



**Response to the call for evidence by the European Commission
DG MARKT – G4
“The need for a coherent approach to product transparency and
distribution requirements for “substitute” retail investment products”**

**from
The Association of Independent Financial Advisers**

1. Background to AIFA

The Association of Independent Financial Adviser (AIFA) is the trade association that represents UK regulated independent financial advisers (IFAs). Membership of AIFA is voluntary and on a corporate basis. AIFA currently represents over 80% of IFA firms in the UK.

There are over 16,000 advisory firms in the UK, employing 128,000 people. IFA firms are the leading distribution channel for retail financial products in the UK. They generate over 65% of business by monetary value and are the major sector advising and arranging on investment products in the UK. Around 45% of the UK adult population has consulted a professional financial adviser, and 95% of IFA clients state that they would trust their IFA more than any other source for advice on financial services matters (a far higher percentage than for the government, banks or insurance companies). As such, IFAs represent a dominant force in the maintenance of a competitive and dynamic retail financial services market.

2. Introductory Comments

Time for a review

In our view it is entirely appropriate that the Commission should review the market from time to time. Product innovation, the impact of technology, and distribution changes have brought new layers of complexity and sophistication to the retail financial services market. Given that competition assists consumers to get the best from financial services, the Commission should seek to ensure that the market is working fairly for consumers and firms.

The impact of the Insurance Mediation Directive is yet to wash through the market – and the Markets in Financial Instruments Directive has only just been introduced. The scale of regulatory change introduced by just these two Directives should not be under-estimated: it will take a period of at least five years to understand the structural changes they will bring about. In the

meantime, the Directives have introduced potentially different standards – in regulatory approach and in the impact on manufacture and distribution.

The UK has sought to harmonise the impact of the Directives through adopting a common regulatory “platform” in terms of its Conduct of Business Regime. Being one of the first states to implement the IMD (and having done so with significant “gold plating”), the UK has had the opportunity to observe the effects of the IMD on the market at first hand – and has amended its regulatory approach following a review of the regime’s effectiveness. The review resulted in a two-tier system based on “lower risk products” (such as car insurance, buildings insurance and private medical insurance), whilst “high risk products” (such as income protection, critical illness cover and payment protection insurance) had more onerous rules attached to them. (There are also considerable differences between non-investment life products and those with underlying investments between which UK regulation differentiates.)

Thus, it can be seen that even states with a considerable experience of implementing the IMD are still, actually, digesting its implications and effects. We would suggest to the Commission that greater distance is needed between the implementation of these Directives and a review, in order that a more informed analysis can be undertaken.

Regulatory structures

We view financial services products as being the final stage of a process which begins with a review of the individual circumstances of an individual client – and is entirely focused on what meets the needs of that person.

We have concerns that a “product centred” approach focuses more on the products that can be sold to consumers, than what is in the best interests of the individual.

The Commission has identified a list of products which may be substitutable but this is entirely dependent on the individual client, their personal circumstances, and what they are trying to achieve. A better organisation of a client’s existing portfolio may make far better financial sense than the purchase of another product – rationalisation and simplification of a client’s existing affairs can prove more cost effective and meet the client’s needs. This runs counter to the usual view of “selling another product to fix the problem” which we often encounter in some circles.

We favour a regulatory regime which:

- focuses on the firm’s behaviour (a Conduct of Business regime),
- has an open and transparent policy towards remuneration (the client is fully aware of the manufacturing and administration cost, separate from the initial advice cost – with any costs for on-going advice clearly labelled).
- Requires firms to have clear Conflicts of Interest policies (which protect clients and the firm)

- has clear measures for financial robustness of firms (through Prudential regulation)

Further, we wish to see a clear demarcation between two types of firms. The first type is those firms who are the “agent of the client”, who only act in the best interests of their clients by offering personal financial advice. The second type of firm offers a clearly articulated sales-process, where the individual is made aware that no advice is being given and that they are only being offered the products of that company.

This clear delineation of “financial advisers” and “salespeople” will help consumers better understand the type of firm they are dealing with, what the drivers and motivations are of those people who are dealing with them, and consumers will be better informed as a result. This will assist greatly with areas of concern such as financial capability (as consumers will come to understand the different roles of various organisations), and is a significant step forward to helping consumers become engaged with their own, personal, long term financial planning.

Level playing field

It is essential, we believe, that those who distribute “direct” (who opt not to make use of the professional intermediary channels) are subject to a disclosure regime which mirrors that applicable to intermediaries. Without this direct writers will be able to unbalance the market and present consumers with a distorted view of the cost of their services. Direct operators have distribution costs which can be equal to or higher than the cost of using an intermediary (indeed, in the UK, it has been found that use of an intermediary is a cheaper distribution choice than other channels). Presenting intermediary costs as being “on top of” the price of a product available through other outlets can distort the market.

Further, we recommend that the Commission seeks to harmonise the other aspects of disclosure that may distort the market: rules around suitability and demands and needs etc. Consumers have the right to expect a similar level of service whichever outlet they chose to deal with for financial services – unless it is clearly indicated that a particular service is offered.

It is our view that firms should have two options on how to transact business. Given the complexity of financial services, the bewildering product choice open to consumers, and the long term nature of the products, consumers need, at ten most basic level, to understand the type of business they are dealing with (financial advice or sales). The disclosure regime should reinforce this separation – but so should the way in which the firm conducts its affairs.

We support a unified disclosure regime which would apply equally to all market participants: whether direct writers, intermediaries, or those with a tided salesforce. This disclosure regime would apply to IMD and MiFID retail business.

Regulatory level

The list of substitutable products provided by the Commission seems to be based around the “tax wrapper” rather than the underlying investment. For instance, IFAs can advise clients about investments at the “tax wrapper” level (life and pension policies), or at the underlying fund level (exchange traded or listed funds). A client review would take account of both to make sure the tax advantages had been gained where possible and that the asset allocation (the right investment, in the right funds, at the right time), still reflected the client’s needs and attitude to risk.

Any action the Commission may take will need to be mindful of the different impact on the market of addressing products at the tax wrapper, or underlying investment, level. We would be more than happy to provide further detail on this point.

3. Answers to specific questions

Question 1

In general terms, we do not observe that that different regulatory regimes give rise to significant problems for consumer protection. We do believe that anomalies exist (especially between the regulatory requirements of the IMD and MiFID) but we feel that the Commission should focus its efforts on ensuring the smooth adoption of these Directives across member states, and ensure as little super-equivalence occurs as is possible.

We firmly believe that a common disclosure standard is required for all market participants, thus, direct writers must have the same obligations as intermediaries, if they are holding themselves out as delivering a similar service. Our preference, as stated above, would be to see a clear delineation of firms between those offering “financial advice” and those who are offering a “sales process”. The common disclosure approach would be maintained even in this scenario, but consumers would have a deeper understanding of the service being offered to them.

Question 2

Somewhat disagree.

We do not regard this as a “significant threat” to the further development of EU markets for retail investment products. There are other, more deep rooted areas that need to be considered (cultural and linguistic barriers, for instance) that provide more significant threats.

Social security systems, tax regimes, and the public policy pursued by individual member states’ governments also have a role to play. For instance, the tax regimes that encourage investment in personal pensions vary across member states.

As has can be seen from the UK experience, and the work by Mercer Oliver Wyman, intermediaries are a force for innovation and actively increase the competitive forces at work within the market. As consumers can access professional advice from intermediary firms, this helps redress the “information asymmetry” that exists within financial services (where the products are complex and consumer knowledge is low). We do not believe that this information asymmetry will ever disappear (it exists in other highly developed markets where complexity is inevitable: law, medicine, architecture etc) but the reliance consumers can have on intermediary firms working for them, reduces the impact of this situation.

In the UK, intermediary firms advise on products and services available across the EU. This can be seen in such things as cross-border house purchases, accessing funds in different member states, and even in the mergers and acquisitions of intermediary firms across the EU themselves.

Further development of EU markets for financial services products will be driven by the economy in general. A flexible labour market, the free movement of capital, and a robust economic policy will favour continued EU growth, and this will ensure consumers will be better able to protect themselves.

The public policy of member states, and of the Commission, will also encourage greater engagement with retail financial services by consumers. A deeper understanding of the need to self-provide for a financially secure retirement, will arouse consumer interest in financial services products that can provide a pension income. Consumer demand is the biggest driver for innovation and performance.

Question 3

The products provided may be “substitutable” but this depends entirely on the individual consumer, what they wish to achieve and their attitude to risk. The list could also include: property investment funds, hedge funds, REITs, off-shore investments, and buy-to-let property in member states (when viewed as an alternate investment solution). Of course, there are also more esoteric investments such as fine wines, art etc as well as commodities such as gold.

The essential point is that rather than the starting point being “products”, it must be the “consumer” and what the motivations of that individual really are. Failure to do this results in ill-judged solutions and a temptation to offer another product as this may fix a problem.

We find it surprising that “some annuities” are included in the list of substitutable products. For us, annuities are associated with asset decumulation whilst the others products mentioned are essential about the acquisition and allocation of wealth. We would not regard annuities as being substitutable with other products in the list. Decumulation products should be viewed as being in a class of their own.

Question 4

This is a complex question which risks putting consumers into “neat little boxes” through segmentation. It is our view that whilst tax regimes and cultural preferences may be underlying drivers of behaviour, they are only the backdrop to the individual motivations of consumers and their attitude to risk and reward.

Regulation in the UK has created opportunities and also led to a series of “unintended consequences” where changes to the regulatory regime saw specific products being developed, new sales practices employed, all to take advantage of real (or perceived) loop-holes. The Government has also encouraged consumer behaviour by the introduction of tax-free saving schemes such as Individual Savings Accounts.

Whilst this affect behaviour they do not present a significant threat to the greater harmonisation of EU markets.

Question 5

We suggest that the word “understanding” is incorrect here. Only the individual can determine their level of “understanding” all a firm can do is seek to provide information and, if appropriate, advice, to the individual. The consumer has the responsibility to ask for a more detailed explanation if they do not understand what is being said or offered to them.

Pre-contractual disclosure should focus on providing consumers with information they can understand in as short and simple a way as possible. Heavy reliance has been placed on written disclosure, this only addresses part of the problem, and the Financial Services Authority, now insists on a verbal explanation of key parts of some products too. This, however, presents other problems in terms of evidencing what was said, in the event of a consumer complaining.

We are keen to see a level playfield for disclosure which captures, and places the same obligations on, all market participants.

Question 6

IMD and MiFID impose different requirements on firms but, in the UK, FSA’s move towards a more principles based regime, and its work on “Treating Customers Fairly” seeks to minimise any detriment that may arise from this. Given the relative newness of these projects, it is too early to derive any meaningful lessons, apart from to state that every firm should have a clear “conflicts of interest” policy which is there to protect the consumer (and the firm).

The UK has an active Financial Ombudsman Service which is also regarded by firms and consumers as being an effective check-and-balance in the system. Last year the FOS received 115,000 complaints. Despite IFAs conducting over 65% of retail investment business (by value), they received only 14% of complaints, and only 3% of these went against the firm. This compares very favourably with larger organisations (banks and insurers) who received the vast majority of all complaints – and have higher uphold rates.

The role of Ombudsman services and other arbitration services should be factored into the Commission's deliberations on this matter.

Question 7

The UK has significant conflicts of interest requirements both in terms of disclosure and of how business decisions are taken. These provide a very important reassurance for consumers.

Question 8

The UK has a recognised "financial promotions" regime as part of the FSA's rules. For areas of financial services outside of the FSA's remit, the Office of Fair Trading has a similar financial promotions rulebook and the two organisations discuss matters of common interest.

The most important area where consumer detriment can now occur in these matters concerns the internet. There are thousands of websites that heavily promote and market financial services products and services. Unregulated entities, these websites are often little more than "shell" sites which collect leads and sell them onto other organisations. They distort the market as they do not adhere to the FSA's or OFT's rules and so compete unfairly with regulated firms (their practices make exaggerated claims, offer unrealistic projections etc.).

Question 9

As discussed above, whilst products are important, it is the consumer's needs and motivations that must come first. The consumer must understand the status of the firm they are dealing with (financial adviser or salesperson).

Having decided what product or service is required, if any, the comparability of products then becomes important. The disclosure regime should operate at a common level (either at tax wrapper or underlying investment), and be comparable in terms of the nature of the product (investment, insurance etc).

All market participants must operate under a common disclosure regime, failure to ensure this happens risks creating a bias in the basis of competition between firms, and puts another barrier to the consumer making appropriate choices.

Question 10

We would advise that the first place to start is to ensure all member states implement existing Directives at the same level. This would then allow the Commission to review the working of the market at that time – and draw lessons. To seek to bring further change at the moment risks making decisions based on inaccurate and incomplete information and producing solutions which are not well founded.

Annex 1 Research findings

In Q3, 2007, AIFA conducted research with clients of IFAs to better understand the relationship between the adviser and their client. These results demonstrate the value of independent financial advice, why clients chose to deal with IFAs, and what they regards as being most important when seeking to make a financial decision.

Why did you decide to visit an IFA? (tick all that apply)		Response Percent	Response Total
Seeking professional financial advice that was free of bias		43.4%	309
Recognised a need (for example, pension query, inheritance etc.)		29.8%	212
Recommended to do so by a friend or family member		15.7%	112
Recommended by another professional e.g. solicitor / accountant		7.4%	53
Other		3.7%	26

Statistics based on **465** respondent(s) 1 skipped.




This chart demonstrates that the bias-free advice offered by IFAs is the major motivator in consumers seeking firms out.

How long have you been a client of your IFA?		Response Percent	Response Total	
1	0-3 years		17%	79
2	4-7 years		17.8%	83
3	8-15 years		35.6%	166
4	Over 15 years		29.6%	138

Statistics based on **466** respondent(s). Q3 2007

Clients and their IFA build long term relationships. This is at the heart of the IFA business model which is client-centred, recognising the value in long term relationships. This finding is re-inforced by the results of the next chart:

Why did you select this IFA?		Response Percent	Response Total
Personal recommendation (from family member, friend, colleague or other)		56.7%	271
Saw an advertisement		5.2%	25
Referred by accountant / solicitor / other		14.6%	70

solicitor / other professional adviser			
Have always used an IFA		5.2%	25
IFA Promotion or other sourcing service		6.5%	31
Other		11.7%	56
Statistics based on 465 respondent(s) 1 skipped.			

This chart clearly shows the high regard for IFAs, as most people trust their IFA more than any other source.

Who do you trust most to offer financial advice?		Response Percent	Response Total
Your IFA		97.7%	461
Banks		1.1%	5
Insurance companies		0%	0
Journalists		1.3%	6
The Government		0%	0
Statistics based on 463 respondent(s) 3 skipped.			