund and in its ongoing administration. In addition, the provider will incur costs in supporting the distribution of the product, which it may undertake itself, or through an intermediary such as a financial adviser.

Financial Advisers

Figure-2 financial adviser workflow value chain



Source: Engage Partnership Ltd; RDR advice workflow.

The RDR enforces professionalism across all financial adviser activities. An adviser's costs will arise mainly from marketing; prospecting for, and negotiating with, potential customers and providing the advice that is given before the consumer makes the final purchase. Knowledge of the product markets in and between which they are providing advice is paramount, and this

information needs to be updated regularly.

Regulatory requirements need to be complied with to ensure that the purchaser is provided with adequate and appropriate information in order to make a suitable choice. These requirements will involve the 'lifestyle assessment' or needs analysis where the client's circumstances and investment needs are discussed before a recommendation is made. A financial plan on suitable products must then be provided, including an indication of potential risks and returns according to standardized regulatory requirements.

The adviser must provide documentation post-purchase to confirm their assessment of the client's circumstances and the appropriateness of the product recommended. In the case of certain retail products (e.g. company pensions), the adviser may also need to monitor the product and provide updated advice as necessary on an ongoing basis. At all stages, for regulatory purposes, the adviser must ensure that records are kept of the advice given and the transactions undertaken.

If the adviser is part of a network, some of the compliance activity and administration of the client's assets may be undertaken centrally.

Platforms

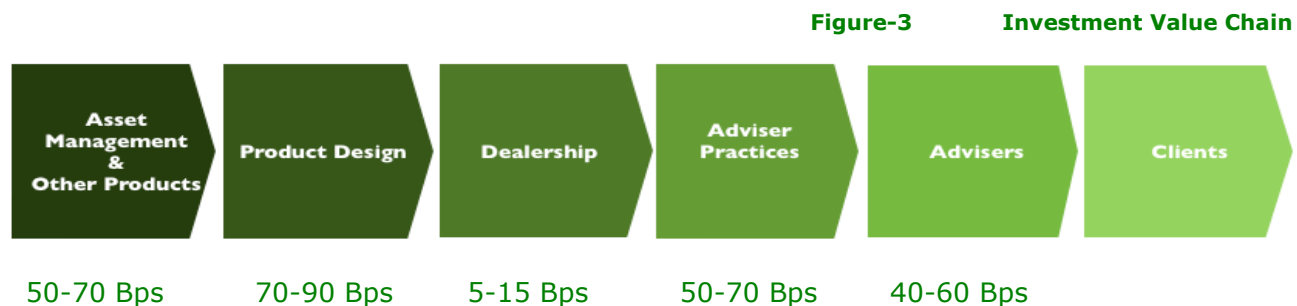
As discussed the development of platforms has further reduced the potential administration costs incurred by advisers. These, largely online, services enable the adviser to screen investments on offer more efficiently, as well as enabling a more holistic approach to be taken to the management of a client portfolio.



EPL ACTION POINT: *EPL have developed a unique adviser workflow which incorporates the need for e-learning tools for professional development. The advancement of platform technology will also aid the consumer with product choice.*

3.2 Investment Value Chain

Costs in the present structure for the wealth management industry value chain are detailed in Figure-3. This shows the total approximate cost of investment to the client whatever the investment platform and fund type used. Although generalist in nature, this information is essential when considering the need for transparency and fairness in costs and remuneration that the RDR stipulates.



Total (Approx) 250 Bps + Inflation

Source: Macquarie Financial Services Group

Figure-3 clearly illustrates the Total Expense Ratio (TER) when money flows through the investment value chain, currently with an inflation lag of approximately 3%+. This means that the total cost to the consumer is as much as 5.5%+ pa before they are in a position to enjoy a

Return On Investment: ROI -Effect of Inflation

A return may be adjusted for inflation to better indicate its true value in purchasing power. Any investment with a nominal rate of return less than the annual inflation rate represents a loss of value, even though the nominal rate of return might well be greater than 0%.

When ROI is adjusted for inflation, the resulting return is considered an increase or decrease in purchasing power. If an ROI value is adjusted for inflation, it is stated explicitly, such as "The return, adjusted for inflation, was 2%.

real return from their investment. EPL believe this is a conservative estimation.

This effectively means (where the investment value chain is concerned) that the discretionary fund manager needs to add a huge amount of value before the investors sees real return on their investment.

Such an asymmetric system means that consumers

have already become distrustful of the financial services industry and this problem is one that now must be addressed where RDR compliance is concerned.

EPL believes the move to transparent fee based advising gives an opportunity for all parties in the value chain to address any confusion and mistrust the industry has fairly or unfairly garnered and ensure that once and for all the client feels empowered by the knowledge of what the advice and the investment value chain they enter is actually costing in real terms.

This 'trusted' status will be reflected in the revealing of the value chain internal expense ratio that lies beneath the surface (see section 4). Indeed, the effects of taxation on the return on investment must also not be underestimated, thus leaving the consumer with a fair amount to consider before an investment should be made.

Taxation

The big question for any financial services organisation's value chain is one of return on investment and the effect of inflation and taxation on the consumer and the product purchased are firmly associated with this but sometimes conveniently forgotten.

As illustrated the financial services industry is now facing an unprecedented challenge to show fair value through the external value chain of services or products offered this is compromised not only by charges but also by the effect of taxation along the chain.

One key area is the taxation of insurance companies through the I-E system. With the exception of pensions customers get a vicarious form of tax relief on their advice charges because under the commission regime they sit within the relievable expenses of life companies. In theory these were being passed on by lower product charges. It is still unclear how adviser charging will affect this, but it is difficult to see how under current taxation legislation it could be anything other than moved out of life company expenses. This adds a double blow to the consumer who will no longer enjoy current practice of passing on the effect of taxation in the form of charges to the consumer and furthermore be more likely to be charged VAT into the bargain. Just the thing for encouraging savings!

This quite simply remains unaccounted for by the FSA's RDR proposals and may have intangible ramifications on both product and adviser charging.



EPL ACTION POINT: *The internal and external organisational value chain needs to be clear, understood and efficient for both the industry and consumer to enjoy healthy engagement post-RDR. Our eTpI™ facilitates such a relationship.*

4. EPL's Value Chain "Efficient Transparency Index" (eTpI™)

As has been illustrated with such wide ranging consequences, the costing and charging of financial services post-RDR will highlight the need for clarity and reinforcement of the FSA message throughout the consultancy papers, i.e. the need for transparency in charging and communication of the value chain to consumers.

Bringing Clarity to the Value Chain:

EPL's Transparency Index (eTpI™) will ensure consumer engagement with the financial services industry.

This means a clear, concise, consistent client proposition.

Without such transparency the financial organisations both on the wholesale and retail side of the equation will struggle to compete and gain traction and sustainable growth in the new RDR market place. The client is king in the RDR new world order and EPL

believe their transparency index will give product providers and retail financial intermediaries alike the tools they need to not only comply with the RDR but crucially to retain and gain clients trust.

It is apparent through the FSA's paper 10/2 "Platforms: delivering the RDR and other issues for discussion" that trail fees will no longer be acceptable as fees. This means a move to adviser charging is just that, and retrocession payments of any kind (kickbacks, trailer, finders fees) will be banned.

So by January 2013 we will find ourselves in a brave new world, where those financial organisations that have taken the initiative to employ full transparency in the relation to communication of their external value chain to the consumer will gain momentum and prosper.

EPL's Transparency Index is an arbitrage and leverage audit programme that will ensure an organisation's value chain offers real value to the consumer at all times.

The index is comprised of two audit programmes:

- **Price Factor Chain:** This follows the Investment value chain.
- **Risk Profiling:** Ensuring consumers trust is retained.

EPL believe the Transparency Index will offer great value for the following reasons:

1. **Ensuring a competitive structure:** As we have realised FGP's, AC's and the value chain itself will be under severe scrutiny post-RDR. End-user pressure placed on fees and product charges will ensure competition in the industry. EPL realise those organisations who employ the transparent index and a clear stance will compete the best and keep prices affordable.
2. **Price discrimination:** As we have detailed, this is currently occurring through commission rebating and EPL expect the transparency index to bring behavioural change management to a fair and unbiased charging structure focused on the consumer's needs.
3. **Product quality:** Again EPL have highlighted the fact that strong competition through application of the transparency index through value chain communication will bring excellent service levels in terms of responsiveness and efficiency in handling client support issues. As a direct result of hourly billing, this will mean a cost save with a quick response time to consumers.
4. **Product suitability:** The EPL Transparency Index will ensure all products risk definitions and understanding are harmonised along the value chain increasing the confidence that product and solutions recommended will be suitable for consumers' needs. As evidenced by the FSA's recent consultative paper on suitability and risk they are at long last giving their attention to this important area. If you read the tenor of the consultation you can clearly see that they are nervous about their own thinking in this area and have issued the paper in a consultative form. This is the ideal time to prepare for this change.

Summary

The Efficient Transparency Index (eTpI™) offers the financial services organisations and consumers a product that illustrates the true worth of advice given and advice bought.

Both the price factor and the risk factor transparency index will be measured against the value chain index. This means the value chain will be perceived as an add-value to the consumer through the measurement of its transparency which, as we've seen, is crucial to the sustainability of organisations on both the wholesale and retail side post-RDR implementation.

The problem EPL sees is the fact that the financial services industry may not want, or indeed, see the need to change. Ingrained behaviour and philosophy based on a commission culture

EPL's Transparency Index: Avoiding the "Chinese Whispers" of the Investment Value Chain

Any value chain can suffer from cumulative error. This may mean corruption will carry down through the chain in the form of pricing error, miscommunication or just high charging levels.

Most of us have heard an apocryphal example from World War I of a message being sent down the trench line as "*Send reinforcements, we're going to advance*" which became "*Send three and fourpence, we're going to a dance.*"

means the challenge is for EPL to show how the transparency index adds the huge value we see.

Yet EPL's evidenced-based transparency models ensure advice and products are absolutely transparent with full disclosure given. This will ensure the best examples of value chains endure, ensuring sustainability and growth post-RDR and thus financial organisations avoid the often quoted fate of the British troops as a crucial

trench line message was accidentally and fatally mistranslated.

5. Consumer engagement: EPL's Hard Case for Soft Facts

One of the first casualties in a recession for most organisations is frequently the training and development budget. Focus tends to shift to the hard facts for business survival and bottom-line results are king. In the case for RDR, this is currently represented in the focus on the business and remuneration model, fee structure and the attainment of 'professional standards', i.e. QC I4 qualifications driven by the regulatory carrot and plenty of stick.

As mentioned in the executive summary economic behaviour and behavioural finance have seemingly little influence in the RDR directives. Yet David de Meza et al in their consumer research paper 69 suggest otherwise; "people's financial behaviour may primarily depend on their intrinsic psychological attributes rather than information or skills or how they choose to deploy them". The paper also illustrates how financial capability does not align with economically rational behaviour.

Emotional Intelligence: Hard facts to prove soft skills are essential:

Research on 181 jobs at 121 companies worldwide showed that two out of three abilities vital for success were emotional competencies such as trustworthiness, adaptability and a talent for collaboration.

According to a study of what corporations seek when they hire MBAs, the three most desired capabilities are communication skills, interpersonal skills and initiative -- all of which are elements of emotional intelligence.

Emotional intelligence matters in surprising places such as computer programming, where the top 10% of performers exceeded average performers in producing effective programs by 320%, and the superstars at the 1% level produced an amazing 1,272% more than average. Assessments of these top performers revealed that they were better at such things as teamwork, staying late to finish a project and sharing shortcuts with co-workers. In short, the best performers didn't compete -- they collaborated.

Studies of close to 500 organisations worldwide indicate that people who score highest on EQ measures rise to the top of corporations. Among other things, these "star" employees possess more interpersonal skills and confidence than regular employees who receive less favourable performance reviews.

SOURCE: Daniel Goleman 1995 "Emotional Intelligence: Why it can matter more than IQ"

EPL argues this applies to both the consumer and individual employed in financial services and is a good example for the need for assessment of the psychological aspects of the affect RDR will have on all parties. Assessment of clients' needs, expectations and objectives has never been more important, whether involved in the wholesale or retail, it is now imperative to understand how to maintain and engage client relations.

EPL's RDR assessment tools focus on the hard and soft facts, ensuring transparency of the firm's advice and investment value chain is clearly communicated and risk assessment is fair

and accurate. What is essential is a focus on the soft skills that are needed for firms to deliver their services and engage their clients to maintain trust and satisfaction successfully in the run up to and post-RDR.

EPL's RDR assessment tools focus on the hard facts to ensure that transparency of the organisation's advice and investment value chain is clearly communicated and that risk assessment is fair and accurate. Yet EPL believe this only completes half the picture. What is also essential is a focus on the soft skills that are needed for firms to deliver their services and engage their clients to maintain trust and satisfaction successfully in the run up to and after RDR.

EPL have structured a behavioural engagement management programme tailored for RDR transition called 'The RDR Relational Programme'. This learning and development project focuses on the core communication, language and personal behavioural traits that characterises the essential elements of interpersonal skills needed by fee-based financial advisers, product providers and other firms who fall under the RDR rubric.

Soft-skills complement hard-skills and are an important contribution to the success of the organisation. Business success post-RDR requires an holistic model to ensure advisers build trust across the sector.

As can be seen from Daniel Goleman's and subsequent researchers' work on emotional intelligence. The results that hard-facts on soft-skills research has provided cannot be ignored and are essential ingredients in ensuring that employees and advisers alike have their core skills honed to engender and foster client trust with the move to fee-based planning.

Change, renewal or transformation programmes are critical for ensuring RDR readiness and ensuring the firm is more flexible and adaptive. However, as change initiatives can be stalled or derailed, EPL have devised their RDR programmes as a solution to organisations committed to change and RDR development.

When used together, EPL's RDR programmes enable business leaders and consultants to analyse their current state, envision and communicate the desired, and identify the most important levers for moving the organisation and its people in the desired direction.

EPL's RDR programmes will strengthen the organisation and ensure RDR readiness through individual, team and cultural development.

eTpI™ RDR relational programme

- Educates individuals/teams/organisations on their existing skills and gaps for improvement.
- Ensures consumers will stay informed and understand services offered
- Deters consumer procrastination and confusion, promoting simplification and transparency.
- Encourages personalised self-improvement for effective communication of fee based services.



EPL ACTION POINT: *Behavioural economics and consumers psychological relationship to finance is underestimated by the RDR. Our eTpI™ RDR relational programme will ensure organisations and their people know their strengths and weaknesses, and maintain client support and trust during and after the transition to RDR.*

6. Efficient and Controlled Processes

What therefore does all this mean for systems and processes? Assuming that one of the outcomes of RDR is to effectively get rid of the cross-subsidies this means that inefficiencies will no longer be paid for without a transparent effect on the price of advice and arrangement. Customers will no longer be willing to pay for the mistakes and ineffectual processes which abound throughout the industry. Providers have been able to retain a great deal of control in this area since it has been they who have *paid the piper* to-date. No longer! It is difficult to say how this will play out in the longer term. However, let's say that straight through processing (STP) will be aided by this change. Now more than ever each part of the value chain needs to re-examine its processes, realise where there are overlaps and where there are gaps.

EPL's business and process models

In addition to clarifying and simplifying processes, these models have been specifically designed to graphically embed compliance rules, and operational risks and controls into a highly useable format, ensuring that senior managers through to non-executive directors have exactly the information they need, delivered to them in a way that aids the development of experiential wisdom. See examples in Appendix 2.



EPL ACTION POINT: *EPL will take your organisation's experts through our RDR modelling tool, customising them along the way as we develop bespoke reference and training material. We will then assist with disseminating the RDR models and rolling-out the training course throughout your organisation, providing a speedy transition to RDR compliance and sustained success.*

7. Conclusions

RDR will reward strong firms

There is no doubt that those who are already engaging the RDR are well on their way to ensuring the bridge is built to continue the journey of offering financial advice to consumers.

Most organisations who embrace ethics and TCF have already made significant steps to change their business model and gain essential experience in implementing regulatory demands. Such strength in change management is now needed in abundance to fully engage the RDR requirements.

Companies need to:

- Ensure the value chain is understood internally and externally.
- Understand the levers for change.
- Engage the RDR communication and soft skill demands.
- Communicate the firm's fee processes clearly.

Clarity of charges and fees

All relevant parties are now in their implementation phase. With the FSA paper on Wraps and Platforms published, and follow-up work to be delivered shortly, firms now find themselves in a non-compromise position where charging and fees are concerned.

The problems given by asymmetry and understanding of the fine detail and information provided by financial service firms means both the consumer need help translating such information overload into simple clear and concise language. Financial firms too need tools to help them engage consumers and maintain their trust and acceptance of the new remuneration models RDR demands.

Transparency

As can be seen from the section on busting the RDR myths and legends, EPL aim to help the consumer and financial organisations to engage with the RDR in a healthy, transparent manner in the run-up to December 2012 – and then continuing to do so afterwards.

As an industry, financial services has been pretty good at disguising some inconvenient truths, particularly in relation to the real cost of products and services, and about the level of risk that to which some of these products and services expose the public. Much of this is not the fault of individuals, as a lot of the worst excesses have become institutional. Extra allocation rates, trail commission rebates, opaque layering of charges and a conspiracy of obfuscation about how much and how the industry earns money out of the investing public, serves to keep them in the dark. The complexity of the financial services industry, which requires the delivery value chain to be distributed amongst different business entities with each relying on the transparency of each other, makes it almost impossible for the client to figure-out just:

- Whom should they engage?
- What and who offers value for money?
- Are all parties interests' aligned, or are there significant conflicts of interest?

The Efficient Transparency Index - eTpI™

It is for these reasons that we at Engage Partnership Limited have decided to introduce a suite of Efficient Transparency Index (eTpI™) software tools to help in the process of realigning businesses - or re-building them if that is necessary as part of RDI.

To our knowledge, transparency indices have previously been used in relation to County corruption and to Sovereign Wealth Funds.

The eTpI™ will not only apply to individual processes and constituent process steps - it will allow for a total Transparency Index across the entire delivery value chain. Its aims are to provide:

1. a useful indicator to members of the public in deciding whom they should engage.
2. a prime indicator of TCF outcome three.
3. an indicator of the potential impact of recommending or utilising any other business in the delivery of the engaged services.
4. product and service providers with a means of ensuring they are adding to transparency, and not decreasing it.
5. encouragement for reflection on time-honoured practices in relation to the spirit of RDR.
6. a means of ensuring that transparency is increased, not decreased, by product providers and service providers.
7. public confidence by encouraging payment for financial advice.

Through the eTpI™ tools, we aim to expose the six major processes which we have identified as applying to RDR compliance and competitive advantage post-2013:

1. Customer/Client Lead Generation
2. Customer/Client Engagement
3. Advisory Services and Processes
4. Investment Services and Processes
5. Administration and Services (Arrangement)
6. Quality Control and Customer/Client Satisfaction

Client interfaces

We should recognise that transparency in our context involves three components:

1. The transparent quality of the information in written form
2. What we say and do in engaging the relationship
3. What we say and do in maintaining the relationship

Even the best documentation is opaque if the process or system being described is designed to be opaque. One of the great problems in documentation is determining where we are engaged in multi-party deals. Many cases will have either similar but separate client engagement documentation, or the documentation will be couched in multi-party language in the same document. Invariable charges and important conditions will be scattered across differing documents, the sheer volume of which, puts clients at a disadvantage. We think there are some important new principles to be promoted. It is likely that if there is a need for tri-partite or more documentation, it is likely to tend towards a restricted service. Assessing the transparency of documentation is relatively straightforward.

Greater difficulty comes when you try to tackle transparency of what is said to a client. For a start it has to support the documentation and the only way of really ranking this factor is to look at the training of soft skills and materials produced as part of the training regime.

Assessing how transparent we are in maintaining the relationship is even more difficult, requiring an assessment of the whole outcome of the customer experience but, importantly, assessed from the standpoint of an individual who is on our side of the asymmetrical line. As experience with TCF will tell you, frequently clients do not have the information or knowledge to make sound judgements in this area.

What does total transparency look like?

This is where the client has enough information and is brought to an adequate understanding of how much he is paying for each part of the service. He will also understand how the payment can be withheld or altered if he is not happy with the service. Also, each interface between supporting parties must support the desired level of transparency.

Ideally the client would agree to pay the adviser initial charge by cheque and it would be entirely clear how much was being paid. For instance, if the charge for investing a £100,000 is 3% then the clearest way to charge is to invest £97,000 and make a deduction of £3,000. On-going charges would be agreed as a retainer or billed against time.

Evidence Based Practice

Evidence-Based Practice:

- Learning about *cause-effect* connections in professional practices.
- Isolating the variations that measurably affect desired outcomes.
- Creating a culture of evidence-based decision-making and research participation.
- Using information-sharing communities to reduce over-use, under-use, and misuse of specific practices.
- Building decision - supports to promote practices that the evidence validates, along with techniques and artefacts that make the decision easier to execute or perform (e.g. checklists and protocols).
- Having individual, organisational and institutional factors promote access to knowledge and its use.

Our eTpI™ tools are longitudinal in nature as they aim to conduct a study of the value chain's transparency and its effects on the consumer and business model over time, not just a single snap-shot.

This means the eTpI™ results will be based on evidence gleaned from a solid and unbiased assessment of organisations' value chains, communication channels and client engagements, taking into account all issues discussed in this paper:

Value chain assessment

- Product charging
- Return on Investment
- Taxation effect

Business modelling

- Efficiency of the organisation
- Service cost efficiency

Client interface efficiency

- Written and verbal engagement of the consumer
- Sustenance of the relationship between the provider and the consumer.

The eTpI™ process will then give organisations the crucial information and evidence to ensure business models and client relations are sustainable post-RDR.

eTpI™ essential processes

1. **Full audit trail:** Value chain and distribution channels, i.e. what the organisation does, why and how it is done, and where the value is held.
2. **Take the client view:** Understand the client (outside-in) perspectives and feedback.
3. **Value the team:** The greatest strength is in the right people being in the right place at the right time with the right skills.
4. **Understand the key steps/processes:** What to take on, what to lose and what to keep (also know as *Lean Process Improvement*).
5. **Work in progress:** Transparency, whether in written or oral form, needs monitoring. Fairness in business requires an eTpI™-enabled process to accomplish this.

7. About Engage Partnership Ltd

Engage Partnership Ltd (EPL) is a performance consultancy structured by industry professionals to deliver measurable results and improvements for organisations facing radical change.

We focus on developing the quality of organisations' communication, consumer engagement and human capital through a range of methods including process modelling, audits, workshops, coaching, multi media and shadowing.

We work with senior management and have structured a compensation formula where we are rewarded for meeting the objectives set for any given project.

EPL are able to provide insight brought about by harnessing disparate views from industry and international perspectives. We have a wide understanding of the practicalities of business across distribution and value chains and their impact on society. We are passionate about 'getting it right', i.e. where the RDR is concerned, EPL implement and advocate 'evidence based practice' which is both intuitive and demonstrable.

When preparing for corporate transition to the RDR, EPL employ a state-of-the-art business modelling tool, namely ProVition, by Metastorm Inc. This is a repository-based, object-oriented software tool enabling us to model the current and future states of a company in terms of its processes, domain taxonomy, goals, risks, controls, costs, systems, locations, organisational structure and staff skills. These have been developed by a leading process modelling expert and provide a generic reference model of the whole industry and its customers, which can then be tailored to suit your company's requirements.

These *before* and *after* business models provide a three-dimensional means of planning a corporate transition programme, including the preparation of bespoke RDR reference and staff training material.

The finalised RDR business model, designed with the objective of providing transparency to investors and risk mitigation to the business, will prove to the regulatory authorities and consumers alike that compliance has been achieved and is being maintained.

We look forward to having the opportunity to discuss our approach with interested parties, in particular our business models and eTpI™ Efficient Transparency Index. We can be contacted on:

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Email **info@engage.uk.net**
Address **135/137 Station Road**
 London
 E4 6AG
Website **www.engage.uk.net**

Key Individuals:

Les Cantlay

Les Cantlay's unique difference in the field of financial services consulting lies in his talent for ambitious and bold original thinking, and his ability to stimulate strategic innovation.

Les is a Fellow of the Chartered Insurance Institute and his experience is entirely in the industry. He joined a leading UK financial services group from university in 1973, where he held various management roles in new business, training and business projects. He began his experience in strategic consulting in 1988 as managing director of TBO, successfully expanding its services from a niche training organisation to embrace all aspects of the distribution process.

Les has worked personally on leading edge distribution projects throughout the World, bringing his influence to a number of major global financial institutions. During the 90s and the early part of this decade Les spent 50% of his time consulting outside the UK.

Chris Davies

Chris Davies' extensive work experience within the financial services industry extends from the UK to Asia. Chris has managed high-calibre multi-national financial sales-teams, ensuring that business is conducted within a strict professional, culturally sensitive and regulatory controlled environment.

Over the past five years, Chris has been working on innovative financial service consultancy projects with key areas of focus, i.e. aligning strategy to results, structuring back- and front-office functions, implementing wealth management strategies and lifestyle fee-based financial planning systems, along with implementing Corporate Social Development (CSD) learning and development programmes.

Chris is a member of the Chartered Insurance Institute and is a graduate of Birkbeck London University's MSc in Organisational Behaviour.

Matthew Brown

Matthew Brown is an accomplished business and process modelling specialist with additional skills as a trainer, facilitator and manager.

Applications of his talents include

- proving the business case for process improvement and transition programmes via process simulation.
- aligning processes with systems and goals.
- assigning controls along the value chain to mitigate risks.
- conducting Enterprise Architecture projects with particular focus on the association between processes, systems and equipment.

Matthew has a varied background encompassing marine seismic surveying, business system design and development, IT personnel recruitment, software and service sales, senior management and directorship positions.

Process Improvement Projects which Matthew has conducted include ...

- A well known insurance company was required by the FSA to prove its processes satisfied government regulations and that staff were enabled to execute the processes (especially customer-facing processes) efficiently and effectively. By attaching appropriate documents and links (e.g. fraud policy script) to each of the constituent activities in their processes, and then publishing the output to the web, they were able to gain FSA approval for their business.
- A remote device-management company providing new-technology systems to the mobile telecoms industry needed to 'prove' the savings that could be achieved using their technology. Proforma UK designed example business and process models, the latter being simulated to show the Customer Technical Support Process in *before* and *after* guises, demonstrably 'proving' to

mobile phone operators the improvements and cost (waste) savings that could be achieved in their customer support centres.

- The NHS Prescription Pricing Authority needed to model the planned architecture for an automated pharmaceutical supply-and-demand system. The purpose was to be able to identify, through prescription tracking, such things as epidemics as they were actually happening - not some while later - and therefore able to ensure that supplies were maintained and available.
- A high-street retail bank planning the acquisition of another organisation needed to put in place a *To-be* business model of the new joint venture, enabling the cultures, systems and processes of the two organisations to be consolidated into one. This required a good deal of consulting with management and staff of both organisations to ensure that everyone was in agreement, simplifying the merger and greatly reducing the stress, problems and upset that can occur in these situations.

Appendix 1: Why we are where we are with RDR?

UK FINANCIAL SERVICES REGULATION RDR TIMELINE:

- 1981:** A 'disorderly' financial services market prompts the Thatcher Government to appoint Professor L C B Gower to conduct a commission examining investor protection.
- 1984:** Gower recommends a conduct of business regulatory regime to curb excesses and a maximum commission agreement to stop prices rising. Gower expects the government to reject the maximum commission idea. Self Regulatory Organisations (SRO's) were seen as the best way forward by the government, yet one SRO introduced a threshold to commission hard disclosure rulings. This was abolished by the Director of Fair Trading on the grounds of artificially holding prices up. This meant rising commission levels!
- 1985:** Securities and Investments Board Ltd (SIB) incorporated to enforce a new framework for investor protection.
- 1995:** The collapse of Barings Bank and other notable financial scandals meant an end to self-regulation of the financial services industry, and SIB revoked the recognition of Financial Intermediaries, Managers and Brokers Regulatory Association (FIMBRA) as an SRO, and members moved to the Personal Investment Authority (PIA).
- 1997:** SIB changes its name to Financial Services Authority
- 1999:** Office of Fair Trading (OFT) investigates polarisation of the industry due to PIA rules and finds them anti-competitive, thus FSA removes them.

2002: FSA Consultancy Paper 121 (CP121) advocates reforming of polarisation rules and adviser charging, yet this is not well received by the industry.

2005: Polarisation abolished.

2006: RDR announced by FSA due to distribution model being broken and bias to be given to consumer.

2007: Financial economic crisis hits all major financial service organisations and creates a climate of fear and distrust for consumers.

2010: UK General election ousts the Labour government with the electorate undecided on who to govern thanks to the financial crises and politicians expenses scandals. The coalition government decides to go along with Conservative proposals to replace the FSA with the Consumer Protection and Markets Authority (CPMA) and in their June consultation paper the treasury confirm the CPMA will uphold the RDR, together with citing a more pro-active and interventionist approach to financial regulation.

2010 November sees the House of Commons (HOC) debate the RDR with significant emphasis on professionalism and grandfathering of existing experience/qualifications, and Hector Sants clarifying the issues surrounding the change of RDR directives by reducing them from six to three.

2011 onwards:

- Clarification is expected on the FSA consultancy papers, particularly on platforms and adviser charging.
- Treasury Select Committee expected to follow through on HOC RDR debate, treasury paper on simple financial products and behavioural economics analysis.

Appendix 2: Example screen-shots showing outputs from the eTPI™ models

Figure-2.1 High-level Concept Model

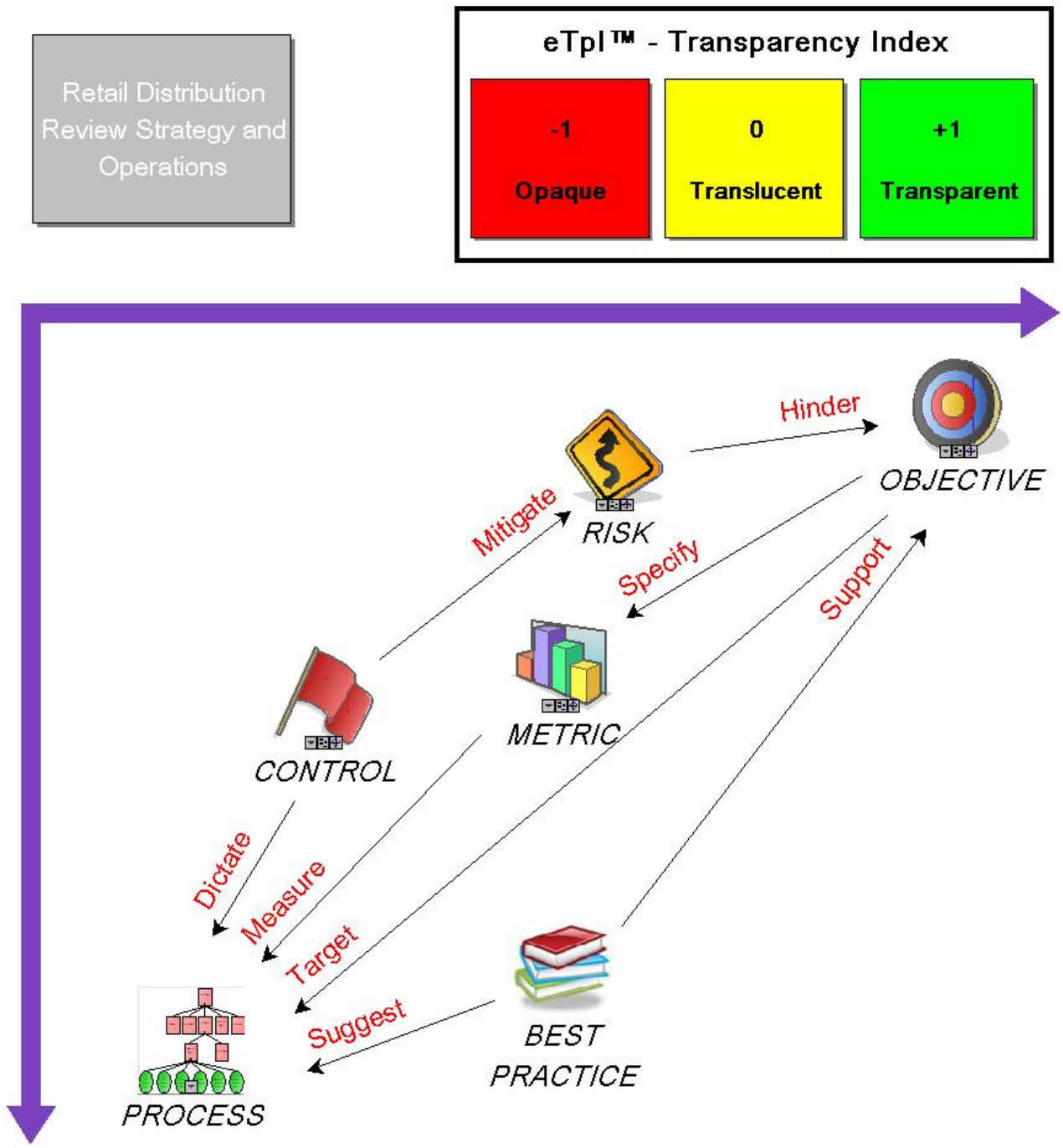


Figure-2.1 shows the high-level object interdependencies. From each of these objects, it is possible to drill-down to see more detail.

Figure-2.2 Market Organisation Model

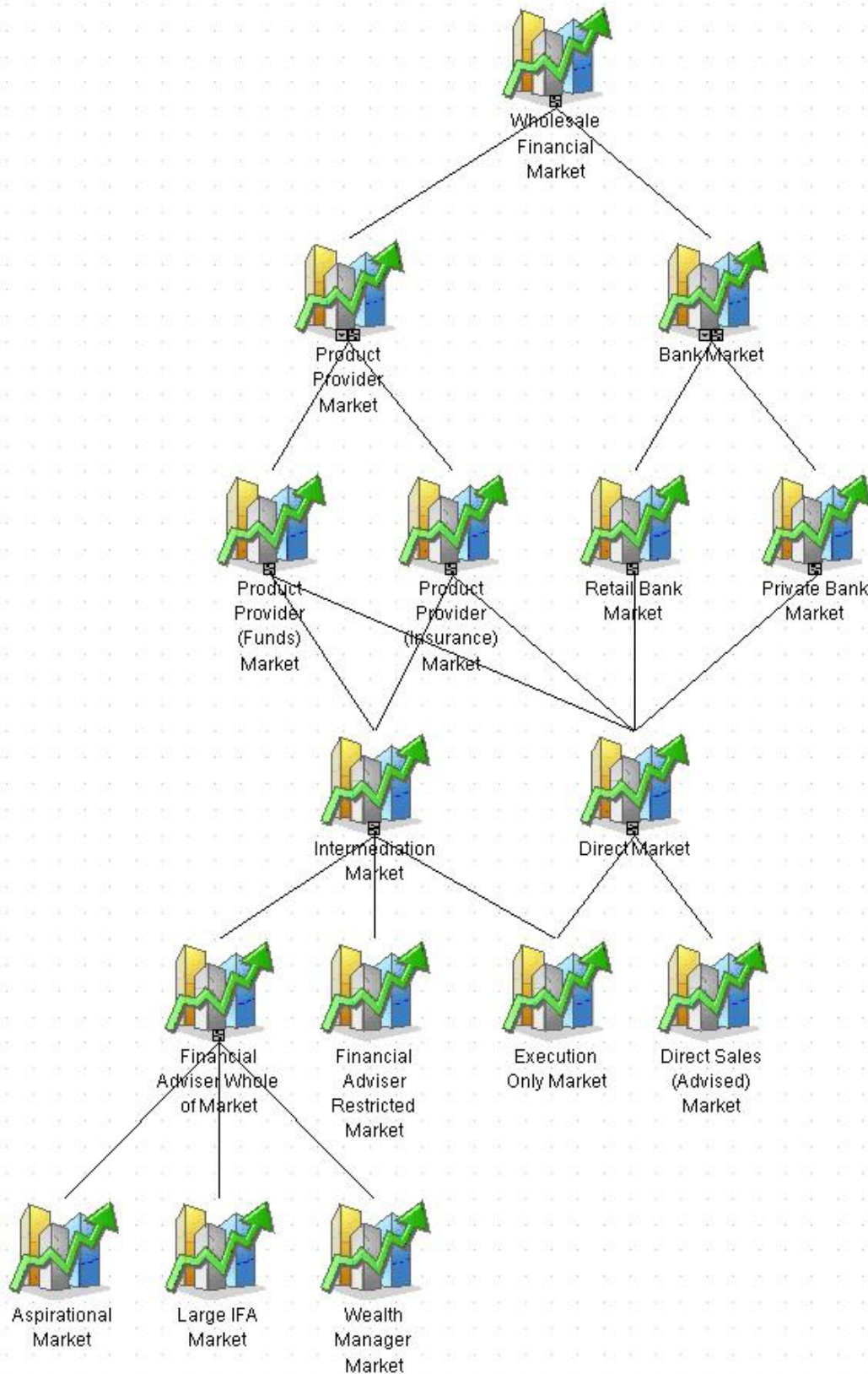


Figure-2.2 shows the structure of the financial market, into which your organisation will fit.

Figure-2.3 Role Organisation Model

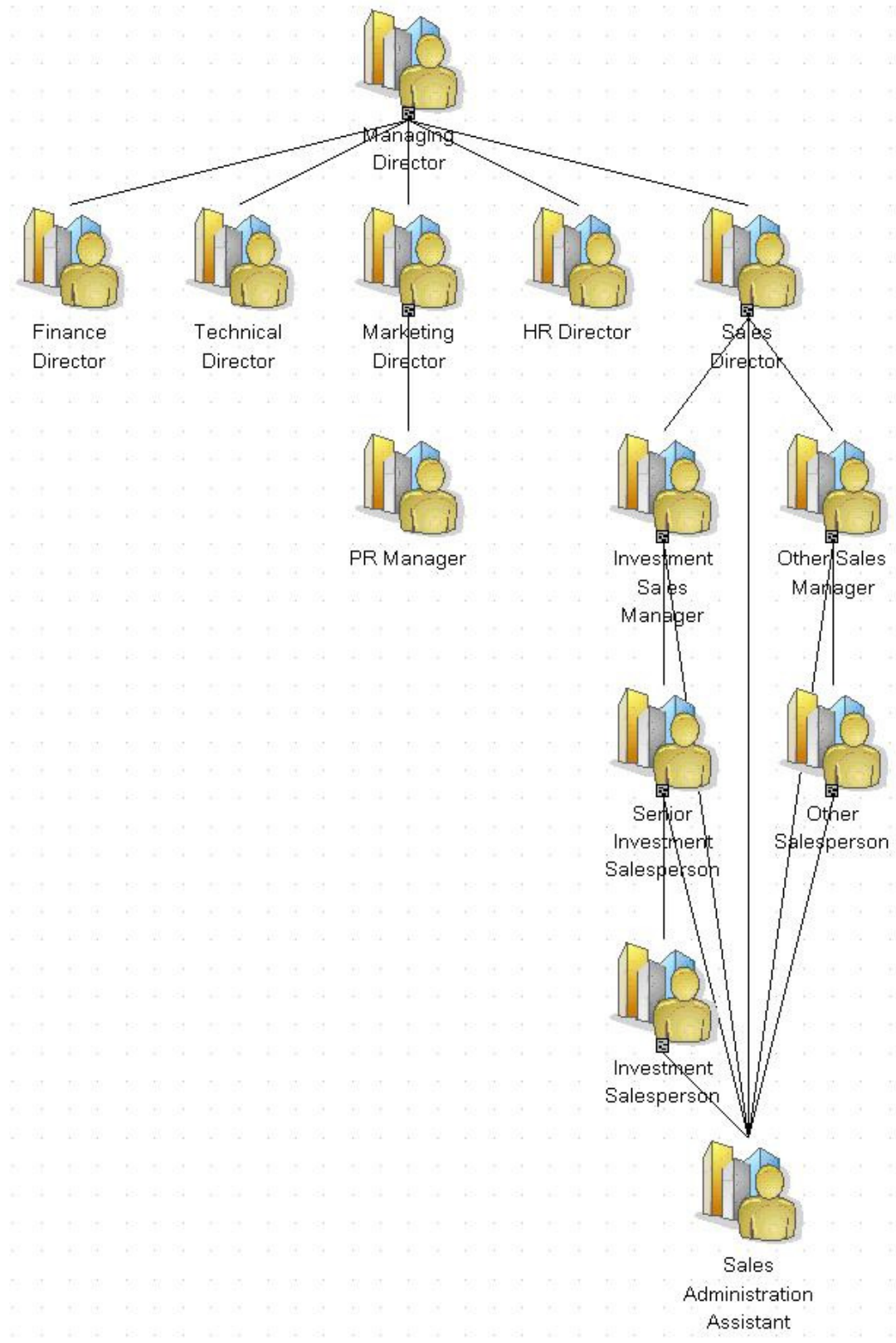


Figure-2.3 shows the possible structure of your organisational roles.

Figure-2.4 Domain Taxonomy Model

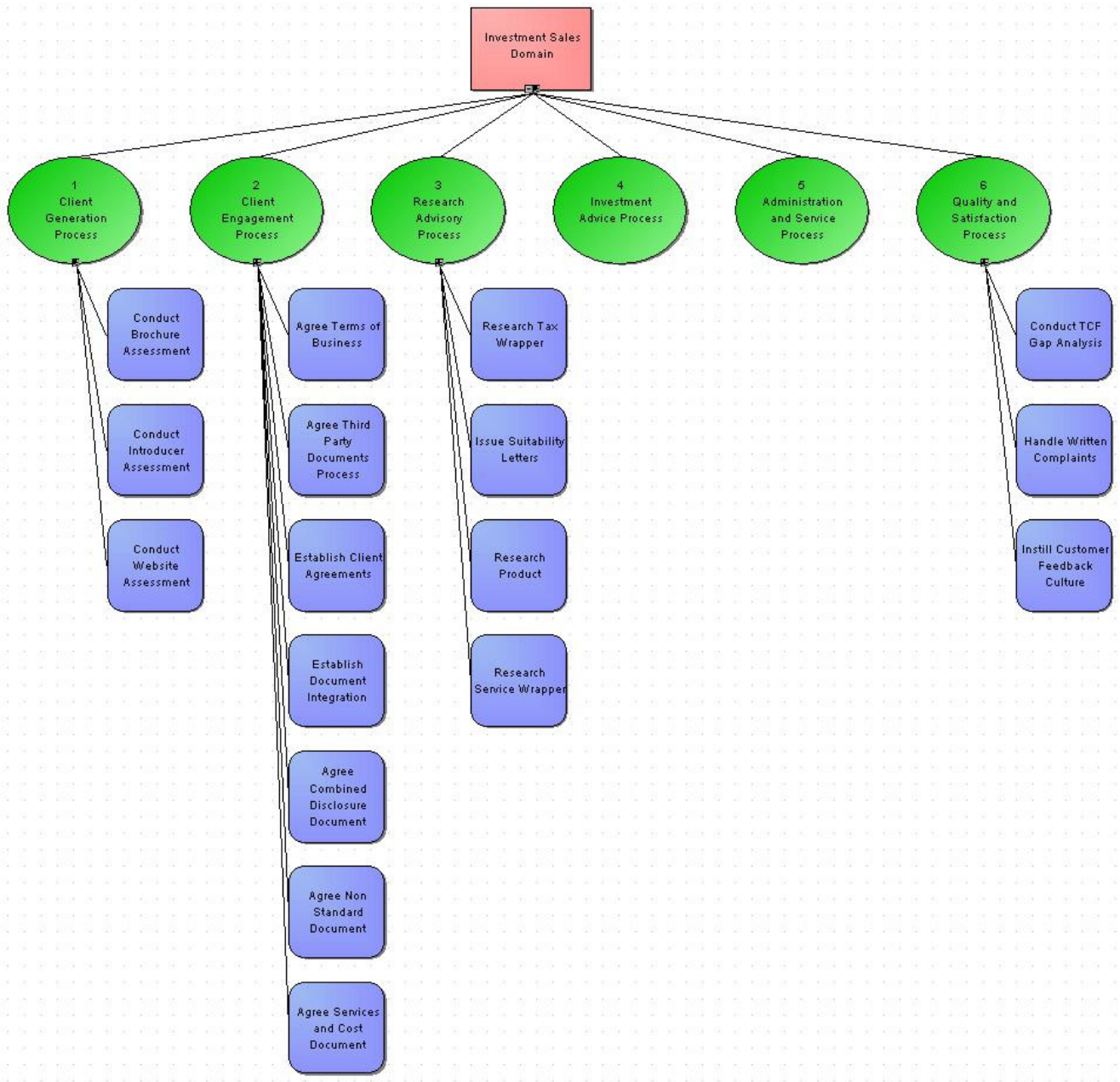


Figure-2.4 shows the domain taxonomy for an example Investment Sales Process Domain (pink), with the six Processes required to be RDR-compliant (green), and their constituent Process Steps (blue).

Figure-2.5 Textual Report (part) of Figure-2.2

<p>Private Banks (a component of Bank Market)</p> <p>It includes one component:</p> <table><tr><td>Market: Direct Market</td><td>Tied representatives</td></tr></table>	Market: Direct Market	Tied representatives		
Market: Direct Market	Tied representatives			
<p>Retail Banks (a component of Bank Market)</p> <p>Huge</p> <p>Problems:</p> <ul style="list-style-type: none">Demonstrating TransparencyPublic Trust IssuesRemuneration Structure IssuesRetaining Trust <p>Artifacts:</p> <table><tr><td>Web site of all Retail Banks</td><td>(www.allretailbanks.com)</td></tr></table> <p>It includes one component:</p> <table><tr><td>Market: Direct Market</td><td>Tied representatives</td></tr></table>	Web site of all Retail Banks	(www.allretailbanks.com)	Market: Direct Market	Tied representatives
Web site of all Retail Banks	(www.allretailbanks.com)			
Market: Direct Market	Tied representatives			
<p>Direct Market (a component of Retail Banks, Private Banks, Product Provider (Insurance) Market and Product Provider (Funds) Market)</p> <p>Tied representatives</p> <p>It includes two components:</p> <ul style="list-style-type: none">Market: Direct Sales (Advised) MarketMarket: Execution Only Market				

Figure-2.5 is the textual report equivalent of the diagram in Figure-2.2.

Because the modelling tool is repository (i.e. database) based, the reports are generated from the same data as the diagrams – in other words, they can never be out of sync.

Figure-2.6 Controlled Functions Model

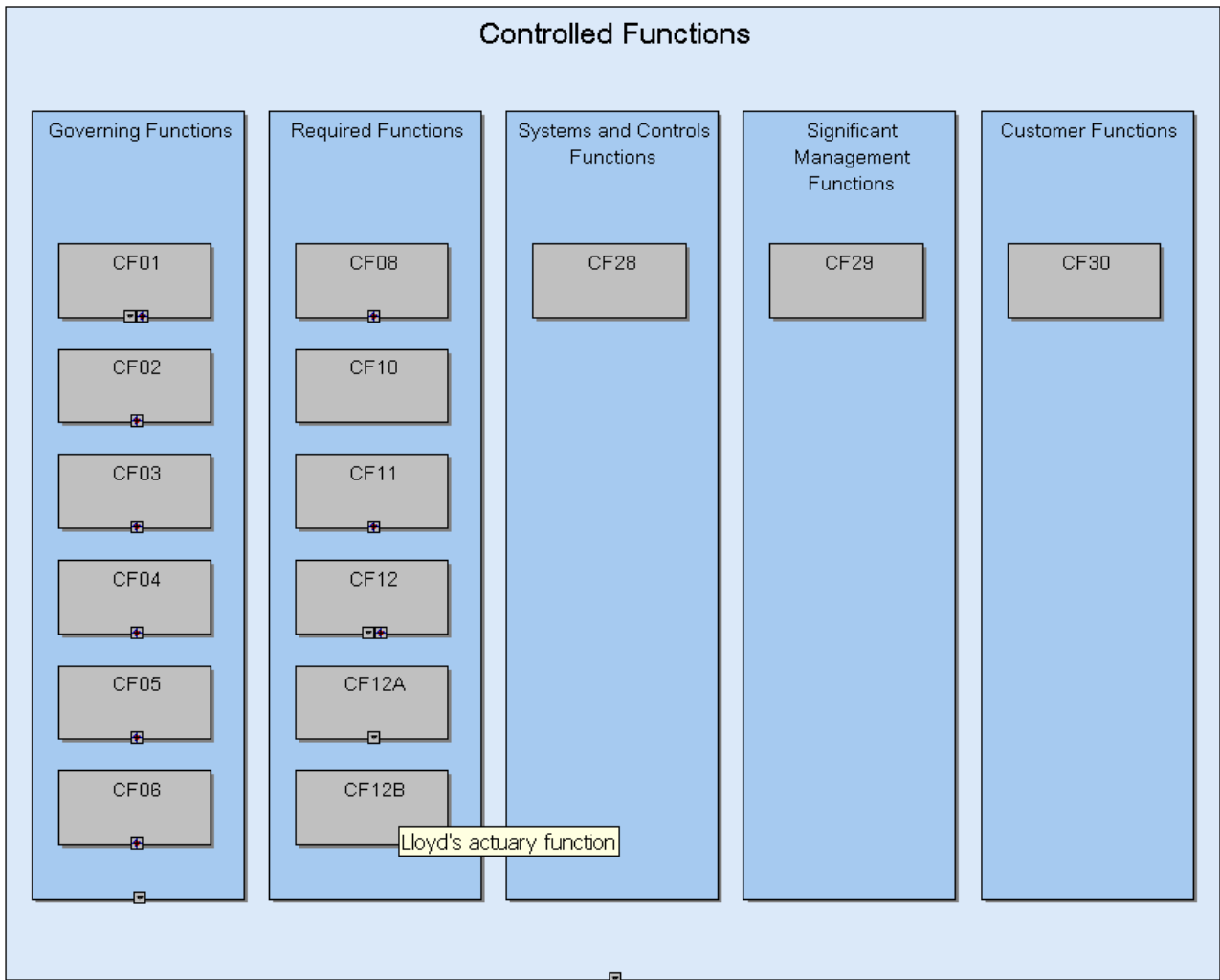


Figure-2.6 shows the groupings of Controlled Functions (and a mouse-over on CF12B showing the description).

Each Controlled Function links to all the appropriate information on the FSA website, the Roles that need to have a particular CF, and the CFs required for each individual Role to be permitted to perform each particular Process Step.

Figure-2.7 Association Matrix

Activity-CF from Activity to Controlled Function Role-CF from Controlled Function to Role	Finance Director	HR Director	Investment Sales Manager	Investment Salesperson	Managing Director	Marketing Director	Other Sales Manager	Other Salesperson	PR Manager	Sales Administration Assistant	Sales Director	Senior Investment Salesperson	Technical Director
Agree Combined Disclosure Document	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Agree Non Standard Document	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Agree Services and Cost Document	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Agree Terms of Business	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Agree Third Party Documents Process	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Conduct Brochure Assessment	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Conduct Introducer Assessment	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Conduct TCF Gap Analysis	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Conduct Website Assessment	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Establish Client Agreements	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Establish Document Integration	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Handle Written Complaints	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Instill Customer Feedback Culture	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Issue Suitability Letters	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Research Product	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Research Service Wrapper	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Research Tax Wrapper	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Figure-2.7 is an association matrix showing two object types connected via another (proxy) object type:

- *Process Step – Controlled Function – Role*

Matrices can show the relationship between any two object types.

Matrices have many uses, being particularly important when conducting gap and risk analyses. A good example of this would be the association between Process Steps and Systems, enabling:

- identifying redundant Systems
- ensuring the correct Systems are assigned to each Process Step
- understanding the impact of System failure on a Process

Figure-2.8 eTPI™ Simulation Results

	Cost	Occurs	Total Cost	Total Direct Cost	Mobile Phones	Total Indirect Cost	Floorspace	Total Resource Cost	Customer Support Representative	Senior Customer Support Representative	Shipping Agent
1	Research and Resolve Service Issues Process	100.00	£1,167.82	£825.00	£825.00	£2.73	£2.73	£340.09	£240.64	£97.33	£2.13
2											
3	Customer Support Representative		£236.66	£0.00		£1.82	£1.82	£234.84	£234.84		
4	1 Identify and Verify Customer	100.00	£61.65	£0.00		£0.91	£0.91	£60.74	£60.74		
5	1.1 Check Customer ID Details	100.00	£35.80	£0.00		£0.00		£35.80	£35.80		
6	1.2 Check Customer Account Status	89.30	£12.79	£0.00		£0.00		£12.79	£12.79		
7	1.3 Check if Ongoing Technical Query	84.90	£12.16	£0.00		£0.00		£12.16	£12.16		
8	2 Resolve Customer Technical Problem (Simple)	65.90	£175.01	£0.00		£0.91	£0.91	£174.10	£174.10		
9	2.1 Obtain Phone and Problem Details	65.90	£75.49	£0.00		£0.00		£75.49	£75.49		
10	2.2 Research Customer Technical Problem	62.60	£98.60	£0.00		£0.00		£98.60	£98.60		
11											
12	Senior Customer Support Representative		£931.16	£825.00	£825.00	£0.91	£0.91	£105.25	£5.80	£97.33	£2.13
13	3 Resolve Customer Technical Problem (Complex)	25.30	£931.16	£825.00	£825.00	£0.91	£0.91	£105.25	£5.80	£97.33	£2.13
14	3.1 Research Customer Technical Problem In-D	25.30	£98.54	£0.00		£0.00		£98.54	£5.80	£92.75	
15	3.2 Check if Customer has Visited Retail Shop	11.30	£2.59	£0.00		£0.00		£2.59		£2.59	
16	3.3 Instruct Customer to Visit Retail Shop	5.80	£1.99	£0.00		£0.00		£1.99		£1.99	
17	3.6 Return Phone to Manufacturer	5.50	£1.42	£0.00		£0.00		£1.42			£1.42
18	3.4 Ship Replacement Phone	5.50	£825.71	£825.00	£825.00	£0.00		£0.71			£0.71
19	3.5 Return Phone to Service Provider	5.50	£0.00	£0.00		£0.00		£0.00			
20											

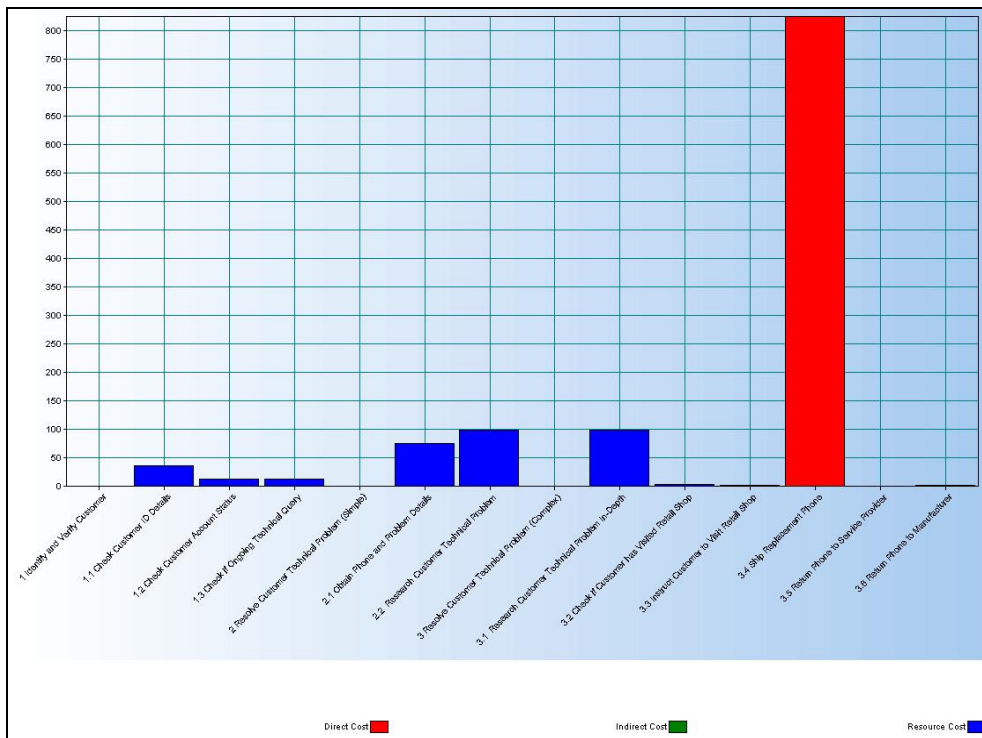


Figure-2.8 shows the numerical and graphical results of a Monte Carlo simulation used to calculate the Efficient Transparency Index (eTPI™) for each Process Step.

These individual results are then aggregated to give an eTPI™ for each Process.

Finally, the individual Process eTPI™ values are aggregated to give a total Transparency Index for the whole Process Domain value chain.