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THE RETAIL DISTRIBUTION REVIEW

“A CRITICAL EVALUATION OF THE RETAIL DISTRIBUTION REVIEW”

JAMES MccOURT

A thesis submitted for the fulfilment of the requirements for the degree
of
Doctor of Philosophy
University of Edinburgh
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I DECLARATION

This is to certify that the work contained within has been composed by me and is entirely my own work. No part of this thesis has been submitted for any other degree or professional qualification.

James McCourt
December
II ABSTRACT

Despite the high profile nature of the interventions made by regulators after the global financial crisis, there have been few objective assessments of their success and of the orthodoxy of market failure analysis that underpins the rationale for taking action. This study addresses both literature gaps by developing a distribution landscape segment model to measure the success of an exemplar; the Retail Distribution Review (RDR). It also undertakes exploratory research to establish a basis for a diagnostic paradigm based on customer value rather than well established, but criticised, classical economic indicators.

A “stock flow” based model was constructed to assess post-RDR levels of asymmetry, agency and trust. The absence of source data prompted a second exploratory phase of research into Trust as a welfare benefit, using customer focus groups and telephone surveys. An evidential basis for an alternative framework based on what consumers value, rather than how economists think is rational for them to act, was established. The model results indicated a landscape which is more complex than 2013, with competing interests transmuted rather than eradicated and information asymmetry growing rather than shrinking. The results support a view that interventions focussing on narrow “market” definitions do not reflect the complexity of human behaviour and are simply “squeezing the balloon”. The customer value research found that trust is complicated and related to several key “motivators”. These have underlying attributes which differ between socio economic groups, the financial objectives and whether customers have advisers. The conclusion reached is that an evidence based customer perspective should be at the heart of regulatory analysis, if public welfare is to be maximised. The study provides evidence of complexities and connectedness between actors and economic forces in the retail financial services landscape, cautiously supporting the literature on regulatory interventions as socio-technical assemblages. It argues that the customer value framework enriches the regulatory toolkit by forming a guard against intellectual capture and unintended consequences of shaping reality to fit a so-called perfect market model.

Key words: RDR, Trust, Market- Failure Theory, Asymmetry, Agency, Regulation, FCA. Performativity, Agencement.
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1. INTRODUCTION

1.1 Opening Statement

This thesis investigates the extent to which the prevailing market focussed approach to regulation is appropriate to the welfare needs of the consumers whose interest it acts in. Through an exploration of a landmark structural reform within UK financial services – the Retail Distribution Review (RDR) – it aims to develop the scholarly debate on public interest theory of regulatory interventions at a time when the post financial crisis regulatory architecture is still evolving. The study has two strands of parallel enquiry. First, it seeks to quantify the success of the RDR in addressing the specific market “failures” it was created specifically to resolve. Second, a conceptual model of customer value not aligned to market theory is developed and reviewed as a basis for an alternative rationale for structural and conduct regulation.

This chapter serves as an overall introduction to the subject matter and rationale for study. The following section sets the scene and goes on to introduce the RDR within the context of a changing regulatory system. The high level scope and overarching rationale for study is then set out, followed by a summary of the economic concepts which underpin the analysis undertaken by the then regulator – the Financial Services Authority (FSA) – and defined the “problem statement” which RDR was created as a response to.

These economic concepts frame the first part of the study. The final section of this chapter provides a forward-looking context to the study by describing the still evolving nature of regulatory approach to financial services within the UK. Neo-classical economic theory has given way to behavioural economics influenced
interventions, but crucially, the efficiency of markets paradigm remains. Indeed, the Financial Conduct Authority (FCA), which succeeded the FSA, has a strategic overarching objective to ‘ensure relevant markets work well’. This reinforces the need for a study of this type, which explores the role that the customer perspective can play in setting regulatory priorities.

1.2 Introductory context

Before RDR, in the mass market…the vast majority of those people weren’t really getting advice – they were just getting a sales pitch.”

*Martin Wheatley, CEO, Financial Conduct Authority, 2013*

Financial products and services are not discretionary consumer lifestyle goods; they are necessities that people need to live their lives within the modern UK economy. As the senior civil servant Charles Roxburgh highlighted (FAMR, 2016) government policymakers recognise that people in the UK will have to face increasingly complex financial choices throughout their entire lives as a result of a number of powerful socio-economic trends such as increased longevity, later life employment and the retreat of employers from providing pensions with defined benefits linked to salaries. Furthermore, he and his colleagues across government recognise that regulated financial advice is very important in addressing the information asymmetry unique to financial services (Llewellyn, 1990), which is necessary to avoid poor outcomes such as continued insecure housing provision or poverty in later life (FAMR, 2016). The importance of regulated advice and support when purchasing financial products is also
recognised by consumer groups such as the EU Financial Services User Group (FSUG). This group argues that firms providing such services should be deemed as *socially important*, even when not deemed by entities such as the Financial Stability Board as *Systematically Important Financial Institutions* (FSUG, 2012).

With this in mind, it seems appropriate that when senior UK policymakers had concerns that the market for financial advice was not working well for all consumers, they acted. In 2015, Mr Roxburgh and the CEO of the Financial Conduct Authority – Tracey McDermott – were tasked with leading a government-sponsored review of the financial advice market. This review was initiated just two years after the landmark reforms of the Retail Distribution Review (RDR) were implemented. Given that RDR was very much focussed on addressing failings such as in the market for retail investments, this seemed a prima facie acknowledgement that it had not been entirely successful.

The RDR came into effect on 31 December 2012 but was conceived before the global economic crisis of 2008 started. Its scope was substantial. It encompassed the entire retail investment landscape regulated under the Financial Services & Markets Act 2000 and changed many market parameters. It introduced both *conduct* and *structural* elements of economic regulation, as described in the literature (Kay & Vickers, 1988). For instance, the regulated boundary for retail investment products was redefined; the level of threshold qualifications for financial advisers was changed, the dismantling of commission linked advised sales and unbundling between product and advice charging; the introduction of a more granular demarcation between independent and non-independent advisory services; the limiting of cross-subsidisation between product manufacturing and distribution. Its genesis is from a time when the UK had a
single financial services regulator, the Financial Services Authority and its development predated the overhaul of the international and domestic regulatory architecture for both retail and wholesale financial services.

The UK has now reverted to what is commonly referred to as a *Twin Peaks* supervisory model, separating the macro-prudential supervision from that of the micro-prudential. The Prudential Regulatory Authority operates under the authority of the Bank of England with the Financial Conduct Authority addressing the conduct of business agenda in addition to prudential regulation of less systemically important firms such as investment and insurance advisers which hold client money and credit brokerages. The FCA’s powers have been enhanced to include a specific reference to consumer protection and competition. The FCA can use product intervention and the public naming of firms subject to investigation now applies across an extended range of the retail landscape, such as electronic payment services and all retail credit firms. It now employs a behavioural economics led approach, using randomised controlled trials to inform its market studies, which in turn lead to “market remedies” such as capping the interest that can be charged on payday loans, for example. Whilst its approach is still evolving, as evidenced by the recent release of an Occasional Paper introducing a new market intervention methodology, these changes ultimately flowed from a Financial Services Bill, whose parliamentary Joint Committee cited the government’s view that “the box ticking approach to financial regulation in the run up to the financial crisis, failed” (HMT, 2012).

In addition to this legislative change to the domestic supervisory model, a number of supra national regulatory initiatives and frameworks such as Solvency 2, MIFID 2 &

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1 Economics for Effective Regulation, FCA Insight Series
Insurance Distribution Directive (IDD) have arisen from the EU’s post crisis policy agenda, not to mention global initiatives such as Basel III and the “too big to fail” SIFI\(^2\) policy measures emanating from the G20 sponsored Financial Stability Board. Some of the specific domestic changes to market supervision are very technical and are explored in more detail later in this document in order to understand the full regulatory context of the current market. However, the key point to be made at this juncture is straightforward. It is simply that the consensus on how best to regulate financial services has changed substantially in the UK since the RDR was first formulated. It was designed before the financial crisis hit and launched after a long gestation period which was contentious in part.

This thesis seeks to establish whether RDR was the right solution delivered at the right time; the right solution delivered too late, or simply the wrong solution for any time. Fundamentally, it seeks to identify if it is an example of regulation which was fated to be inefficient and ineffective, due to unexpected side-effects and even adverse effects of regulation that will always result from fusing an economic rationale with a welfare objective, as identified by critics of the neo-classical economic rationale for regulation. (Wolf, 1987, 1993; Tullock, Seldon and Brady, 2002).

### 1.3 Overview of the Retail Distribution Review (RDR)

As stated above, the Retail Distribution Review (RDR), came fully into effect at the beginning of 2013, and is the most recent in a series of regulatory reforms in the UK

\footnote{Systemically Important Financial Institutions, see www.FSB.org}
retail advice sector. Its stated aim was “to create a competitive advice market which provides clarity and innovation in relation to retail financial products and services, along with adviser professionalism that inspires trust and enables consumers to have their needs addressed” (FSA, 2009a:5). Various commentators (Goff and Cadman, 2014), suggested previous reforms had limited effect on the advice market and consumer outcomes. As the Financial Services Authority (FSA) itself put it in 2007, “there are features associated with the distribution of retail investment products that result in inefficiencies for the market and poor outcomes for consumers. This is despite intensive regulation in this area for nearly two decades” (FSA, 2007:12).

Following the publication of 18 Consultation Papers, 5 Discussion Papers, 15 Policy Statements and 17 separate pieces of underlying commissioned research, the implementation of reforms constituting “the RDR” was completed on 31 December 2012.

The reforms had three main strands:

- The first concerns advisers and the service they provide. Under the changed disclosure rules, advisers must either be ‘independent’, taken to mean providing unbiased, unrestricted advice based on a comprehensive and fair analysis of the relevant market; or be restricted, a term capturing the provision of any advice which is not independent. The nature of the service being provided must be disclosed to the client in writing. The aim is to provide greater clarity for customers (FSA, 2009b).

- Second, the payment of product provider commission to advisers recommending provider products to clients is now prohibited. Instead, advisers can only be remunerated by adviser charge, agreed with the client at the start
of the advice process. The intention is to avoid any potential of commission bias influencing adviser recommendations (FSA, 2009b:23).

- Third, advisers must obtain an increased level of professional competence. Thereafter, they must meet annual Continuing Professional Development requirements as well as following a Code of Ethics, in order to obtain their Statement of Professional Standing, which provides a licence to trade.

It was argued these reforms would “deliver more clarity” in relation to products and services, establish “remuneration arrangements that allow competitive forces to work in favour of consumers”, and create an advice market where consumers can “have their needs and wants addressed” (FSA, 2007:17). The removal of commission is regarded as particularly important for addressing incentive issues and increasing consumer perceptions of adviser professionalism and trust. At the same time, the regulator believed that transparency in the cost of advice can enable consumers to exert more influence in the financial advice marketplace (FSA, 2007). Policy Statements (PS10/06 and PS11/01) have now been fully implemented, bringing a new way for consumers to pay for financial advice and reinforcing the standards of professionalism required from those who provide advice to consumers.

We now have an advice landscape that includes regulated, independent, restricted, focused, simplified, basic and generic advice. In fact, very recently, the FCA has added another – streamlined advice (FAMR, 2016). Perhaps it is understandable that research undertaken for the FCA in 2013 indicated significant confusion between the main agency demarcations introduced by RDR; independent and restricted advice (NMG Consulting, 2013). Furthermore, whilst the FCA’s own post RDR thematic studies indicate disclosure by advisers to clients has improved (FCA, 2014), consumer
research indicates that differences between independent and restricted advice are still complex and confusing for consumers (Europe Economics, 2014:33).

Whilst it is encouraging that such comments exist in research commissioned by the FCA, there remains a lack of detailed, independent scrutiny of the RDR, dealing with it in the round and from a consumer perspective. The FCA and FSA commissioned qualitative and quantitative studies at various stages in recent years - NMG Consulting, Frontier Economics, ESRO Ltd amongst others - however the scope of these reviews was narrow, answering specific questions set by the FCA and within the context of its own definition of market analysis. For example, the 2014 NMG study stated consumers were clear when they were receiving regulated financial advice or not. However, this conclusion was reached on the basis that they were told before answering the question that it meant what they had received ‘is a tailored recommendation from a qualified individual given after due consideration of your personal circumstances and objectives, so they recommend products or give you advice that is suitable only for you’. They may have been clear they did not receive this specific service; however, as the Financial Services Consumer Panel (FSCP, 2012) has noted in its research into the advice gap, consumers interpret the word “advice” in a much broader and more elastic way which can introduce dubiety and confusion. For example, there is also evidence indicating many consumers believe all regulated financial advice is independent (NMG Consulting, 2014a) and the recent Financial Advice Market Review expressly clarified its use of the word “advice” at the outset of its report (FAMR, 2016).

The introduction of RDR was also used as a mechanism with which to sweep up other regulatory priorities. It is more than seven years since the FCA concluded that the
market demand for Basic Advice was likely to be smaller than its earlier assumptions and so focussed its efforts on addressing the gap through its RDR work (FSA, 2008). This included consideration of the separate Thoresen Review into generic advice which correctly identified an under-served demographic (HMT, 2008). However, by 2012 concerns were still being raised about the effectiveness of the retail investment market for less affluent consumers, resulting in parliamentary interest in the role of the Money Advice Service. It had been provided with an expanded role and an increased budget compared to its inception. Another strand of policy which was shelved was the recommendation from the Sergeant review that “simple” products be developed, which required less stringent sales conduct rules. The RDR focussed on market behaviours rather than product regulation, reflecting perhaps the role that other actors such as HMRC and DWP play in the formulation of products.

More recently, reforms to private pensions have also given people more access to their retirement savings, potentially leading to a greater need for advice than before. This in turn has led to the recent government reviews into the abilities of the financial advice market and publicly supported guidance services such as MAS and The Pension Advisory Service (TPAS), respectively to meet the needs of non-affluent consumers.

In summary, the RDR was a substantial piece of financial market intervention, impacting regulatory boundaries, remuneration and incentives, conduct of sales standards as well as increased provision for addressing poor financial capability. Research commissioned by the FCA in 2014 confirms that it had a material impact, noting in the Cost Benefit Analysis that the ongoing costs could reach in excess of £700m (Europe Economics, 2014a) and that “taken altogether, post-RDR there has been a shift in the dynamics of competition” (Europe Economics, 2014a:p101).
Further to the FCA’s own view that there has been a market impact, there is consensus across stakeholders that it has been a major and contentious undertaking. This is reflected in an article in the Money Marketing trade newspaper stating that it “has proved to be one of the most debated and criticised pieces of financial regulation in the UK” (Money Marketing, 2014). That being said, as will be established from a review of the literature, there has been very little academic study into the RDR as a subject in the round and framed from the perspective of its own objectives. The post implementation review work was conducted from the scope of the new regulator’s market and competition objectives, but always within the context of market dynamics and not from a practitioner’s perspective. As the Frontier Economics report of 2014 stated “the FCA’s statutory objectives differ from the FSA’s. We have therefore considered topics relevant to the competition remit of the FCA” (Europe Economics, 2014:p1).

There have been some substantial and positive academic contributions which cast elements of its scope under a spotlight, such as the Financial Services Trust Index which has been produced by Nottingham University twice annually from 2009 and the Conduct Costs Project, led by Roger McCormick which tracks censures and fines (CCP Research Foundation, 2015). However much of the debate has been conducted between parties with vested interests, such as advisory firms, product providers and the FSA / FCA. Furthermore, given that an early act of the incoming government which followed the Blair / Brown administration was to criticise and break up the existing regulatory structure, it is difficult for even the several vociferous challenges from the Treasury Select Committee from 2013 onwards, to be viewed as impartial.
1.4 High level scope and overarching rationale for study

This thesis starts from the position that the RDR is potentially anachronistic in that the changes it proposed could be reflective of the prevailing regulatory paradigm which existed before the global financial crisis.

Reviewing its relative success should, on close examination, help improve understanding to what extent supervision of the UK’s retail investment market was informed by a similar type of “intellectual capture” to that which led to a widespread underestimation by regulators of the risks building in the wholesale financial system prior to 2008. The FSA may have correctly identified repeated mis-selling scandals and failing distributor firms as symptoms of a something going wrong in 2006 but we should consider whether the effectiveness of the responding market-led intervention, the analysis of the underlying causes and the design of the subsequent solution was influenced by a consensus-based conceptual framework. Essentially, would the FCA or a similarly modern supervisor now review the distribution of financial products in the same way and deploy a different kind of solution?

The post crisis approach to retail financial services regulation has firms’ cultures firmly in its scope – as evidenced by the recent thematic review into treatment of legacy customers in insurance (FCA, TR16/2, 2016) – which is in stark contrast to the approach of its predecessor. Hector Sants, FSA CEO, stated in a response to the Treasury Select Committee’s deliberations into the financial crisis that he was told that “the FSA doesn’t do culture” (HMT, 2011). Furthermore, recent publications and

3 In this context, the extent to which regulators and regulated view a circumstance through the same frame of reference. For example, by relying on VaR in “mark to market” trading exposure models.
market interventions\textsuperscript{4} indicate that the FCA now recognises the shortfalls of regulation based on the context of the neo-classical economic analytical tradition. Richard Thaler, a longstanding opponent of that tradition coined the term “\textit{Econs}” to describe the kind of person that neo-classical economic models are based on. Such a person always pursues the highest utility and is free from the behavioural constraints, preferences and shortcuts which would impede this. Such “biases” he argues, is actually what makes us essentially human and we should take account of that in our policy making. In short, \textit{Homo-sapiens} rather than \textit{Homo-economicus} (Thaler, 2010).

From its inception, when it published its very first discussion paper, the FCA has willingly incorporated the similar lessons from noted behavioural scientists such as Amos Tversky, Daniel Kahneman, Cass Sunstein and others and now expects its regulated firms to do so as well. Its Smarter Communications programme is reflective of this and sets the regulatory expectation that historic consumer protection approaches, such as imposing ever more granular product disclosure to address asymmetry, are below its expectations of treating customers fairly. As its own research has found, such an approach is actually counter-productive in eradicating the inertia commonly displayed by real people in situations involving the purchase of financial services. Regardless of how much written information detailing charges and terms and conditions is presented, many customers still roll over into uncompetitive annuity contracts, purchase unnecessary ancillary insurance products or simply fail to switch bank accounts (FCA, 2014b). The existence and success of the UK’s Behavioural Insights Team (commonly referred to as the Nudge Unit), which from its creation has influenced a range of government activities from tax collection to house insulation

\textsuperscript{4} GI Insurance Add-ons, Cash Savings Remedies, Payday Lender APR Limits etc…
grant take-up (Halper, 2015) and the use of defaults in the large scale Auto Enrolment of employees into workplace pensions, underscore just how pervasive this approach has become in a short space of time.

1.5 Study Aims

This study has two aims:

1. To critically examine to what extent the role of the RDR has been effective as a public interest regulatory intervention, correcting the retail investment market failings identified by the FSA in 2006.

2. To determine if a non-market perspective can be established as an alternative viable basis for understanding interactions between individuals and financial services vendors.

By reviewing the outcomes the regulator set out to be achieved through RDR and then thoroughly assessing the distribution market as it is currently formulated, it should be possible to establish what areas of the RDR intervention have achieved sub-optimal outcomes and which have been successful. Establishing a “report card” such as this is a valid exercise in its own right, providing interested parties with an evidential basis from which to develop further consumer focussed strategies. However, its status as a pre-crisis regulatory initiative also accords an opportunity to contribute to the wider academic debate on what effective regulation of financial markets should look like in a post crisis world. By critically examining the regulatory basis underpinning each set of objectives, it is possible to draw out which assumptions and theories continue to be
valid and should play a meaningful role in the supervisory and legislative framework as it develops.

It is almost 10 years after the desire to intervene in the retail investment market was reinforced by Calum McCarthy, the then FSA chairman. His address at the time was notable for its focus on the role of financial sales incentives as a contributor towards skewed agency and causal to the “bust model” he wanted to reform (FCA, 2006). The speech also focussed heavily on the impact that financial capability could play in resolving market issues such as information asymmetry. This was entirely consistent with the views on regulation posited by key UK influencers such as David Llewellyn and Charles Goodhart, which had been in circulation for some time (Llewellyn, 1999. Goodhart, 1998). Contemporaneous regulatory orthodoxies such as this and others are discussed later in this chapter and the subsequent overviews of RDR and the academic literature in this thesis also draw out the broader economic concepts which influenced the way the FSA approached the RDR development and are also worthy of critique. For example, it is clear from the FSA’s objectives that its intervention started from a position of market failure; the assessment of sales behaviour was framed by agency theory professionalism was cited as key to reducing externalities such as lack of trust. Even the way in which investment products are viewed as credence goods informs their regulation and informed the extent to which customer protections were reviewed when RDR was being formulated.

The attainment of both aims will provide further evidence as to the limitations of the market-failure approaches which are at the core of public interest theories of regulation. Insights from establishing the impact of RDR will also advance the academic literature concerning the approaches to measuring the benefits of regulatory
agency activity. Furthermore, by understanding the post RDR environment and the unintended consequences which have occurred will contribute to the emerging academic study of regulation through the lens of *agencement* (Callon, 2005) and the subsequent concept of counter-performativity (Mackenzie, 2007).

This study will provide further evidential basis for Ring’s assertion that regulatory agency itself is caught within the *assemblages* which frame the overarching activity of consumers as economic agents and are therefore pursuing an impossible task to correct behaviours of a market (Ring, 2015). This concept will be explored further in the study but at its heart is the theory that the deployment of market efficiency models can make thing less ‘efficient’.

The second aim informs the debate about what an alternative approach would look like.

In examining the RDR through these market lenses and undertaking some primary customer research, insight can be offered on which theoretical constructs were appropriate to the situation, whether they were applied correctly and/or to what extent they have had the desired effect and why. It is also hoped that areas of omission or mis-directed focus can be identified and put into context.

We know policy makers are looking to intervene in the retail advice market, again. At the very least, it is hoped that this study contributes to an understanding of the dynamics of a regulatory intervention in retail financial services and brings to life how that should take account of what customers value and how advisory firms align to shifting regulation. This has never been more important to “real” consumers with real needs. It is predicted savings levels will continue to be amongst the lowest in the

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5 The UK Government has recently instigated the Financial Advice Market Review.
Organization for Economic Cooperation and Development (OECD) countries (OECD, 2014). The automatic enrolment of individuals into pension arrangements, as well as the introduction of pension ‘freedoms’, mean individuals faced with increased longevity have to make more, and more complicated, financial decisions. Such decisions involve the management of financial risk to ensure secure long-term outcomes which ultimately, are underpinned by financial products and services, whose availability and quality are shaped to a great extent, by their regulation.

As stated earlier, the high level focus of this study is to establish in broad terms to what extent RDR has been successful and explore to what extent the RDR reflects a dated regulatory paradigm.

1.6 Introduction to the theoretical economic concepts of the RDR

This section reviews the various strands of theory underpinning the RDR with a view to establishing and refining the scope and structure of the study.

A good starting point is defining regulation, itself. Defining regulation is not easy with many contributors (Baldwin and Cave, 1999; Morgan and Yeung, 2007; Ogus, 2004), supporting a view that it is a flexible concept, defined entirely by its context. For the purposes of this study, a straightforward definition that it is the employment of legal frameworks for the implementation of policy objectives in defined areas of economic activity is a good starting point and works in the case of the UK financial services landscape. Entities such as firms or even individuals are compelled by government legislation - the FSMA 2000 - to comply with behaviour, defined by secondary regulations such as the Retail Activities Order, under penalty of sanctions, delegated to
the supervising entity, the FSA. Within the context of UK financial services, businesses can be forced, for example, to observe certain prices (such as the Auto Enrolment charge cap), to observe market boundaries (such as prohibiting marketing materials for Non-Mainstream Pooled Investments) and to apply particular techniques (such as establishing “suitable advice”). Sanctions can include fines, the publication of investigations, criminal prosecution or closing down the business.

In Llewellyn’s words “The purpose of regulation is not to replace competition but to enhance it and make it effective in the marketplace by offsetting market imperfections which potentially compromise consumer welfare. Regulation and competition are not in conflict” This reference to competition is important to our study. As stated before, the very first Occasional Article published by the FSA in 1999 was The Economic Rationale for Financial Regulation in which economic justifications for regulation were identified. These were grouped around what have been noted by Ring, (2015) as key justifications for efficiency-enhancing interventions in the market. They are; information asymmetries; lack of competition; and externalities such as confidence and trust. Furthermore, Llewellyn argues that in addition to an economic rationale for regulation, there can be a consumer protection rationale but, as we can see, this is still framed very much in a market theory context: “The ultimate rationale for regulation designed to protect the consumer is to correct for market imperfections or market failures which would compromise consumer welfare in a regulation-free environment” (Llewellyn, 1999). He then goes on to list such imperfections as agency costs (asymmetric information can be used to exploit the consumer); potential principal-agent problems and issues related to conflicts of interest; problems of ascertaining quality at the point of purchase; imprecise definitions of products and contracts;
inability of retail consumers to assess the safety and soundness of financial institutions; ‘free-rider’ problems (whereby all consumers assume that others have investigated the integrity of suppliers of financial services); difficulties in assessing the quality of financial services and products.

It is clear, therefore, that the FSA, from its inception, was framing its analysis of how customers obtained and engaged with financial services through a market theory lens. Subsequent to this, many other initiatives were undertaken, such as de-polarisation, which introduced a concept of “multi tied” advisory firms, in order to boost competition (Ring, 2015). By the time the FSA had decided to make a substantial intervention, the focus was very firmly on market dynamics. As the Discussion paper launching the RDR stated “there are features associated with the distribution of retail investment products that result in inefficiencies for the market and poor outcomes for consumers” (FSA, 2007). It noted that the distribution of retail investment products was characterised by market failures’. When we review the failures it cites, we recognise the same context which Llewellyn had posited several years earlier: Linkages between 2007 view and Llewellyn’s original theoretical regulatory framework are shown in Table 1.
Table 1 – Comparison between FSA Occasional Paper & FSA Retail Distribution

Review rationales for intervention

<table>
<thead>
<tr>
<th>FCA drivers of market failure</th>
<th>The economic rationale for regulation</th>
<th>The consumer protection rationale for intervention</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Complexity of products and charges</td>
<td>• information asymmetries</td>
<td>• problems of ascertaining quality at the point of purchase</td>
</tr>
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<td></td>
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<td>• imprecise definitions of products and contracts</td>
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<tr>
<td>• Lack of consumer experience and knowledge;</td>
<td>• information asymmetries</td>
<td>• asymmetric information can be used to exploit the consumer</td>
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<td>• inability of retail consumers to assess the safety and soundness of financial institutions</td>
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<td></td>
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<td>• ‘free-rider’ problems (all consumers assume that others have investigated the integrity of suppliers of financial services)</td>
</tr>
<tr>
<td>• A misalignment of interests between advisers</td>
<td>• information asymmetries</td>
<td>• principal-agent problems and issues related to conflicts of interest</td>
</tr>
<tr>
<td></td>
<td>• lack of competition</td>
<td></td>
</tr>
<tr>
<td>• Cost of advice leading to poor access</td>
<td>• lack of competition</td>
<td></td>
</tr>
<tr>
<td>• Low qualification threshold resulting in lack of trust</td>
<td>• <em>externalities</em> such as confidence and trust</td>
<td></td>
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</tbody>
</table>

Adapted from FSA Occasional Paper Series 1 (April 1999) & FSA “A Review of Retail Distribution” (June 2007)

As the table illustrates, the “problem statement” that the FCA formulated ahead of RDR revolved around issues arising from three broad economic concepts. These are set out below and will be the primary lens through which the assessment of the reforms will made.

1. Agency Theory. This frames the relationship between principals and agents in business and concerned with resolving problems that can exist in relationships such as between Principals and Agents. In the theory, problems arise when the
desires or goals of the principal and agent are in conflict and the principal is unable to verify what the agent is actually doing. It’s pertinence to RDR is in the context of the financial adviser acting as an agent of the customer yet influenced by selfish economic interests or those of a product provider.

2. Asymmetry Information Theory. This theory proposes that an imbalance of information between buyers and sellers can lead to inefficient outcomes. Within financial services, it is heavily linked to low financial capability, such as the inability to determine a balance from a bank statement found in c.30% of a sample conducted by the Money Advice Service in 2013 (MAS, 2014) which in turn is linked to the credence good idea that financial services are intrinsically different from physical goods, due to their long term nature and/or reliance on the standing of their manufacturer, to deliver.

3. Externalities. This is a multi-faceted concept within economics but, in broad terms, defines negative or economic effects which act on those who did not necessarily take an active part in requesting them. In the context of financial services, trust and confidence are prime examples and can be said to link to the idea of credence. The maintenance of confidence in financial markets is sufficiently well embedded as to have formed one of the FSA’s statutory objectives (FSA, 2001). The principle being that if confidence falls; so would demand for services, resulting in reduced access to required products and services. This is reflected in the UK Government stating, “a responsible and well-regulated financial services sector is essential to the success of the UK’s economy. The financial crisis of 2008 and 2009 demonstrated that when things
go wrong in the financial sector, the impact on the economy can be severe”
(HM Treasury, 2012,p107)

1.7 Changes to the UK regulatory philosophy and frameworks

Since inception of the twin peak approach in 2014, there has been a continuous change in the approach to how authorised firms are regulated. Twin-Peaks regulation was brought about by The Financial Services Act 2012. This is now the UK law in force, having received Royal Assent on 19 December 2012 and coming into force on 1 April 2013. The Act was the culminations of aggressive work by, inter alia the political institutions, scrutiny committees, the Independent Commission on Banking, the Bank of England and the Financial Services Authority (FSA). The FSA “failed dreadfully” in its supervision of the banking sector (Treasury Committee, 31 July 2009). Simply put, the new twin peaks UK regulatory architecture is designed to prevent, or at least better handle, a new financial crisis, and, by means of the Banking Reform Bill, to protect the general public from having to fund bailouts of institutions that have previously been considered too big to fail.

New domestic supervisors were needed, with a different culture and a different approach to regulation and supervision. The result is the Financial Policy Committee (FPC), the Prudential Regulation Authority (PRA) and the Financial Conduct Authority.

Although the PRA and FCA have sought to differentiate the context of their supervisory models from that of the FCA; the current focus on incentives and personal accountability, as exemplified by the Senior Managers regimes being introduced, has
its roots in the self-examination which took place shortly after the financial crisis and before their creation. From a situation where it was a case that “the FSA doesn’t do ethics”, a clear willingness to assess, even if not to define, the culture of firms emerged and is now firmly embedded in the assessments firms face on a regular basis: “For regulators, the starting point should be that we want the firm to have a culture which encourages individuals to make the appropriate judgements and deliver the outcomes we are seeking” (Sants, 2012).

The industry now faces regulators who exercise forward-looking “judgement-based” and outcome-focussed supervision. There is also, as exemplified through the Senior Managers regimes, an increasing desire to hold those at the very top of organisations, personally accountable.

Nonetheless, it remains to be seen if the new regime and its revised approach will actually be any more successful than the FSA-led regime, As Alistair Darling, the former Labour Chancellor, commented at the changeover of government in 2010: “You can change the architecture if you want, but you’ve got to make sure that you’ve got the right skills, the right judgments, because that’s what makes the difference at the end of the day”. However, the National Audit Office remains broadly supportive of the achievements of the FCA and PRA to date, commenting that “… have responded to significant challenges during the year. They are subject to considerable external pressures from domestic and international legislation, events in the markets and the behaviour of financial services firms and customers alike” (NAO, 2015.p22).

Conduct Risk is the cornerstone of the new style of regulation that the FCA is adopting throughout its dealings with authorised firms. The concept of conduct risk comes from the FCA’s eleven principles for business, in particular principle number
six which states “A firm must pay due regard to the interest of its customers and treat them fairly” (FCA, 2014). The FCA’s Clive Adamson stated in a speech about culture: “We expect customers’ interests to be at the heart of how firms do business. Customers can expect to get financial services and products that meet their needs from firms that they can trust. Meeting customers’ fair and reasonable expectations should be the responsibility of firms, not that of the regulator” (FCA, 2013)

The FCA applies a conduct lens to all firms that it regulates. The scope of conduct is broad and it has reset conduct standards to achieve three outcomes:

- Consumers get products that meet their needs from firms they can trust;
- The UK has sound & stable markets with transparent pricing; and
- Firms compete with twin objectives at the heart of how they run their businesses:
  - Interests of policyholders & customers
  - Market integrity

There are many views on the importance and motives of conduct. Some regard conduct as a means for the regulator, when unable to find a rule breach but nonetheless are unhappy with the firm’s activities, to use conduct as an overarching way of finding fault with the firm. From this rather cynical view, there is the polarised view that conduct is just a label, as this is how a good organisation conducts itself. This latter view is supported by Mike Roemer, Barclays’ Group Head of Compliance (July 2015) in which states that he had no doubt of Barclays' commitment to what he called its ‘conduct and cultural journey’, which includes the firm-wide values of respect, integrity, service, excellence and stewardship.

Current FCA activity around conduct risk is inviting firms to think about their overall approach, the aim being for each firm to develop a sensible culture of internal risk
management, based on the customer perspective. How the FCA will in practice monitor adherence by firms to the conduct framework has yet to emerge. The internal conduct risk frameworks that firms will create to evidence their approach will be critical empirical evidence in the debate on external regulation versus self-regulation and market forces.

It is with this in mind that the regulator has revisited the subject, although through the guise of “simplified advice” research and within the context of its new competition mandate which perhaps confusingly, requires that it explores regulation as a barrier to outcome enhancing disruptive technologies and techniques. These include full “robo advice” services such as that offered by investment managers such as Nutmeg and new ways of communicating terms and conditions of products available through digital channels (FCA, 2015).

It is clear that the FCA is seeking to shift to a different model of market intervention and this can be seen in the recent publication of its Economics for Effective Regulation (EFER) approach. This is the name of the new approach to economic analysis of financial services, and builds on methodologies for economic analysis used at FSA and seeks to improve understanding of the variety and interconnectedness of root causes of problems in markets and the channels through which regulatory interventions affect market outcomes. Although its foundations lie in analytical frameworks for the policy cycle, EFER, the FCA’s words “has been designed to support market-based regulatory analysis for competition and strategy, as well as complex instances of rulemaking” (FCA, 2016b). It cites complexity of the underlying drivers of poor outcomes in markets and the growing importance of behavioural economics as key tenets, for analysing “markets in the round”. It is too soon to see
how this approach will work in practice but an area for further study would be to back-test its methodology to the RDR intervention to ascertain if the intervention test would have been met under this new toolkit.

### 1.8 Overview of approach to method

The research exercise is fundamentally an exploratory study, primarily qualitative in nature which employs quantitative data and analysis methods to strengthen and deepen the evidential basis for answering the research questions. A material element of the study employs a case study approach whereby the RDR is used within the context that Yin defines “as an empirical inquiry that investigates a contemporary phenomenon within its real-life context; when the boundaries between phenomenon and context are not clearly evident; and in which multiple sources of evidence are used.” (1984:p23).

In this regard, the regulatory “phenomenon” is of a public interest derived intervention within a market using classical economic “solutions”. The sources of evidence in this part of the study included both open source regulatory quantitative data as well as primary analysis of internal and external commercially available market and firm level information. An early stage of this phase of the research was to develop an approach to describing the retail financial services market. Facilitated nominal group technique sessions were used to generate the key metrics which underpin the resultant model. These were made up of subject matter experts from across the organisation. The model was then constructed and used as a lens to assess the RDR. The overall objective for this element of the study was to establish the impact of RDR, not only against specific questions such as “has information asymmetry increased”, but also more contextual
and judgment based queries such as “what are the unintended consequences we can see?”. Answering such points is difficult precisely due in part to the lack of base-lining which occurred prior to RDR and elsewhere in financial services regulatory interventions. This in itself contributes to the wider question of what lessons can be learnt for future regulatory policy.

The second part of the research was very much a qualitative piece of work, in the spirit of an exploratory study. The objective was to identify key issues and key variables relating to the role of end consumers in formulating regulatory policy in financial services. From a starting point of very bland inductive statements about what customers would value from financial services, the voice and view of real customers was leveraged - through focus groups and telephone based surveys - to identify and draw out differences in perspective between the regulators and themselves as recipients of the “public interest” interventions. Building a model of “customer value statements” through an iterative process conducted over several months would flush out contradictions and/or support for the assumptions employed through the neo-classical economic model of analysis. Its context was therefore to help elicit hypotheses to be taken forward as part of a broader falsification process, centred on the appropriateness of market theory when used for public good in retail financial services.

The two phases of work have validity in their own right: establishing the extent to which RDR was successful against its own criteria is useful as a policy or practitioner case study, whilst seeking to understand the relationships and dependencies upon which customers will be happy in a financial services market is also a valid pursuit. However, in combining both elements in one overall exercise, a richer set of real life
comparative insights can be gained which identify the potential areas for existing market theory to be refuted or made less bad (in the vein of sophisticated falsification epistemologies).

1.9 Structure of thesis

This thesis is structured to reflect the broad chronological direction the study followed. Chapter 2 sets out the relevant literature, covering financial services regulation in the academic sphere, as well as detailing the extent to which RDR has been the subject of serious academic study, as distinct from regulatory sponsored and practitioner publications. The consumer perspective is also covered with a view to establishing clearly the rationale for undertaking the study. The overall conclusion reached is that although written about extensively in practitioner publications, the study of RDR as a case study within the context of developing the regulatory theory remains an under researched topic.

Chapter 3 builds on the gaps in the literature by identifying the relatively straightforward research questions which provided the basis for formulating the objectives of the study. Chapter 4 covers the objectives which are reflected on in the discussion and conclusions provided later in the thesis. Chapter 5 provides details of the mixed methodology study design. Methods were tailored to the objectives and for some elements, reputable research partners were employed for efficiency and also to mitigate unconscious bias arising from the author’s position in the industry. In chapter 6, the results of the RDR review work, insights from the consumer perspective research and the limitations of the study and assumptions used, are set out. Chapter 7
provides a focussed discussion on the study and places the results in the context of the wider study aims and objectives. Finally, chapter 8 concludes the thesis by referencing back to the literature and making suggestions of further areas of study and recommendations arising from this work.
2. LITERATURE REVIEW

2.1 Financial Services Regulation within the Literature

2.1.1 The arguments for and against financial services regulation

Johan de Hertog wrote in his 2010 paper that there are two broad traditions which deal with the economic rationale for regulation. The first tradition assumes that regulators have sufficient information and enforcement powers to effectively promote the public interest and works on the basis that they always aim to pursue the public interest, whilst the second starts from the perspective that regulation is captured by the same self-interest as any other economic agent and so (ultimately) reflects the influence of entities enacting or driving it. This distinction between ‘public interest vs private interest theories of regulation’ (Hertog, 2010) is useful for this purpose as it draws out the vociferous competing views within the literature on what type of regulation is effective in financial services - for instance the self-regulation of the 1980s - and suggests the kinds of influence which regulators can be subject to which limits their effectiveness – for instance, regulatory and intellectual capture.

A good starting point for understanding the strength of opinion on financial services regulation is the well regarded\(^6\) summary by George Benston of Emory University. Benston argues that whilst regulation of financial services starts from a benevolent perspective, in practice, it is ‘detrimental to most consumers’. (Benston, 2000.p277)

Whilst Llewellyn (1996) dismissed Benston’s applicability to the UK market, he does support the argument against too much prescriptive regulation, which he states causes a negative impact on several areas of the financial sector. The concerns raised by

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\(^6\) See Lewellyn, D in FSA Occasional paper 1, 1999
Llewellyn are not so much about regulation itself, but about externally imposed regulation, as opposed to self-regulation. This was the situation in the UK before the FSMA 2000. Financial services firms up until then were supervised by Self-Regulatory Organisations (SRO) such as the Personal Investment Authority and Investment Management Regulatory Organisation. These entities existed primarily due to the natural economic forces of free markets, with Goodhart citing Coase’s observation (1998, p42) that emphasised, “require considerable internal infrastructure and self-regulation to function efficiently with minimal transaction cost”.

The concept of “over regulation” is a familiar refrain in practitioner literature, such as trade press and trade association publications. For example, Angela Knight (Association of Private Client Investment Managers and Stockbrokers) addressed the impact of over-prescriptive regulation in a speech made in 2003: “Changes and yet more changes from the Financial Services Authority. So far this year, we have had to handle 27 Consultation Papers, 10 Policy Statements and eight Discussion Papers from the FSA, in addition to the monthly notices… plus Treasury and DTI papers… plus Bank of England work. Add to this… Directives… (from) Brussels… you can see why regulation in all its forms is such a large burden.” (APCIM, 2003).

This bemoaning extends across national borders, with professional consultancies such as PWC, contributing to its visibility in Boardroom agendas. It advised in its 2015 survey of 175 banking and capital markets chief executives in 54 countries that “Over-regulation was a concern for 89% of them, up from 80% last year, while 87% of chief executives thought that it would continue to have a disruptive effect in the next five years” (PWC, 2015). This leads us to a paradox. The UK is viewed as having one of the best-regulated systems in the world, but has also had a series of regulatory failures,
impacting on most sectors of the market, insurance company failures, life insurance and pension mis-selling, split capital investment trusts, Equitable Life, to name but a few. Proponents of self-regulation argue that this can be seen as the moral hazard of imposed regulation generally; regulation itself creates an environment where following the rules and pronouncements of the regulator, reduces the capability to manage risks internally. This point was made by the Wallis Committee of Inquiry in Australia in April 1997 and to be fair to the FCA, it has sought to bring culture and ethics to the fore in a way not previously done by its predecessor (FCA, 2015). However, a more nuanced perspective can be obtained by understanding the role that regulatory and intellectual capture can play. Regulatory capture, as highlighted by John Kay in his recent book “Other People’s Money (Kay, 2015), is the process by which a body created to act in the public interest, can end up advancing the commercial or special concerns of interest groups that dominate the industry and which the agency is charged with regulating. The probability of regulatory capture is therefore economically biased, in that vested interests in an industry have the greatest financial stake in regulatory activity and are more likely to be motivated to influence the regulatory body than dispersed individual consumers, each of whom has little particular incentive to try to influence regulators.

While the traditional concept of regulatory capture in the academic literature has focused on material incentives between regulators and different stakeholders, the recent financial crisis has led a number of authors to broaden this concept. Terms such as “intellectual capture”, “cognitive capture”, “cultural capture” have been used to signal instances where, as James Kwak argues, special interests are able to ‘shape policy outcomes through influences other than material incentives and rational debate”
(Kwak, 2014). As he and others (Medinger, 1987; Ayres & Braithwaite, 1991) argue, the traditional view that regulatory decisions or actions can be skewed by personal economic interests such as seeking a job in the private sector, are too narrow. Motivations are mundane. For instance, in the period preceding the crisis, he argues “regulators found it natural to utilise models and datasets developed by private interests” (Kwak, 2014.p95). This diagnosis of regulatory failure has been acknowledged by critics of traditional economic applications such as Nassim Taleb who argues that the very mathematical models for risk evaluation were fundamentally flawed and unexposed due to group-think (Taleb, 2012).

This sentiment has been echoed by the former chair of the FSA, Lord Adair Turner, who argued that, before the crisis, regulatory authorities were prone to ‘regulatory capture through the intellectual zeitgeist’ (Turner, 2011.p1). This point goes to the heart of the RDR, which was influenced by the broader intellectual climate of the period, in particular the ascendancy within the academic community and many regulatory authorities of ideas highlighting the efficiency of financial markets in understanding and allocating risks. As Kwak notes, within financial services, regulators “identify themselves as “economically sophisticated stewards of efficient markets” (Kwak, 2014.p83). By accommodating such a world view, regulators such as the FSA will have been subject to both a public and a private interest. In the case of the former, there is well founded belief that they are acting in the interests of the greater good on a basis of perfect technical analysis. In the case of the latter, they were avoiding the cognitive dissonance of adopting a position which goes against the training of their own intellectual peer group.
2.1.2 Market failure within financial services

Public interest theories of regulation indicate that regulation in financial services benefits good firms, the consumer and ultimately the stability and growth of the economy. For firms, addressing these problems with regulation always applies a restriction of competition. If there are no regulations then bad firms may behave opportunistically, prepared to take the risk of not being ‘found out’. Moreover, unbridled competition can lead to firms taking practices and products close to the wire. If this behaviour occurs and is later exposed, consumers, unable to differentiate properly between good and bad firms and products, will view all firms and products as equally culpable and the whole industry is damaged. Warland (2005) offers that “if the correct balance is found between competition and regulation, it is the best firms that have the most to gain from regulation. So in that sense regulation can be good for business”.

Downd, Benston and Kaufman subscribe to the school of thought that many of these crises and problems are “indirectly malign effects on external regulatory efforts… interposing regulation and supervision into an otherwise free-market context, weakens the incentives for the owners/managers to monitor and control themselves, and for their clients to exercise due diligence”. This perspective is consistent with the political philosophy of Milton Friedman which grew in popularity through the 1970s and 1980s and extolled the virtues of a free market economic system with minimal intervention. The case for less regulation is most recently supported by Booth (2012) who argues that the concept of “market failure” is relatively new – promulgated by Pigou in his view – and fundamentally flawed due to its starting point of supposing an idealised state of perfection. He cites the fact that economics teaching commonly focusses on
the preconditions of a so-called perfect market – full information, no transaction costs, no externalities and so on – and then looks at how markets, in practice, deviate from that textbook model. We then call those deviations ‘market failures’ and suggest policies which governments could, in theory, use to make an imperfect market perfect regardless of whether it is possible, in practice, to improve economic welfare by adopting such policies.

This approach to understanding economics is then applied in practical policy. Many regulatory bodies in the UK have adopted the market failure approach to regulation. This means the development of regulation can involve a process by which the regulatory body identifies market failures and then develops instruments focused on ‘correcting’ them. This state of affairs was evident within the FSA before RDR was introduced and exemplified by the following quote from its Chairman in 2003 ‘In meeting our objectives in a manner consistent with the principles of good regulation, we have adopted a regulatory approach based on correcting market failure...There are, however, numerous cases where unregulated financial markets will not achieve the best outcome due to some form of market failure, making action on our part necessary.’

In its 2006 internal guide to conducting a “market failure analysis”, the FSA identified three types of market failure, being:

- externality/third party effects making social marginal benefit (or cost) differ from the “private” marginal benefit for the buyer (cost to the seller);
- some buyers (or sellers) are imperfectly informed, so that their mistaken estimates of actual marginal benefit (marginal cost) lead them to take incorrect decisions;
market power, on the part of seller(s) or buyer(s), leads them to exploit their influence over the price, which they no longer take as given – leading, typically, to under-provision of the good in question.

We can see that these manifestations of failure are consistent with the Lewellyn analysis referred to earlier and can be caught under the asymmetry, agency, externalities labels.

A counter-point to this market theory paradigm was made by Sandel, who argues that there is a limit to how much of human life can be put in a market context. His argument is that such an approach is the “commodification and privatisation of public life” and represents a false definition of freedom (Sandel, 2012). The case for self-regulation has been referenced above as positioned by Coase (1988,p6)), his school of thought being that “a free market based on private self-regulation, reinforced by common, commercial and contract law could meet in-itself a level of regulation” However, he continues by expressing that it is more likely that “public revulsion at the effects and outcome of failures in unregulated financial systems can force the establishment of system of deposit insurance and external regulation”. (Coase, 1988,p10)

This idea of public demand and the concept of external versus “internal” regulation was developed further by Goodhart (1998.p162) who states that the “excessive public demand” is a prime driver for the imposition of regulation on financial services institutions. Whilst they argue that while there must always remain a role for external regulation, they see no cost effective alternative to placing greater reliance on internal risk management techniques and reference contemporaneous developments such as Value At Risk (VAR) and modelling science as ways forward. With such a system in
place, they argue regulation is essentially about changing the agency of financial intermediaries through the creation of the appropriate incentive structure. These are important points for consideration within the context of this study. Firstly, the paradigm that regulation was primarily to be viewed in an economic context was promoted by Goodhart, Llewellyn and others representing the prevailing academic mind-set, when the FSA was set up and developing its framework for market intervention. Indeed, in DP 07/1 the FSA states “A principal aim of regulation is to deal with market failures. These have manifested themselves in various ways in the distribution of retail investment products. We are using this review to address these issues with a view to improving the working of the market and thereby reduce the need for regulation. It is difficult to address all of the market failures directly” (FCA, 2007, p15).

Government policy reiterated a belief in market power and the space between academic theories of finance had narrowed, as evident when Myron Scholes and Robert Merton operated internal sophisticated risk management techniques in their LTCM hedge fund. This, in turn, created the basis for the intellectual capture which held sway when analysing the “market failure” which in turn, became almost exclusively focused on concepts of agency, asymmetry and externalities. These are discussed below, followed by an overview of RDR within the literature.
2.1.3 Information Asymmetry & Agency within the literature

Information Asymmetry

While information asymmetry is present in many human interactions, there is a longstanding view that it is exacerbated within financial services. This argument has been made by the FSA, whose first chair; Howard Davies provided a basis for Callum McCarthy’s analysis by arguing that two forms of information asymmetry are particularly apparent in financial services. The first relates to the complexity of contracts and the second relates to the difficulties in judging the soundness of firms. Both are reflective of Llewellyn’s analysis and attempted remedies can be found within the consumer protection legislation from the advent of the FSMA. The first, as we have seen, resulted in several attempts to improve information through standardised product literature as well as process regulation, as evident within the conduct of business standards within the FSA Handbook. The second, financial soundness, was the focus of information based efforts such as solvency ratio publication but, more effectively addressed through capital adequacy rules, mandatory professional indemnity insurance and the creation of retail depositor insurance in the form of the Financial Services Compensation Scheme. This broad consensus was repeated in the Sandler Report “savings products are inherently more complex than almost all other consumer goods.” but this has been challenged by proponents of less extensive and granular regulation such as Benston who argue that white goods are just as complex. Nonetheless, the prevailing view remains that financial services are different.
Principal – agent problem

This asymmetry helps create the context for detriment which can be exacerbated by the principal-agent problem as described within agency theory. This situation arises whenever one person, “the principal”, engages another person, “the agent”, to undertake “imperfectly observable discretionary actions that affect the welfare of the principal” (Sitkoff, 2014.p89). In short, the lack of oversight reduces accountability of those who may be subject to competing interests. Agency problems are pervasive in the financial services landscape, as financial capability remains low (Money Advice Service, 2014) meaning few people have the cognitive skills, knowledge and attitudes necessary to navigate the complexities inherent in such credence goods. For example, in 2013 a study by the MAS advised that 16% of respondents were unable to identify the balance on a bank statement (MAS, 2014). By delegating a task to an agent (such as a financial adviser), the principal (retail consumer) benefits from specialised advice. However, these benefits come at the cost of being vulnerable to abuse by the agent, if their discretion cannot be easily monitored. In such circumstances, the agent may be tempted to favour their own interests over that of the principal, resulting in losses and inefficiencies to the principal. In the words of Callum McCarthy “incentives drive behaviour” and given the prevalence of mis-selling scandals in the mid-1990s such as endowments, structured capital at risk products (SCARPS) and pension transfers from occupational schemes, it is clear why the FSA concluded that the principal-agent problem was pervasive in the retail market. This was partially supported by FSA data showing switching levels (thus generating new commissions) and research commissioned by the Association of British Insurers (ABI) and conducted by Charles River Associates in 2005, focussed on product selection bias (ABI, 2005). The report
indicated that there was no significant overall commission related bias between products and therefore no significant detriment to the consumer brought about by commissions but it did identify issues around the sale of single premium lump sum investments. This was attributed to the affinity and bank assurance model of tied distribution. A related study conducted by the Australian Securities & Investment Commission (ASIC, 2006) found that advisers were six times more likely to offer “bad advice” (advice that was subjectively determined not to have considered key factual issues, did not fit the client’s needs, or was likely to leave the client worse off) when the adviser had a conflict of interest over compensation (e.g., commissions) and three times more likely when suggesting an associated product (e.g., an in-house fund). The study also found that consumers were rarely able to detect bad advice.

However, this research was not followed up with more substantive studies, with the FSA focussed on the highlighting of the “perception of bias” as being contributory to the low levels of trust in financial services. In effect, it argued that as commission based remuneration to the adviser was endemic across all distribution models, it must have created a principal-agent problem. This assumption is not in itself terribly contentious but as can be seen from the RDR rules, it naturally led to a remuneration focus on the problems of agency. This is explored below.

Remuneration as a specific driver of competing interests
The literature presents evidence that financial advisers’ behaviour is influenced by incentives, specifically remuneration. Mullainathan, Noeth, and Schoar (2010) and the work undertaken by Australia’s ASIC (ASIC, 2006) find that financial advisers display a bias towards actively managed funds and funds with higher fees. This has
been supported by a recent study by the US Department of Labor, focussed on “rollover” retirement plans (US DOL, 2014). Further to this, and Hackethal, Inderst, and Meyer (2010) find that asset flows are correlated with differences in adviser bonuses. A slightly spate strand of investor focussed research finds that retail investors using brokers have a greater prevalence to hold actively managed funds, thus over the longer term, earning lower returns than investors in the direct channel. Del Guercio and Reuter (2014), Hackethal, Haliassos, and Japelli (2012), all present evidence to this effect.

We should note that studies into returns are subject to data limitations and do not encompass softer benefits such as tax related advice or even reinforcing discipline such as remaining in the market during bouts of volatility. This has been highlighted by studies such as the Investment Company Institute which found that retail investors do indeed receive numerous intangible benefits including help understanding choices, generational planning and prioritisation (Investment Company Institute, 2007). That is not to say, however, that they are aware of them, or even the potential for conflicts to present.

**How consumers perceive conflicts**

The extent to which conflicted advice can harm customers depends on how likely they are to take the advice they are given. This is not an area of deep empirical study and we must turn to experimental work by Yaniv (2004) to evidence that individuals can discount advice when it is radically different from their own view. However, DeCarlo, Laczniak, and Leigh (2013) show that less knowledgeable individuals discount advice less. By extension, they are more exposed to the damage of conflicted advice. The
study’s findings leverage results of a rudimentary online trial: subjects who were financially knowledgeable knew that high commission levels might impact an adviser’s recommendations and were unlikely to purchase from an adviser with a large bonus riding on the outcome. Further experimental work by Gino (2008) showed that individuals tend to discount advice that they pay for to a lesser degree than advice they receive for free. This is consistent with behavioural economics, due to the endowment affect (Kahneman, 2008) and sunk cost theory. This indicates that advice which is received by paying a fee may be less likely to be discounted than advice paid for through bundled fees, or advice subsidised through kick-backs.

While the empirical articles discussed to this point are consistent with brokers delivering conflicted advice that harms consumers, it is difficult to establish a broad consensus on whether clients would have been better off by avoiding or ignoring the advice they received. However, the ICA research conducted in the UK found that some respondents were aware of potential conflicts of interest; one in four claimed they always conduct independent research to confirm recommendations. The respondents who no longer rely on financial advice and invest on their own do so in part because of a bad experience with a financial adviser previously (50% of respondents) and this supports the FSA’s view of a lack of trust as emanating from poor professionalism (FSA, 2006). In this vein, the 34% of respondents without a financial adviser cited “advisers put their own interests before those of their clients” as a major reason for not seeking professional advice and this strongly underpins the rationale put forward by the FSA that the lack of trust was spilling over to create a barrier to gaining advice.
**Action taken by regulators**

The regulation of commissions appears in the academic literature as well as in policy-making. Inderst, R. and Ottaviani, M. (2012), ‘How (not) to pay for advice’ and ‘Commission Bans and the Source and Quality of Financial Advice’ (Gorter, 2012) are good examples. The focus of Inderst and Ottaviani (2012) was in relation to whether applying a ban was related to the proportions of sophisticated customers to less capable counterparts. Gorter (2012) concludes that, in practice, the welfare benefits of a ban on commissions may be limited and this conclusion was reached by the study into remuneration across 5 developed markets (Oxera, 2014). Gorter’s model is of interest to RDR studies in that he suggests that customers who are less aware about conflicts of interest tend to prefer direct advice (i.e. that from a direct sales force of a provider such as “the man from the Pru”) over independent advice, in spite of the fact that the latter may be of better quality and free from some of the conflicts.

Within the UK, financial advisers facilitate transactions between retail consumers and providers such as life insurance or investment companies. Commission payments can be characterised as payments from the provider of the financial products to the distributor of those products, with the commission generally depending on the completion of a transaction.

**Financial services pricing in the literature**

Financial products can be relatively complex and, partly due to their complexity, they may involve multiple charges at the time of purchase and throughout the product lifecycle.
Financial products often involve multiple prices and charges that are incurred at the time of purchase. This could be the result of the market structure: there may be multiple agents involved in the provision of a product - for example, when investing in a fund, consumers have to pay separate charges such as a fund management fee, adviser fee and platform fee. Consumers may be purchasing auxiliary products (for example, insurance add-ons) that add to the main price; the cost structure of the industry may require a two-part tariff pricing - for example, a mortgage provider may charge a fixed administrative fee that is uniform across customers, and an interest rate that depends on the client’s riskiness.

The US Federal Trade Commission conducted an experiment which explored the impact of mortgage brokers disclosing to prospective consumers the commissions that the brokers received for arranging a loan with a particular provider. It found that consumers treated the commission information as particularly salient. They placed too much emphasis on the commission, and too little on whether the loan was keenly priced. Consumers paid more for their loans than they would have done without the commission information.

On the other hand, if the consumer is focused on finding a financial adviser to advise on a broad range of possible investment options, for example, including the option not to invest at all, then it might be beneficial for the consumer to be better informed about the payment that goes to the distributor for providing this advice. In this case, the consumer is not focused on judging the quality and price of the final product, but rather on judging the quality and price of the distributor.

The history of FSA discussion papers confirms that it considered these issues when developing the RDR package of reforms. It stated that low consumer engagement with
financial products could result in consumer demand being below the optimal level. This issue could be further exacerbated by payments for the distribution of services.

In its study of remuneration for the German regulator, Oxera cited the behavioural economics literature which indicates that an upfront fee for advice or other intermediation services could have a larger negative impact on consumer demand than a payment spread over time, particularly if the continued payment depends on the continued provision of services (Oxera, 2014). Given that people can be reluctant to deal with future financial requirements in the first place (due to inertia and optimism bias), it is reasonable to state that the regulation of payments to distributors could have unintended consequences for consumer demand, even if the size of payments remains exactly the same. These potential impacts need to be considered alongside the impacts on the behaviour of distributors.

Oxera’s study examined the developments in six countries where restrictions on the payment of commissions were introduced recently - the UK, the Netherlands, Denmark, Sweden, Finland and Australia.

As we have established earlier, the FSA identified three types of bias that might stem from commission payments. These are

1. **Product bias** - recommendations towards a type of product that pays higher commission than other types.

2. **Provider bias** - recommendations towards a particular provider based on expected commission payments.

3. **Sales bias** - recommendations towards the sale of a product (or switching provider in relation to an existing product) based on receiving a payment for
each new transaction, even though the transaction yields insufficient benefit to the consumer. Also known as “churning”.

Notably, after discussions with the industry, the FSA did allow for ‘provider facilitation’ of payments. This is where the customer agrees payments with the intermediary, but it is the provider that delivers the payment to the intermediary, for example from premiums paid.

In respect of life insurance contracts, not covered by RDR, the FSA considered whether to include pure protection products. These include critical illness cover, income protection and non-investment life insurance, which are commonly sold by retail investment advisers.

However, it declined to extend the coverage of RDR based on the falling number of complaints to the Financial Ombudsman Service (FOS) and an absence of the kind of large-scale mis-selling episodes that the regulator identified in the context of the investment advice such as pension mis-selling (FSA, 2007).

The regulator’s assessment was that the types of adviser behaviour that had driven the detriment in the investment advice market - the sale of expensive or inferior policies and switching - were less prevalent with regard to pure protection products. This was because of the inherent differences between pure protection and investment products.

2.1.4 Challenges to the conventional neo-classical economic model

As Thaler and Sunstein (2008), Kahneman and even the UK Government now argue, policymakers have too often assumed that, given the right market conditions, the animating spirits of competitive markets will automatically lead to positive outcomes.

7 UK Behavioural Insight Department aka “The Nudge Unit”
for financial users. But, as the EU Financial Services User Group has argued, the presence of hundreds of providers and thousands of financial products on the market does not guarantee the right outcomes for financial users (see below). In its words, “the illusion of competitive activity has been confused with effective markets” (EU, 2012). This challenge to regulatory theory built on the traditional ‘rational’ economic model points to an over emphasis on information asymmetries and competition theory to explain market failure. In contrast with the traditional (neoclassical) economic assumption that decision-makers, given their knowledge of alternatives and outcomes, can identify the alternatives that will yield the greatest expected satisfaction, behavioural economics questions whether the traditional assumption that people act solely to maximize their self-interest (i.e. utility maximisation) approximates to real behaviour. Traditionally, regulators favour interventions such as information disclosure to change market behaviour by enhancing consumer influence (the demand side). This can be evidenced by the prevalence of information requirements in the FCA’s Handbook8 and the continued EU disclosure directives such as PRIIPs. The expectation is that the right market outcomes will then result from the interaction between more equal and opposite forces in a transaction. However, while interesting in theory, this model may have limited application in the real world of financial services. Not all market participants behave with the degree of rationality assumed by conventional economic models.

In recent decades, cognitive psychologists and behavioural economists have been incorporating empirical findings about human behaviour into the existing neo classical economic model of utility maximisation. Those findings have the potential to

8 See COBS 13, 14, 2.3.1 and others
transform the nature of regulation and its likely consequences (Sunstein, 2014) and are also providing instructive lessons about the appropriate design of “nudges”, described as “low-cost, choice preserving”, behaviourally informed approaches to regulatory problems, including disclosure requirements, default rules, and simplification (Thaler & Sunstein, 2008).

This behaviour informed that the “nudging” approach is in line with a “libertarian paternalism” (Thaler and Sunstein, 2008) school of social policy which seeks to respect personal freedoms while also steering people in directions that will make their lives go better. The approach however, has also drawn criticism, partly due to its continued link to the neo classical economic model and a desire to model human behaviour mathematically. Psychologists such as Gigerenzer argue that it is pointless to keep adding frills to a mathematical account of human behaviour that, in the end, has nothing to do with real cognitive processes (Gigerenzer).

2.2 The Financial Services Consumer Perspective within the Literature

Whilst asymmetry theory underpins a broad rationale for intervening as consumers are not in the position to judge the safety and soundness of a financial institution or the merits of a complicated, long term non-physical product, it requires behavioural economics to improve upon remedies⁹ that are more than just information based. Behavioural economics helps us understand to what extent classic responses such as

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⁹ The response to market imperfections – see FCA, 2015
detailed disclosure can ever be effective and is welcome in bringing “real” people and their behaviours into the regulatory context.

However, as Cartwright has pointed out, academic studies to date have focussed on identifying an individual’s personal characteristics which constrain his or her ability to be “rational maximises of their own utility” (Cartwright, 2012). He cites studies by Ringold and Cooper-Martin as indicators of this continued narrow classical economics context and instead, introduced a broad taxonomy of “vulnerability” framed along drivers of disadvantage. This approach is designed to assist policymakers build a more rounded picture of the human element within financial services and is consistent with the conclusions of the Thoresen Review of Generic Advice of 2008. This review, conducted by the then CEO of Scottish Equitable, presented a combination of market factors - such as supply side constraints - with personal characteristics such as low literacy or numeracy. It called for improvements to the provision of basic guidance, rather than regulated financial advice services, for the “missing market” of people unable or unwilling to pay for regulated advice. Rather than recommend specific products, the service would focus on giving people information and guidance on matters such as budgeting, saving and borrowing, protection, retirement planning, tax and welfare. It would also have a “jargon-busting” function. While it was proposed that the service would be nationally directed, most of the delivery would be through partner organisations. The initiative was launched by the then Chancellor of the Exchequer in March 2010 as part of the Moneymadeclear service. The service includes a helpline, website and face-to-face advice services, and is delivered through a range of partners such as the Citizens Advice Bureau and Age Concern.
In broad terms however, these perspectives are still very much aimed at “fixing” shortfalls in utility from either one side of a transaction or the other. Burden’s argument that consumers should be identified as vulnerable based on their inability to withstand the impact of poor decisions - “impact vulnerability” in Cartwright’s lexicon - is positive in that it reinforces that regulation in financial services needs to start from the consumer.

The role of the consumer in forming regulation has recently been acknowledged by a cross-regulatory body - the UK Regulators Network Consumer Working Group – which in 2014 advocated effective dialogue between regulators and consumers that ensures that regulation, and the outcomes it delivers, are designed around consumers’ needs (Coppack et al). This builds on the “Accountability” principle within the Government’s six principles for economic regulation which seeks to ensure that a variation of the agency issues consistent with the private interests theory of regulation, do not occur. The Network working group strongly supported advocacy groups which during the FSA’s tenure, consisted of the Consumer Panel, and was balanced by the Practitioners panel. However, as it acknowledges, such panels can suffer from “capture” in due course and may not actually be reflective of all constituents (Coppack et al, 2014). This critique reflects an overall progression in understanding that customers engage with financial services in a variety of ways and not always with an “investor” mind-set. Mental accounting, framing and present bias concepts support the case for a complex set of interactions not easily defined within the context of market behaviour. This point has been highlighted in various points from 2011 by the European Consumer’s Organisation (BEUC) and more latterly, the EU Financial Services User Group which both draws attention to the narrow framing of industry led
“solutions” to the challenges faced by consumers (BEUC, 2011). However, this awareness was not evident within the literature when the RDR was being formulated. For example, research by Oxera in 2009, commissioned by the FCA, was focussed on “market structure” and reviewed indicators of market efficiency such as concentration and barriers to entry, consistent with a mind-set that competition would result in positive consumer outcomes. Interestingly, the research indicated that overall the product market was not concentrated and supported the OFT study on the effects FSMA 2000 that that there were no significant concerns about anti-competitive effects, even when vertical integration had taken place in distribution. It replayed the findings from a 2007 OFT study on markets with commission which concluded that asymmetric information and bounded rationality (whereby consumers are unable to consider all options potentially open to them) were likely to be exacerbated when payment was by commission but had not established how a consumer selects an adviser, how long they have a relationship with that adviser, and the scope of the relationship.

In summary, the weight of academic and industry study into financial services regulation has generally acknowledged the strong need for consumer protection, be this on a solely economic rationale or one that blends a social objective within that rationale. Some commentators argue that regulation can only be effective when it is limited to regulating incentives whilst there is a widespread acknowledgment that regulators, like all actors in economic scenarios such as financial advisers, can be caught by issues of agency. Even when operating from a public interest perspective, the prospect of intellectual, cultural or regulatory capture looms large and until relatively recently, this has taken the form of looking at retail financial services
through the lens of an efficient, or otherwise, market. The development of a consumer perspective has progressed, with the growth in awareness of behavioural economics acting as a catalyst. However, at the time the RDR was being formulated, the consumer perspective was largely represented by the consumer panel formed at the FSA’s inception. As we will see from reviewing the specific RDR literature, its input was based on much the same market perspective as the regulatory establishment, albeit with a heightened awareness of the “missing market”. Indeed, as we will explore, even when the FCA commissioned qualitative and quantitative research into consumers’ after RDR, this was focussed on transactional interactions such as the growth of non-advised distribution channels rather than understanding what customer’s value from the financial world. It seems that the wrong questions are still being asked.

2.2.1 Trust in the literature

Trust is cited as a key externality influencing the working of a market (Stiglitz, 2008) and this analysis was carried through to the FSA’s analysis (FSA, 2007). It is relevant therefore to examine its presence in the literature. The analysis of trust broaches many academic disciplines such as sociology and psychology, in addition to economics. There are many interpretations and many different definitions, although it is possible to identify common themes and issues. For example, trust implies a relationship and a degree of dependence (Ennew & Sekhon, 2007). A good working definition is that it is ‘a psychological state comprising the intention to accept vulnerability based upon positive expectations of the intentions or behaviour of another. (Rousseau et al., 1998). If we are thinking about the importance of trust in the context of retail financial services, it is clear that we are talking about the risks that individuals perceive in
relation to their financial future. While a number of authors seek to maintain a theoretical distinction between trust and confidence, in practice the terms are often used interchangeably. The main usefulness of such discussions is the reminder that it is necessary to distinguish between interpersonal trust and institutional trust, while recognising that the two may well interact. For example, there may be an important relationship between an individual’s generalised level of trust in financial advisers and the degree to which they trust their own individual financial adviser. Such differentiation is important for its own sake in that it suggests the potential for prior studies of trust in the sector to be conflating concepts. It is also helpful in that we can begin to understand that we can make several situational distinctions between different kinds of trust. For instance, this can take the form of a kind of cognitive trust based on rational, instrumental judgement. Less logical but still intellectual is affective or personal types of trust. This is based on relational aspects such as ethics, values generated through interaction, and empathy. The less personal type is trust in system, expertise as well as generalised trust which is grounded in the idea that others will, in general, behave reasonably. Finally, we see through studies such as Ipsos Mori professional classes index that we have category based trust when you are more likely to trust someone from a similar social category, i.e. based on race or gender or social class.

The literature also deals with other aspects of trust such as ‘thickness’ thick and thin trust (Khodyakov, 2007); bandwidth (Rousseau et al., 1998) and ‘fast’ trust (Blomqvist, 2005).

As discussed earlier, Llewellyn (1999) notes a number of market imperfections in relation to financial services including: inadequate information on the part of the
consumer; specifically asymmetric information and agency. Under these circumstances, the need to trust and have confidence in financial institutions increases. Prosaically, consumers have no way of knowing the financial soundness of firms offering guarantees. As we have also seen from the discussion on remuneration, problems associated with agency costs, coupled with the dual role of adviser and salesperson, resulted in the impartiality of advice being brought into question. Research by the Association of Independent Financial Advisers, the Chartered Insurance Institute and other trade bodies highlights the concern within the industry over declining consumer trust but crucially, these studies are not longitudinal and vary in format from year to year. While acknowledging the specific features of financial products discussed above, they also draw attention to the impact of mis-selling and the tendency for media coverage of the industry to focus on negative stories such as endowment shortfalls and even the poor quality of “safe” products like annuities (BBA, 2013). This problem can be exacerbated by a government desire to address problems and introduce changes, such as “pension freedoms” in 2014. With respect to restoring trust the report recommends a separation of sales from advice so as to overcome the problem that: ‘Consumers are confused as to the role of IFAs as they are unsure of whether they are getting impartial advice or being sold a product.’ (AIFA, 2008). This was exactly the problem that RDR sought to address, as indicated by Martin Wheatley, in 2013 “Before RDR, in the mass market…the vast majority of those people weren’t really getting advice - they were just getting a sales pitch.” (FCA, 2013).

As we have seen from the behavioural economics literature, providing more information to the consumer, while apparently an obvious response to this degree of
complexity and uncertainty is not always straightforward either. Research suggests that generic advice or information may have much less impact on retirement planning than specialist advice which addresses the individual’s or the household’s specific situation (Clark et al., 2008). Furthermore, age, ethnicity, social mobility and educational attainment all have an impact on people’s confidence in this area (King, 2003). The balance of conclusions from the literature would suggest that affective types of trust are stronger and more enduring than cognitive trust. In the context of the retail financial services landscape in which RDR was forged, people find it is easier to trust someone who they have known through a long standing relationship than to trust an entity such as a financial product manufacturer. The well-worn “people buy from people” and “financial services are sold, not bought” maxims indicate that this was well known in the industry, perhaps leading to an over-reliance on interpersonal skills rather than technical financial planning ability. In the words of the Treasury Minister at the time “most advisers are qualified to the level of someone in McDonalds” (Citywire, 2010).

It is perhaps unsurprising that business owners focussed on this element. As Will Hutton points out in his FEED paper, a more cost effective use of resources is to use trust and reciprocity to get the results they want. In his view, the demand for trust is extremely intense but a result of ineffective government, akin to operating in a casino (Hutton, 2012).
Measuring trust

It is worthwhile to review the literature on how to measure trust since this was a key outcome of the RDR. Earlier studies of social trust leveraged the scope of large-scale surveys, such as the General Social Survey conducted by the National Opinion Research Center in the US. In 1997 it started asking respondents if they “were, generally speaking, careful in dealing with people?” The advantage of large-scale surveys is their large sample size and the additional information gathered about respondents can then be analysed for correlations such as geography, class, gender and so on. As interest in trust grew so did new forms of tracking trust. The most common alternative methods of measuring trust are Trust Scales, Trust Games and Qualitative measurements of trust. Trust scales aim to measure trust attitudes using from a few to many questions or items. Trust games aim to measure the way in which individuals act out trust behaviour. Interviews and focus groups describe the latter.

The Financial Services Research Forum at Nottingham University Business School operates the Financial Services Trust Index. The trust index was developed from a pilot in 2005 by Christine Ennew and Harjit Sekhon who developed a framework for measuring trust through robust, multi-item Likert scales for different trust attributes. The resultant framework is shown in Figure 1 (below).
At its heart is a telephone-based survey in which in its most recent iteration, 1,400 respondents are asked a series of questions about two institutions or product contexts: main bank, building society, general insurance provider, life insurance provider, broker/adviser, investment company and credit card provider (Devlin, 2014). A simple reduction of the method is that attributes in line with the framework are ascribed a score between 0 and 100 and from this, aggregated scores trust can be elicited and then ranked and sorted accordingly.

The index recognises that trust and trustworthiness may exist at two levels: ‘Base level (cognitive) trust or trustworthiness relates to the extent to which an organisation can be relied on to do what it says it will do. Higher level (affective) trust or
trustworthiness relates to the extent to which the organisation is concerned about the interests of its customers.’ (Ennew, 2007:p2).

This approach is inherently more granular and powerful than prior studies which were in the tradition of Yes / No questions described earlier and criticised by Ennew (2007:p3). In his “Lessons from previous simple reviews” literature review for HM Treasury, Devlin acknowledges the previous research of Gooby & Ring supporting a view of low levels of trust in pensions but draws attention to the fact that “issues surrounding trust and perceived fairness are undoubtedly complex and multi-faceted” (Devlin, 2010) citing the trust index work showing that trust in financial services institutions was not significantly below that of comparator institutions such as supermarkets, mobile phone providers and the NHS (Devlin, 2010).

The trust index is therefore extremely valuable in developing further rigour in the measurement of trust. At this stage, it focuses on organisations and as we have seen, there remains much complexity in the relationship between trust in systems or organisations and interpersonal trust between the various economic actors as part of an assemblage of factors and agency. This is significant for retail financial services as clearly people are influenced by a general climate of mistrust in firms and even government but may still trust their individual financial adviser. Individuals also build up an understanding of issues like retirement and pensions from those in their immediate family and social circles. They may find it easier to trust the advice of a partner or close relative than that of an expert. It is not clear how these levels of trust interact and affect each other. This suggests a need for a further exploration in customers’ perceptions of value.
2.3 RDR in the Literature

2.3.1 Financial advice in the literature

Financial advice makes a significant contribution to the UK economy with industry surveys indicating that over 160,000 active individuals participate in financial advice (Spectrum Data Management, 2013). It is estimated that the UK long-term savings and investment industry has assets of £2.7 trillion making it a mainstay of UK economic life and so it is surprising that academic studies into financial advice provision are rare (Tjandra et al, 2013).

As we have noted, the academic literature has established that financial services and financial advice is considered to be “credence good” (Darby & Karni, 1973: p. 68; Llewellyn, 1996), where the consumer has less knowledge than the service provider (Eraut, 1994). Furthermore, financial service products are often difficult to understand (Gaskell & Ashton, 2008), and consumers may have insufficient knowledge to evaluate the service or product until many years after the purchase. Consequently, consumers have difficulty in determining whether they need advice and what type of advice is appropriate, while evaluating whether the advice was suitable has to be deferred until a future date (Clarke, 1999). It is therefore understandable that consumers should be cautious when making decisions that could affect their long-term financial well-being. Additionally, the regulatory environment of retail financial services makes it difficult or impossible to use marketing communications tactics that would be regarded as perfectly normal in other markets, such as physical goods. Providers are heavily constrained in terms of the ways in which they are allowed to
describe their financial product offerings and whom they can market these to (FCA Handbook, 2015).

As stated above, much of the work on understanding how customers interact with advisers has been relatively recent. Some of this work has studied the trustworthiness and usefulness of different channels such as physical face to face versus video or telephone based. For example, researchers investigated the financial advice available online, relative to that given by trainee financial advisers, and found mixed results (Ciccotelo & Wood, 2001; Mantel, 2000). In another exercise, financial advisers were represented by video, audio and other non-physical engagements and whilst audio and video were higher rated than text only, all resulted in a similar uptake of advice (Riegelsberger et al., 2005).

It is possible however, to identify academic studies and papers which may have influenced the market analysis which prompted the RDR and led to directly focussing on issues of trust and agency. Messenger effects are crucial in influencing this aspect of financial capability. The importance of the adviser’s expertise has been cited as critical to the development of trust and proceeding with recommended actions albeit reducing in influence on more experienced and knowledgeable consumers (Harvey & Fischer, 1997; Lim & O’Connor, 1995, Siegrist et al., 2005) and those considered to be trustworthy are, in the main, typically heeded more often. The adviser’s personality also seems to matter and consumers are more influenced by confident advisers, irrespective of advice quality (Harvey et al., 2000).

These studies were borne out by the FCA commissioned NMG research of 2014, which has always been intuitively known; consumers trust their own advisers but may not trust the sector as a whole.
This issue is at the heart of the RDR problem statement, as framed by the FCA and prompting action on qualifications, commission removal and increased clarity of status. However, until the development of Nottingham University’s Financial Services Trust Index, designed by Devlin et al, there had been little formal, objective benchmarking of the impact of this externality or spill over effect (Stiglitz, 1999). Its Centre for Risk, Banking and Financial Services has been collecting comprehensive data of consumer perceptions’ of trust in financial services providers since 2005 with data collected on an annual basis and directly comparable back to 2009 – the height of the financial crisis. The information is gathered using a nationally representative sample of more than 2,000 participants. It is collected for seven types of financial providers, encompassing insurers, banks and financial advisers.

Even adviser trade associations such as the Association of Professional Financial Advisers concede that it directly plays a part in disengagement, quoting the Treasury Select Committee’s July 2004 conclusion that "It is widely accepted that a lack of consumer confidence in parts of the financial services industry is now deterring many households from saving as much as they might otherwise choose to do" (APFA, 2014). This causal relationship seems sensible, given that modern accounting allows for goodwill in balance sheets and that high profile reputational issues such as the recent Volkswagen “cheat devices” scandals have been shown to damage sales in the short term (FT, 2015). After all, as Warren Buffet (1995) has said “It takes twenty years to build up a reputation, and five minutes to ruin it”.

The need to maintain trust is therefore accepted as a consensus across all participants but there is an additional dimension that places the erosion in trust in retail financial services in the context of a deeper reduction in the role of trust generally within the
financial services system. Under an analysis commissioned as part of the UK Government’s Foresight Project, (The Future of Computer Trading in Financial Markets, 2012), the development of financial mathematical modelling and algorithms, far cheaper computer power, securitisation, and deregulation of financial markets greatly encouraged banks and other financial intermediaries to depart from their traditional core business of allocating private savings to long-term investment in the real economy. For this, profits depend on reputations built up over the long term. It surmises that “this role naturally makes greater use of computers, and IT more generally, has been partly instrumental in the erosion of trust in the financial system by the general public. Tighter regulation can only be a partial substitute” (gov.uk 2012).

This perspective is useful because it casts in sharp relief the relatively limited narrative of the RDR analysis. It saw financial product scandals as failures of advice and cited these as the primary driver for a loss of trust in the retail investment market, which in itself contributed to lack of engagement and access issues. However, even when tracking the costs of conduct with a view to explicitly reporting in annual accounts, as advocated by the Conduct Costs Project (CCP Foundation, 2015), it is not clear that fines, censures and write-downs due to conduct issues, actually results in less engagement. For example, bank account take-up, low levels of switching or even the willingness to pay high rates of interest do not seem to be driven by issues of trust, as evidenced by recent FCA thematic work which focuses on other remedies (FCA, 2014). This may be an argument for viewing certain financial services as essential “plumbing” where customers do not see a difference between providers and have no option but to engage. This may be evidenced by the introduction of basic bank
accounts within the UK as part of a financial inclusion strategy. However, even allowing for this distinction, it is evident that during the formulation of the RDR, efforts to address the trust externality within the financial advice sector were pursued before fully quantifying how it was actually impacting customers as they lived their lives.

2.3.2 Origination of RDR

As we have established, the FSA stated in 2007 that the market for the distribution of retail investment products was characterised by a number of market failures. This paper, complemented by Callum McCarthy’s “Gleneagles speech” essentially framed the problem which the FSA wanted to solve. It is instructive to re-visit this for two reasons. First, it reinforces the notion that the RDR was a response to “market failures”. Second, it brings to life the complexity of the landscape.

The following excerpt is taken directly from the FSA Discussion paper “A review of Retail Distribution”

1. Many retail investment products have complex charging structures and it is often not clear how benefits accrue to consumers. Consumers purchase them relatively infrequently, so have little experience to draw on. Retail investors do not have the same information as the sellers of these products. Consequently, many consumers rely heavily on advisers through whom retail investment products are sold. Product providers often remunerate advisers, and there can be a mis-alignment of advisers’ interests with those of consumers.

2. This, in addition to the above market failure and the importance of these products to consumers, creates the risk that substantial consumer detriment will
occur. Remuneration-driven sales can also lead to inappropriate advice to switch between different products in order to generate income for advisers, often resulting in high levels of early termination of these long term products. The costs of this low product ‘persistency’ are borne mainly by providers but may ultimately be passed back to consumers.

3. The costs of poor quality advice may not be fully faced (or perceived to be faced) by advisers as unsuitable sales may be identified only years after the sale, if at all. There are limitations in the way that capital resources requirements and Professional Indemnity Insurance (PII) requirements for firms currently remedy this. The result of this can be uncertainty for consumers, and mean potential claims against those who supplied the product or gave advice, many years after the original purchase. And by the time these claims come to light, those that gave the advice may no longer be in business, leaving others in the industry to meet the costs of compensation.

There are two further problems that are linked to the market failures that we would like the review to address:

1. Many consumers who have the means to save are simply unable to afford full advice relating to their financial situation. Moreover, some consumers may not be able to access advice because the costs of regulatory requirements and the ways in which many firms apply these requirements limit the number of firms willing to serve certain types of consumer.

2. Those providing advice can do so with relatively little training and testing when compared to other professions. So one reason why the problems of
consumer understanding set out above may be occurring is because the provider of the services cannot explain the benefits, risks and costs of the services sufficiently clearly. And so consumers have low levels of trust in those selling and advising on products.

2.3.3 Establishing the success of RDR

Since the RDR began in early 2013, the FCA has produced publications and tools to help firms understand and comply with the RDR rules. These are based on its findings and engagement with the financial advice sector and were structured around three cycles of thematic work. It published the findings from the first cycle of its thematic review in July 2013; cycle two in March 2014, and finally, in December 2014, the third set of findings.

A focus across all three cycles was on firms’ disclosure of costs and services, as well focusing on the services firms provide to clients in return for the ongoing adviser charge and how they are delivering these ongoing services in practice. This is consistent with a classic economic reliance on addressing asymmetry. However by the third cycle, it was clear that the FCA was looking for evidence of more fundamental market shifts. As Martin Wheatley, FCA CEO stated 'It is still early days but the indications are that the sector has responded positively to the reforms… we have seen a reduction in product bias, with a very noticeable decline in the sales of those products that before RDR came with higher commission’.

Europe Economics, which was commissioned by the FCA to undertake the post-implementation review, found that the RDR has reduced product bias. This was based on the premise that it noted a decline in the sale of products which had higher
commissions pre-RDR and an increase in the sale of those which paid lower or no commission pre-RDR. This was framed as confirming that commission is no longer a driving factor in advisers' recommendations (FCA, 2014). In general terms, this is a reasonable conclusion. However, it only points to product type selection and leaves unanswered product manufacturer selection queries. This is especially important where vertical integration has occurred and the choice available to consumers may have reduced or charges increased. In short, the creation of a different manifestation of the same kinds of agency issues.

In addition to meeting the required qualification standards, Europe Economics found that an increasing number of financial advisers were gaining further qualifications, demonstrating (in its view) a growing professionalism in the sector. This up-skilling was supported by the Consumer Panel at the time which recognised that accordingly, the focus of advisers would increasingly be customers with greater wealth. It’s warning that an advice gap would emerge unless addressed with a comprehensive solution such as publicly provided guidance, simple products with reduced sales protocols or something else; was echoed in representations from advisers to the Government inquiry into RDR in 2010 and 2011.

The advice gap

The FCA was alive to this and commissioned quantitative research - using Towers Watson - to assess the capacity of the market following the introduction of RDR and the well-publicised withdrawal from face to face financial advice by Banks (such as Barclays Financial Planning) around the period of the RDR introduction (Citywire, 2011). It found little evidence that the availability of advice has reduced significantly,
with “advisers still willing and able to take on more clients” (FCA, 2014). Further to this, the Frontier Economics research also found that while a small group of those with less to invest may find it more difficult to find an adviser, there were still those in the market willing to serve them. Whilst these two conclusions are fair in their own right, it is doubtful if they comprehensively deal with the complexities at play when understanding how financial advisers engage with clients. More significantly, it is clear they don’t attempt to deal with the fundamental issue at hand, which is the existence of a “savings gap” that is not being closed (Hurman, 2011). For example, in the first instance, by simply looking at absolute market capacity based on the hours available to advisers in a typical working week, the Towers Watson research ignores consideration of demographic profile, geographic location and area of specialism within adviser business. It simply adds up available hours and places this in the context of consumers who would be willing to pay for advice (Towers Watson, 2014). This is an important point in that it continues the classical economic approach to maximising utility and ignores how financial advisers actually work. On the second point, the Financial Services Consumer Panel was alive to the broader issue that the “mass-market” consumer was not able to access or even keen to use services which could be useful in identifying financial solutions to real risks in life. As Hurman & Costain’s paper for the Consumer panel stated in 2011, “Public policy around the advice gap seems far from settled and, yet, at the same time the market is currently being defined by a strong regulatory framework. There appears to be a disconnect in that so much attention is being paid to the solution when the problem statement remains so poorly defined” (Hurman & Costain, 2012.p6).
The theme of an advice gap has been circulating round the RDR and it is difficult in the literature to find supporting positions that the improvement of trust would lead to an improvement in advice take-up. During December 2008, the Consumer Panel told the Treasury Select Committee that financial advice would be less widely available in the post-RDR world. During June 2009 management consultants, Winchester White, found that 64% of product providers believed the overall cost of advice would increase and during July 2009 NMG Consultancy calculated a 20% adviser exodus and “found no evidence to suggest the RDR will improve the accessibility of advice to consumers”. Origen Financial Services blamed the RDR for redundancies announced in October 2009 (Money Marketing, 2009). This general viewpoint was buttressed by the CoreData Research study from September 2010, which revealed that advisers are already offloading mass market clients. “The trend is being driven, in part, by hard-up investors either unwilling or unable to pay fees”. (CWC, 2010). By late 2011, the Treasury Select Committee - which had been receiving evidence on RDR – called on the FSA to delay RDR by 12 months. The FSA responded even before the Committee’s report had been published, rejecting any such delay. In that response, the FSA reiterated its view that the development of more streamlined or cost effective advice models would be up to firms to design and implement (TSC, 2011).

At this juncture, it is important to draw attention to a fundamental shortfall in the data required to establish the market’s characteristics. Simply, there is no consensus or definitive assessment of how many advisers there are actually in the market. Further to this, there is no consolidated ‘map’ of adviser firms. This is partly due to the nature of the FCA regulatory register, which tracks ‘investment advisers” holding the ‘customer function’ - CF30 – yet this designation extends beyond what a typical mass affluent
customer would recognise as a financial adviser. In addition, it is possible to track the number of “Personal Investment Firms” yet this ignores other entities (including professional firms such as lawyers or accountants) who may carry on the regulated activity of dealing with retail customers. Indeed, within the FCA commissioned Towers Watson research into the advice gap, there is little more than a cursory statement acknowledging the difficulty in coming up with a true number, and settling on a round estimate of 32,000 advisers. This is contradicted by the trade body – APFA – which has estimated as little as 23,000 active advisers (APFA, 2014). The situation is complicated further by the presence of several “Accredited Bodies” who issue the Statements of Professional Standing which denote active professions. Finally, there is no central publication of the revenue, capital or financial wellbeing of adviser firms.

It is perhaps telling that the Government, with a keener focus on the reputational damage to its pension freedoms, has essentially ignored the FCA’s own research and commissioned a review into “the advice gap”. In fairness to the FCA, its research predated the pension freedoms introduced in 2015. This essentially brought forward the decision making point for many people approaching retirement. The Financial Advice Market Review has now looked at factors such as the affordability of advice, which the FCA could have included in previous cycles, but essentially ignored in its focus on disclosure, product bias and capacity. In that report, it confirmed that RDR had resulted in improved outcomes for those customers at the wealthier end of the spectrum and left the question around what to do with people who do not have disposable assets of £50k-£100k to further consultations on Public Guidance (HMT, 2016) and further consultations on workplace guidance (FAMR, 2016).
The conclusion to be drawn by much of this activity is that research sponsored by a regulatory body comprised many of the same individuals who introduced the previous reforms, is likely to be framed so as not to wholly question the validity of the exercise. External studies on the subject of RDR effectiveness are rare and so we have to look at indirect sources, such as the National Audit Office (NAO), for insights. The NAO was tasked by the Treasury Select Committee to conduct a review into the effectiveness of the FCA in preventing mis-selling. In February 2016 it issued a report that suggested that increased fines and redress payments reduced the financial incentives for firms to mis-sell, but that the FCA’s framework for assessing mis-selling risk was not robust enough to clearly show that its efforts were reducing this risk. According to Amyas Morse, head of the NAO “gaps in the FCA’s overview of mis-selling create a risk that its interventions may not be well coordinated, and mean that the FCA cannot be sure that it has chosen the most cost-effective way of intervening” (NAO, 2016).

The academic sources that have touched on the FCA have in the main, incorporated it within the context of other similar, regulatory developments, in other jurisdictions (Bateman & Kingston, 2014; Billingham, 2014; Stace, 2015). An exception to this is Ring who focussed initially on critiquing the potential for earlier “depolatisation” reforms to have a real effect and latterly on the ability of the RDR to make a positive impact. His recent paper argues that the creation of the RDR “assemblage” has, in some respects, actually made things less efficient for individuals. This is driven from the fact that RDR is flawed by its own base logic, that retail investment markets should be understood in the context of a market, and that the players in the market can be made to work efficiently. He cites Sandler’s work in this regard, as well as applying the concept of performativity, introduced by Callon, (2006) which describes how
processes and outcomes have differed from what might have taken place if the underpinning rationale or world view had not been present. The paradigm of an efficient market has created its own reality rather than amended an existing natural, set of circumstances. Taking Callon’s own words, we can see that RDR with its combination of conduct rules, capital adequacy measures, disclosure requirements, qualification thresholds, amendments to remuneration and cross-subsidy clearly “contributes to the construction of the reality it describes”. This analysis provides a strong basis for understanding why we appear to have so many unintended consequences of many aspects of RDR and perhaps why its development and implementation have resulted in vociferous arguments. Taking just one of Ring’s examples to illustrate; in the attempts to reduce information asymmetries and adviser bias, consumers are faced with distinctions between guidance and regulated advice which don’t reflect the services they see advertised (such as the Money Advice Service and Pensions Advisory Service which offer guidance, not regulated advice), and the understanding of independent versus restricted advice is no greater than the pre RDR situation of Tied versus IFA, partly due to the technocratic definition of independent being based on “a comprehensive and fair analysis of the relevant market” (FCA COBS, 2015). Furthermore, the defining of an amended “Retail Investment Product” list, which focusses on “packaged products”, creates a further layer of sub optimal complexity due to its operating across a product set defined by the RDR and excluding many of the services customers actually engage with, such as bank accounts, general insurances and debt products.
2.4 Conclusion to literature review

To summarise, there is clearly a substantial weight of comment in the literature concerned with regulation generally and regulation within financial services, specifically. Some of this can be demarcated between arguments as to the economic rationale versus the social objective and these can be framed within public or private interest theories. In broad terms, however, there is established consensus that consumer protection lies within its core remit and that market theory holds sway as the way to interpret the dynamics.

In contrast to this well-trodden area of research, there seems to be less focus within the UK at least on establishing an empirical evidential basis for exploring how underlying aspects, such as agency issues, manifested themselves and are still prevalent, within retail financial services. Much of the literature has focussed on investment theories such as challenging the capital asset pricing model within the Efficient Market Hypothesis devised by Markowitz. There is much literature on active versus passive fund management as a source of value (see Carhart et al, 2008) but less on the role that financial advisers have played. The US is the greatest source of information and whilst it has established that product recommendations are influenced by remuneration, there remains a persistent indication that softer or ancillary benefits accrue for having the services of a financial adviser to call upon.

Trust has been cited as a barrier to markets working well (FSA, 2007) and we can see that a variety of measurements have been undertaken by varying entities. However, the lack of the demarcation between interpersonal types of trust evident within an advised
relationship and a less personal type of confidence when surveying an institution or an
industry remains a feature in the UK literature.

We have seen that the dye was cast for a market theory approach from the very
inception of the FSA and that as financial markets deregulated, the provision of
financial services was increasingly viewed in the context of information asymmetry,
agency theory and externalities such as trust. This informed the design of the RDR
intervention and although there has been much commentary through the lifespan of the
reforms and through to the present day, perhaps surprisingly this continues to be
viewed through the same market context lens, even when ostensibly customer
focussed. Much of it has been commissioned by the successor to the architect of the
reforms, leaving a general gap in the literature for simply assessing the success of the
RDR on its own terms.

Further to this, the increased focus in the advice gap and the lack of streamlined
models of advice have started to generate some interest in understanding real customer
behaviours and recent publications from the FCA focussed on behavioural economics
are positive indicators. Crucially, there is no centrally aggregated and published
picture of the firms that have remained after RDR and it is well acknowledged that
even established adviser numbers is an estimate, rather than a definitive figure
(Towers Watson, 2014). We simply do not have a structured model of distribution to
review the retail “market” through.

There clearly remains a need to further develop this and also the customer lens, free of
market analytics. The recent paper by Ring provides an excellent starting point for
challenging the logic of viewing the hugely complex socio-economic landscape
encompassing customers’ interactions with financial services. This study hopes to
augment that technical analysis and align with excellent work undertaken to develop a benchmarked Financial Service trust index the promotion of cohesive approach to measuring conduct costs. By undertaking primary and desk based research to produce a comprehensive picture of the key outcomes and experiences that customers value in their engagement with financial services, it is hoped that further stakeholders and policymakers will have another building block to add to those initiatives. This will support a more evidence-based framework for understanding what legislative or regulatory actions are required to meet the social policy requirements of the people in the UK.

3. RESEARCH QUESTIONS & AREAS OF STUDY

3.1 Introduction

The previous section identified some gaps in the literature and these shortfalls present opportunities to explore in this study. The first grouping relates to the ability of regulators to quantify the impact and track the benefits of their regulation in a rigorous manner. Whilst recent studies by Oxera (2014) have provided some comparative analysis of interventions such as banning commissions, this and the related cycles of FCA commissioned RDR research fall short of the specificity set out in the Oxera/FSA paper on the subject, produced in 2006 (Oxera, 2006). The FSA’s own internal guidance on market failure analysis references agency, asymmetry and externalities were cited yet the focus of post implementation research has been on the successor body’s objectives and avoided a critique of the initial market failure assessment. There
is, therefore, a valid rationale for reviewing the changes which have taken place in the regulated retail investment market, through the lens of these economic concepts.

Within this context, we anticipate more granular gaps would benefit from further exploration, such as the lack of a consolidated framework for understanding the retail distribution landscape. Having this would assist with benchmarking changes arising from regulatory interventions. We can also point to a lack of consolidated insight into product flows aligned to such a model. As a result, there has been no meaningful study of market power within the section of the retail financial services landscape. Although there are several trust related studies which have been undertaken, there has been no attempt made to undertake a comparative analysis of these in order to establish the types of trust failures which could be acting as negative externalities.

The second gap within the literature has grown in prominence from the post financial crisis experience and concerns the lack of an established substantial alternative framework to regulators’ inherent instinct to frame the interactions of individuals (i.e. non-professional, or retail customer in the context of the FCA regulatory terminology) primarily within a market behaviour context. The economic rationale for regulation has taken hold, albeit with a clear consumer protection focus, awareness of behavioural economics and acknowledgment of a need to consider other regulatory objectives (FCA, 2014). This in itself may be a form of bounded reality typified as cultural or intellectual capture. The concept of capture is explored further in this thesis. But in essence, is a variant of the ide of group-think. This term, coined by social psychologist Irving Janis (1972), describes an entity of individuals which makes faulty decisions because group pressures lead to a deterioration of “mental efficiency, reality testing, and moral judgment” (Janis, 1972 p.9). Where individuals within the cohort
are similar in background, or when the group is insulated from outside opinions, and when there are no clear rules for decision making, the potential for group-think to occur, increases. This study is concerned with the extent to which regulators are susceptible to this phenomenon in the sense that a homogenous world view renders them “captured”. If, it argues, all interventions centre around the “market failures” and concepts like agency, externalities hold sway, there is a risk that with no challenge or “step-back”, regulators could essentially be creating their own reality. This in turn, could simply seeds further market ‘failures’.

This is a contentious point and separate from a blunt criticism of over-regulation (which is prevalent within the literature). My interest is in the consideration of whether the starting point for deciding on regulatory intervention is doomed to failure and actually inhibits competition. This is an extension of the question whether this will result in reduced welfare, rather than increasing it (Booth, 2012). It is also provides an empirical focus for the points made by Sandel (2012) about the applicability of market analysis and builds on Ring’s (2015) proposal that regulatory interventions such as the RDR are performative in nature and through a combination of their own sense of agency and socio-technical arrangements, meet the definition of agencement.

These linked concepts are still quite controversial in the field of economic-sociology. Economic models are said to be performative when they not only describe a situation or reality, but intervene in it. Regulatory models could, in theory, become performative when once in use, if they increase their own predictive power. Turning the other side of the coin, it has been argued that economic models can become counter-performative when their employment increases the number of unintended
consequences, to the extent that the empirical validity of such models can be undermined by their very use (MacKenzie, 2003).

With respect to agencement, the retention of the original French term created by its originator, Michael Callon, instead of arrangement, stresses its central premise that when socio-technical arrangements such as market interventions occur, they should be considered as having their own agency, gathering momentum and shaping realities as they move forward (Callon, 2005).

The complexity of these concepts ensures debate will continue for some time to come. Indeed, complexity in this field is pervasive; the relatively well accepted western liberal democratic notion of competition as a force for good challenged by user groups and the consumer lobby when applied to financial services (EU FSUG, 2013). There is therefore a need to propose an alternative perspective, centred on the individual, which is free of externally imposed labels such as “advised customer”; “DIY customer”.

Taken in aggregate the literature review served to shape the thesis’ scope around these two main strands of enquiry. The research questions and considerations of relevant factors are discussed in the following section.

3.2 Research questions used to develop objectives

This study has two high level aims:

1. To critically examine to what extent the RDR has corrected the market failings identified by the UK’s single financial services regulator in 2006.
2. To determine if a non-market perspective could be a viable basis for understanding interactions between individuals and financial services in the UK.

The neo-classical paradigm employed by the FSA provides a good basis for establishing some high level questions. Some of these are set out as follows:

*Regulatory capture* - Was this the focus on “market failure” the correct way to frame the problem of unprofitable distributors, unprofitable providers and continued mis-selling scandals? Was this articulation of the problem and resultant design of the “rule-book” a prisoner of an approach which placed too much emphasis on a belief in the equilibrium of markets?

*Over-emphasis on Principle-agent / asymmetry and agency* - We know from the literature that the regulatory consensus had moved on by the time the RDR was launched, with a new focus on behavioural economics and a structural separation of conduct supervision and prudential capital requirements and oversight. This rendered the RDR somewhat anachronistic but could its underpinning regulatory theory be tested by assessing the success of the interventions of the main drivers of “failure”; Principle-agent; information asymmetry; externalities?

*Lack of consumer perspective* - to what extent does the consumer perspective align with the regulatory market paradigm? Is there a need to develop a consumer perspective framework which provides a counterpoint to the market failure analysis?

The above questions are helpful in that they can be broken down to specific objectives and provide a basis for assessing the kinds of methodology required to achieve them. The approach to examining the success of RDR through its own criteria is to focus on the main drivers for intervention. These were; information asymmetry; agency
problems and the lack of trust. In examining the RDR through these market lenses and undertaking some primary customer research, insight can be offered on which theoretical constructs were appropriate to the situation, whether they were applied correctly and/or to what extent they have had the desired effect and why. Also, areas of omission or mis-directed focus can be identified and put into context.

In the relevant economic literature the most frequently adopted framework for analysing issues related to retail markets is that of ‘principal-agent’ theory. In this framework, the principal (consumer) does not have the same goals/objectives/preferences as the agent. Whilst much of the literature has concentrated mostly on individual principal-agent interactions, issues of imbalances in economic power, associated with the division of knowledge, also occur at more aggregative levels within the retail investment landscape. As described by John Kay in his influential report into asset management, the number of intermediaries in the value chain has expanded in recent times within the UK. This accords an excellent opportunity to explore how regulatory analysis copes with complexity of multiple relationships.

Further to this angle of Principal-Agency, the strand of economic research that directly supports a role for regulation, in terms of addressing issues of equity and fairness in the financial services markets, is work that focuses on third-party or “spill over” effects. These are also known as externalities. This work suggests that if the financial services market is structured in such a way so as to only provide access to specific groups (such as the very wealthy, or those with financial literacy), this may inadvertently have the effect of causing large numbers of members of a market to turn away. These participation issues are effects that the FSA saw in the retail investment
market as deriving from a lack of confidence in financial advisers. This “lack of trust” had in its view, an economic effect - the overall level of market activity is lower than it should be - and further supported its ‘economic rationale’ for intervening. There have been some substantial and positive academic contributions which cast elements of its “trust” agenda under a spotlight, such as the Financial Services trust index. This has been produced by Nottingham University twice annually from 2009 and the conduct costs project, led by Roger McCormick and tracks censures and fines. However, much of the debate has been conducted between parties with vested interests, such as advisory firms, product providers and the FSA / FCA.

The well accepted argument that financial services are different from other goods - credence goods in Llewelyn’s terminology - creates the basis for asymmetry of information which exposes customers to detriment. Whilst this in itself is an argument that has been proved through the years of experience, commentators such as Patrick Ring and David Blake have been longstanding critics that this can be, or even should need to be mitigated against. Understanding how this asymmetry would be addressed by RDR and reviewing the situation after “re-polarisation” into restricted and independent adviser segments, would contribute to this line of enquiry.

Turning to the need to develop a consumer perspective, it is evident that how, even in the midst of communicating a change in approach, utilising behavioural economics and “real life”, the FCA continued to frame areas of intervention and risk in terms of the market. For example, by referencing inefficiency, integrity and sub-optimal pricing (FCA, 2014).

In other words, the paradigm of regulation in respect of the provision of financial services distribution continued to be one of “fixing” shortfalls in utility from either
one side of a transaction or the other. The role of the consumer in forming regulation has recently been acknowledged by a cross-regulatory body - the UK Regulators Network Consumer Working Group – which advocated effective dialogue between regulators and consumers that ensures that regulation, and the outcomes it delivers, are designed around consumers’ needs. This builds on the “Accountability” principle within the Government’s six principles for economic regulation which seeks to ensure that a variation of the agency issues consistent with the private interests theory of regulation, do not occur. The Network working group strongly supported advocacy groups and this point has been highlighted in various points from 2011 by the European Consumer’s Organisation (BEUC) and more latterly, the EU Financial Services User Group which draws attention to the narrow framing of industry led “solutions” and to the challenges faced by consumers (BEUC, 2011). However, this aspect of regulation formation was not immediately evident within the literature when the RDR was being formulated. For example, research by Oxera in 2009, commissioned by the FCA, was focussed on “market structure” and reviewed indicators of market efficiency such as concentration and barriers to entry, consistent with a mind-set that competition would result in positive consumer outcomes. There is an opportunity therefore to develop a customer orientated framework of value, which can be used as a counterpoint to the existing framework.
3.3 Specific Objectives

The specific objectives of the study are as follows:

1. Develop a model for framing the distribution of retail investment products and related advised services within the UK. The rationale for this objective lies in the clear gap in existing literature for a standard model which is capable of being used to describe and understand the landscape in which regulatory interventions are made. Developing such a model is necessary if we are to quantify aspects of market failure such as market power, agency and externalities.

2. Use the model to attempt to establish the nature of market power and agency in the retail distribution landscape and where, possible draw comparison to the pre RDR landscape, cited as “bust” by Callum McCarthy.

3. Leveraging the model and incorporating open source product sales, complaints and other data, attempt to establish to what extent conflicts of interest have been eradicated by RDR.

4. Utilise the model to establish the extent to which existing trust studies cover the market and establish to what extent RDR can demonstrate improved trust through improved professionalism.

5. Develop a conceptual framework for articulating and measuring what consumers’ value within financial services.

6. Establish to what extent the market failure analysis approach is capable of delivering value to those who it seeks to protect, i.e. its consumers.
4. METHODOLOGY

4.1 Overall approach

This research exercise is fundamentally exploratory in nature, with a focus on determining the nature of the problem in using classical economic approaches to regulatory interventions within retail financial services. It is not intended to provide conclusive evidence of what works but is designed to help gain a better understanding of the problem of why it may not, for all of those involved. However, it should be noted that the research exercise does seek to establish on an evidential basis whether key parts of the overarching regulatory theory succeeded. Through the development of a model of customer value, it seeks to offer alternative options and suggestions on how to move towards more conclusive studies. It is therefore in the “direction of travel” as defined by Sandhursen, whereby it is a key milestone in identifying the final information that is the only solution to an existing research problem (Sandhursen, 2000).

This research exercise has the phenomenon of the RDR as one of its two key areas of focus. It measures to what extent the theoretical framework underpinning it continues to be appropriate and attempts to draw out the nature of the result, using the theoretical basis for its being and design as a framework for examination. As such, this research lies broadly within the case study tradition defined by Yin (1984) as “an empirical inquiry that investigates a contemporary phenomenon within its real-life context; when the boundaries between phenomenon and context are not clearly evident; and in which multiple sources of evidence are used”. Through case study methods, a researcher is
able to go beyond the quantitative statistical results and understand the behavioural conditions through the actor’s perspective.

By including both quantitative and qualitative data, case study helps explain both the process and outcome of a phenomenon through complete observation, reconstruction and analysis of the cases under investigation (Tellis, 1997). Case study methodologies have been the subject of much focus within the literature with some researchers such as Yin highlighting “the lack of rigour and the tendency for a researcher to have a biased interpretation of the data” (Yin, 1984). This is in part due to the potential for single areas of focus to become overtly descriptive and focussed on studying something for its own sake (Stake, 1995). They can also suffer from limited general applicability, particularly if focussed on small samples (Yin, 1984).

However, it is important to note that detailed qualitative accounts often produced in case studies not only help to describe phenomena but can progress an explanation of how theoretical concepts operate in real-life situations. This is precisely what is required in this study, given the need to establish if the market theory model can be made to work in the current retail financial services landscape, or is even appropriate.

In order to do this, this study employs a modified case study approach, as described by McDonough and McDonough (1997). They identified case study types which continue with this specific focus but which can be interpretive and/or evaluative, in their design. Through interpretive case studies, the researcher aims to interpret the data by developing conceptual categories, whereas in evaluative case studies, the researcher goes further by adding their judgement to the phenomena found in the data. This study seeks to evaluate the success of RDR on its own merits but also talks to the market failure theory’s applicability within UK financial services.
Given the wide ranging nature of describing the retail investment distribution
landscape, a mixed methodology approach has been followed in order to get to the
position where an evaluative judgment on market power and agency can be made.
Mixed methods research represents more of an approach to examining a research
problem than a methodology. Mixed method is consistent with the real-life context we
require in this study but also utilises an “intentional application of rigorous
quantitative research…and rigorous qualitative research exploring the meaning and
understanding of the constructs; to formulate a holistic interpretive framework for
generating possible solutions or new understandings of the problem” (Tashakkori and
Creswell 2007).

The second area of primary study within the research was less concerned with
reviewing real life behaviour against the theoretical framework but rather sought to
generate a basis for an approach or “theory of customer value” from the ground up.
That strand of enquiry was deliberately kept separate from the case study in order to
limit pollution of the generation of concepts, relationships and themes about what was
important to people as humans, rather than economic actors or “econs”, in the
behavioural economic jargon (Thaler, 2000).

The development of the model of customer value relied primarily upon three phases of
qualitative work, from an initial generation of bland “customer value statements”
utilising existing paid for research and facilitated Nominal Group Technique
workshops, followed by focus groups of financial service customers and then a
refinement and validated stage using customer surveys and quantitative analysis.
4.2 Considerations of strengths and limitations of approach in the literature

This section discusses the strengths and limitations associated with the main methods employed in this research study. These are essentially:

- Focus groups
- Telephone interviews surveys
- Group prioritisation work, specifically Nominal Group Technique

4.2.1 Focus groups

Powell describes the existence of a general consensus defining focus groups in the literature as a “group of individuals selected and assembled by researchers to discuss and comment on, from personal experience, the topic that is the subject of the research” (1996:p499). As such, they utilise a collection of individuals but care needs to be taken to separate their use from Group Interviewing. The latter involves interviewing a number of people at the same time, the emphasis being on questions and responses between the researcher and participants. Focus groups however rely on interaction within the group based on topics that are supplied by the researcher. (Morgan 1997:p12).

In terms of historical development, Merton and Kendall provided a baseline for practitioner development by insisting that predetermined research questions are followed and the participants’ own personal context is known and collected as part of the work undertaken. This is important as a key element is to pull in attitudes, views, judgments and experiences when other methods may not. For example, employing a
survey or interviewing on a 1:1 basis. As Morgan identified, such attitudes, feelings and beliefs have greater potential to be revealed via the social context and the interaction which being in a focus group brings. As a result, the gap between what people say and what they do can be better understood (Lankshear 1993). Also, focus group enables the researcher to gain a larger amount of information in a shorter period of time. Observational methods tend to depend on waiting for things to happen, whereas the researcher follows an interview guide in a focus group.

The challenges associated with focus groups can be separated into operational and ontological themes. Conducting an individual interview is easier for the researcher to control than a focus group in which participants may take the initiative and the researcher can have less control over the data produced (Morgan, 1998). The moderator has to also allow participants to talk to each other while having very little control over the interaction other than generally keeping participants focused on the topic. Finally, they can be difficult to assemble.

The constraints in respect of the output can be related to this logistical constraint. It may not be straightforward to sample representatively, particularly amongst those who have communication problems or special needs. The group discussion may also discourage some people from trusting others with sensitive information. Taken in tandem, there is a risk that the information obtain is skewed or unreliable (Morgan, 1998).

It should not be assumed that the individuals in a focus group are expressing their own definitive individual view. They are speaking in a specific context, within a specific culture, and so sometimes it may be difficult for the researcher to clearly identify an individual message.
4.2.2 Means-end Chain Framework

The study of customer value and motivations is not new with research relating to achieving a competitive advantage over competitors a regular occurrence since the 1980s ((Dibley & Baker, 2001; Gutman, 1981; Reynolds & Gutman, 1988). According to Holbrook & Hirschman, 1982) two major paradigms were adopted to achieve this goal, (1) the "cognitively" oriented approach, supported by a wide range of quantitative analytical techniques and (2) the "motivational" approach, typified by qualitative techniques (depth interviews, projective techniques, etc.), emphasising "self" as the driving force behind product purchases.

Both perspectives have proven to be to some extent inadequate to depict and clarify consumer behaviour, with Claeyse et al (1990) arguing the cognitive approach tends to focus on product knowledge and the other “self-based” system motives identified and the objects involved (products or brands) in a satisfactory way. Faced with this, Means-End-Chain Theory (Gutman, 1982) offers a different way to study consumer behaviour and has the advantage of reconciling the contrasting paradigms.

The central tenet of Means-End-Chain Theory is that one must focus on a product or service’s complete meaning structure stored in memory which is thought to comprise a hierarchy of cognitive elements captured at different levels of abstraction - which form the “means-end” chain. See Figure 2. The basic assumption of the means-end chain approach is that products are bought for what they do for the consumer (Peter & Olson, 1987). The interview technique used to derive the chain is known as “laddering” which, it is acknowledged, has attracted challenge in the literature as to whether it is grounded in sufficient empirical data (Claeys, 1990). Scholderer & Grunert go further by stating it suffers from an unconfirmed validity problem and their
experimental testing highlighted the situational factors which can shape outcomes (2004).

The challenges are recognised and to a certain extent, are common to all “think & feel” product motivation studies (Claeys, 1990). However, consideration was given also to alternative approaches to customer value. These were a benefit-sacrifice approach and also an experiential approach.

The benefit sacrifice approach stresses the need to assess both positive and negative aspects of customer perceptions. To increase customer value, it is necessary to identify both as it is a trade-off between benefits and sacrifices perceived by customers to a seller’s offering. The benefits/sacrifices involve recognition of all the gains/costs the customer incurs when engaging with different offerings or objects of evaluation (Payne and Holt, 2001). However, the benefit-sacrifice approach faces certain downsides when compared to means-end chain. Firstly, the approach fails to address the distinction between the object’s characteristics and higher-level abstractions (Zeithaml, 1988). It fails to assist in understanding the sources of value (characteristics) and reasons why something is seen to provide or not to provide value while according to the means-end approach, it is necessary to distinguish consequences (benefits and sacrifices) from offering’s characteristics, as these are concepts of different levels of abstractions – characteristics being concrete and consequences being more abstract concepts, where the consequences stem from the characteristics (Reynolds and Gutman, 1988). Finally, the approach has been criticized for treating a customer only as a rational individual and overly constrained by questionnaire response (Korkman, 2006). As an objective of this study was to
challenge the status quo of overtly rational economics in regulatory policy, it was felt that means-end chain was superior to this approach.

The other approach to understanding customer value is the experiential method. It treats customers not only as thinkers but also as feelers and doers (Holbrook and Hirshman, 1982). The approach maintains that the essence of value proposition is in the customer’s resulting experiences. According to this approach, customer value is defined as an interactive. Measuring it would involve essentially constructivist methods (i.e. observations) through which customer activities can be captured. It therefore ventures beyond customer perceptions and looks into what customers do and how they feel.

This approach also faces some limitations and was not suitable for this study. Firstly, extensive observations of customer activities were deemed as logistically very difficult due to the difficulty of accessing customer premises. Secondly, this approach oversimplifies customer value and, as per the benefit/sacrifice approach, does not capture the full richness of the abstractions and underlying drivers of value. This study was set from the outset as exploratory in nature, with a view to expanding the available knowledge of Trust in financial services. Accordingly, attaining the widest set of data points as possible was important.

For the purposes of this study, Means End Chain analysis is a sufficient tool to produce the kind of insights associated with an early stage exploratory study. This context, as Olsen & Reynolds (1983) observe, can be combined with descriptive data - such as the model results in our earlier market failure analysis - to provide a framework for speculating about the concepts and their relationship (Olson &
Reynolds, 1983). That notwithstanding, it is recognised that expert facilitation is required. Given that the use of the focus groups will take place alongside already initial customer value statements generated in part by the author, it is also important that the facilitation takes place at arm’s length using a nationally recognised research agency – KPMG Nunwood.

Figure 2 - Schematic showing the Means End Chain Framework employed in this study

Note: Created by Nunwood for this study
4.2.3 Telephone interview

According to many researchers, the telephone interview is an accepted and well-studied approach for quantitative data collection (Aday, 1996; Bernard, 2002). Its advantages over other forms of research include the ability to reach a broad range of geographically spread respondents, avoid cluster sampling as well as the ability to oversee interviewers (Aday).

The literature points to the potential for the telephone effect of interview mode to impact on survey outcomes although it is still not clear what accounts for them. Several studies, such as Hensen et al., (1978) indicated absence of visual cues as a possible explanation for mode-related differences.

Constraints evident within the literature are to do with obtaining adequate response rates when a "cold" call is made. Related to this are challenges as to whether individuals answer sensitive questions related to their behaviour truthfully over the phone; however some studies indicate that telephone surveys are at least as successful as face-to-face interviews in obtaining such information (Sykes and Collins 1988; McQueen 1989).

Other researchers suggest that some questions are answered differently over the telephone and that the interviews are shorter, however this is disputed by other empirical accounts such as Sweet (2004). Irvine’s study of telephone based research indicates that answers to open questions are shorter than face-to-face interviews (Irvine, 2011). However, for non-sensitive factual questions few differences have been reported in the distributions of responses obtained (Sturges, & Hanrahan, 2004).

The telephone interviews incorporate existing approaches to customer satisfaction operated by Royal London, in particular the Net Promoter Score (NPS). It is a
customer loyalty metric developed by Fred Reichheld, in his Harvard Business Review article "One Number You Need to Grow" (Reicheld, 2003) This is used by a number of established businesses to monitor and manage customer relationships. In essence, the score is calculated based on responses to a single question: “How likely is it that you would recommend our company/product/service to a friend or colleague”. Despite its widespread adoption by such companies as General Electric, Intuit, T-Mobile, Charles Schwab and Enterprise, there is some debate regarding its merits. In particular, criticism that is less accurate than composite index of questions and fails to predict loyalty behaviours are worth noting.

This study does incorporate NPS as part of its approach and so is not immune from incorporating some of the potential shortcomings which are currently the subject of debate. However, the overall design of the customer value research undertaken, allows for and deals with these. Reichheld and co-author Rob Markey revisited the metric in a follow up book and concluded that it should be used alongside a key driver analysis to identify the attributes or components that have the greatest impact on loyalty (Reichfield & Markey, 2011). This study does precisely that and simply employs NPS as a benchmark variable to help elicit the attributes which customers truly value.

4.2.4 Group work - Nominal Group Technique (NGT)

The origin of NGT lies with the paper published by Delbecq and Van de Ven in 1971 with the same authors following up with Gustafson (1975), to summarise several studies designed to compare NGT with interacting groups. Perhaps unsurprisingly, the originators of the approach found it to be superior to other types of group work groups
in terms of satisfaction of participants with the group process, and quantity and quality of ideas generated (Delbecq, Van de Ven, Gustafson, 1975).

NGT is superior to unstructured focus groups in balancing participation and affording an equal status to all participants. Hence, NGT groups impose no restrictions on the number, heterogeneity, or previous acquaintanceship of the participants. In as much as the technique was developed with group decision making within organisations in mind (Delbecq and Van de Ven 1971), it seems natural that both acquaintanceship and heterogeneity are expected.

Because NGT groups can be said to be generally more structured than focus groups, moderator training needs will tend to be lower. The authors suggest that NGT moderators should have some training, the skill requirements are not nearly as high. Calder (1977), delineates three approaches to qualitative methodology including: an exploratory approach, where problems are defined, a clinical approach, where the objective is to get past surface reasons for behaviour, and a phenomenological approach, where the client or moderator attempts to see things from the respondents point of view and in the respondents own terms. That use of NGT is most commensurate to an exploratory study seems most applicable to the exploratory approach. As identified earlier in this chapter, this overarching approach offers less opportunity for detailed explanations. However, where quantity of ideas is at a premium, such as in the focus in this study of developing attributes that customers' value, it should prove superior to a focus group.

The literature also provides a comparison between the NGT approach and its cousin, the Delphi technique. The NGT offers a more immediate result which can then be refined through additional meetings as necessary whereas the Delphi is conducive to
gathering a wider and more reflective response through a laborious but very thorough approach to consensus building. It is important to recognise that whilst NGT has the advantage of immediacy, groups can be influenced and more so than the traditional Delphi method of using anonymised, iterative questionnaires to progress towards consensus.

While not well adapted to larger groups, a smaller group is actually a strength if the participants are well versed in their respective areas. Taken in balance, the availability of subject experts and the initial exploratory nature of this exercise supported the employment of NGT rather than Delphi.

The delivery of the sessions was aligned to established protocol, as set out in the helpful guide by Varga-Atkins (2011). The sessions were initiated by an initial facilitator explanation of context and overview of the Nominal Group Technique process. It was very important that participants were clear about the stages of the process and the reasons for using this technique, and not others. As O’Neil and Jackson (1983) observed, the term, “nominal group”, means that the session is only nominally, in name, a group. Whilst it is relying on individual input in a group environment; the interactions between individuals during the sessions are actively discouraged. It was stressed that this technique was employed because it allows everyone to equally contribute to feedback.

The sessions were structured as follows:

- Introduction – facilitator introduces the purpose of the session, the rules and structure.
- Stage 1: individual responses – responses are collected on the chosen topic in a silent generation phase.
Stage 2: clarification and consolidation – responses are read out and clarified one by one by participants, then similar/same items are merged under one response.

Stage 3: ranking responses – participants rank their top five responses individually in order of importance.

Ranking results are calculated and shared with the group.

Closure and thanks.

The sessions were held in a single location with care taken to ensure that participants’ diaries were managed in order to limit potential distractions such as responding to email or taking phone calls. Where relevant, co-operation was obtained from attendee’s line managers to ensure individuals’ appreciated that the task was seen as supported by senior management.

4.3 Method of enquiry by objectives

Objective 1 - Develop a model for framing the distribution of retail investment products and related advised services within the UK.

As established in the literature review, there remains no standardised model of describing the UK’s retail distribution market. It is therefore difficult for regulators to track progress of interventions such as RDR. The objective was therefore to develop a granular model, segmented at distributor level; covering the total FSMA retail regulated market.
Key elements

The model needed to include the following elements in order to be effective:

- All retail investment adviser firms governed by COBS (Conduct of Business rules) and mortgage and insurance brokers governed by MCOBS (Mortgage Conduct of Business rules) and ICOBS (Insurance Conduct of Business rules) respectively;

- A means by which different entities could be compared in order to establish market power, agency considerations and the extent of any decrease in access to advice; and

- A classification system which could be consistently applied and was robust enough to be repeated year on year as part of a longitudinal study.

Challenges & Constraints

There were numerous challenges identified from the outset by the author, to developing a model such as this, predominantly revolving around access to comprehensive data which encompassed the entire landscape. The UK financial services advice landscape is extremely complex, with multiple layers of overlap in permissions, business models, regulatory entities and reporting requirements. This makes it extremely difficult to separate out discrete areas of focus.
The following provides an overview of constraints:

<table>
<thead>
<tr>
<th>Challenges to building a model describing the retail investment landscape</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Difficulty assessing adviser numbers</strong></td>
</tr>
<tr>
<td>• FCA register database can be purchased but only contains summary firm details and adviser name, controlled function &amp; reference number. Can sort by CF30 (customer function) but this doesn’t show who is active in providing advice to retail customers.</td>
</tr>
<tr>
<td>• There are no published details of Statements of Professional Standing issued by Accredited Bodies.</td>
</tr>
<tr>
<td>• Mortgage brokers and insurance brokers are not individually registered, operating under the firm’s permissions.</td>
</tr>
<tr>
<td><strong>Difficulty classifying firm types and area of focus</strong></td>
</tr>
<tr>
<td>• It is a feature of the UK market that financial advisers traditionally offered advice on investments, pensions, life insurance, with further specialisations in general insurance, mortgages and even niche products like equity release or commercial property.</td>
</tr>
<tr>
<td>• In addition to individual CF30 advisers offering advice across the “RDR regulatory perimeter”, firms can be similarly structured but with individual advisers focussed on single areas of specialism. They are colloquially known as General Practitioners.</td>
</tr>
<tr>
<td>• With the advent of Group Personal Pensions, corporate advisers have become active in engaging employees over their pension arrangements.</td>
</tr>
<tr>
<td>• The cash ISA market is dominated by banks which may offer combinations of face to face, telephone or non-advised models of intermediation.</td>
</tr>
<tr>
<td>• Similarly, since the introduction of PEPS &amp; TESSA products, low cost brokers have entered the market in selling securities.</td>
</tr>
<tr>
<td>• The pension annuity market has been marked by customers “rolling over” their pension products on a non-advised basis.</td>
</tr>
</tbody>
</table>
Overlapping regulatory permissions and classifications

- The regulatory architecture in the UK is an amalgam of FSMA derived perimeter rules and various ancillary legislative acts, including EU mandated directives and regulations.

- The permissions nominally relate to classes of product but these are very wide and complicated by the UK having insurance backed investment products and pensions which can contain unregulated assets (such as commercial property in SIPPs).

- Firms are free to apply for as many permission as they wish, regardless of actual areas of activity.

- The result is that regulatory permissions such as “Arranging contract of insurance” or “Advising on investments” cannot be meaningfully interrogated.

- The new RDR designations of “Independent” or “Restricted” are not tracked at firm level by the FCA Firms can offer multiple offerings within their overall structure, run panels of products or only offer a single range of products but no open source data on this.

Various business models exist which obfuscate the available data

- Personal Investment Firms would seem like the natural home for CF30 advisers however large insurers, investment firms and even accountancy or legal firms, maintain investment advice permissions and distribution capability.

- The smallest authorised corporate unit can be a single person firm and such firms can be directly authorised through the FCA or seek to be exempt from authorisation by being part of a network. In such cases, both entities will enter into commercial arrangements and have separate but related regulatory profiles.

- Large advice businesses can operate a similar structure whereby individual advisers can operate distinctly, or in subordinated structures, called “trading styles”.
- The FSCS and FOS reports do not mirror the FCA’s categorisations. For example, entities within the same group are tracked separately under complaint data.

**Results of advice cannot be meaningfully tracked**

- The FCA operates a Product Sales Data process but this cannot be broken down by firms’ sales.
- There is no convention for measuring “number of recommendations”.
- There is no “event analysis” available such as a change in market behaviour after a stock market crash.
- Recommendations made but not followed or recommendations made where no product sale results, are not available on open source.
- Multiple product iterations like ISA years, segmented Investment Bonds and Phased Income Drawdown plans increase the risk of double counting.
- Entities such as ABI and IA collate information based on their own membership but underlying investments can be held in various wrappers so risk of double counting.
- The persistency surveys previously issued by the FSA are not regularly issued.
- The FCA complaints data and the FOS complaints tables only deal with the largest volume complained firms.
- The results of advice reviews and redress schemes are available but the underlying assessment criteria has evolved through the years so meaningful comparison is difficult.

The approach that best dealt with the above constraints was a mixed methodology. It had a view towards developing a framework. This incorporated quantitative comparative analysis between rudimentary data sets with qualitative sense checking and expert subject matter input to validate the overlays relating to business model.
The chronological process employed was as follows:

- **Establish a relevant baseline population of firms**

The exercise started with distributor level data at firm level from the FCA’s register, published directly by the regulator. This was then filtered down by removing non CF30 individuals to focus on establishing numbers of relevant CF30 individuals. This gross population of CF30 individuals was compared to information from a known provider of industry data - Touchstone Matrix - and sales information available to Royal London was overlaid, in order to screen firms which had CF30 individuals but on a prima facie basis were not active in the retail market.

This was followed by a further extensive screening exercise reviewing errors and double counting. The unique identifier to all firms - FRN (Firm Reference Number) - was the common reference point for firm lists and CF30 adviser count centred on the IRN (Individual Reference Number). A final review at this stage included a comparison with ABI competitor data, firms’ Annual Reports and historical studies purchased from NMG.

- **Determine the size and nature of the retail market.**

As demonstrated through the lack of empirical studies into the composition of firms within the UK financial services landscape, there was a need to determine the most appropriate metrics for capturing the size and nature of the retail market. Given the need for idea generation and the depth of experience and knowledge across the Royal London resource base, group work offered the most appropriate solution. Accordingly, a Nominal Group Technique approach was identified as most appropriate. The history of NGT goes back to the Rand Corporation working on behalf of the US military and since that time it has been applied in a wide range of areas of academic study. The
three most typical applications have been problem identification, development of solutions, and establishing priorities (Carney et al 1996, Delbecq Gallagher et al 1993). The purpose of the NGT in this instance was to generate information in response to an issue that can then be prioritised through group discussion. In the context of this study, using an approach informed by NGT offered quicker results than a Delphi style technique. Whilst the objective was to build a model which described the market, this was within the context of getting to the wider aim of understanding behaviours taking place within the market, rather than establishing a market model which would have the consensus of all market participants - such as regulators, customers and firms. Essentially, NGT was “good enough” to provide the structure needed to ensure that a first iteration of a model could be built and which could be expanded in due course.

The first session was initially held between acknowledged internal subject matter experts spanning the Royal London Group and was facilitated by the author. The focus was to determine the most meaningful metric to be employed in order to quantify the size of the market. This took place after the initial baseline in order that participants could grasp the context of the exercise. Participants encompassed asset management, corporate and individual pensions, life insurance and also general insurance divisions. To limit individual member dominance, participants were all from a similar seniority banding “RL1” with none in Executive positions or reporting to each other.

Aligned to the recommendation by McMillan et al (2014) of the maximum number of participants, seven people attended and in common with NGT discipline, the session was time bound - two hours - and the fundamental criteria and session rules were
explained to the group. The overall focus had to be to obtain the metric that was able
to be employed to bring to life channels of distribution and support econometric
analysis. In short, it had to be something which lent itself to quantitative analysis. A
summary of the session is as follows:

- Pre-reading – explanatory email sent one week prior.
- Introduction, overview of ground rules & aim of session. “What metric is best
  for capturing and explaining the size of the UK retail market”? 10 minutes.
- 10 minutes allocated to self-reflection and generation of ideas.
- A “round robin” resulting in a numbered list of all ideas on flip chart without debate.
- 25 minutes for discussion of ideas, allowing for clarification and ideas to be
  added but none removed.
- 15 minute break to clean up flip chart and allocate a reference to each suggestion.
- The ranking of priorities by each member on an anonymous basis. A score of
  being five for the most important and zero least.
- Scores were aggregated and tabulated.
- The results were then discussed and the group was given the opportunity to
  review, clarify or is then discussed, defended and clarified.

Further discussion on the metrics and their use is provided in the Results and
Discussion chapters of this thesis.

Once the metric(s) were agreed, a second round of data gathering was initiated to work
towards obtaining total relevant market and product numbers with other industry data
sources (e.g. PlatForum, IMA, Fundscape and several others). Due to the disparate
nature of the data, this element of data gathering and modelling was supported through
the use of an industry specialist, NMG. It was selected as a data gathering partner due
to its longstanding association with the distribution market and knowledge of the FCA permissions and regulatory architecture. In fact, NMG had supported one strand of FCA work on post RDR implementation. The specific focus on this stage was to aggregate all sources of New Flow and undertake extensive comparative analysis to remove double counting. A bottom up method whereby industry sources of new business shares such as Mintel and Touchstone, were collated was then challenged by two further stages of top down numerical analysis. The first was based on trade association figures covering the main retail financial services products.

It is important to note at this stage that the segmentation research exercise had attained visibility across the Royal London group and a decision was made to leverage the capability of the firm to obtain data and allocate subject matter expert resource to building the model, by forming a Steering Group & Working Party.

The Steering Group was comprised of the author and four executive members of the Royal London General Executive Committee who led the respective product divisions. These covered Royal London Intermediary, Royal London Asset Management, Royal London Consumer and Royal London Platform Services respectively. An initial meeting of the Steering Group reviewed the initial scope and early internally generated agency data sets. This showed clearly that Retail Investment Advisers also sold pure protection products. A decision was therefore made to extend the remit of the model to cover protection products which exceed the scope of RDR (i.e. those not on the Retail Investment product) list. This, in order to ensure that as full a picture of the adviser landscape was obtained.

The trade association’s data sets which were co-opted were the Investment Association, ABI, TISA, UK Platform Group, NAPF and BBA. A final stage of
validation was carried out using the FCA Product Sales Data figures which cover Protection and Retail Investment data sets.

- *Develop a segmentation model which describes the distribution landscape*

This phase of research was qualitative in nature and relied on multiple semi-structured sessions with individual subject matter experts, who also constituted the Nominal Group Technique group used to generate the key underlying metric(s) at the heart of the segmentation model. This working group finessed the broad categorisations which were emerging from the data sets. It was recognised from the outset that the process of grouping firms into categories of channel would be subjective and so a conscious decision was made to adopt an iterative approach to refinement. The key elements which were incorporated into the initial analysis were:

- Firm size.
- A network overlay, used to aggregate small firms which were effectively controlled by larger entities. This was applied using FCA register data, through key word searches on all the known networks - generated from the earlier NGT sessions.
- Trade body membership analysis. Obtained through purchase from relevant entities such as ABI, IA and so on.
- New Flow patterns, focussed on product types.
- Reviews of annual accounts and public sources of information on business model.

The results are presented later in this paper but it is reasonable to state that the complexity of the segments far exceeds the information presented within the FCA
Product Sales Data reports. With this in mind, a series of semi-structured interviews were held with external industry experts in order to validate the results of this phase. These interviews were conducted by NMG in order to respect competitor sensitivities with anonymised feedback provided. This feedback was then played back through the working group in facilitated sessions with amendments to the model accepted, refined or rejected. A full record of all decisions were then provided to the Steering Group for acceptance.

**Objective 2 - Using the model, attempt to establish the nature of market power and agency in the retail distribution landscape.**

Once the model is established, it provides a useful tool in its own right to start to test some of the assumptions and theories underpinning the RDR. An important area to be examined was that of market dominance and the potential for this to drive agency effects, such as monopolistic behaviour or anti-competitive pricing. One persistent approach for measuring this is through the concept of *concentration*, which can be measured through the concentration ratio and variants such as the Herfindahl–Hirschman Index.

At this stage, it is important to note that this study employs a staged approach to measuring dominance. The development of a segment model is essentially a hypothetical construct and care should be taken not to conclude concentration is an issue when a segment dominates a product class. A meaningful conclusions can only be reached after all of the concentration analysis is completed, i.e. taking into account
concentration of segments within the sector, product distribution and qualitative factors such as overall volume trends.

The primary technique to undertake an analysis of market power and to build a greater understanding of agency was the Herfindahl–Hirschman Index, (HHI). This is an economic concept widely applied in competition law and referenced by both the OFT (now CMA) FSA, FCA and PRA in their analyses of the market. Increases in the HHI generally indicate a decrease in competition and an increase of market power, whereas decreases indicate the opposite. The major benefit of the HHI in relationship to such measures as the concentration ratio is that it gives more weight to larger firms. Criticisms of the HHI approach and the use of concentration generally centre on the potential for conflation of market power with consumer disutility (Roberts, 2014) which may not always be the case.

In this study, the ratio is applied to the segmentation model primarily to draw out potential market power issues but more importantly to bring to life the changed dynamics of the distribution landscape. The objective is not to establish conclusively if welfare has reduced as a result of market power.

The HHI is valuable in that it comes with broadly consensual appetite statements, such as that by the European Union Guidelines on the assessment of horizontal mergers. In broad terms, an HHI of 1500 is the figure at which the EU would start to look for further evidence of sufficient competition in a market. Closer to the specific market at hand, the IA cite a HHI of 420 at manager level, based on funds under management, as indicative of a ‘highly competitive environment’- see Asset Management in the UK 2013 - 2014 - The Investment Association Annual Survey (September 2014). The FCA has also employed it in its recent analysis of banking “however, within just two
years, these gains had been reversed by financial crisis. The index now stood at 1,830 - the higher number representing greater concentration – and the challenger fringe had been significantly reduced, with the disappearance of high street names like Northern Rock” (Martin Wheatley, June 2015). For the purposes of this study, we have utilised a standard endorsed by the Bank of England, as follows “The HHI is bounded between 0 (in highly competitive markets) and 10,000 (in the case of a monopoly). If the HHI is between 1,500 and 2,500, concentration is thought to be moderately elevated but is not typically thought of as a source of major concern (BoE, 2014).

The most common theoretical attacks on the HHI are focussed on its weightings of the number of firms, rather than the nature of their products. For instance, some commentators have suggested that the HHI overstates the potential competitive impact of mergers involving large and small firms which in reality, may not result in a radical loss of choice.

HHI has been selected in the context of this study because it can be flexibly applied to answer several different questions, related to competition, agency and potential conflicts of interest. Specific exercises which were undertaken following development of the model are as follows:

- The general concentration of distributors in the market based on new asset flow. Oxera, commissioned by the FSA, in the later stages of the consultation period of RDR, suggested that the IFA market will change substantially with far fewer small firms of advisers in the market. Where the Oxera Report differs from some others is that although it sees some of the same magnitudes as some other surveys in terms of the number of firms leaving the industry, it forecasts that this does not translate into a corresponding fall in the number of advisers.
In other words, small companies will cease but some of the advisers will move to larger companies that can afford the investment in training and systems which the RDR requires. (RDR Oxera, 2010).

- The concentration of the market based on adviser headcount. This provides a different lens to the above in that it deals with a sub-market, the face to face advised segment. By understanding the concentration within this segment, it is possible to draw conclusions as to the geographic reach of face to face advice.

- An understanding of the different business models within the market. By treating each segment as a discrete entity, it is possible to identify where most marketing power in the individual segments of the retail landscape could potentially lie. Where this is restricted distribution offerings, or even vertical integrated business, there could be an increased potential for conflicts of interest to arise.

The HHI calculations will be complemented by classic market concentration analysis, utilising C4 & C8 ratios, on the asset flow and adviser metrics. This provides context to the concentration figures for the above.

The analysis for the above work was undertaken by the author based on the most recent UK standards for conducting HHI published by the Office of Fair Trading in the UK. The calculations were subject to review by a fully qualified actuary within the working group.
Objective 3 - Leveraging the model and incorporating open source product sales, complaints and other data, attempt to establish to what extent conflicts of interest and information asymmetries have been eradicated by RDR.

The initial focus of this strand of work was to identify through analysis of “detriment” data, a register of “wrongdoing” covering the period since RDR was established. This could then be mapped on to the segmentation model in order to establish to what extent certain segments were over-represented. This exercise involved multiple strands of “detriment data”:

- FCA aggregated complaint date
- FOS complaints data by firms
- FOS complaints data by product
- FCA Final Notices, censure and fines
- FSCS firms in default notices

The overarching aim is to initiate a discussion as to the potential agency issues as drivers of detriment which could exist in segment “hotspots”.

Objective 4 - Utilise the model to establish the extent to which existing trust studies cover the market and establish to what extent it can be demonstrated that RDR has improved trust through improved professionalism.

This phase of qualitative research builds on the various studies which have been undertaken since the launch of RDR to determine levels of trust in the retail financial services landscape. Similar to the previous exercise, the various sources of primary data are mapped on to the segmentation model in order to address two aims:
Establish the areas of the landscape which have higher (if any) levels of trust than others; and

Draw out the potential for the trust surveys to be focussed extensively on certain segments or types of trust. For instance, to what extent do non-advised channels suffer from lack of trust as a result of poorer general levels of confidence in entities rather than affirmative, interpersonal types?

The literature review provided the sources of trust studies.

An additional exploratory exercise was undertaken to examine the extent to which information asymmetry could be assessed using the model and whether it could be established if it had been reduced further to the launch of RDR. Asymmetry in this context is multi factorial, involving baseline financial capability on the part of the individual, which is then played against a context of product, provider and agents.

Recognising this and the linkage with confidence and trust, the approach utilised was to test the model’s applicability as a diagnostic tool to help identify where the greatest differences between consumer and product / provider could be found.

The exercise adopts a qualitative approach in order to drive a discussion of the active factors at play within each segment.

1. First, review the baseline capability surveys undertaken through the aegis of the FSA and successors, in order to establish to what extent a trend analysis could be completed. This required comparative analysis between surveys.

2. Then, establish a “product complexity factor” by organising product type sales ranges using the FCA Product Sales Data (PSD) categorisations into the model segments. Establishing to what extent some segments contained a large number
of the full range of products regulated by FCA is a proxy for the technical understanding complexity that customers face.

An initial review of the industry literature, FSCS, FOS, Pensions Ombudsman, FCA and TPR websites was validated by semi structured interviews with internal experts.

**Objective 5 - Develop a conceptual framework for articulating and measuring what consumer’s value within financial services.**

This phase of the research project was more exploratory in nature than the model development and was consistent with the characteristics laid out in the literature. As noted, the difference between exploratory and other research is that exploratory research design simply explores the subject and looks to provide a basis for further study and refinement of the research questions. It has been stated that “an exploratory study may not have as rigorous as methodology as it is used in conclusive studies, and sample sizes may be smaller. It has been noted that the very exploratory nature of the research inhibits an ability to make definitive conclusions about the findings. Insights are provided instead. Whilst this research is in the vein of establishing to what extent an alternative perspective could be developed to the market theory context, it was designed with a recognition that “it helps to do the exploratory study as methodically as possible, if it is going to be used for major decisions about the way we are going to conduct our next study” (Nargundkar, 2003).

There were three distinct phases in the Customer Value Statement (CVS) research, being:
1. Initial generation of the “customer value statements” utilising existing paid-for research and a facilitated NGT workshop process held over two sessions.

2. A qualitative exercise whereby the statements were explored through focus groups of financial service customers.

3. A refinement and validated stage whereby qualitative and quantitative research was employed to establish which statements really mattered to customers and would increase trust or recommendations of product, providers or services.

The study employed a primarily qualitative approach to explore and build an evidence base for establishing the outcomes and experience of consumers who face financial services decisions in their everyday life. This was internally labelled as a “Customer Value Statements” (CVS) model and was planned to be developed through several iterative qualitative research stages.

This original research exercise was formulated to identify and rank the aspects of financial services that consumers truly value and which could be used as a platform for analysing shortfalls in outcomes and experiences and designing new strategies. Much of the research was iterative and built upon on an initial broad set of Customer Value Statements which were generated through NGT workshop. This is consistent with the generation of ideas stage as supported by the literature.

**Phase 1**

A primary objective of the initial stage was take an initial data set of internally generated practitioner and financial services professionals’ assumptions about what customers perceived as “valuable” in financial services. Similar to the segmentation model build process, it was recognised that tapping into subject matter expert resource
was extremely valuable and that it was desirable to offset any individual bias of the
author by inviting challenge throughout the process.

Similar to the structure of the segmentation work, a Steering Group and Working
Group format was adopted. However, it was recognised from the outset that the
purpose of this element was to explore what customers wanted and so the governance
and participation of the groups was intentionally different. Recognising the formal
apportionment under the FCA Systems & Controls requirements {SYSC} and
Approved Person regime that already exists within Royal London for protecting
customer outcomes, it was appropriate to request that the RL Customer Standards
Committee operate as a Steering Group. This senior committee has a Terms of
Reference explicitly concerned with ensuring good consumer outcomes and which was
recognised by the FCA as part of the formal governance structure of the business.

Each individual is an Approved Person and obliged to act in the best interests of
customers whilst a member of the Committee. For example, the With Profits Actuary
has a statutory responsibility for the welfare of with-profits customers under the FCA
Approved Person regime; the Head of Customer Relations has a role profile centred on
dealing with complainants fairly in accordance with the FCA DISP rules. A full list of
attendees and qualification is supplied in the appendices. Material was made available
from various commissioned and open source documents in order to support
participants.

The context of the project was very much “anti-jargon” and positioned consistently by
the Steering group as the voice of the customer. The steering group met monthly.

The aim of this initial stage was to produce an initial list of 10 statements which were
broadly aligned to the product lifecycle a customer experiences. The process followed
the NGT approach facilitated for the segmentation model, with the following key points of note.

- The number of participants was higher, reflecting the membership of the Customer Standards Committee. Ten persons as opposed to seven.
- Due to the broader range of focus, a larger set of “customer value statements” was generated. It was therefore agreed that the clarification, discussion phase would be conducted through follow up interviews with the members, in order to fully articulate the sense of the suggested value.
- Further to this, the ranking exercise was held in a subsequent Customer Standards Committee break-out session.

**Phase 2 - Focus Groups**

The main body of this qualitative activity consisted of structured exploration of the evolving initial existing customer value model through 12 focus groups, comprising 8-10 individuals held across four UK locations. There are many definitions of a focus group in the literature, but Powell et al define a focus group as “a group of individuals selected and assembled by researchers to discuss and comment on, from personal experience, the topic that is the subject of the research”. (Powell, 1996). Focus groups are not individual interviews in a group setting but rather depend on engagement and multilateral communication within the group based on topics that are set by the leader (Morgan, 1997).

The main purpose of focus group research in this setting was to elicit value from the participants’ beliefs, experiences and views in a way that may not be possible in a 1:1 setting. The literature references their capability to offer up a variety of views due to the group context, group context (Morgan & Kreuger 1993). A key consideration for
this project which encompasses several stages was the practicability of developing a model in a reasonable amount of time. Their applicability to this customer value research lay within their use for the initial stage of a study (Kreuger 1988) and also for triangulation (Morgan 1988) and validity checking.

Consumers were recruited on a 50/50 basis from Royal London Group (RLG) customer groups and competitor customers, sourced and facilitated by Nunwood Consulting, a longstanding research partner of the firm. Nunwood are well respected in their field of consumer research. The recruitment criterion was:

- Individuals had to have purchased a financial services product within the past three years, either through a financial adviser, through an online journey or directly with a product provider.

A small fee was offered.

A deliberate decision was taken not to stream focus groups by product as the focus of the exercise was to avoid extensive self-selection bias with the main filter applied. The focus groups were tasked with discussing gaps or flaws in the model and to generate associations or attributes with which each statement could be associated.

**Phase 3 – Quantitative Prioritisation Exercise**

The CVS statements which had been discussed within the Focus groups were reviewed within the working group, which had authority to refine and trim the long list of attributes associated with each CVS. At this stage, potential gaps in the CVS model were captured and included within the quantification validation phase.

The further quantitative validation stage utilised 1,822 online surveys with UK based customers of Royal London and competitors. The split was 310 RLG and 1,512 competitors. The same qualification criteria was utilised as the focus groups. These
populations were augmented by 235 interviews with consumers in Ireland. The Irish dimension was added to elicit any differences in views from customers due to UK specific regulatory structures.

The focus of the online surveys was to establish the relationship between the CVS statements and their strength in driving trust and the ability to recommend to others.

The surveys were carried out using Nunwood consultants, trained in this line of research. There was no financial incentive offered to participants.

Essentially, each consumer taking part in the survey was asked to discuss one product they held, and to evaluate the performance of their supplier for that product. So RLG performance was only evaluated by RLG customers. Each consumer answered the following question set:

- How likely are you to recommend (YOUR PROVIDER) to a relative, friend or colleague?
- Taking everything into account with (YOUR PRODUCT), to what extent do you trust (YOUR PROVIDER)?
- To what extent do you agree with the following in relation to…..? (Rating given for each CVS)
- To what extent do you agree with the following in relation to…..? (Rating given for each attribute)

Scores were given on a scale of 1-10 and from this; it was possible to conduct linear regression against Trust & Recommendation variables.

Linear Regression Modelling

Nunwood Consulting were engaged to carry out the research questions and presented back the complete results. A straightforward linear regression technique was employed to analyse the responses in order to identify – in a robust manner – those elements
which are most likely to drive increases to the key behavioural outcomes of Recommendation and Trust. The linear modelling was conducted by Nunswood and then reviewed by the senior Actuary in the Steering Group.

In order to ensure that sufficient focus was applied on the correct aspects of CVS their importance was analysed in three separate ways as shown in the Venn illustration in Figure 3:

1. Analysing the impact on Trust
2. Analysing the impact on Recommendation
3. Asking respondents to state explicitly which of the CVS are the most important to them.

Figure 3 – Venn style illustration of three areas of analysis
Objective 6 – Establish to what extent the market failure analysis approach is capable of delivering value to those who it seeks to protect, i.e. its consumers.

This objective will be achieved through a reflective discussion which compares the customer value statements and underlying drivers, with the economic analysis which predicated the introduction of RDR. Area of divergence as well as commonality will be identified through reviewing the respective narratives as well as explicitly reviewing the extent to which customers propose factors aligned to information, agency and trust as central to what they would value.

The segmentation model will be re-visited to understand the extent to which it can act as a mechanism for identifying sub-optimal sectors, through mapping customer values against established segments which have profiles aligned to the market failure indicators.

5. RESULTS: OBJECTIVE 1 - BUILDING THE DISTRIBUTION MODEL

5.1 Introduction

The requirement to build a segmented database (referred to hereafter as “the model) arose from the literature review, which confirmed there is no standardised framework of describing the UK’s retail distribution and regulated advice market. This in turn creates a constraint to evaluating the success of regulatory interventions such as RDR. The overall objective of this stage was therefore to develop a granular distribution model, by which different distributor entities could be compared in order to establish
market power, agency considerations and the extent of any decrease in access to advice.

This chapter deals with objective 1 of this study, as set out in chapter 4:

1. Develop a model for framing the distribution of retail investment products and related advised services within the UK. The rationale for this objective lies in the clear gap in existing literature for a standard model which is capable of being used to describe and understand the landscape in which regulatory interventions are made. Developing such a model is necessary if we are to quantify aspects of market failure such as market power, agency and externalities.

5.2 Sub-objective - Establishing a relevant baseline population of firms

This stage involved the building of a preliminary database which sought to capture all firms and individuals involved in the distribution of retail investment products (RIPs). Post-RDR, the adviser charging, independence and professionalism rules refer to ‘retail investment products (RIPs)’ which is essentially an updated list of “in scope” products from that which originated in the Financial Services Markets Acts 2000. In addition to the previous category of “packaged products”, the definition of ‘retail investment products’ now specifically referred to investments in investment trusts, structured capital-at-risk products and other investments that offer exposure to underlying financial assets, but in a packaged form that modifies that exposure compared with a direct holding in the financial asset.

The early idea to focus solely on the regulated advised market - as this was the core focus of the RDR rules - was quickly superseded by a realisation that in order to
maximise its descriptive power, the model had be able to be extended to cover both non-advised and advised channels. The overarching methodology was to take a primary analysis of FCA Register extract and then incorporate ancillary data sources to synthesise this into a useable database.

The ‘starting dataset’ was an extract from the FCA Register that consisted of all “Authorised” firms as at 1 October 2014. This extract is typically purchased on a monthly basis by market participants from the FCA. It is in ASCII formatted files which enables the data to be read by a range of computer systems. ASCII (American Standard Code for Information Interchange) contains alphabetic, numeric, or special character is represented with a 7-bit binary number (a string of seven 0s or 1s). 128 possible characters are defined.

Seven files in total were obtained from the FCA, highlighted as follows:

- ALT001 – Alternative Firm Name File
- APP001 – Appointment File
- AUT001 – Firm Authorisation File
- PER001 – Permissions File
- PRO001 – Product Authorisation File
- REG001 – Firm Regulators File
- SUB001 – Firm Sub Status File

The above data fields were converted manually into a Comma Separated Value (CSV) format in order to be manipulated using Microsoft Excel. The source for this FCA information comprises the Retail Mediation Activities Return (RMAR) report which
all firms are required to update annually. This is amended and complemented by the modification of permissions, firm type and active individuals between RMAR returns. The usage varies but for product providers it is a key control in reconciling commissions or adviser charge payments to agencies operated.

The next state was to screen out firms that did not hold “advising on” or “arranging” permissions\(^{10}\) as shown in Table 2. The rationale for this was that firms which distribute directly to a retail market will hold such permission. This is an assumption which was logged and returned to at the validation stage.

The remaining dataset essentially represented the ‘regulatory universe’ of retail investment firms, from which we would work from.

Table 2 - Firms that have advising / arranging permissions

<table>
<thead>
<tr>
<th>Status on FCA Register</th>
<th>Do these firms have individuals with CF30?</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No</td>
<td>Yes</td>
<td>Total</td>
</tr>
<tr>
<td>N/A</td>
<td>4</td>
<td>0</td>
<td>4</td>
</tr>
<tr>
<td>Revoked</td>
<td>50</td>
<td>1</td>
<td>51</td>
</tr>
<tr>
<td>Registered</td>
<td>5289</td>
<td>5714</td>
<td>11003</td>
</tr>
<tr>
<td>EEA registered firms</td>
<td>23</td>
<td>5</td>
<td>28</td>
</tr>
<tr>
<td>Cancelled</td>
<td>1862</td>
<td>8</td>
<td>1870</td>
</tr>
<tr>
<td>Authorised</td>
<td>1737</td>
<td>5701</td>
<td>7438</td>
</tr>
<tr>
<td>TOTAL No. FIRMS</td>
<td>8965</td>
<td>11429</td>
<td>20394</td>
</tr>
</tbody>
</table>

- N/A - four firms were extracted from the database with no status. They also had no FRN number and a corrupted name field
- Revoked - 51 firms had permissions revoked which indicates that a temporary intervention order had been placed on their activities

\(^{10}\) Advising on contracts of insurance; advising on investments, advising on pension transfers
• Cancelled - 1,862 firms in the extract were in this category which indicates that they were no longer authorised to undertake advising or arranging activities

• EEA – 28 firms had permissions granted by an external regulatory and thereby benefitting from a MIFID or IMD Passport.

**CF30 Analysis**

Once the “gross data set” had been compiled; the data was filtered further to identify firms which had at least one CF30 Investment Adviser. The CF30 permission simply denotes a Retail Investment Adviser and is awarded on an individual rather than firm basis. Firms which provide regulated investment advice under the overarching legislation - the Regulated Activities Order - are required to have at least one designated and qualified individual to deliver and take responsibility for regulated advice, even when provided on an automated basis (FCA, 2015). The CF30 designation identifies a “controlled function” relating to individuals employed by regulated firms who advise on investments or perform other related functions, such as advising on corporate finance business, acting as an investment manager or dealing and arranging.

The next stage of this “top down” synthesis was to compare it to an internal data set, built from the bottom up and aggregated over several years within Royal London, this data set is extensive and focusses on tracking entities and individuals who have submitted business to Royal London companies. It is therefore a powerful validation tool, reflecting a large provider of protection, investment and pension products, well
established with a solid share of the UK market\textsuperscript{11}. This overlay acted as an exception report, identifying firms which were potentially inactive, either temporarily or permanently.

The results of this stage were illuminating. From a basic “V Look-Up” excel exercise; a material mis-match was identified between the “top-down” data set and the Royal London agency database. As can be seen from the Table 3 below, the mismatched population is characterised by asset managers, operating Collective Investment Schemes (CIS) such as Unit Trusts, OEICS or similar investment vehicles.

Table 3 – Outliers for CF30 analysis

<table>
<thead>
<tr>
<th>Firm reference Number</th>
<th>Firm Name</th>
<th>Authorisation Status</th>
<th>Number of CF30 individuals</th>
<th>Royal London Agency Records</th>
</tr>
</thead>
<tbody>
<tr>
<td>114324</td>
<td>Bordier &amp; Cie (UK) Plc</td>
<td>Authorised</td>
<td>12</td>
<td>No Record</td>
</tr>
<tr>
<td>114354</td>
<td>Thesis Asset Management Plc</td>
<td>Authorised</td>
<td>23</td>
<td>No Record</td>
</tr>
<tr>
<td>114432</td>
<td>Investment Funds Direct Ltd</td>
<td>Authorised</td>
<td>3</td>
<td>No Record</td>
</tr>
<tr>
<td>114627</td>
<td>Credit Suisse Asset Management Ltd</td>
<td>Authorised</td>
<td>52</td>
<td>No Record</td>
</tr>
<tr>
<td>115308</td>
<td>Reyker Securities Plc</td>
<td>Authorised</td>
<td>6</td>
<td>No Record</td>
</tr>
<tr>
<td>116404</td>
<td>Waverton Investment Management Ltd</td>
<td>Authorised</td>
<td>35</td>
<td>No Record</td>
</tr>
<tr>
<td>116413</td>
<td>Jarvis Investment Management Ltd</td>
<td>Authorised</td>
<td>2</td>
<td>No Record</td>
</tr>
<tr>
<td>119178</td>
<td>Aviva Investors Global Services Ltd</td>
<td>Authorised</td>
<td>180</td>
<td>No Record</td>
</tr>
<tr>
<td>119193</td>
<td>Capital International Limited</td>
<td>Authorised</td>
<td>73</td>
<td>No Record</td>
</tr>
<tr>
<td>119230</td>
<td>F &amp; C Management Limited</td>
<td>Authorised</td>
<td>88</td>
<td>No Record</td>
</tr>
<tr>
<td>119272</td>
<td>Legal &amp; General Investment Management Ltd</td>
<td>Authorised</td>
<td>166</td>
<td>No Record</td>
</tr>
<tr>
<td>119273</td>
<td>Legal &amp; General (Unit Trust Managers) Ltd</td>
<td>Authorised</td>
<td>1</td>
<td>No Record</td>
</tr>
<tr>
<td>119293</td>
<td>BlackRock Investment Management (UK) Ltd</td>
<td>Authorised</td>
<td>476</td>
<td>No Record</td>
</tr>
<tr>
<td>119328</td>
<td>M&amp;G Investment Management Ltd</td>
<td>Authorised</td>
<td>193</td>
<td>No Record</td>
</tr>
<tr>
<td>119329</td>
<td>Close Asset Management Ltd</td>
<td>Authorised</td>
<td>153</td>
<td>No Record</td>
</tr>
</tbody>
</table>

\textsuperscript{11} See annual results 2014
The number of “outliers seemed significant, representing 185 firms with a total of 7,000 CF30 individuals. The list was reviewed by the working group which had been established and a consensus of opinion was obtained that such entities were operators of investment funds rather than retail focussed investment advisers.

This assumption was reinforced by a re-visit of the literature.

1. The RS Consulting Study completed in 2012 identified that “around 2/3rd of CF30 individuals were actually Registered Investment Advisers” (Atkin, 2012).

2. The FCA press release of 13 January 2014, stated the total number of advisers active in the market as being 31,220.

3. More recent publically available data from Matrix solutions as at September 2014 cites the number of CF30 individuals in their ‘active investment intermediary universe’ as being 28,199.

4. For the purposes of considering the advice gap, Towers Watson estimated that there are in the region of 30,000 RIAs.

Table 4 below shows the comparative data as being not materially different.

Table 4 – Comparison between sources

<table>
<thead>
<tr>
<th></th>
<th>This study Oct 2014</th>
<th>Towers Watson Dec 2014</th>
<th>FCA Jan 2014</th>
<th>Matrix Sep 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Population</td>
<td>36,736</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less; Outliers</td>
<td>7,705</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of CF30 RIAs</td>
<td>29,031</td>
<td>30,000</td>
<td>31,220</td>
<td>28,199</td>
</tr>
<tr>
<td>Variance from this</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>study</td>
<td>3.4%</td>
<td>7.5%</td>
<td>2.8%</td>
<td></td>
</tr>
</tbody>
</table>
With the decision to accept the data-set as within a tolerable margin for error, the study had completed its first phase and now had a full list of firms and RIAs which were identified as capable of being active in the distribution of Retail Investment Products.

This phase of the study provided a platform from which it was possible to start to build an understanding of the distribution landscape. The key fields such as Firm Reference Number, Individual Reference Number, Individual Names of Controlled Function Holders, and Permissions, Status as Principal or Appointed Representative; were now in place and could be used to triangulate other sources of data. However, what was a relatively straightforward exercise in concept was more difficult in executing and the end result contained some margin for error due to assumptions and other factors. Some of these are listed below:

- The role of Appointed Representatives (ARs) & Networks. An appointed representative firm acts as an agent for the Principal firm and the Principal must be a firm that is directly authorised by the FCA and must accept full responsibility, including any liabilities that might arise for ensuring that the AR complies with the FCA’s regulation. For the purposes of this exercise, the primary issue with ARs & Networks is one of duplication. AR firms operate on individual commercial terms and can be members of multiple Networks (which is simply a firm with more than 26 ARs). Furthermore, CF30 individuals can be members of multiple ARs. For the purposes of this study, 1,067 duplicate CF30s were removed and all ARs were tracked alongside Principle Firms.

- The lack of distinction between CF30 RIAs and CF30 individuals who are primarily concerned with operating collective investment vehicles and/or
corporate finance. There is no designatory field within the FCA extract which identified this, or for that matter, individuals who are active or inactive.

- The Retail Mediated Activities Return (RMAR) does not include consideration of how many individuals have attained Statement of Professional Standing. Since 31 December 2012, competent Retail Investment Advisers have been required to hold such statements which are issued by accredited bodies to those advisers who have passed an Appropriate Qualification (including completing gap-fill where appropriate), adhered to ethical standards and maintained their knowledge through ongoing CPD activity. This is an excellent proxy for “active RIA” and although high level figures are sometimes released by such bodies, individual name level extracts are not available.

- The exclusion from the CF30 RIA account of asset managers assumes that none are actively involved in the provision of providing advice. It is unlikely that this is absolutely the case. Such firms were retained as part of the “firm universe” but were excluded from the CF30 analysis exercise, as the purpose of that stream was to focus on the availability of advice post RDR.

The number of regulated financial advisers active in the market at any one time has always been subject to some data uncertainty and this was acknowledged in the three rounds of RDR professionalism tracking commissioned by the FCA (RS Consulting, 2012). However, the tracking that was completed focussed on progress towards qualification achievement rather than achieving certainty in who was actually active in the provision of advice. The literature reviewed prior to this study highlighted the basic nature of the “capacity” estimate proffered by Towers Watson: in a 50 page
report, there is only one page covering the adviser population and this essentially replays previous FCA estimates countered by the Matrix data referenced above and concludes “For the purposes of considering the advice gap, we therefore make an estimate that there are in the region of 30,000 retail investment advisers active in the UK market”.

The experience in compiling what should be a straightforward list of firms and individuals is consistent to that of Towers Watson, which noted, “the model is sensitive to the assumptions used, many of which require the application of experience and judgement owing to the absence of robust data that is generally accepted to be reliable” (Towers Watson, 2014.p41)

The early conclusion at this stage was simply that it is not possible from available FCA data to establish with certainty the exact supply of Retail Investment Advisers in the market.

5.3 Defining the model framework

The aim of this phase of work was to identify and agree the way in which the distribution landscape could be mapped onto the data-set of relevant firms collated in the previous phase.

This was a qualitative phase which relied on a facilitated session influenced by Nominal Group Technique approach. The exact approach was modified due to availability of senior executives to participate and required deputies to attend in some cases. The group - internally described as the project working group - comprising a range of internal and external experts.
The overall “model build” had a Steering Group which was comprised of senior Executives within the Royal London business. This provided a further level of scrutiny and challenge as to the data handling, as well as ensuring an audit trail of decisions and change control was maintained.

One meeting was held to debate and prioritize activity within the model build and a subsequent de-brief session was held to gauge participant comfort levels and identify potential blockers and puzzles. All individuals were provided with introductory information packs prior to the session which provided an overview of the broad scope “to build a segmentation model that explains the distribution landscape”. The individuals were all “RL1” banded role profiles and no individual reported into another member of the group. The formation of the working group was based on an invitation to the CEO of each business to supply an RL1 individual with responsibility and experience of the distribution of the products in that business. Each individual was also asked to nominate a deputy. The represented were:

- Royal London Platform Services – An intermediary only investment platform, comprising white label platform services and a significant advised platform business.

- Royal London Asset Management – A mid-size asset manager offering institutional as well as retail fund management services, including the unit-linked fund management for Royal London Mutual Insurance Society.

- Royal London Pensions - A large personal and group pensions business serving the intermediated market.
• Royal London Protection - a mid-size life insurance business, offering a range of Life, Critical illness & Income protection products on an intermediated basis.

• Royal London Consumer - a small but growing Direct to Consumer business offering a range of protection and investment business to existing customers who do not have a financial adviser.

• Royal London Consulting Actuaries - a small consulting and administration business focussed on the Defined Benefit sector.

• NMG Consulting - a well-established social sciences research house with extensive experience in the FSMA regulated sector.

The two metrics which were prioritised by the group and endorsed through the Steering Group were New Flow and CF30 headcount. Each metric scored much higher than others.

• The New Flow metric represents customer assets as measured in £ which had moved into products through various distribution channels. By using such a volume indicator, it was possible to calculate market share and also draw out relationships between products, distributors and remuneration models. This stands in contrast to alternative metrics such as “transactions” or “recommendations”. These would capture instances where advice is given but no product activity follows but would require extremely extensive data gathering from all distribution entities in the market, or a very sophisticated level of stratified sampling.
• New Flow means that single premium business is reporting as is and regular premium business is annualised.

• For corporate business, New Flow includes new business from new schemes and new members joining existing schemes but it does not include new contributions (increments) from existing members.

• For retail business, regular premium pension and ISA contributions are annualised.

The CF30 measure was prioritised fundamentally because it offers a different take on market share – that of actual physical human investment advisers – from New Flow. Participants in the working group recognised the anecdotal nature of intelligence on numbers of advisers in the market, particularly since the introduction of Pension Freedoms could place a strain on accessing the mandatory advice required to access pension funds with safeguarded benefits. The CF30 metric also provides a good level of evidential basis to challenge, corroborate or otherwise recent studies on where an advice gap could feasibly lie.

Metrics discarded:

The metrics which were discarded in order of popularity were:

1. Assets Under Management (AUM). This was recognised as valuable but seen as secondary to understanding the movement of assets. For example, it was acknowledged in the group that there would be a large amount of assets still in Defined Benefit but that understanding where new contributions were being directed was more useful.
2. Annual Premium Equivalent. This is a common measure utilised in Life business. As above, it was recognised as valuable – particularly by the RL protection attendees – but not readily transferable to asset management.

3. Turnover. This is a valuable indicator of business performance but was cited as potentially misleading by most working group participants. Examples of large turnover business were given – such as Tenet and other networks – which don’t reflect the value of the asset flows through subsidiary Appointed Representatives. Representatives from the asset management business highlighted the potential for asset returns to skew this figure.

4. Profit. Similar to turnover. Valuable in context but prone to adjustment due to accounting.

5. Customer Segments. A focus on customer segment was initially prioritised but after a subsequent round of challenge, dropped in priority. This was due to the perceived difficulties participants foresaw in obtaining standard metrics.

6. Commission / Adviser Charge. Similar to customer. Was initially a favourite to be focus of the model. However, after further investigation by Pensions participants, the difficulties in separating out commissions, adviser and consultancy charge by product were brought to life and the group acknowledged there was likely to be a gap in obtaining reliable data.
5.4 Determining the size and nature of the retail market

The specific focus of this stage was to aggregate all sources of assets under management and New Flow in order to determine how large the relevant UK market was and in which products, consumer assets existed.

The method employed was iterative with many internal validation sessions held. The working group established to build the model sought to identify as many available sources of data as possible.

The model had to be granular (at firm distributor level) and so the following “bottom up” approach was employed:

1. Start with distributor level data market shares from Touchstone, Matrix and Internal (RLAM) data sources;

2. Ensure Touchstone and Matrix data sources were screened for double counting;

3. Scale up Touchstone volumes for missing competitors using ABI competitor data, individual firm annual reports and NMG’s BQM studies;

4. Review against initial Firm data-set to identify gaps in individual distributor firms; and

5. Reconcile to total market and product numbers with other industry data sources (e.g. PlatForum, Fundscape, IMA).
The agreed stock flow methodology is shown above in Figure 4. Essentially, 2013 assets under management were adjusted for inflows and outflows and asset returns (net flow) to give a 2014 total assets picture.

The initial stage of this phase focussed on aggregating assets under management and held in product categories. The full product taxonomy is set out in the Appendix 3 and reflects primarily the Retail Investment product list as set out by RDR, as well as the most common groupings from the Touchstone and other data sources.
Table 5 shows the broad product categories; which emerged from the data.

Table 5 – Product Categories

<table>
<thead>
<tr>
<th>Supra-category</th>
<th>Category</th>
<th>Sub-category</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate Pensions</td>
<td>Corporate DB</td>
<td>Final salary occupational pension schemes</td>
</tr>
<tr>
<td></td>
<td>Corporate DC / PP</td>
<td>Money purchase occupational and group personal pension schemes</td>
</tr>
<tr>
<td>Retail Life</td>
<td>Life Wrappers</td>
<td>Investment Bonds and Endowment plans</td>
</tr>
<tr>
<td></td>
<td>SIPP / PP</td>
<td>Individual personal pensions</td>
</tr>
<tr>
<td></td>
<td>Drawdown</td>
<td>Individual personal pensions which have been crystallised</td>
</tr>
<tr>
<td>Retail Non-Life</td>
<td>Direct Shares /</td>
<td>Individual equities; discretionary managed portfolios of equities</td>
</tr>
<tr>
<td></td>
<td>DAM</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Direct Funds / ISA</td>
<td>Unit trusts or OEICS held directly with asset managers; Cash; Stocks &amp; Shares ISAs</td>
</tr>
<tr>
<td>Risk</td>
<td>Annuities</td>
<td>Lifetime annuities</td>
</tr>
</tbody>
</table>

The aggregation of data sources resulted in a total sum of £3.4trn invested within the UK in “long term savings”, i.e. products which are identifiable as capable of growing at a rate faster than inflation, if held for over three years or more. Figure 5 sets out how these are split out.
### TOTAL ASSETS (STOCK) BY PRODUCT

**UK LONG TERM SAVINGS MARKET IS £3.4TRN BUT SIGNIFICANT ASSETS ARE IN LEGACY DB SCHEMES**

#### Total Assets Under Management – 2014 - £3.4trn

<table>
<thead>
<tr>
<th>Category</th>
<th>Assets (£bn)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corp DB</td>
<td>£1,014</td>
</tr>
<tr>
<td>Life Wrappers</td>
<td>£298</td>
</tr>
<tr>
<td>Personal Pensions</td>
<td>£143</td>
</tr>
<tr>
<td>SIPP</td>
<td>£147</td>
</tr>
<tr>
<td>Corp DC / GPP</td>
<td>£332</td>
</tr>
<tr>
<td>Drawdown</td>
<td>£61</td>
</tr>
<tr>
<td>Direct Shares / DAM</td>
<td>£249</td>
</tr>
<tr>
<td>Direct Funds</td>
<td>£433</td>
</tr>
<tr>
<td>Cash ISAs</td>
<td>£230</td>
</tr>
<tr>
<td>SS ISAs</td>
<td>£260</td>
</tr>
<tr>
<td>Annuities</td>
<td>£209</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>£1,350</strong></td>
</tr>
<tr>
<td><strong>Total under Management</strong></td>
<td><strong>£648</strong></td>
</tr>
<tr>
<td><strong>Total under Management</strong></td>
<td><strong>£1,178</strong></td>
</tr>
<tr>
<td><strong>Total under Management</strong></td>
<td><strong>£209</strong></td>
</tr>
</tbody>
</table>

**Notes:**
1. Protection, Local Government and Charities excluded from graph, 2014 AUM estimated at £280bn
2. Life wrappers including endowments (e.g. with profits), onshore and offshore life investments but not protection
3. DAM is Discretionary Asset Management

**Sources:** Touchstone, ABI, Fundscape, Matrix, IMA, Platforum, TISA, Annual Reports, NMG BQM, NMG Estimates, Project Team

### New Flow

The identification of New Flow yielded some interest results with a clear picture emerging of reduced monies moving into legacy DB arrangements, the emergence of Master Trust pension arrangements and flows into cash ISAs representing almost half
of the amount invested. The high level picture was of a flow of around 5% of the assets under management.

Figure 6 - New Flow by product

NET FLOW BY PRODUCT

NET FLOW IS 4.3% OF ASSETS AND WEIGHTED TO RETAIL PRODUCTS; DIRECT FUNDS/ISAS HAVE GROWN RELATIVE TO LIFE/PENSIONS

Total Net Flow – 2014 - £145bn (4.3% of AUM)


Note 1: Protection, Local Government and Charities excluded from graph, 2014 New Flow estimated at £40bn
Note 2: Where possible increments have been removed from New Flow figures
Sources: Touchstone, ABI, Fundscape, Matrix, IMA, Platforum, TISA, Annual Reports, NMG BQM, NMG Estimates, Project Team

However, this is not a net flow figure compared to the 2013 gross asset figure in Figure 7.
This phase of the model build was characterised by repeated iterations and adjustments applied to incomplete data sources. Similarly to the exercise conducted to create an overarching data set of retail focussed distribution firms, judgment had to be exercised to address gaps and inconsistencies. The main challenges and assumptions are highlighted as follows:

- Top down vs bottom up. Entities such as the Investment Association (formerly the Investment Management Association), the Association of British Insurers, Fundscape, the National Association of Pension Funds and similar trade bodies all provide assets under management and new business volumes which are
capable of being converted to a New Flow metric. However, such data extracts do not typically operate at the level of individual distributor “Personal Investment Firm” level. Coverage at this level was provided predominantly from Touchstone & Matrix purchased data sets, supported by disparate information sources such as annual reports, consolidated trade press extracts and summary reports obtained from Touchstone “BQM” surveys of distribution firms.

- Double counting. It became clear when managing the different data sources that the potential for some duplication to occur was high. For example, within SIPP & Drawdown categories where contract options include partial decumulation and assets. The primary method for addressing this was treating ABI, APMA and NAPF data sources as of primary importance, setting the aggregate “pot” size. Furthermore, there was a clear potential for funds data to be double counted due to platforms acting as nominee asset holders yet asset managers also including in their returns. This was mitigated by excluding platforms from this stage of work and relying on the IA and BBA for ISA and fund data. This information was validated by a separate TISA report.

- Net flow conversion. Given the various methods for contributing to new and existing products, it is likely that the Net Flow methodology will not be 100% accurate. For example:
  - Monies in transit such as pension switches will not be counted.
  - Irregular contribution patterns will not be factored into the aggregate total. The assumption that regular small premiums are annualised is subject to future payments continuing in same size.
o Increments such as index linking are not accounted for. This was a known unknown and accepted from outset. The result is therefore that some under counting may have resulted.

The result of these challenges and application of judgment is an inevitable sensitivity around the exact flow mapping. This was discussed within the project working group and when presented to the steering group, a sensitivity of 10% was expressed as a reasonable estimate of accuracy.

DB pensions has been captured within the picture of overall assets under management held in the UK retail market even though it reflects a category of products which sit outside the confines of the Retail Investment Product list. Such products are not regulated by the FCA under its FSMA remit and would not ordinarily be within scope of a study of the RDR. They are regulated by the Pensions Regulator and governed by legislation passed by the Department of Work & Pensions and related government agencies. However, during the aggregation of data it became evident that a material amount of wealth held for retail consumers was within such products. This reflects the heritage of final salary schemes offered through public and private sectors in the UK.

The metric was included purposefully in order to enrich the picture of New Flow. As can be seen, this is relatively small for DB pensions, reflecting:

(a) Their decreasing importance in new contributions since the advent of Auto Enrolment and DC pension generally;

(b) The fact that employee contributions into such schemes is capped by legislation (at 15% of earnings) and taken straight from grow salary; and

(c) Most DB schemes do not allow transfers-in from outside pensions or other assets

The overall picture is therefore of very little asset flow into DB schemes.
While shares / equities were not captured within all of the changes arising from the 
RDR (e.g. independence or adviser charges), the professionalism changes did apply to 
retail investment advisers advising on shares / equities. They have therefore been 
included as a relevant investment product. Similar to DB, this ensured that we did not 
lose important insights into consumers' relevant investment experience.

Turning to Net Flow, it is interesting that the environment is broadly one of stasis. 
There is some indication that money seems to be flowing from Corporate DB, Life 
Wrappers, Direct Shares and Stocks & Shares ISAs. This is reversed for Corporate 
DC, Direct Funds and cash Funds especially.

RDR Considerations

The high level movement of assets contributes to a greater understanding of the post 
RDR landscape however, on its own, it is of limited use. Discussions from the 
working group resulted in a number of assertions. For example RDR influencing a 
move towards more holistic advice, a greater trend of outsourcing to discretionary 
managers, as well as a broader range of investment solutions, away from traditional 
life based products such as investment wrappers. These assertions are aligned to 
anecdotal insight that RDR has resulted in adviser firms charging more for increased 
professionalism but without a detailed review of costs of advice to customers, cannot 
be supported on an empirical basis.

That being said, there is some consistency with FCA findings in its first post 
implementation review (Figure 8), conducted by Europe Economics in October 2014. 
It saw “a decline in the sale of products which had higher commissions pre-RDR and 
an increase in the sale of those which paid lower or no commission pre-RDR” (Europe
Economics, 2014, p.2). The outflow for the whole of 2014 in relation to Investment Bonds is consistent with the FCA’s own data, as indicated by the ABI Data the FCA refer to in its post implementation review.

Figure 8 - FCA Post Implementation Review – Investment Bond Sales

Table 6.3: Decline in investment bonds

![Chart showing decline in investment bonds]

Source: Association of British Insurers (2014). Note data refer to ABI members only.

Having the broad asset flow captured by product is in itself, valuable. It provides a high level measure basis for tracking the consumer purchasing behaviour on a year on year basis. More specifically, for the subject of this study, it also provides a measure which can be broken down into constituent segments in order to increase our understanding of the competitive forces at work. The next phase of the study does this.
5.5 **Develop a segmentation model which describes the distribution landscape**

The aim of this phase of the model build was to tie together the top down product New Flow analysis into the bottom up firm data-set, with a view to capturing the shape of the distribution landscape. Having decided on a focus on CF30 and New Flow as key metrics, the Touchstone, Matrix, internal and external data sources were brought together with a view to segmenting the retail distribution landscape.

A further series of facilitated workshops were held to identify “Segment approach”. These sessions were not governed by a strict Nominal Group Technique due to the inherent complexity of formulating categories. These sessions proved more discursive in nature, with many participants providing insights which complicated initial suggestions or factors to govern the segments. Examples of this are:

- **Geographic coverage.** It was proposed that national vs non-national coverage should be a factor. However, RLPS & RL Pensions participants highlighted the growth in D2C and robo-advice. These are ostensibly non geographic. Another participant highlighted that local firms will often have clients spread all over the country, which would complicate matters.

- **FCA permissions.** This proposal centred upon mapping firms by permissions held. The premise was that firms would hold permissions for which they were active yet a member of the internal Agency team highlighted a pseudo “Pareto rule” where almost all advisers held the same set of permissions, regardless of their activity. In his view, this was based on compliance consultants and support networks offering pre-packed application services.
Some consensus did emerge that Firm Ownership had a role to play. The examples of providers owning shares in Networks (such as Tenet, Openwork) and others being fully vertical (St James Place) versus the presence of “one man bands” struck a chord with the group as potentially driving out issues of influence, sustainability, competence and market power generally.

Likewise, the input from the Intermediary division’s participant was useful in that it highlighted the importance internally for certain firms for certain product lines. For example, the concept of “Risk Specialist” was used to draw out that even within the Professional Investment Firm category (which is based on the Advising & Arranging permissions), CF30 individuals could be focussed on non RDR products, like whole of life insurance.

An initial ground rule had been set that >3/4 of participants had to agree to a segment approach before it could be carried forward. However, borrowing from NGT, a ranking process was undertaken which clearly identified a preference for two primary factors.

The finalised segment framework is characterised by organising individual firms into clusters against two factors which were elicited from the New Flow and CF30 metrics. The two factors are:

1. Product specialism. Broadly a copy out of the supra-product categories derived from the earlier phase (such as Annuity, Pensions, and Investment) but with the addition of “ancillary” products that CF30s could be active within.

2. Firm size and structure. Reflecting the organisational entity (such as Banks, small IFA, Employee benefits Consultant).
With this approach agreed, it was possible then to start to apply some basic criteria and rules to categorise firms into groupings of similar characteristics and take this forward to the working group for discussion and validation. The high level framework schematic which resulted from this stage is set out in Figure 9.

Figure 9 – Schematic for Segment Framework

Note 1: Non advised includes Direct to Consumer (D2C) investments (H1, Bestinvest, Charles Stanley), non advised bank ISAs, non advised annuities (e.g. Age, KRS, Closed Books) and D2C protection (e.g. SunLife)
Sources: Signed Off by working group and Steering Committee

The full list of segments is set out below in Table 6, alongside the criteria for inclusion in each segment.
<table>
<thead>
<tr>
<th>Segment</th>
<th>Attribute</th>
<th>Allocation Criteria</th>
<th>Example Firm</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-Advised (N-A)</td>
<td>All direct channels</td>
<td>Manual</td>
<td>Hargreaves Lansdowne, Bestinvest / Charles Stanley</td>
</tr>
<tr>
<td>Controlled Advice (TA)</td>
<td>Vertical / Provider influenced distribution firms</td>
<td>Manual</td>
<td>Intrinsic, St James Place, Nationwide</td>
</tr>
</tbody>
</table>
| Small FA (S-FA)         | Independently owned           | • Non TA / L-FA  
• Remaining Touchstone  
• <10 CF30s                                               | Compass Wealth, JF Finn                         |
| Large FA (L-FA)         | Financial Adviser controlled | Manual                                                                               | Towry, Bellpenny                                  |
| Risk Specialist (RS)    | Protection focussed           | >50% flow is protection (by cases)                                                   | Lifesearch, First Complete                        |
| Holistic FA (H-FA)      | Fee based financial planning  | Formula plus manual  
>£1m New Flow plus >20% offshore  
Or >20% of protection is WOL                   | Skipton FS, Grant Thornton                     |
| Private Client (PC)     | High Net Worth Wealth Manager | Manual                                                                               | Brewin Dolphin, Close Brothers                   |
| Corporate FA (C-FA)     | IFA focussed on corporates    | >50% of New Flow is corporate                                                        | Chase de Vere, capita                             |
| Employee Benefits Consultant (EBC) | Actuarial, Fiduciary & Trustee services | Manual                                                                               | Mercer, AON                                       |
| Asset manager (I-AM)    | DB Focus                      | Manual                                                                               | BlackRock                                        |
Table 7 – Manual Allocations

<table>
<thead>
<tr>
<th>Total Firms</th>
<th>Formula</th>
<th>Manual</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non Advised</td>
<td>24</td>
<td>0</td>
<td>24</td>
</tr>
<tr>
<td>Controlled Advice</td>
<td>2797</td>
<td>0</td>
<td>2797</td>
</tr>
<tr>
<td>Private Client EBC</td>
<td>19</td>
<td>0</td>
<td>19</td>
</tr>
<tr>
<td></td>
<td>20</td>
<td>0</td>
<td>20</td>
</tr>
</tbody>
</table>

Formulaic allocations (in order of priority):

| 1: Out of Scope | 368 | 348 | 20 | These are firms who write business in areas that can generally not be accessed by retail customers |
| 2: Holistic FA  | 421 | 411 | 10 | Formula = >1m new flow PLUS >20% offshore OR WOL >20% protection – Manual allocation based on NMG own insight. |
| 3: Risk Specialist | 5919 | 4948 | 971 | Formula = >50% protection (by cases) – Manual allocations include all First Complete, all Intrinsc Mortgage Planning and all PTFS – These account for 94% of manual allocations. Other manual includes Lifesearch, Cavendish, Moneyworld etc. |
| 4: Corporate FA | 375 | 363 | 12 | Formula = >50% corporate new flow – Manual allocations based on NMG BQM and internal. Segment reviewed by Paul Spriddle. |
| 5: Large FA    | 689 | 61   | 628 | All Intrinsc Independent and a large % of Sesame Ltd have been manually allocated to this segment (67% of manual allocations). Other allocations based on NMG BQM data & internal suggestions. Formulaic allocations based on firms that have >£50m APE market sales that haven’t hit other formula parameters. |
| 6: Small FA    | 7543 | 7540 | 3  | This is effectively the remainder. All have <£50m APE market sales. Manual allocation based on NMG BQM and Touchstone / New Flow. |

**TOTALS** | **18175** | **13671** | **4504** |

Table 7 above shows the manual allocations. In order to help bring the model life, facilitated sessions were held to draw up “pen portraits” of the individual segments. The final version is shown in Figure 10.
Figure 10 - Finalised pens portrait for each segment

<table>
<thead>
<tr>
<th>Segment Name and % of UK adviser market (by business volume)</th>
<th>Small FA 20%</th>
<th>Controlled Advice 16%</th>
<th>Private Client 10%</th>
<th>Large FA 6%</th>
<th>Holistic FA 7%</th>
<th>Corporate Adviser 7%</th>
<th>EBC 6%</th>
<th>Risk Specialist 0.5%</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>What defines this segment?</strong></td>
<td>Small, mostly independent general practice advice firms</td>
<td>Advisers working for a large firm, which imposes an element of centralised control. This restricts their ability to offer the full range of propositions/platforms/providers.</td>
<td>Discretionary advisers working with high value clients</td>
<td>Large, structured advice firms, working across the full suite of products</td>
<td>Financial planning focused smaller advice firms</td>
<td>Small to medium size advice firms very focused on Group business</td>
<td>Larger firms advising large and mid size businesses on their employee benefit requirements</td>
<td>Advisers focused on protection advice for clients.</td>
</tr>
<tr>
<td><strong>Product Focus</strong></td>
<td><img src="image" alt="Product Focus" /></td>
<td><img src="image" alt="Product Focus" /></td>
<td><img src="image" alt="Product Focus" /></td>
<td><img src="image" alt="Product Focus" /></td>
<td><img src="image" alt="Product Focus" /></td>
<td><img src="image" alt="Product Focus" /></td>
<td><img src="image" alt="Product Focus" /></td>
<td><img src="image" alt="Product Focus" /></td>
</tr>
<tr>
<td><strong>Investment Solutions</strong></td>
<td><img src="image" alt="Investment Solutions" /></td>
<td><img src="image" alt="Investment Solutions" /></td>
<td><img src="image" alt="Investment Solutions" /></td>
<td><img src="image" alt="Investment Solutions" /></td>
<td><img src="image" alt="Investment Solutions" /></td>
<td><img src="image" alt="Investment Solutions" /></td>
<td><img src="image" alt="Investment Solutions" /></td>
<td><img src="image" alt="Investment Solutions" /></td>
</tr>
<tr>
<td><strong>What do they want from us?</strong></td>
<td>Make their life easier and help reduce their business risk.</td>
<td>Deliver great support and training to help us remain on their panels.</td>
<td>Need to demonstrate a value proposition.</td>
<td>Make things as streamlined and efficient as we can.</td>
<td>A quality product and a great platform proposition.</td>
<td>Fantastic service and a strong pensions proposition.</td>
<td>Bespoke propositions, completely tailored to their business model.</td>
<td>A competitive price and great service.</td>
</tr>
</tbody>
</table>
Networks

As discussed earlier, the presence of Networks adds a complicating layer to any segmentation model. It is possible for a principle firm – such as Tenet – to provide regulatory cover (in the form of an exemption from the General Prohibition under FSMA) to a multitude of individual Appointed Representative firms. Each may have a slightly different focus, either in terms of product specialism, client proposition or structure. To this end, a specific manual allocation exercise of AR firms within Networks and other firms (a firm can have 6 ARs with a maximum of 26 AR CF30 before being classed as a network by FCA) was undertaken. Table 8 illustrates these.

Table 8 - Network AR allocations

<table>
<thead>
<tr>
<th>Network Name</th>
<th>Class</th>
<th>Vol (£m)</th>
<th>N-A</th>
<th>TA</th>
<th>S-FA</th>
<th>L-FA</th>
<th>RS</th>
<th>H-FA</th>
<th>PC</th>
<th>C-FA</th>
<th>EBC</th>
</tr>
</thead>
<tbody>
<tr>
<td>TenetConnect Limited</td>
<td>AR</td>
<td>1,254</td>
<td>1</td>
<td></td>
<td>245</td>
<td>4</td>
<td>69</td>
<td>8</td>
<td>9</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Intrinsic Financial Planning Ltd</td>
<td>AR</td>
<td>642</td>
<td></td>
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<td></td>
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<td>Intrinsic Independent Limited</td>
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<td>334</td>
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<tr>
<td>Intrinsic Mortgage Planning Ltd</td>
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<td>23</td>
<td></td>
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<td>Positive Solutions</td>
<td>DR</td>
<td>657</td>
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<td>Openwork Limited</td>
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<td>376</td>
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<td>558</td>
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<tr>
<td>Openwork Limited (firm level)</td>
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<td>20</td>
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<td></td>
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<td>1</td>
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<td></td>
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<td></td>
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<tr>
<td>Openwork Market Solutions</td>
<td>DR</td>
<td>22</td>
<td></td>
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<td>Sesame Limited</td>
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<td>743</td>
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<td>260</td>
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<tr>
<td>Sesame Limited (firm level)</td>
<td>AR</td>
<td>26</td>
<td></td>
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<td>CAEXUS Financial Limited</td>
<td>AR</td>
<td>502</td>
<td>1</td>
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<td>9</td>
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<td>3</td>
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<td>In Partnership</td>
<td>AR</td>
<td>401</td>
<td>1</td>
<td></td>
<td>81</td>
<td>106</td>
<td>5</td>
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<tr>
<td>St. James's Place Wealth Management P</td>
<td>AR</td>
<td>299</td>
<td></td>
<td></td>
<td></td>
<td>1,848</td>
<td></td>
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<tr>
<td>Twistonck Investment Plc</td>
<td>AR</td>
<td>294</td>
<td>185</td>
<td>1</td>
<td>39</td>
<td>8</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Best Practice IFA Group Limited</td>
<td>AR</td>
<td>204</td>
<td></td>
<td></td>
<td>33</td>
<td>13</td>
<td>3</td>
<td>6</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Sense Network Limited</td>
<td>AR</td>
<td>231</td>
<td></td>
<td></td>
<td></td>
<td>62</td>
<td>1</td>
<td>8</td>
<td></td>
<td></td>
<td>4</td>
</tr>
<tr>
<td>Lighthouse Advisory Services Limited</td>
<td>AR</td>
<td>259</td>
<td></td>
<td></td>
<td>86</td>
<td>1</td>
<td>36</td>
<td>4</td>
<td></td>
<td></td>
<td>1</td>
</tr>
<tr>
<td>The Whitechurch Network Limited</td>
<td>AR</td>
<td>134</td>
<td></td>
<td></td>
<td>53</td>
<td>1</td>
<td>26</td>
<td>1</td>
<td></td>
<td></td>
<td>2</td>
</tr>
<tr>
<td>Network Direct Limited</td>
<td>AR</td>
<td>118</td>
<td></td>
<td></td>
<td></td>
<td>40</td>
<td>5</td>
<td>4</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Personal Touch Financial Services Ltd</td>
<td>AR</td>
<td>79</td>
<td></td>
<td></td>
<td></td>
<td>287</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>First Complete Ltd</td>
<td>AR</td>
<td>12</td>
<td></td>
<td></td>
<td></td>
<td>326</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>TenetLine Ltd</td>
<td>AR</td>
<td>6</td>
<td>1</td>
<td>6</td>
<td>180</td>
<td></td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Safe6Secure Insurance Services Ltd</td>
<td>AR</td>
<td>3</td>
<td>2</td>
<td>10</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Once the segments had been agreed and firms allocated, an Microsoft Excel based model with pivot tables was constructed to hold and link the various data sets. The model was completed in early 2015 and is now capable of being updated and added to as data arises.

The model comprises a Front End and Back End, each made of constituent Microsoft workbooks. The focus of the Front End is to produce segment and product analysis, with “Lasgane” charts provided as a macro. The Back End largely serves to provide input, distributor level data.

The model structure is briefly summarised in Table 9.

**Table 9 - Description of segmentation model**

<table>
<thead>
<tr>
<th>Front End Model</th>
<th>Back End Model</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tabs from left to right across model:</td>
<td>Tabs from left to right across model:</td>
</tr>
<tr>
<td>• Mapping: Outlines the product categories, products, and segments across the entire model.</td>
<td>• Final Output 201x: Final output of the Back-End model, is pasted directly onto the “Back End 201x” sheet in the Front-End model.</td>
</tr>
<tr>
<td>• Product Model: AUM, New Flow, Increments, Outflow and Asset Returns by product for years 2010 to 2014.</td>
<td>• TS Own 201x: Summary of RLI’s own New Flow by product for each unique FRN. From Touchstone.</td>
</tr>
<tr>
<td>• Net Flow: Market-level movements by product for 2014, along with a graph of Net Flow by product.</td>
<td>• TS Mkt 201x: Summary of Market-level New Flow by product for each unique FRN. Allocation of each FRN to a segment also takes place in this tab. From Touchstone.</td>
</tr>
<tr>
<td>• Segmentation: Segmentation outputs for 2014 including lasagnes and product/channel growth</td>
<td>• TS Mkt Cases 201x: Summary of Market-level sales case count for</td>
</tr>
<tr>
<td>• Protection: Protection outputs for years 2010-2014 product-level and channel-level (though channel level from Touchstone data)</td>
<td></td>
</tr>
<tr>
<td>• Coverage: Summary and graph of Touchstone’s coverage of total market for latest year’s New Flow</td>
<td></td>
</tr>
<tr>
<td>• Asset Returns: Module used to calculate asset returns for each</td>
<td></td>
</tr>
<tr>
<td>---------------------------------------------------------------</td>
<td></td>
</tr>
<tr>
<td>• IndPen Module: Sizes all individual pensions products bottom-up (by competitor) based on the aggregation of multiple incomplete data sources.</td>
<td></td>
</tr>
<tr>
<td>• Platform Module: Sizing for the platform market bottom-up (by competitor). Used for separate platform exercise.</td>
<td></td>
</tr>
<tr>
<td>• Segment Model: Sizing of all metrics (AUM, New Flow, Increments, Outflow, Asset Returns) across years 2010 to 2014 by segment and product. “Product Model” tab is used for high-level product values.</td>
<td></td>
</tr>
<tr>
<td>• Segmentation 201x: One for each year of Back-End model data. Calculates the Touchstone coverage of each product and allocates the missing flow to segments.</td>
<td></td>
</tr>
<tr>
<td>• Back End 201x: Data extract hardcoded directly from the relevant year’s Back-End model. Breakdown of Product vs Segment for Touchstone total market.</td>
<td></td>
</tr>
<tr>
<td>• Platform Data: Fundscape data at a competitor level. Can be updated by Royal London internally.</td>
<td></td>
</tr>
<tr>
<td>• ABI Individual Pensions: Competitor-level Individual Pensions data from ABI. Used in the IndPen Module for market sizing.</td>
<td></td>
</tr>
<tr>
<td>• Other Data: Alternative data sources such as Investment Association, The Purple Book, etc.</td>
<td></td>
</tr>
<tr>
<td>• ABI Summary: Summary of New Flow by product for years 2010 to 2015 in ABI.</td>
<td></td>
</tr>
<tr>
<td>• ABI_201x: Compilation of ABI product-level data for a given year. Each line attributed to product.</td>
<td></td>
</tr>
<tr>
<td>• certain products for each unique FRN. Used in allocation formulae in the “TS Mkt 201x” tab.</td>
<td></td>
</tr>
<tr>
<td>• Matrix RLPS 201x: Summary of RLPS’s own New Flow by product for each unique FRN. From Matrix.</td>
<td></td>
</tr>
<tr>
<td>• Matrix RLAM 201x: Summary of RLAM’s external wholesale NewFlow by product for each unique FRN. From Matrix</td>
<td></td>
</tr>
<tr>
<td>• Manual Allocations: Firms can be manually allocated to segments in this sheet. This will take priority over formulaic allocations.</td>
<td></td>
</tr>
<tr>
<td>• Mapping: Mapping sheet that aligns Touchstone/Matrix products to the overall model’s product categories. Also defines the formulae that drive segment allocation.</td>
<td></td>
</tr>
</tbody>
</table>
Once constructed and in a stable format, it was possible to leverage the model to bring to life how the flow of assets correlates to different distribution channels. Figure 11 shows this.

**Figure 11 – New Flow by Segments & Product**

Note 1: Increments have been removed from New flow figures
Note 2: Protection, Local Government and Charities excluded from graph, 2014 New Flow = £40bn
Sources: Touchstone, ABI, Matrix, IMA, Platforum, TISA, Annual Reports, NMG Estimates, Project Team

**Discussion**

The development of the segmentation framework underpinning the model proved to be as iterative and complex as the data manipulation phase. The initial focus of the working group was identifying the most clearly delineated primary distribution channels. Initial expectations from the discussions were that segments would form into hard clusters based on products sold and type of firm ownership (fully vertical, provider owned, adviser owned) but once the comparative analysis between firms was
underway, it became clear that soft clustering patterns were evident in the data. For example, the concept of “Risk Specialist” which had been raised in an earlier round was complicated by the presence of investment products in the New Flow data. In terms of ownership, the group identified that some provider owned entities operated Independent advisory businesses whilst others were Restricted. Others had combined entities. Tenet (part owned by Aegon, Aviva and Standard Life); St James Place (fully vertical) and Intrinsic (combined with Positive Solutions owned by Old Mutual Wealth) are all examples of this complexity. As a result of this and the absence of a “Restricted” designator within the FCA data extract, the group agreed that “Controlled” should be a separate category and that this would focus on the most prominent firms which market intelligence confirmed offered a narrower range of products than traditional whole of market IFAs.

The product spread data showed a distribution of the full Retail Investment Product list within smaller firms and it was agreed this balanced out the risk that such firms were Restricted (and thereby Controlled advice firms). This is an acknowledged assumption and deemed acceptable. Given that one of the purposes of the model was to understand agency issues, it is of relatively lower import when dealing with many “one man band” sole trader firms.

The model therefore reflects a multivariate reality with the following determinants involved:

- Firm size; influence over product or provider; focus on retail customer; focus on corporate customers; focus on large employers; focus on High Net Worth individuals; focus on holistic (life planning).
The primary omission from the model relates to Professional Exempt Firms, such as legal firms, which are not directly regulated by the FCA. There are estimated to be 2,000 such firms in the UK.

Once the model constructed with firms allocated segments and an underlying base of CF30 count, product mix and net flow, it was possible to start to slice the model to interrogate different themes and also to sense check the original allocations. For example, an exercise was conducted to identify the largest firms offering financial advice which were not networks. Another area of focus was the role of platforms which have received an increasing share of retail investment flows in recent years (Fundscape, 2014) However, the group reviewed and agreed that those platforms which distributed through to retail customers, rather than intermediated (such as Hargreaves Lansdowne or Charles Stanley) should be included in the model as were carrying out “advising & arranging” activity. Assets flowing through platforms carried a high risk of double counting and it was agreed that for intermediated models (such as Ascentric or Standard Life) the New Flow would be attributed to the distribution entity that recommended the asset flow. This assignment was also confirmed as most useful in that it aligned with FCA RMAR data which excludes platforms.

Finally, the Distribution Map highlights the following current market dynamics

- The UK long term savings market is £3.4 trillion in assets and New Flow is £145bn or 5% of assets
- Overall the industry is in net outflow (-£53bn in 2014) due to large outflows from DB schemes (-£50bn in 2014)
- Direct funds and stocks and shares (SS) ISA is large (£693bn)
• SIPP has grown faster than PP (£6bn more in net flow) but trend seems to be driven more by competitors than product (product offerings are similar).
• Despite industry commentary on the death of small advisers, Small FA (S-FA) remains the largest segment.

5.6 Conclusion

The substantial exercise to build a model describing the retail investment market was not undertaken lightly. The reality was that the initial literature review and immersion in the subject matter did not flush out any comprehensive quantitative description of the current Post RDR market which could show the role of product, firm nature and size, and whether advice was given or not.

The market analysis undertaken by Oxera in 2009 to review the likely impact of RDR was by its own admission, reliant on secondary sources and a limited sample basis; “Due to time constraints, only very limited primary research was conducted…The sample of firms interviewed is not representative of the whole market” (Oxera, 2009).

This is unsurprising in that its earlier advice to the FSA in 2006 only contained one reference to “market structure” yet recommended econometric benchmarking (Oxera, 2009.p17)

However, the 2009 report does contain reference to “standard competition indicators” such as concentration, vertical integration and product ranges which provides at least a narrative basis for providing an ex-ante and ex-post comparison. Unfortunately, the post implementation work conducted by Europe Economics did not pick up where this left off, relying instead on abstractions such as “market capacity” and whether customers felt they knew what independence meant (Europe Economics, 2014).
Furthermore, the original Cost Benefit analysis conducted on RDR proposals was focussed primarily on compliance cost with other impacts not articulated in quantitative terms.

An overarching aim of the study is to draw out the extent to which a market-failure paradigm is effective as a tool in delivering increased welfare through regulatory policy. One criticism of the market failure model is that it is not sufficiently derived from an empirical base (Coase, 1975; Zerbe, 1999) for interventions to be judged. Developing such a segmented model provides a “map” of the market where risks and issues can start to be plotted. The immediate use is to leverage the model to assist in establishing whether the key areas of failure have been addressed. This could not be done without a consolidated view of the actual outcomes of consumer decision making – such as net flow. This is a step forward from the samples and surveys undertaken in limited areas of RDR post implementation review.

Looking forward, there is a clear basis for using such a model to track market developments. This initial humble proof of concept could be taken forward by further researchers interested in tracking the incidence and shape of unintended regulatory impacts. Identifying a change in market dynamics as rudimentary as who is selling what to who and how is a basic but essential first step in identifying economic reactions such as “mimicking, believing, undermining, operating and resisting” (MacKenzie et al, 2007). This in turn is a start towards making a case for the performativity of the sort defined by Callon (1998) as an “over-flowing” of economic decision making whereby economic agents may defy framing and thus create market failures that need to be addressed by further regulation of regulatory interventions.
6. RESULTS: OBJECTIVES 2, 3 & 4 – USING & LEVERAGING THE MODEL

6.1 Introduction

The previous chapter was concerned with building a model which described the post-RDR retail distribution financial services landscape. The initial purpose of constructing such a model was to engender a systemic understanding of the impact of RDR in order to establish if the intervention was successful on its own merits. From that work, a wider assessment could be made on the nature of market failure analysis and the limitations of any regulatory intervention in retail financial services and not just RDR.

This chapter deals with objectives 2, 3 & 4 of this study, as set out in chapter 3. These are:

2. Use the model to attempt to establish the nature of market power and agency in the retail distribution landscape and where, possible draw comparison to the pre-RDR landscape, cited as “bust” by Callum McCarthy.

3. Leveraging the model and incorporating open source product sales, complaints and other data, attempt to establish to what extent conflicts of interest have been eradicated by RDR.

4. Utilise the model to establish the extent to which existing trust studies cover the market and establish to what extent RDR can demonstrate improved trust through improved professionalism.
Essentially, this section leverages the model to explore the market dynamics that have come to bear in the UK after the RDR’s introduction. Specifically, the competition and market efficiency aspects referred to in the FSA and FCA’s own analysis are examined. These centre on issues of agency, including conflicts of interest and bias, the prevalence of information asymmetries and relative growth in trust. Signals of detriment such as complaints, fines and the size of levies resulting from firm failures are also mapped against the model segments in order to draw out impacts, both intended and otherwise arising from RDR.

The initial focus is on an exploration of market power. This is important as it assists in building a granular understanding of the competitive landscape which is emerging post RDR FSA. It envisaged a greater competitive landscape where “firms compete on products rather than access to distribution”. Market power, as a concept, is intrinsically linked to competition analysis and also plays a direct role in understanding the impact of agency issues, such as Principle-Agent problems, which also underpinned the market failure analysis which led to the RDR.

## 6.2 Market Power & Agency

### 6.2.1 Market power of distributors based on asset flow within product “markets”

This exercise examined the extent to which the segments established previously in the model dominated the market share of the full product list agreed as appropriate for understanding the retail landscape.
Use of HHI

This phase of the work utilises the The Herfindahl index (also known as Herfindahl–Hirschman Index, or HHI) which is a measure of the size of firms in relation to the industry and an indicator of the amount of competition among them. It is a summary statistic of the structure of a market, reflecting the number of firms supplying the market and their relative size. The HHI becomes higher as (1) the number of suppliers falls and (2) one or more of the suppliers has a relatively large market share compared to others (for any given number of suppliers the HHI is minimised where there are equal market shares). The current Competition & Markets Authority (CMA) has maintained use of the original guidance on the use of HHI for Market Interventions / Investigations issued by the Office for Fair Trading (and endorsed by the Competition Commission). It states that that concentration measures like the HHI “can be indicators of the ability of the leading firms in a market to exercise market power collectively” (OFT, 2010).

As regards the HHI, the OFT in its guidelines for assessing whether it would refer a potential merger for investigation, stated that it would have regard to the following thresholds:

- Market with a post-merger HHI exceeding 1,000 may be regarded as concentrated
- Market with a post-merger HHI exceeding 2,000 as highly concentrated. (OFT, 2010)

It should be acknowledged that the genesis for such thresholds lies with EU work on market concentration and that these are framed as indicators rather than validated competition assessments. Furthermore, following a critical report issued by the CC on
concentration within the Audit market in the UK, PWC made the case that such thresholds had been superseded by work undertaken in the US. In particular, on 19 August 2010 the US Department of Justice and the Federal Trade Commission issued updated guidelines on mergers, setting out amongst other things their revised guidelines on the interpretation of HHI figures. It categorises HHI as follows: “Based on their experience, the Agencies generally classify markets into three types: Unconcentrated Markets: HHI below 1500; Moderately Concentrated Markets: HHI between 1500 and 2500; Highly Concentrated Markets: HHI above 2500”.

A fundamental criticism of HHI is that it is simply too arbitrary and simplistic to be used for such large policy decision. For example, Williams and Rosen hold the view that it is a static measure which doesn’t capture dynamic market effects such as strategic bidding, the balance of supply and demand and the pattern of ownership over the supply curve (Rosen & Williams, 1999). That notwithstanding, and as stated in earlier chapters, the purpose of the HHI in this study is to draw out differences in market power from an a priori perspective, from which to look at the deeper and more specific elements concerning the distribution of financial products. It is not intended to be a final determinant.

Given that HHI will be employed simply to identify concentration, that this is a UK based study and also that the OFT has previously reviewed the impact of the FSMA on financial services markets using the UK HHI thresholds, it makes sense for the purposes of this study to maintain these as benchmarks.
Results

The results showed a high degree of concentration in many segments. This was not unsurprising in that some of the segments were defined by formulaic or manual product concentrations (such as Risk Specialist, Corporate Financial Adviser).

However, that notwithstanding, the results did highlight some interesting points elicited from Table 10 below.

Table 10 – Retail Segment market share

<table>
<thead>
<tr>
<th>PRODUCT</th>
<th>Non Advised</th>
<th>Controlled Advice</th>
<th>Risk Specialist</th>
<th>Holistic FA</th>
<th>Private Client</th>
<th>Corporate FA</th>
<th>EBC</th>
<th>Institutional AM</th>
<th>HHI</th>
</tr>
</thead>
<tbody>
<tr>
<td>Defined Benefit</td>
<td>-</td>
<td>6%</td>
<td>39%</td>
<td>14%</td>
<td>0%</td>
<td>13%</td>
<td>0%</td>
<td>21%</td>
<td>6%</td>
</tr>
<tr>
<td>Trustee DC</td>
<td>0%</td>
<td>0%</td>
<td>3%</td>
<td>1%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>18%</td>
<td>78%</td>
</tr>
<tr>
<td>GPP (RP)</td>
<td>0%</td>
<td>5%</td>
<td>24%</td>
<td>11%</td>
<td>0%</td>
<td>5%</td>
<td>0%</td>
<td>33%</td>
<td>21%</td>
</tr>
<tr>
<td>GPP (SP)</td>
<td>0%</td>
<td>3%</td>
<td>27%</td>
<td>11%</td>
<td>0%</td>
<td>6%</td>
<td>0%</td>
<td>29%</td>
<td>23%</td>
</tr>
<tr>
<td>Group Stakeholder Pensions</td>
<td>0%</td>
<td>7%</td>
<td>22%</td>
<td>7%</td>
<td>0%</td>
<td>4%</td>
<td>0%</td>
<td>23%</td>
<td>36%</td>
</tr>
<tr>
<td>Master Trust</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Personal Pensions (RP)</td>
<td>0%</td>
<td>8%</td>
<td>65%</td>
<td>12%</td>
<td>1%</td>
<td>9%</td>
<td>0%</td>
<td>3%</td>
<td>2%</td>
</tr>
<tr>
<td>Personal Pensions (SP)</td>
<td>0%</td>
<td>8%</td>
<td>56%</td>
<td>12%</td>
<td>1%</td>
<td>8%</td>
<td>0%</td>
<td>9%</td>
<td>6%</td>
</tr>
<tr>
<td>Personal Stakeholder Pensions</td>
<td>1%</td>
<td>11%</td>
<td>53%</td>
<td>15%</td>
<td>5%</td>
<td>8%</td>
<td>2%</td>
<td>4%</td>
<td>3%</td>
</tr>
<tr>
<td>SIPP</td>
<td>1%</td>
<td>8%</td>
<td>59%</td>
<td>16%</td>
<td>1%</td>
<td>12%</td>
<td>1%</td>
<td>2%</td>
<td>1%</td>
</tr>
<tr>
<td>Pension Drawdown (Insured)</td>
<td>4%</td>
<td>7%</td>
<td>66%</td>
<td>13%</td>
<td>2%</td>
<td>6%</td>
<td>0%</td>
<td>2%</td>
<td>0%</td>
</tr>
<tr>
<td>Pension Drawdown (Platform)</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Onshore Bonds</td>
<td>0%</td>
<td>9%</td>
<td>63%</td>
<td>13%</td>
<td>1%</td>
<td>12%</td>
<td>1%</td>
<td>1%</td>
<td>0%</td>
</tr>
<tr>
<td>With-Profits</td>
<td>0%</td>
<td>19%</td>
<td>63%</td>
<td>11%</td>
<td>1%</td>
<td>5%</td>
<td>0%</td>
<td>1%</td>
<td>0%</td>
</tr>
<tr>
<td>Offshore Bonds</td>
<td>1%</td>
<td>9%</td>
<td>41%</td>
<td>11%</td>
<td>1%</td>
<td>27%</td>
<td>7%</td>
<td>2%</td>
<td>2%</td>
</tr>
<tr>
<td>Endowments</td>
<td>3%</td>
<td>-</td>
<td>39%</td>
<td>47%</td>
<td>-</td>
<td>11%</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Mutual Funds</td>
<td>21%</td>
<td>9%</td>
<td>32%</td>
<td>12%</td>
<td>0%</td>
<td>8%</td>
<td>16%</td>
<td>1%</td>
<td>0%</td>
</tr>
<tr>
<td>SS ISA</td>
<td>0%</td>
<td>10%</td>
<td>59%</td>
<td>18%</td>
<td>1%</td>
<td>10%</td>
<td>0%</td>
<td>1%</td>
<td>0%</td>
</tr>
<tr>
<td>Direct Shares</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Cash ISA</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Individual Annuities</td>
<td>14%</td>
<td>10%</td>
<td>48%</td>
<td>11%</td>
<td>2%</td>
<td>6%</td>
<td>0%</td>
<td>5%</td>
<td>5%</td>
</tr>
<tr>
<td>Bulk Annuities</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Over 50s/Funeral Plans</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Individual - Term</td>
<td>0%</td>
<td>19%</td>
<td>16%</td>
<td>6%</td>
<td>55%</td>
<td>2%</td>
<td>0%</td>
<td>1%</td>
<td>0%</td>
</tr>
<tr>
<td>Individual - Whole of Life</td>
<td>0%</td>
<td>20%</td>
<td>24%</td>
<td>8%</td>
<td>37%</td>
<td>9%</td>
<td>1%</td>
<td>1%</td>
<td>0%</td>
</tr>
<tr>
<td>Individual - Critical Illness</td>
<td>0%</td>
<td>20%</td>
<td>21%</td>
<td>8%</td>
<td>47%</td>
<td>3%</td>
<td>0%</td>
<td>1%</td>
<td>0%</td>
</tr>
<tr>
<td>Individual - Income Protection</td>
<td>0%</td>
<td>29%</td>
<td>15%</td>
<td>5%</td>
<td>47%</td>
<td>3%</td>
<td>0%</td>
<td>1%</td>
<td>0%</td>
</tr>
</tbody>
</table>
The findings can be summarised as follows:

- Most product lines identify a concentrated market. Although not completely, the significant concentrations of powers are around the Small F-A & Large F-A segments, respectively.

- The HHI figure in some segments is extremely high. This is obvious for some entities such as Trustee DC sales where employee Benefit Consultants like AON, Mercer and a few others dominate (HHI 6,418). However, less obviously, in Personal pensions (4,528), Pensions Drawdown (4,634) and Bonds (>4,000) it is the Small F-A segment exercising most power.

- Moving away from RDR products, we can see that a number of investment intermediary segments (Small F-A; Large F-A; Holistic F-A) also contribute to distributing protection products.
Figure 12 illustrates graphically the “market share squared” components of each product line.

Figure 12 – Bar Chart showing Market Power (measured as market share squared)
Discussion

This exercise is useful as a scene setter and reflects the criteria used to select some of the segments. However, its most use is in highlighting the strength of the Small F-A segment in distributing many key products. The concentration number for this segment is advisory only in that it is already understood from the initial data set phase that a great deal of CF30 individuals resides in this segment. In order to understand to what extent the market in such products as Income Drawdown is overly concentrated, it is necessary to look at concentration levels within the segment. The following exercise does this.
6.2.2 Market structure based on adviser population

The purpose of this exercise was to explore the extent to which individual model segments were dominated by a few firms, thus indicating excessive market power and potentially driving poor outcomes for customers. The metric which underpinned the analysis was the CF30 adviser count. Figure 14 and Table 11 provides market share and the HHI count as calculated for the market as a whole, based on market share of CF30s in each segment.

Figure 14 – CF30 Split
Table 11 - HHI by CF30 count & Firm Segment

<table>
<thead>
<tr>
<th>Actual CF30 numbers by segment</th>
<th>Market share (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Controlled Advice</td>
<td>5524</td>
</tr>
<tr>
<td>Corporate FA</td>
<td>722</td>
</tr>
<tr>
<td>Employee Benefit Consultant</td>
<td>830</td>
</tr>
<tr>
<td>Holistic FA</td>
<td>1681</td>
</tr>
<tr>
<td>Large FA</td>
<td>4465</td>
</tr>
<tr>
<td>Non Advised</td>
<td>490</td>
</tr>
<tr>
<td>Private Client</td>
<td>936</td>
</tr>
<tr>
<td>Risk Specialist</td>
<td>451</td>
</tr>
<tr>
<td>Small FA</td>
<td>13932</td>
</tr>
<tr>
<td>Grand Total</td>
<td>29031</td>
</tr>
<tr>
<td>HHI</td>
<td>3079</td>
</tr>
</tbody>
</table>

The findings can be summarised as followed:

1. In terms of segments, the market is concentrated, with an HHI of 3,079.
2. The Small F-A segment, as per the New Flow metric calculation, accounts for a material slice of the market, with 50% of CF30 advisers in scope of this study.
3. Large F-A and Controlled Advice also provide a material swathe of the adviser population.
Taken together, the overall New Flow HHI and CF30 HHI calculations demonstrate the Small F-A segment as powerful within the distribution landscape. However, further analysis is required in order to understand the concentrations within these segments. This “Russian doll” process is crucial to determine the relationship between supply and demand and the buying power of individual distributors.

Concentration by CF30 within segment

This exercise focussed on determining the market share of CF30s within each segment. Table 12 sets out the results.

Table 12 – Market share by segment by CF30

<table>
<thead>
<tr>
<th>Segment</th>
<th>HHI (Based on CF30 Count)</th>
<th>Concentration</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall Market</td>
<td>3079</td>
<td>Highly Concentrated</td>
</tr>
<tr>
<td>Controlled advice</td>
<td>5524</td>
<td>Highly Concentrated</td>
</tr>
<tr>
<td>Corporate Adviser</td>
<td>278</td>
<td>Not concentrated</td>
</tr>
<tr>
<td>Employee Benefit Consultant</td>
<td>830</td>
<td>Not concentrated</td>
</tr>
<tr>
<td>Holistic</td>
<td>1678</td>
<td>Concentrated</td>
</tr>
<tr>
<td>Large FA</td>
<td>4465</td>
<td>Highly concentrated</td>
</tr>
<tr>
<td>Non advised</td>
<td>4340</td>
<td>Highly concentrated</td>
</tr>
<tr>
<td>Private Client</td>
<td>2890</td>
<td>Concentrated</td>
</tr>
<tr>
<td>Small IFA</td>
<td>24</td>
<td>Not concentrated</td>
</tr>
</tbody>
</table>
Results

This exercise yielded some interesting results which can be summarised as follows:

- Whilst the overall market HHI figure indicates a concentrated market in terms of physical CF30 advisers, the picture is more nuanced.
- The Controlled Advice & Non-advised segments are highly concentrated, reflecting the small number of vertically integrated and narrow panel firms active in this proposition.
- The non-advised segment actually retains a small number of CF30 individuals, reflecting a “Guided” Service offering from the banks.
- The Small F-A segment is incredibly fragmented, supporting the “cottage industry” anecdotal view from the project group.
- There is some support for a market structure view where large parts of the adviser supply is actually provided by a small number of firms which can be shown in Table 13.

Table 13 – Segment & Concentration

<table>
<thead>
<tr>
<th>Segment</th>
<th>Concentration by HHI</th>
<th>Overall CF30 Market</th>
</tr>
</thead>
<tbody>
<tr>
<td>Controlled advice</td>
<td>Highly Concentrated</td>
<td>18% of CF30s</td>
</tr>
<tr>
<td>Corporate Adviser</td>
<td>Not concentrated</td>
<td>2% of CF30s</td>
</tr>
<tr>
<td>Employee Benefit Consultant</td>
<td>Not concentrated</td>
<td>3% of CF30s</td>
</tr>
<tr>
<td>Holistic</td>
<td>Concentrated</td>
<td>6% of CF30s</td>
</tr>
<tr>
<td>Large FA</td>
<td>Highly concentrated</td>
<td>15% of CF30s</td>
</tr>
<tr>
<td>Non advised</td>
<td>Highly concentrated</td>
<td>2% of CF30s</td>
</tr>
<tr>
<td>Private Client</td>
<td>Concentrated</td>
<td>3% of CF30s</td>
</tr>
<tr>
<td>Small IFA</td>
<td>Not concentrated</td>
<td>50% of CF30s</td>
</tr>
</tbody>
</table>
Specific RDR Focus

The CF30 Segments were screened to provide a specific “practical” RDR advice market context. CF30 numbers were removed if they belonged to the following firms:

- Employee Benefit Consultant (EBC) – These firms in theory could provide advice to retail customers but are focussed on providing multi-platform solutions for large employers’ remuneration and employee benefits

- Corporate Advice – These firms also offer regulated investment advice but focus on corporate solutions from business owners and SMEs, such as Group Personal Pensions, Group PHI and so on.

- Risk Specialist – Although Professional Investment Firms under the FCA categorisation, these firms focus heavily (although not exclusively) on provision of products outside the RDR Retail Investment Product List (RIP).

- Non-advised – The overall focus of the RDR was on eradicating issues in the advice sector. The adviser charging, professionalism, and disclosure regime was not applicable to non-advised business. For the purposes of this exercise – identify the availability of advice – it is necessary to exclude.

The population that was left can be described as the “RDR advice market” whereby the firms involved all actually offers investment advice to individual retail customers as a central part of their activity. These firms were ranked on a pure market share percentage measure with the top 25 examined and a further C8 & C5 analysis conducted. Further, a CF30 HHI analysis was undertaken across the population to complement the C analysis.
Table 14 below indicates the results.

Table 14 - Top Eight firms Concentration of Retail Advice Market by CF30 count

<table>
<thead>
<tr>
<th>FRN</th>
<th>Name</th>
<th>CF30s</th>
</tr>
</thead>
<tbody>
<tr>
<td>195351</td>
<td>St. James’s Place Wealth Management Plc</td>
<td>3336</td>
</tr>
<tr>
<td>440703</td>
<td>Intrinsic Financial Planning Ltd</td>
<td>1099</td>
</tr>
<tr>
<td>408285</td>
<td>Openwork Limited</td>
<td>749</td>
</tr>
<tr>
<td>149826</td>
<td>TenetConnect Limited</td>
<td>498</td>
</tr>
<tr>
<td>184591</td>
<td>Positive Solutions (Financial Services) Limited</td>
<td>486</td>
</tr>
<tr>
<td>124444</td>
<td>Brewin Dolphin Limited</td>
<td>438</td>
</tr>
<tr>
<td>529810</td>
<td>True Potential Wealth Management LLP</td>
<td>402</td>
</tr>
<tr>
<td>195199</td>
<td>Lighthouse Advisory Services Limited</td>
<td>339</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>7347 CF30s</td>
</tr>
</tbody>
</table>

C5 Based on CF30 count 23%
C8 Based on CF30 count 28%
C25 Based on CF30 case count 39%
HHI 208

As can be seen, the top five firms make up 23% of available CF30 with only a small increase in concentration when expanded to C8.

- St James Place dominates with over 3,000 CF30s.
- The overall level of concentration seems low based on C and HHI measures.
• Whilst it is true that the overall HHI figure for the retail market was 3,079 and therefore marked as Highly Concentrated, this should be tempered by the fact that the largest amount of that “market power” is exercised by the Small IFA (comprising in excess of 13,000 CF30s) segment. This segment is in itself extremely fragmented with an HHI of 24 and thousands of firms. There is clearly a long tail.

However further analysis suggests a more restrictive picture. The 2007 Oxera study commissioned by the FCA to investigate possible impacts of the RDR referenced market concentration concluded that the market was relatively un-concentrated. It stated that “in terms of market share, the top five networks, by turnover, had an estimated combined market share of 15.2% and the largest 25 networks had a combined market share of just 21%”.

This analysis sets asides networks as a separate segment, due to the varying individual businesses operating under their umbrella. Our analysis confirms that some offered Restricted and other Independent models, with variations there-in. However, in broad terms, the networks represented the big non-bancassurer or direct sales force adviser firm. All were IFA in status in 2007 (Oxera, 2007).

From this analysis, it is clear that the market share of the analogous 2014 combined category - bigger adviser firms - has increased and concentration has increased. The results show market power structure when split by the types of advice and services offered by the largest (non-small IFA) entities. From the table above, it is possible to start to understand the types of firm, rather than number, has become a greater dynamic in the market. For example, the model shows that 5,552 CF30s come under a firm structure described as “Controlled”. This excludes any further small firms which
operate such a model, whereby the choice of products or providers in a “relevant market” (FCA, 2014) is Restricted. From the table above we can see that St James Place - which is a fully vertically integrated firm occupies a market share of around 12% of CF30s on its own.

Within our model, the Controlled Advice segment has an HHI of 5,524, the highest of all advice segments. Further to this, it is also noted that Intrinsic & Positive Solutions are both under common ownership, whilst all of the top eight firms - with the exception of Tenet & Lighthouse – offer in-house products or investment funds (Touchstone & Matrix data).

The conclusion to this CF30 analysis is that the post RDR advice landscape does not necessarily demonstrate a high degree of concentration when viewed from the perspective of the number of advisers still available to give advice to consumers across the UK. It has maintained a reasonably healthy population of smaller firms. However, such firms represent a long tail when compared to the larger firms. The top 25 firms by CF30 headcount account for almost 40% of all advisers. Whilst many of those firms are not fully “controlled” within the exact parameters of our model, it is clear that a number operate with a greater degree of potential advice conflicts than the pre RDR Networks.

Before RDR, such networks which were primarily organised to provide regulatory cover and commission sharing for individual firms and were all Independent, and by definition Whole of Market (Oxera, 2007). It seems that after RDR, access to the physical advice market is influenced to a greater extent by a smaller number of such “big firms” and crucially, these firms are increasingly restricting the choice of products and providers offered to customers.
This aspect of market shape and tentative conclusion will be reviewed through the Net Flow lens in the following section.

6.2.3 Market power by New Flow within each segment

This exercise builds on previous exercises but focusses on establishing the market power of each segment and then within each segment. In doing so, it serves to complement the CF30 analysis to build the picture of influence on the distribution landscape.

Table 15 and Figure 15 below provide an overview of the results of the exercise. The key findings from this initial analysis are set out in Table 15 and are:

- Actual flow from Small F-A is less on a pro-rated basis than CF30s would indicate the Controlled Advice segment distributes more New Flow per head of CF30 than Small F-A.
- Non-advised New Flow is significant, representing slightly more than 1/3rd of the entire asset flow.
### Table 15 – Market share by New Flow

<table>
<thead>
<tr>
<th>Segment</th>
<th>New Flow (£Bn)</th>
<th>Market Share (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non advised</td>
<td>34</td>
<td>23.45</td>
</tr>
<tr>
<td>T-A (Controlled Advice)</td>
<td>32</td>
<td>22.07</td>
</tr>
<tr>
<td>Small FA</td>
<td>33</td>
<td>22.76</td>
</tr>
<tr>
<td>Large FA</td>
<td>9</td>
<td>6.21</td>
</tr>
<tr>
<td>Risk Specialist</td>
<td>1</td>
<td>0.69</td>
</tr>
<tr>
<td>Holistic FA</td>
<td>6</td>
<td>4.14</td>
</tr>
<tr>
<td>Private Client</td>
<td>18</td>
<td>12.41</td>
</tr>
<tr>
<td>Corporate FA</td>
<td>7</td>
<td>4.83</td>
</tr>
<tr>
<td>Employee Benefit Consultant</td>
<td>4</td>
<td>3.45</td>
</tr>
<tr>
<td>Institutional AM</td>
<td>1</td>
<td>0.69</td>
</tr>
</tbody>
</table>

**Figure 15 - HHI analysis within segment**

![Model Segments by New Flow (%)](image-url)
The results from the exercise are captured in Table 16 below and discussed in the following sections:

Table 16 – Concentration by segment

<table>
<thead>
<tr>
<th>Segment</th>
<th>HHI within segment</th>
<th>Concentration level within segment- OFT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall Market as per segmentation model</td>
<td>1,801</td>
<td>Concentrated</td>
</tr>
<tr>
<td>Controlled advice</td>
<td>1,643</td>
<td>Concentrated</td>
</tr>
<tr>
<td>Corporate Adviser</td>
<td>991</td>
<td>Not concentrated</td>
</tr>
<tr>
<td>Employee Benefit Consultant</td>
<td>1189</td>
<td>Concentrated</td>
</tr>
<tr>
<td>Holistic</td>
<td>151</td>
<td>Not Concentrated</td>
</tr>
<tr>
<td>Large FA</td>
<td>200</td>
<td>Not concentrated</td>
</tr>
<tr>
<td>Non advised</td>
<td>4059</td>
<td>Concentrated</td>
</tr>
<tr>
<td>Private Client</td>
<td>1427</td>
<td>Concentrated</td>
</tr>
<tr>
<td>Small IFA</td>
<td>5</td>
<td>Not concentrated</td>
</tr>
</tbody>
</table>

The results reinforce the CF30 analysis of Small F-As which are again, extremely fragmented in terms of their market power. Both the private Client segments and Controlled F-As meet the definition. Although these segments can be categorised as Concentrated based on the OFT HHI threshold, the clear outlier is the Non-Advised segment, with an HHI of 4,059.
In terms of actual Flow, this is evident from a top five ranked list of the New Flow in that segment. Hargreaves Lansdowne Charles Stanley dominates the sector as can be seen in Table 17 and Figure 16.

Table 17 - Non-advised segments by New Flow

<table>
<thead>
<tr>
<th>Firm</th>
<th>New Flow</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hargreaves Lansdown Asset Management Limited</td>
<td>2,640,037,684</td>
</tr>
<tr>
<td>Charles Stanley &amp; Co Ltd</td>
<td>1,007,732,507</td>
</tr>
<tr>
<td>TD Direct Investing (Europe) Limited</td>
<td>171,974,260</td>
</tr>
<tr>
<td>My Pension Expert Limited</td>
<td>140,399,228</td>
</tr>
<tr>
<td>Bestinvest (Brokers) Limited</td>
<td>95,958,833</td>
</tr>
</tbody>
</table>

Figure 16 - The Non-Advised Market as a percentage of New Flow

Similar to the CF30 analysis, further work was undertaken to filter out segments which in practical terms, have little to do with RDR. Based on a simple market share metric, we see again in Table 18 and Figure 17 that Controlled Advice and Small F-As share almost 2/3rd of the asset flows.
Table 18 - Market share by RDR focused segment

<table>
<thead>
<tr>
<th>Advised RDR retail investment market</th>
<th>New Flow (£Bn)</th>
<th>Market Share (as a percentage of £98b)</th>
</tr>
</thead>
<tbody>
<tr>
<td>T-A (Controlled Advice)</td>
<td>32</td>
<td>33</td>
</tr>
<tr>
<td>Small FA</td>
<td>33</td>
<td>34</td>
</tr>
<tr>
<td>Large FA</td>
<td>9</td>
<td>9</td>
</tr>
<tr>
<td>Holistic FA</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>Private Client</td>
<td>18</td>
<td>18</td>
</tr>
</tbody>
</table>

Figure 17 – RDR Concentration

Conclusion of market power analysis

These series of exercises focussed on describing the structure of the retail investment and ancillary product landscape, in terms of an accepted measure of competition, the HHI index. The results of the exercises, taken in aggregate, provide a number of
findings which can be taken forward to help ascertain how the RDR has shaped the market it sought to improve.

Before these are set out though, it is important to acknowledge that the HHI is an indicator, and its use comes with criticisms and caveats in the literature and market practice. These are set out as follows:

- As markets become more narrowly defined, limiting the maximum potential number of suppliers, there is a constraint on how small the HHI can be, and a tendency for it to be higher as a consequence of the more limited opportunities for suppliers in the constrained buyer population definition. This is essentially what we saw in the sectors pointing towards corporate and larger employer business.

- As PWC explained in its 2012 rebuttal to the CC, this both provides a floor on what the level of the HHI can realistically be (particularly in narrow industry sub-markets) and provides countervailing buyer power to offset any possible seller power indicated by a high HHI. A second factor cited by PWC concerns the questionable relevance of the HHI in a market like large firm audits where market competitive pressures are exerted through the threat of, and actual, competitive tenders. Again, this is pertinent to corporate focussed businesses which win tenders rather than simply benefitting from referrals. This picture resonated with the project group’s representatives from the asset management and group pensions divisions.

- It may be just as pertinent to look to the potential for a shift in market power rather than just the absolute HHI or market share figure. According to the OFT, “In a concentrated market, a horizontal merger generating a delta (meaning ex-
post difference) of less than 250 is not likely to give cause for concern”. For the purposes of the market power exercise, it may be that we should be more concerned if non-advised firms such as Hargreaves Lansdowne and Charles Stanley propose to merge, than worrying about their respective market share. Likewise, should St James Place propose to purchase Old Mutual Wealth, which owns the Intrinsic Controlled F-A firm, as well as (the Independent Large F-A) Positive Solutions advisory firm.

With the above in mind, we can turn to the findings to be drawn from the market power study.

• The first point which resonates clearly from the modelling is that if the small F-A firms were a homogenous population, they would – as a segment – be a dominant competitive force. It provides almost half of the CF30 population and almost a 1/3rd of the New Flow. It is clear from the concentration analysis within that group of firms that this is not the case and so it is difficult to point to an overly concentrated retail market on that basis.

• Compared to recent indicators such as the CC investigation into the Audit and Power markets, it is difficult to see how the Competition & Markets Authority would view the “Retail Investment market” as causing concern due to monopoly concerns.

• Notwithstanding that a small number of segments were defined by the volume of particular product flows and focus on specific areas of commercial activity (Corporate, EBC) there does seem to be sufficient differentiation in product and proposition focus to support the overarching principle that the distribution landscape can be mapped.
• These segments, it can be seen, have different concentration profiles. For example, the Small F-A segment is extremely fragmented in both CF30 and individual firm market share, and contributes, in aggregate less flow per CF30 than some other segments.

• This provides a tentative basis for viewing the distribution landscape as comprised several sub-markets rather than one single “Retail Investment Market”. Our model incorporated non RDR products such as defined benefit pensions and protection because the assets under management and New Flow methodology identified these as material to the professional “Investment Firms” caught by the RDR changes.

• The analysis of these sub-markets supports a view that advice which is actually influenced, or has the potential to be influenced, by provider firms or a narrow set of products or provider, has an increased amount of market power. This stands in contrast to Small F-A sector which still drives the majority of personal pension and income drawdown asset flows and which the model assumes to be retaining an Independent focus.

• Viewed from an RDR perspective, it is clear that market power has shifted significantly. The top eight advisory firms now hold a greater market share than the top 25 firms cited in the study by Oxera in 2007. These top 25 firms by CF30 headcount account for almost 40% of all advisers which our model identifies as relevant to the study. It is noted however, that market share analysis in 2007 excluded Bancassurance, citing a paucity of data and that the CF30 calculation itself is fraught with uncertainty.
• Furthermore, the presence of large and concentrated non-advised sector is an obvious difference to the pre RDR environment. According to this study, it has a small CF30 footprint, yet is dominated by a small number of monolith firms.

6.3 Conflicts of interest & poor conduct

6.3.1 Introduction

This phase of the study builds on the competition analysis to progress an understanding of agency issues in the post RDR environment. This work again seeks to utilise the segmentation model to bring this to life and seeks to offer a view on how such a model can assist regulators.

In the case of retail financial services, there is a persistent perception that both product and provider bias has existed in the past, although actual evidence to support this perception has often been hard to identify. In a 2002 study for the FSA by Charles River Associates, evidence was found which indicated some provider bias (such as favouring Standard Life over Aegon for example), but only for single premium products (such as Investment Bonds). The study did not identify issues with regular premium products such as personal pensions. With regard to product bias, the study found evidence of this in certain products, such as ISAs and investment bonds, but it was not widespread and this conclusion was endorsed by parallel research by the ABI (Europe Economics 2014). The perception, coupled with poor contemporaneous persistency statistics for life and pensions business, led to the conclusion by the FSA that there were conflicts of interest at play within the retail distribution landscape. At the heart of such conflicts was the remuneration model, whereby providers paid
commission to intermediaries on the sale of the product. This was referenced in Callum Mccarthy’s Gleneagles speech “…incentives matter…” and was a recurring theme throughout the RDR formulation. The FCA as part of its articulation of success factors for RDR, stated “a market where firms compete on the quality of products rather than influencing distribution”.

The Europe Economics post-implementation research indicated cautiously that product bias was reducing following RDR (FCA, 2014). The basis for this conclusion was on the reduction in sales volumes of Investment Bonds at around the time RDR came into being. As stated earlier, the CRA and ABI research into bias indicated the presence of some bias in single premium business, such as Investment Bonds. Indeed, the Oxera report from 2012 referenced the commission levels of Bonds specifically, in contrast to that of Investment Trusts (which have never attracted commission for being sold by advisers due to their stock market and direct distribution model). This was seen as anomalous as Retail Investment Advisers always had permissions to recommend such “package products to retail customers (FCA PERG, 2014).

With this in mind, an exercise was undertaken to extract successive FCA Product Sales Data reports for a comparative analysis. The primary objective was to determine to the pattern of product sales prior to the RDR market failure assessment in 2006, and carrying on through the RDR formulation period and into the post RDR timeframe.

Consistent with a study concerned with agency issues and resultant bias, a particular focus was maintained on the products caught within scope of RDR (the Retail Investment Product list) and which can be framed as “commission sensitive”. 

Results

The chart below shows the product sales volumes for the full range of products reported by firms through the RMAR reports submitted annually.

Figure 18 – Product sales by new products from RMAR

The graph highlights the complexity of the product landscape through the period. The key points to be made are as follows:

- Prior to RDR “market failure” assessment, ISA and PP sales were ascendant.
- Group personal pension sales are a clear recent outlier, primarily due to the introduction of Auto Enrolment.
- SIPP sales have also increased markedly since the period immediately prior to RDR introduction.

Further to this exercise, a further filter was applied to the data to focus on those products commonly cited as markers of bias, or lack of it (both in the Oxera report and
To this end, the following product sales reports were reviewed:

- Bonds – With profit; Unit Linked; Other (such as Guaranteed; Distribution etc…). Included as by definition Single Premium Non-Qualifying Whole of Life policies, cited by Oxera as paying up to 7.5% initial commission.
- Unit Trust / OEIC - Open ended collective investment, typically paying 3% initial commission.
- ISA – Non-cash ISA (as per PSD notes) also typically paying 3% commission pre RDR.
- Investment Trust – Packaged RIP product typically not paying commission to IFAs.

Figure 19 - Bonds vs Collectives

Note: Data aggregated from FCA Product Sales Data (FCA, 2015)
The results from this exercise are highlighted in Figure 19. From these, a few findings can be garnered:

- The overall trend is for much less sales generally. This reflects the withdrawal from the market of the provider owned Direct Sales Forces and Bancassurance sales forces during the period concerned.
- The long term trend for Investment Bond sales from well before RDR introduction, was downward. Indeed the rate of decline for Unit Linked Bonds of 95,066 in 2006 to 22,463 in 2010 illustrates the extent to which market behaviour was already changing.
- Unit Trust & ISA sales far exceed those of Bonds, consistently through the period although ISA sales decreased markedly after the global financial crisis of 2009. Unit Trusts actually experienced an upturn following the introduction of RDR.
- Investment Trust sales within the overall context of the period, were, and remain negligible in terms of percentage of the sold product volumes. The PSD figures actually indicate a 2/3rd drop between the figures at the time of the Callum McCarthy speech and Q4 2014.

6.3.2 Advised vs Non-advised

As an adjunct to the product based sales volume analysis, the opportunity was taken to compare the volumes of advised sales to that of direct to consumer distribution over the period. The results are set out in Figure 20:
The results of the aggregate data reflect the anecdotal insight provided by the earlier project group sessions and also those suggested by the New Flow modelling work. It is clear that non-advised sales of products caught by the RDR scope have clearly grown rapidly since 2012 although interestingly, the advised sales figures have rebounded somewhat since the introduction of RDR. The previous downward trend from 2010 may reflect advisers leaving the industry and/or suffering reduced productivity due to studying for exams. This is conjecture but partially reinforced by the 2011 FCA study into professionalism progress (FCA, 2011).

6.3.3 Limitations of exercise

Whilst this exercise provided insight and challenge to the conclusions drawn by the FCA within its own post-imp review, there are a number of factors which serve to put
into context both the impact of this study. More generally, they also illustrate the potential weakness in any post implementation study into RDR.

1. It is difficult to establish causality between some of the trends and the RDR reforms. The growth in technological capability, changes in taxation or other government fiscal and monetary policy, as well other factors, could all have played a part in changing market dynamics. Individual, case specific studies would be required to conclusively demonstrate

2. It should be acknowledged that the FCA’s PSD only captures new sales. Transfers, top-ups, alterations, increments and renewals are generally not included. As a result, there is no clear picture of the net flow of assets in the retail sector.

3. It also does not include data on transactions made through nominee accounts such as those used in platforms and some investment management firms. There is no “platform” category even though it has a regulatory definition which arose from the RDR “an investment service where the products of more than three providers are offered (FCA Handbook, 2013). Whilst this has the benefit of reducing the potential for double counting with asset management returns, it leaves a regulatory blind spot in an important and growing (see Lang Cat; Platform, Fundscape, FCA, 2014) distribution channel.

4. A firm may conduct a high proportion of other types of business that are not reflected in the aggregate reporting of “selling firm type”. This is a function of the FCA firm categorisation process whereby a firm’s primary activity – such as that of a personal pension operator – is allocated by its individual supervisor and all sales thereafter of all types allocated to the relevant hierarchal “selling
firm type” encompassing personal pension operators. In this case, Investment Management. A life insurer which also operates personal pensions may have sales of similar products categorized under “Insurer” selling type. This obscures the granular picture of sales origination.

5. Fourth, due to the reporting period and submission process, double-counting or under-counting may be prevalent with other transactions that occur at the same time or are being processed. This is a function of the inefficiencies of certain product switch processes – such as pension switches that can take several weeks (Origo, 2015) or in-specie transfers for SIPPs which can take a similar length of time (TISA, 2015).

6. Fifth, due to re-categorizations of firms and product taxonomies, as well as adjustments, resubmissions and erratum, the FCA states that previous consolidated versions of the PSD are not directly comparable with the latest version, which provides the aggregated trend data going back to 2005. This enables the production of useful trend data but does mean contemporaneous analysis is subject to error or revision.

6.3.4 Post RDR remuneration as a driver of conflicts

The rationale for removing commission - as stated above - was to reduce the potential for a competing interest to dominate between the adviser and the end client. Prosaically, banning commission based advised sales was designed to ensure adviser recommendations were based on sound professional advice rather than the amount of payment offered for certain products and/or by certain providers. This adjustment was
accompanied by introduction of new disclosure requirements covering communication of adviser charging (AC) from the outset of the client adviser relationship. Research by Europe Economics published as part of the FCA’s post-RDR thematic review built on previous cycles of FCA disclosure thematic work and found that 90% of advisers have a charging structure based on a percentage of funds invested. This is commonly referred to as an “ad valorem” basis. Following the publication, the FCA dismissed the prospect of an outright ban on percentage charging, the then CEO Martin Wheatley has been warning on this contingent charging as creating a “dealing bias” since the first round of disclosure reviews (FCA, 2013) and reiterated those concerns in a 2014 interview with Money Marketing: “Contingent charging is something we have raised questions about, and we have some questions about whether that is delivering what we think the answer is, that is, separating out the advisory part from the acquisition and purchase of the product.”

The EE research found that, 86% - 91% firms typically operate a charging structure based on a percentage of assets invested. It also showed between 27% and 55% cent of firms typically offer an hourly charging structure, and between 39% and 67% typically offer a fixed fee model. The overlap reflected the fact many firms offer customers a choice of payment.

The next stage of the conflicts of interest analysis honed in on the potential for remuneration types that could contrast with the RDR objectives, to persist into 2014. Prior to the analysis of the market based on the segmentation model, a brief review of the FCA thematic work was undertaken, as well as a review of trade press. This provided context for the dive into the firms within the model. The review found that
concerns were still prevalent in the market over the structure of some types of remuneration model.
Table 19 below combines the results of this review and the review of the segment model:

**Table 19 - Remuneration & other drivers of conflict**

<table>
<thead>
<tr>
<th>Remuneration</th>
<th>Rationale / Impact</th>
<th>Segment commentary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Self Employed model</td>
<td>Volume based generator of reward. No link to quality of advice.</td>
<td>Project group agreed common across Large &amp; Network financial adviser landscape (Tenet, SJP). Principle firm can have different objectives to the AR. Prevalent in C-A / Large F-A/ but also Small F-A firms which do not have segregated management structure.</td>
</tr>
<tr>
<td>Cited in FCA thematic review of firm remuneration in 2013.</td>
<td>Leads to higher risk of Inappropriate Behaviours / poor sales according to FCA.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Can lead to sales force operating with differing motives from principal firms.</td>
<td></td>
</tr>
<tr>
<td>Contingent charging</td>
<td>Revenue received only if product sale is agreed.</td>
<td>Project group agreed common across financial adviser landscape but usually as part of client choice. Some concern that increasingly common in Vertical firms. Less prevalent in C-A / EBC / Holistic / Private Client.</td>
</tr>
<tr>
<td>Cited in national press “Telegraph” &amp; Trade Press “MM”.</td>
<td>Creates a bias towards product sale rather than holistic financial planning such as placing products in trust or gifting assets for IHT. Greater risk when combined with vertical firm which has ostensibly low advice costs and expensive product charges.</td>
<td></td>
</tr>
<tr>
<td>Charging Method</td>
<td>Description</td>
<td>Popularity</td>
</tr>
<tr>
<td>--------------------------------------------------------------------------------</td>
<td>-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
<td>----------------------------------------------------------------------------</td>
</tr>
<tr>
<td><strong>Ad Valorem charging</strong></td>
<td>Charges customers more for managing or advising on larger assets although costs based largely fixed. Creates an incentive to greater short term risk taking (by chasing market returns). Opaque and runs counter to behavioural insights and low financial capability.</td>
<td>Common across financial adviser landscape and particularly in platform or wealth management sales. Less prevalent in C-A / EBC / Holistic / Private Client. Also cited by project group as increasingly common amongst vertical firms.</td>
</tr>
<tr>
<td><strong>Hourly Fee</strong></td>
<td>Transparent method consistent with other professions. Rewards inefficient working and could be exploitative in strong market power / information asymmetry circumstance.</td>
<td>More prevalent in Holistic / Private Client although offered as part of menu for most FAs.</td>
</tr>
<tr>
<td><strong>Fixed Fee</strong></td>
<td>Good for customers as known entity for clear piece of work. Adviser less likely to undertaken ongoing reviews.</td>
<td>Less prevalent across model but gaining popularity for Private Client work.</td>
</tr>
<tr>
<td><strong>Commission offset</strong></td>
<td>Creates further complexity in client agreements and introduces potential conflict around commission based sale (protection or mortgage).</td>
<td>Project group advised is relatively common in generalist adviser segments such as Small F-A and Large F-A.</td>
</tr>
<tr>
<td>100% Commission based Allowed under RDR for non-advised sales. 2014 review of Annuity brokers indicated potential issues with customer journeys.</td>
<td>Introduces conflicts around placement of products and customer journeys, particularly in Most prevalent in non-advised annuity sales but less so in platform based Non-Advised due to ban on cash rebates.</td>
<td>Most prevalent in non-advised annuity sales but less so in platform based Non-Advised due to ban on cash rebates.</td>
</tr>
<tr>
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</tr>
<tr>
<td>Restricted choice of products FCA requires clear disclosure and underlying Suitability requirements.</td>
<td>Increased risk of poor suitability by missing out on products more suited to circumstances.</td>
<td>Most prevalent in TA (Controlled Advice) / N-A</td>
</tr>
<tr>
<td>Restricted choice of providers FCA requires clear disclosure and underlying Suitability requirements.</td>
<td>Increased risk of poor suitability or missing out on cheaper similar products</td>
<td>Most prevalent in TA (Controlled Advice) / N-A</td>
</tr>
</tbody>
</table>
Segment. Caught under T-A (Controlled Advice).

CF30. Individual advisers are referred to as Partners and fully self-employed.

Tiered “payaway” rates to SJP for authorisation and business support.

Choice of providers. Vertically integrated for investment & pensions solutions.

Utilises SJP funds comprising bespoke and mirror funds. Narrow panel for protection products.

Remuneration. Contingent charging which relies on a product sale. For example, using the Key Investor Information for its North American Unit Trust the maximum initial charge is five percent, which depends on the nature of the service provided by the adviser ‘partner’ to the client. The ongoing charge of 1.55 percent includes the cost of the ongoing advice (0.5 percent), the external investment manager fee (0.24 percent).

6.4 Information asymmetry analysis

As has been established from the literature (from Akerlof’s Lemons and similar) information asymmetry lies at the heart of agency issues and when competing interests (such as remuneration) are factored in, Principal – Agency problem can arise. As demonstrated by Lewellyn and others, financial services are different from physical goods in that customers cannot ascertain easily the quality of the product or service immediately and this lack of assurance is exacerbated by the well acknowledged average poor financial capability of UK customers (MAS, 2013). Whilst this in itself
actually creates a market for intermediated sales of financial products, as discussed above, organisational and remuneration structures within firms can create agency relationships which increase the risk of detriment arising from this information asymmetry.

In order to explore the extent to which RDR changes had reduced the gross level of asymmetry or rendered it less relevant overall, a summary review of the regulatory literature was conducted prior to further analysis of the products and services offered across the distribution landscape. In this regard, two broad concepts were reviewed:

1. Financial capability / literacy literature review.

2. Product & market asymmetry – the extent to which the post RDR product and distribution landscape is less complex

Financial capability / literacy – history of regulatory work

Financial capability is a relatively new concept, lacking a strong, established consensus in how it is defined are measured and marked by a number of components (McQuaid, Edgell, 2010). Around the time of the market failure analysis, the FCA and HM treasury both defined it as “people’s knowledge and skills to understand their own financial circumstances, along with the motivation to take action. Financially capable consumers plan ahead, find and use information, know when to seek advice and can understand and act on this advice, leading to greater participation in the financial services market.” (FCA, 2006) HMT, 2007. Prior to this the Better Informed Consumers evaluation, conducted by the FSA shortly after it came into being (FSA, 2000) and consistent with the timing of the original Economic rationale for Regulation
paper by Lewellyn, studied consumers who were purchasing financial services products.

As McQuad & Edgell argue in their 2010 paper for the Scottish devolved government, there has been difficulty in developing a measure of financial capability that is objective and which provides the detail uncovered by qualitative studies. They cite this in contrast to the quantitative ability of credit scoring system to rate people’s circumstances (McQuaid, Edgell, 2010).

With a view to meeting its objective to promote public understanding of the financial system, and following its 2005 publication “Building Financial Capability in the UK”, the FSA commissioned the Personal Finance Research Centre to undertake an exploratory, methodological study to design a baseline questionnaire that could be used to measure levels of financial capability in the UK in 2006. Following this pilot, it conducted a much cited study: the Financial Capability: Baseline Survey in 2006. A quantitative questionnaire was conducted with 5,328 individuals aged 18 years and identified groups with similar financial capability scores to identify the effects of low financial capability. In order to establish a baseline of financial capability from which to undertake further progress, development work progressed through literature reviews, focus groups and interviews. Within the specific context of financial literacy, questions about applied to knowledge and understanding of financial products were also addressed in a ‘Money Quiz’ which tested mathematical abilities and knowledge of financial products (FSA, 2006; Atkinson et al., 2006; Atkinson et al., 2007).

The 2006 study highlighted the importance of skills and knowledge as influencers of financial behaviour. It is clear that poor financial skills are still prevalent, with, for example, 16% of people unable to identify the available balance on a bank statement.
Following this work, the National Audit Office highlighted the complexity within this subject by suggesting that “The FSA may be able to build on its successful record of consumer research by using sophisticated methodologies to demonstrate a clearer link between improved outcomes and its own work”. (National Audit Office Review, 2007). The FSA took this lead and commissioned a further two studies:

1. Adele Atkinson’s Evidence of Impact paper which confirmed that, not only has there been relatively little work in the past on financial capability in the UK or other countries, but also that rigorous, credible policy evaluation showing the incremental impact of financial capability work is difficult to find (Atkinson, 2007).

2. A separate paper by de Meza et al looking at behavioural aspects of financial capability.

Drawing the literature on consumer behaviour, De Meza’s report argues that psychological factors are more important than information asymmetries and in fact explain much of the variation in financial capability reported in the FSA’s 2006 survey. The authors conclude that financial capability initiatives which are designed to inform and educate should be expected to have a positive but ultimately modest impact.

This conclusion perhaps explains the fact that no further iterations of the baseline survey were undertaken by the FSA, or indeed the FCA. The Financial Services Act 2010 introduced a number of amendments regarding the provision of financial education which in effect reduced the regulator’s direct responsibility for addressing information asymmetry attributable to poor financial capability. The Act removed the FSA’s regulatory objective of promoting public understanding of the financial system.
and required the FSA to establish a new consumer financial education body (now named the Money Advice Service). The Money Advice Service was launched in 2011 and after some intense criticism (TSC, 2014, Farnish, 2014) has asserted its position as an enabler of financial capability work in the UK.

The MAS started this strategic focus with a new, large scale quantitative survey that provides a benchmark for financial capability in the UK in 2013. For this financial capability tracking survey over 5,000 adults were asked “about their money, how they feel about it and what they do with it” (MAS, 2013). Part of the survey was intended compares progress with the 2006 baseline of financial capability report published by the FSA however, on closer comparison, only 11 questions were initially taken forward, which were even then subject to extensive modification due to shifting requirements (MAS, 2013).

The 2013 MAS study indicated that people were in fact struggling with their finances more than they were in 2006. It stated that a third of people said they were struggling in 2006, but this figure has risen to over half only six years later. Furthermore, 16% of people unable to identify the available balance on a bank statement and the overall ability understand the impact on inflation had reduced marginally since 2006 (MAS, 2013).

Conclusion
The overriding conclusion gained from the summary review of regulatory efforts on low financial capability is that not much progress has been made since the FSA first engaged with pursuing its mandatory objective at the turn of the century. Efforts to improve customer ability to understand the financial system through improved
financial literacy never really progressed beyond the establishment of a baseline survey. Although much cited for its efforts in progressing an understanding of the “domains” of financial capability, the baseline has offered only a handful of questions which have been taken forward, on a single occasion in 2013. In terms of regulatory obligations, it is clear that the amendment to the FSMA - which created the MAS - served to reduce the FSA & FCA’s direct interest in improving the “buy-side” capability of consumers. However, there appears to be little clear results that indicate the FCA changed its approach to information asymmetry following the De Meza study concluded that informational aspects were not primary factors to be addressed. Finally, as can be seen from the three wave study from the Personal Finance Society, overall awareness of regulatory changes had actually declined slightly in 2014 (29%) from the previous year for both unadvised and advised respondents. This indicates that even baseline knowledge of the regulatory activity within the landscape has not yet improved.

6.4.1 Product & market complexity

The aim of this exercise was to establish to what extent the products available following the RDR are less complex and the extent to which the elements of the distribution landscape are simpler for consumers to navigate.

The method was to undertake a review of product taxonomies and utilising the segmentation model, draw out differences and consistencies.

The analysis sought to map the Retail Investment Product list, which was created as part of the RDR amendments to FSMA, against the volumes contained within
segmentation model. The results of this would be used to suggest whether the range and type of products offered within segments were reduced in number, thereby being simpler to understand by customers with limited understanding of products.

The first element of this was to produce taxonomy of products available from the data.

The data sets used to compare product categorisations were:

1. The Retail Investment Product List - produced by FCA
2. The FCA Product Sales Data – produced by FCA
3. The FCA Complaints Aggregate Data – produced by FCA
5. The segmentation model built as part of this study

Figure 22 – A Taxonomy of product reporting

<table>
<thead>
<tr>
<th>TAXONOMY OF PRODUCT REPORTING WITHIN SCOPE OF RDR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail Investment Product List</td>
</tr>
<tr>
<td>FCA Product Sales Data</td>
</tr>
<tr>
<td>Life policy</td>
</tr>
<tr>
<td>Unit Linked Bond</td>
</tr>
<tr>
<td>With-profit Bond</td>
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<tr>
<td>Other Bonds</td>
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<tr>
<td>Endowments</td>
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<tr>
<td>Onshore Bonds</td>
</tr>
<tr>
<td>FCA Product Sales Data</td>
</tr>
<tr>
<td>Unit Trust/OEIC</td>
</tr>
<tr>
<td>Unit trusts/OEIC</td>
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<tr>
<td>Offshore Bonds</td>
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<tr>
<td>FCA Complaints</td>
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<tr>
<td>Investment bonds</td>
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<tr>
<td>Endowments</td>
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<tr>
<td>- unit linked bonds</td>
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<tr>
<td>- &quot;with-profit&quot; bonds</td>
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<tr>
<td>- guaranteed-income bonds</td>
</tr>
<tr>
<td>Endowments</td>
</tr>
<tr>
<td>FOS Complaints Statistics</td>
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<tr>
<td>Investment linked annuities</td>
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<tr>
<td>Income drawdown products</td>
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<tr>
<td>- annuities</td>
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<tr>
<td>- income draw-down</td>
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<tr>
<td>Mutual Funds</td>
</tr>
<tr>
<td>Unitised Collective</td>
</tr>
<tr>
<td>Group Personal Pension</td>
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<tr>
<td>Other Personal Pensions</td>
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<tr>
<td>Personal Pension</td>
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<tr>
<td>SIPP</td>
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<tr>
<td>Stakeholder Pension</td>
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<tr>
<td>Annuities</td>
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<tr>
<td>Income Drawdown</td>
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<tr>
<td>GPP (RP)</td>
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<tr>
<td>GPP (SP)</td>
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<tr>
<td>SIPP (SSASs) and s (SIPPs)</td>
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<tr>
<td>Personal Pensions (RP)</td>
</tr>
<tr>
<td>Personal Pensions (SP)</td>
</tr>
<tr>
<td>Annuities</td>
</tr>
<tr>
<td>Income Drawdown</td>
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<tr>
<td>PEPs / ISAAs (exc Cash ISAAs)</td>
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<tr>
<td>Other decumulation, life and pensions</td>
</tr>
<tr>
<td>Investment management/service (inc. platforms)</td>
</tr>
<tr>
<td>Other investment products /funds</td>
</tr>
<tr>
<td>Group Stakeholder Pensions</td>
</tr>
<tr>
<td>Offshore Bonds</td>
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<tr>
<td>Pension Drawdown (Insured)</td>
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<tr>
<td>Pension Drawdown (Platform)</td>
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<tr>
<td>SIPP</td>
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<tr>
<td>Interest in Investment trust</td>
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<td>Security in an investment trust</td>
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<tr>
<td>Investment Trust</td>
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<tr>
<td>Investment trusts</td>
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<tr>
<td>ISA</td>
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<tr>
<td>PEPs / ISAAs (exc Cash ISAAs)</td>
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<tr>
<td>Other decumulation, life and pensions</td>
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<tr>
<td>Investment management/service (inc. platforms)</td>
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<td>Other investment products /funds</td>
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<td>SCARPs</td>
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<tr>
<td>Structured products</td>
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<tr>
<td>- &quot;structured&quot; products</td>
</tr>
<tr>
<td>SII/ISA</td>
</tr>
<tr>
<td>Any other designated packaged investment</td>
</tr>
</tbody>
</table>

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As can be seen from the schematic in Figure 22, the Retail product list maps unevenly across the data sets. Key points of note are:

- The FCA RIP list can be seen more as a descriptor of attributes rather than individual products.
- The RIP list does not contain ISA as a category yet this is a common product term used in industry, and indeed by its PSD, Complaints, FOS and segment model data.
- FOS data does not explicitly capture Investment Trusts but captures a range of ancillary products such as directly held shares and equities.
- There is no single industry taxonomy of products, partly because the FCA does not regulate all products.

Further to this, the individual categories of RIP were mapped to the firm segments in order to identify which segments offered a simpler range of products for consumers. Table 20 refers.

Table 20 - Retail Investment Product List & Model Segments

<table>
<thead>
<tr>
<th>Retail Investment Product List (RIP)</th>
<th>Consolidated RIP List</th>
<th>Non Advised</th>
<th>Controlled Advice</th>
<th>Small FA</th>
<th>Large FA</th>
<th>Risk Specialist</th>
<th>Holistic FA</th>
<th>Private Client</th>
<th>Corporate Adviser</th>
<th>EBC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Life policy</td>
<td>Life</td>
<td>0</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>N/A</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Unitised Collective</td>
<td>Mutual</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>N/A</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>SIP or Group SHP</td>
<td>PP</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>N/A</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Interest in investment trust</td>
<td>Investment Trust</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>N/A</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Security in an investment trust</td>
<td>N/A</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>N/A</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Any other designated packaged investment</td>
<td>Other packaged (inc ETFs)</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>N/A</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Structured capital-at-risk product</td>
<td>SCARP</td>
<td>0</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>N/A</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>TOTAL NUMBER OF RIP LIST IN SCOPE</td>
<td>4</td>
<td>6</td>
<td>6</td>
<td>6</td>
<td>6</td>
<td>6</td>
<td>6</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
</tbody>
</table>
As can be seen from this rudimentary exercise, the RIP is a fairly broad sweep of product attributes which can be consolidated into six basic categories of:

- Life related product such as an Investment Bond
- Mutual fund such as OEICS / Unit Trust or other ICVC
- Personal pension products
- Investment Trusts
- Other packaged collective investments such as ETPs
- Structured products which are not deposit based

The mapping exercise confirmed what was known anecdotally; that most segments were active to some extent across most categories. Also:

- Segments such as Employee Benefit Consultants and Corporate F-As in theory, offered the easiest menu of product choices, with a focus on employment and pensions.
- Most segments could offer any of the six consolidated RIP categories, although New Flow volumes confirms actual volumes low in some cases (such as investment trusts for Small, Controlled, Large F-As).
- Non-advised distributors such as Hargreaves Landsowne typically focussed on SIPP & Mutuals, thereby reducing the range of RIP products available to confuse the customer.
- This was complicated by the presence of direct equity stockbroking services, which are not caught by the RDR Adviser Charging or Independence requirements directly, although subject to professionalism standards when advice provided.
• There are no statistics available capturing the extent to which individual firms are Restricted, either in terms of their product focus or relevant market restrictions.

• There is no set criteria for establishing the relative complexity of individual products. The FCA has stated in past that SIPP and Structured Products sales should be made to appropriate customers but has stopped short of identifying to what extent Investment Bonds or Unit Trusts are simpler.

• Stakeholder Pensions do have the potential to be tracked but other CAT marked or Basic Advice products are not.

This brief study established to what extent information asymmetry has changed since RDR. From the extremely confined FCA efforts and the very limited work undertaken by the Money Advice Service, it can be stated with confidence that financial capability has not increased and there is some evidence that it has worsened.

This leaves the supply side. This analysis focussed on changes introduced to firm structure (Independent or Restricted); remuneration (through Adviser Charging), types of sale (advised vs non-advised) and the expanded range of product types in scope (as set out in the Retail Investment Product list).

Starting with the growth of non-advised sales, although this evident in both the FCA and segment model New Flow analysis, it cannot be conclusively shown to be solely due to RDR. It seems self-evident that the emergence of new technology and increasing societal use of the internet has played a factor. However in its review of the impact of RDR on consumer behaviours, NMG consulting identified that among non-advised respondents who bought an RDR investment product, 66% did not believe
they had paid a fee or commission (NMG, 2014). NMG goes on to state that while most were unlikely to have paid a direct fee, it is likely that a great many of these would have purchased products which contained an element of commission. This is reinforced by the pen portraits of non-advised business and annual reports of firms such as Hargreaves Lansdowne which generates fees from a range of provider sources. This lack of awareness in consumers of the costs associated with purchasing a product on a non-advised basis may lead consumers to believe that they are lower cost, which may not necessarily be the case.

Continuing with the NMG work, in the advised segment where an RDR investment product was purchased, 29% stated that the adviser received commission. This also demonstrates a high level of asymmetry and a shortfall in understanding in how advisers are remunerated post RDR, when provider firms were obligated to “validate and verify” adviser charges payments (FCA, 2014). This is concerning given the strict rules that are in force requiring advisers to explain their charges clearly when first meeting a potential client but perhaps this is a symptom of the continued presence of confusing charging models.

The segment and qualitative analysis highlighted the continued presence of contingent charging models. Coupled with ad valorem methods of quantifying payments and the ability for advisers to offset RDR related advice fees from commensurate life insurance product sales, it is perhaps unsurprising that customers have not yet fully grasped the details.

Finally, the segmentation model highlighted the range of distribution models which are influencing flows of a variety of products. Whilst the introduction of a standard RIP list, there remains no standardised product type conventions, even within the FCA
data sets. As the segmentation model further highlights, ancillary products such as insurance types and defined benefit pensions are part of the distribution landscape, yet not fully articulated within the RDR scope. This is acknowledged in the NMG research into customer behaviours which included “wider investment products” such as direct equity purchases, due to “reflecting the reality of customer purchasing behaviour”.

Furthermore, firm types vary whether reporting complaints, sales, FSCS levies. This is layered on top of a range of advice models which range from Independent, Restricted, Non-Advised, Simplified, Basic and Focussed (as set out in the FCA Perimeter of advice paper in 2014).

The original “market failure analysis” undertaken by Oxera in 2007 stated “consumers who are less well informed find it difficult to shop around for both products and advice. (Oxera, 2007). The concluding picture from this analysis is one of increased, rather than reducing complexity, against a backdrop of static or reducing financial capability. The RDR has, it could be argued, had an overall effect of increasing asymmetry, rather than reducing it. This is consistent with Ring’s view that “The agencement of RDR, in producing actions and outcomes that appear to undermine the RDR itself, exhibits counter performativity” (Ring, 2015).

6.5 Detriment Analysis

This strand of investigation was focussed on undertaking an analysis of “detriment” data which is relevant to the distribution landscape, since the RDR. The hypothesis was that by collating a straightforward register of “wrongdoing” in the period since
RDR was established and mapping this onto the segmentation model, it may be possible to establish to what extent certain segments were over-represented. This in turn would provide a basis for further insight as to the drivers of poor customer outcomes in the period since RDR was introduced, as well as providing a platform for a qualitative assessment of whether poor conduct had persisted following its introduction.

This exercise involved multiple strands of “detriment data”:

- FCA aggregated complaints from prior RDR to Q4 2014, supported by narrative from its notes
- FOS complaints data aggregated by firms, supported by narrative from its annual report
- FOS complaints data, aggregated by product, supported by similar narrative
- FCA Final Notices, censure and fines covering the period since January 2013
- FSCS firms in default and levy summaries for the period prior to RDR up to 2014

The results in below have been organised into a series of charts and tables, interspersed with comment with a discussion provided at the end. Figure 23 below indicates the high level direction of travel of complaint numbers, covering complaints received in respect of all financial services products, with the exception of Current Accounts & PPI which dwarf the overall trends.
Figure 23 - Aggregate Complaints FCA Data

Note: Data aggregated and synthesized from FCA Complaints Tables (FCA, 2015)
The following chart provides an RDR lens, covering products in scope of RDR before and after 2013.

Figure 24 – FCA Aggregate Complaints Data - RDR Products only pre RDR to 2014

![Chart showing RDR products complaints data pre and post RDR](image)

Note: Data aggregated and synthesized from FCA Complaints Tables (FCA, 2015)

The results at a high level indicate support for a slight downward trend across the majority of RDR products, from the period since RDR was introduced. The long term trend however, is for aggregate RDR related complaints to complaints to come down.

The next exercise extracted individual annual reports from FCA by cause of complaint to gain an understanding of the longer term trend. If we focus solely on what is at the heart of RDR distribution activity – the “advising and selling” FCA complaint cause category - the results are show in Table 21.
Table 21 – Advising & Arranging Complaints Trend

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>48,525</td>
<td>48,828</td>
<td>35,207</td>
<td>33,595</td>
<td>40,143</td>
<td>40,139</td>
<td>47,622</td>
<td>45,575</td>
<td>40,120</td>
<td>41,240</td>
<td>36,553</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investments / Decum, Life &amp; Pensions: As a % of Advising &amp; Arranging total</td>
<td>54.00%</td>
<td>65.00%</td>
<td>56.00%</td>
<td>55.00%</td>
<td>62.00%</td>
<td>66.00%</td>
<td>66.00%</td>
<td>77.00%</td>
<td>71.00%</td>
<td>68.00%</td>
<td>65.00%</td>
<td>67.00%</td>
<td></td>
</tr>
<tr>
<td>As a % of overall complaints across all categories</td>
<td>3.20%</td>
<td>1.80%</td>
<td>2.08%</td>
<td>1.80%</td>
<td>2.17%</td>
<td>1.79%</td>
<td>1.80%</td>
<td>1.40%</td>
<td>1.50%</td>
<td>1.60%</td>
<td>1.70%</td>
<td>1.60%</td>
<td></td>
</tr>
</tbody>
</table>

* Complaints prior to H2 2009 were recorded against “mis-selling” categories and product category was “Life & pensions”

Note: Data sourced from FCA complaints data tables (FCA, 2015)

From the table we can see the following points:

- The absolute level of complaints for RDR products arising from “advising & arranging” has fluctuated between 33,000 and 49,000 per half year from 2009 until the end of 2014.
- Complaints arising from RDR products within the advising & arranging conduct has fluctuated between 64% and 67% over the period.
- Results were relatively flat throughout 2013 and 2014.
- It is evident that RDR products constituted a high proportion of advising and arranging complaints from prior to RDR and that this has continued.

The graph in Figure 25 below provides some balance in that it draws out the size of the sub-set population concerned with “mis-selling” RDR equivalent products. From 2009, the proportion of all complaints derived from advising and arranging products in scope of RDR was consistently less than 2%.
Figure 25 – Complaints relating to advising & arranging RDR products as a percentage of all complaints

![Bar chart showing complaints relating to advising & arranging RDR products as a percentage of all complaints over time.](chart.png)

Note: Data in chart synthesized from FCA Complaints Returns Data (FCA, 2015)

Table 22 - FOS Complaints received by “type of complaint”

<table>
<thead>
<tr>
<th>type of complaint</th>
<th>2014</th>
<th>2013</th>
<th>2012</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>banking and credit</td>
<td>65,077</td>
<td>77,176</td>
<td>64,234</td>
<td>65,063</td>
</tr>
<tr>
<td>Invest &amp; pensions</td>
<td>15,938</td>
<td>19,834</td>
<td>14,862</td>
<td>15,483</td>
</tr>
<tr>
<td>insurance exc PPI</td>
<td>31,213</td>
<td>33,172</td>
<td>27,563</td>
<td>20,978</td>
</tr>
<tr>
<td>PPI</td>
<td>399,939</td>
<td>378,699</td>
<td>157,716</td>
<td>104,597</td>
</tr>
<tr>
<td>new cases in total</td>
<td>512,167</td>
<td>508,881</td>
<td>264,375</td>
<td>206,121</td>
</tr>
</tbody>
</table>

Table 22 - FOS Complaints received by “type of complaint”

Note: Data sourced from Financial Ombudsman Service, 2015
The review from the FCA complaints data & FOS data in Table 22 provided the following findings:

• The overarching volume of complaints arising from products in scope of RDR was relatively flat throughout the period before and after the introduction of RDR.

• The proportion of RDR product complaints as a percentage of the range of products complained about has been consistently lower than most other financial services products. Complaints in respect of banking products and credit exceed the aggregate of all RDR products by a factor of 10.

• This figure does not reflect the monetary value of complaints quantum, however.

• In respect of FOS statistics, the 2014 report indicates 63% of new complaints were about the sale of payment protection insurance (PPI), from 204,943 complaints overall.

• Six in ten of the total number of complaints FOS dealt with in 2014, involved four banking groups while 4,037 financial businesses accounted for just 3% of complaints.

On the basis of the complaints data, swamped by non RDR products, there is no evidence that RDR has reduced the risk of poor advice.

6.5.1 FCA Final Notice & Fines Analysis

The purpose of this exercise was to review the extent to which the distribution sector has become more resilient since RDR. As part of the market failure analysis, attention was paid to the large advisory firms such as Inter-Alliance, DBS and Berkely Berry Birch which had failed or been bought as distressed sales (FCA, 2007). The root cause
was cited as an unsustainable model whereby liabilities accrued due to misconduct arising from agency issues such as bias. The failure of firms was also referenced as part of the cause for the lack of trust in the sector, which in turn acted as unwanted externality on the market performance.

This initial exercise focussed on the size of the Financial Services Scheme levy which has been applied to the two categories analogous with the FCA “advising & arranging” activity, cited in its complaints data.

The rationale for reviewing the FSCS figures partly was based on the following factors:

1. The number of firms which fail ever year cannot be distinguished from orderly wind downs arising from retirement or commercially attractive business sales. These are not tracked by FSA or FCA which requires only that permissions are cancelled.

2. Levies are allocated based on anticipated liabilities within the originating business categories and then cascaded into adjacent categories.

3. Within advisory firms, the liabilities are typically advice complaints where recourse cannot be sought from the Financial Ombudsman Service.

4. The trend of the size of the levy is therefore correlated to the volume and scope of firms which fail.
The table & chart below indicate the trend since 2009 impacting the SD01 & SC02 levy categories.

**Table 23 - FSCS Levy trends**

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>SD02 - Investment Intermediaries</td>
<td>108</td>
<td>112</td>
<td>94</td>
<td>98.3</td>
<td>78</td>
<td>112</td>
</tr>
<tr>
<td>SC02 - Life &amp; Pensions Intermediation</td>
<td>17</td>
<td>9.6</td>
<td>21.5</td>
<td>46</td>
<td>13</td>
<td>53</td>
</tr>
<tr>
<td>Total Levy (£m)</td>
<td>642</td>
<td>847</td>
<td>615</td>
<td>694</td>
<td>1076</td>
<td>1141</td>
</tr>
</tbody>
</table>

*Note:* Data sourced from Financial Services Compensation Scheme

The table and chart confirm that:

- The overall levy (combining interim & final adjustments) across financial services reached its highest ever points in the range during 2013 and 2014, reflecting failures in investment sector relating to Key Data (an investment provider and distributor) as well as several stockbroker businesses holding client monies.
• The huge amount of payments made following the collapse of Icelandic banks (KSF, IceSave etc…) were resourced through a loan direct from UK government and not in these figures.

• The SD02 levy has consistently been much higher that the equivalent Life & pensions intermediation.

• The overall pattern of firm failure has been relatively minor in respect of pure advisory firms.

Based on the narratives from annual reports, the FSCS continued to see high volumes of SIPP-related claims, involving advice given by financial advisers to invest in SIPPs and to hold within these SIPPs, investments in high-risk, non-standard asset classes, which have often become illiquid. This trend began in late 2013 but continued into 2014 with claims against an increasing population of failed adviser firms.

In addition to dealing with continuing high volumes of investment claims in relation to advice to invest in non-standard asset classes, including unregulated collective investment schemes, FSCS began to see increasing numbers of claims concerning advice to participate in tax avoidance schemes linked to film partnerships or environmental plans. These however are modest with around 250 claims seen to date and there continues to be some uncertainty as to the jurisdiction of FSCS in respect of these non RDR asset types (FSCS, 2015).

Further to these points, it should be noted that the FSCS levy approach continues to attract criticism from advisers and is under review following the FAMR review (HMT, 2015). These criticisms are broader than the scope of this study but include reference to the fact that that the “SD02” category of “Investment Intermediary” includes both classic financial adviser firms (which typically do not hold client monies) and more
complex firms such as stockbrokers (such as Pritchard’s which did hold monies and failed), as well as hybrid entities such as Keydata & SLS which distributed its own packaged “product”. The liabilities of such firm’s failures exceed by the far the size of those relating to mis-selling complaints which typically involve some notional loss due to investment or other factors, rather than complete capital loss due to depository failure.

As per previous comments in respect of taxonomies and categorisations of products, the FSCS categories are not consistent with those of the FCA RMAR return. The basis for the levy arises from the initial classes which are separated into “buckets” which cut across the RDR product list. This makes it very difficult to conduct a root cause analysis exercise on a meaningful quantitative basis, as the firms which generate sales (as per the PSD) are not necessarily comparable to the FCA complaints data, and in turn cannot be measured on a pro-rated basis with FSCS levies.

In conclusion, the data does not point to RDR reducing the number of firms failing within the advisory sector, although the period leading to RDR introduction did receive some large claims, arising from investment intermediaries which held advising permissions.

6.5.2 Final Notices Analysis

This exercise involved a qualitative review of the Final Notices & Fines issued by the FCA in the 2014 calendar year. The rationale for conducting such an initial exploratory analysis was simply to gain a greater understanding of level and scope of FCA censure in the period. The results of this initial study were used to inform the
decision on whether to conduct a “deeper dive” chronological review of all Final Notices in the period prior to and following the RDR.

There were 39 Fines issued to firms during the 2014.

These were issued to a broad range of firms and individuals, ranging from global banks and asset managers such as deutsche & State Street, down to individual people (Hannam, Eler, for instance). These entities were mapped across to the segmentation model in order to identify which were in scope of RDR changes.

In addition to recording the entity and understanding the rationale for the Fine, consideration was given to the “Relevant Period” which in FCA terms, refers to the date in time when the regulatory breaches took place.

It was clear from this review of 43 firms that the majority pre-dated RDR, reflecting the FCA CEO’s comments (influenced by her previous role as Director of Enforcement) that enforcement is a “costly, in terms of resource and timescale, exercise which FCA does not enter into lightly” (FCA, 2015). Of the 43 final notices resulting in a fine, in only three did the misconduct occur in the years 2013 or 2014, following the introduction of RDR. This latency is repeated in the previous year.

Table 24 below confirms the results of the exercise:
### Table 24 – FCA Fines in 2014

<table>
<thead>
<tr>
<th>Firm</th>
<th>When</th>
<th>Segment</th>
<th>Date of wrongdoing</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Royal Bank of Scotland Plc, National Westminster Bank</td>
<td>20/11/2014</td>
<td>Other - Banking</td>
<td>2012</td>
<td>£42,000,000</td>
</tr>
<tr>
<td>Citibank N.A.</td>
<td>11/11/2014</td>
<td>Other - Capital Markets</td>
<td>2008</td>
<td>£225,575,000</td>
</tr>
<tr>
<td>JP Morgan Chase Bank</td>
<td>11/11/2014</td>
<td>Other - Capital Markets</td>
<td>2008</td>
<td>£222,166,000</td>
</tr>
<tr>
<td>The Royal Bank of Scotland Plc</td>
<td>11/11/2014</td>
<td>Other - Capital Markets</td>
<td>2008</td>
<td>£217,000,000</td>
</tr>
<tr>
<td>UBS AG</td>
<td>11/11/2014</td>
<td>Other - Capital Markets</td>
<td>2008</td>
<td>£233,814,000</td>
</tr>
<tr>
<td>Anthony Peter Clare</td>
<td>05/11/2014</td>
<td>General Insurance</td>
<td>2011</td>
<td>£208,600</td>
</tr>
<tr>
<td>Nicholas Bowyer</td>
<td>05/11/2014</td>
<td>General Insurance</td>
<td>2011</td>
<td>£306,700</td>
</tr>
<tr>
<td>Peter Joseph Halpin</td>
<td>05/11/2014</td>
<td>General Insurance</td>
<td>2011</td>
<td>£412,700</td>
</tr>
<tr>
<td>Sesame Limited</td>
<td>29/10/2014</td>
<td>Large FA</td>
<td>2014</td>
<td>£1,598,000</td>
</tr>
<tr>
<td>Yorkshire Building Society</td>
<td>28/10/2014</td>
<td>Mortgage</td>
<td>2012</td>
<td>£4,135,600</td>
</tr>
<tr>
<td>David Gillespie</td>
<td>09/10/2014</td>
<td>Private Client</td>
<td>2012</td>
<td>£30,647,400</td>
</tr>
<tr>
<td>David Welsby</td>
<td>09/10/2014</td>
<td>Private Client</td>
<td>2012</td>
<td>£30,647,400</td>
</tr>
<tr>
<td>Barclays Bank Plc</td>
<td>23/09/2014</td>
<td>Other - Corporate Banking</td>
<td>2007</td>
<td>£37,745,000</td>
</tr>
<tr>
<td>Peter Thomas Carron</td>
<td>16/09/2014</td>
<td>Small FA</td>
<td>2010</td>
<td>£300,000</td>
</tr>
<tr>
<td>Craig Stuart Cameron</td>
<td>29/08/2014</td>
<td>Small FA</td>
<td>2009</td>
<td>£350,000</td>
</tr>
<tr>
<td>The Royal Bank of Scotland Plc and National</td>
<td>27/08/2014</td>
<td>Mortgages</td>
<td>2012</td>
<td>£14,474,600</td>
</tr>
<tr>
<td>Deutsche Bank AG</td>
<td>21/08/2014</td>
<td>Other - Capital Markets</td>
<td>2010</td>
<td>£4,718,800</td>
</tr>
<tr>
<td>Stonebridge International Insurance Limited</td>
<td>07/08/2014</td>
<td>General Insurance</td>
<td>2011</td>
<td>£8,373,600</td>
</tr>
<tr>
<td>Lloyds Bank plc and Bank of Scotland plc</td>
<td>28/07/2014</td>
<td>Other - Capital Markets</td>
<td>2008</td>
<td>£105,000,000</td>
</tr>
<tr>
<td>Ian Charles Hannam</td>
<td>22/07/2014</td>
<td>Other - Capital Markets</td>
<td>2011</td>
<td>£450,000</td>
</tr>
<tr>
<td>Credit Suisse International</td>
<td>16/06/2014</td>
<td>Controlled Advice</td>
<td>2012</td>
<td>£2,398,100</td>
</tr>
<tr>
<td>Yorkshire Building Society</td>
<td>16/06/2014</td>
<td>Controlled Advice</td>
<td>2012</td>
<td>£1,429,000</td>
</tr>
<tr>
<td>Barclays Bank PLC</td>
<td>23/05/2014</td>
<td>Other - Capital Markets</td>
<td>2012</td>
<td>£26,033,500</td>
</tr>
<tr>
<td>Daniel James Plunkett</td>
<td>23/05/2014</td>
<td>Other - Capital Markets</td>
<td>2012</td>
<td>£95,600</td>
</tr>
<tr>
<td>Martin Brokers (UK) Ltd (Martins)</td>
<td>15/05/2014</td>
<td>Other - Capital Markets</td>
<td>2007</td>
<td>£630,000</td>
</tr>
<tr>
<td>Invesco Asset Management Limited Invesco Fund</td>
<td>28/04/2014</td>
<td>Asset Management</td>
<td>2012</td>
<td>£18,643,000</td>
</tr>
<tr>
<td>David Lloyd Wren</td>
<td>31/03/2014</td>
<td>Capital Markets</td>
<td>2005</td>
<td>£70,000</td>
</tr>
<tr>
<td>Philip Eley</td>
<td>27/03/2014</td>
<td>Small FA</td>
<td>2013</td>
<td>£7,200</td>
</tr>
<tr>
<td>Santander plc</td>
<td>26/03/2014</td>
<td>Controlled Advice</td>
<td>2012</td>
<td>£12,377,800</td>
</tr>
<tr>
<td>Mark Stevenson</td>
<td>20/03/2014</td>
<td>Capital Markets</td>
<td>2011</td>
<td>£662,700</td>
</tr>
<tr>
<td>Besso Limited</td>
<td>19/03/2014</td>
<td>Corporate Banking</td>
<td>2005</td>
<td>£315,000</td>
</tr>
<tr>
<td>City &amp; Provincial</td>
<td>13/03/2014</td>
<td>Mortgages</td>
<td>2011</td>
<td>£1,100</td>
</tr>
<tr>
<td>Forex Capital Markets Limited (&quot;FXCM Ltd&quot;) &amp; FXCM</td>
<td>26/02/2014</td>
<td>Capital Markets</td>
<td>2010</td>
<td>£4,000,000</td>
</tr>
<tr>
<td>HomeServe Membership Limited</td>
<td>12/02/2014</td>
<td>General Insurance</td>
<td>2005</td>
<td>£30,647,400</td>
</tr>
<tr>
<td>State Street Bank Europe Ltd; and State Street Global</td>
<td>30/01/2014</td>
<td>Capital Markets</td>
<td>2010</td>
<td>£22,885,000</td>
</tr>
<tr>
<td>Ewan King</td>
<td>30/01/2014</td>
<td>Small FA</td>
<td>2013</td>
<td>£19,900</td>
</tr>
<tr>
<td>7722656 Canada Inc formerly trading as Swift Trade Inc</td>
<td>24/01/2014</td>
<td>Capital Markets</td>
<td>2010</td>
<td>£8,000,000</td>
</tr>
<tr>
<td>Standard Bank PLC</td>
<td>23/01/2014</td>
<td>Corporate Banking</td>
<td>2010</td>
<td>£7,640,400</td>
</tr>
</tbody>
</table>

*Note:* Modified from FCA Final Notice Data, 2015
Discussion

This initial study confirms that for the most part, the period necessary for a regulator to investigate and conclude an enforcement process can be lengthy, thereby making ex-post analysis of changes in behaviour subject to delay.

The change in the FSMA which allows FCA to publish proposed enforcement proceedings (as used in recent notices considering Countrywide, Police Mutual and others) (FCA, 2014) should provide some proxy data which could be more contemporaneous.

Nevertheless, it was seen from the review of one calendar year that firms within the segment model were in the minority of the notices issued. This could reflect a less acute situation, whereby FCA considers changes in behaviour can be achieved through other regulatory tools such as issuing guidance, Private Warnings or s.166 reports. These do not generally see the light of day and are subject to confidential conditions (FCA SUP, 2014).

In this regard, the fines issued herein may reflect serious but singular instances of wrongdoing, which is perhaps reflected in the notices issued in respect of LIBOR / FX benchmark related fraudulent activity notices to Barclays, Deutsche and others.

That notwithstanding, there are mis-selling related fines within the sample. This misconduct is central and square to the concerns of RDR, although here in this simple relate to mortgages (RBS) and Homeserve (General Insurance). Another notable fine related to YBS & Credit Suisse which does fall under distribution activity and covered the marketing of a structured product as simpler than it really was. This compliance breach fell fall of financial promotion requirements - to communicate in a fair, clear
and not misleading manner” and so do play into the overall focus on reducing information asymmetry.

The most pertinent instance of RDR wrongdoing can be found in the fine issued to Sesame, which followed the publication of industry guidance in respect of conflicts of interest post RDR. In this case, Sesame engaged in a “pay to play” exercise whereby providers could only get their products on its restricted product panel if they supported this with sizeable non-Adviser Charge marketing payments. This censure is highly relevant to the purpose of this study in that it reinforces the potential for conflicts to arise in the Restricted model and the FCA continuing to take the view that conflicts in regard to disallowed inducements continue in the post RDR market, as evidenced in a recent speech by David Woolard of the FCA (FCA, 2015). Sesame was a major network and would have sat in the Controlled Advice segment if it had not given up its investment advising permissions in 2014. It also contributed to a significant volume of complaints, being the only advisory firm published in the FCA’s individual firms complaints data (where more than 500 complaints per annum are required before publication) but as it is owned by Aviva, its liabilities will not fall on the FSCS. It has re-positioned itself as a mortgage adviser network, focussing on mortgage, general insurance and pure protection. These products which attract commission sit outside the scope of RDR.

In conclusion, the data reviewed provides limited support for Ashton’s view that mis-selling is a complex phenomenon with multiple causes (Ashton). Second, the latency of investigations limits the potential usefulness of such data, particularly when subject to what Ashton references as the “politics, influence and bureaucracy of the FSA” (Ashton).
In pure terms of fines attributable to misconduct, there is no evidence that conduct arising from issues the RDR intended to resolve (agency, bias, professionalism) has improved, based on the issuance of fines by the regulator.

It is clear however, that on the limited sample presented, the scale and focus of the FCA censure activity has overwhelmingly been on sectors outside the scope of retail investment advice and retail investment product list.

### 6.6 Discussion & analysis of model

An early objective of this study was to construct a segmentation model of the distribution landscape which, it was hypothesised, would help drive a greater and more granular understanding of the conduct profile of the firms in its scope. With this in mind, an exercise was undertaken to map several aspects of the data and results of analysis conducted in this study, against the segmentation model. A focus was maintained on “detriment” data in order to prove the concept.

**Results**

- The result of the mapping exercise is contained in a schematic in Figure 27.
- In order to bring the model to life, and point to how it could be leveraged, a Red, Amber, Green (RAG) status was applied to some data components for illustrative purposes and to highlight how a regulator could apply its own appetite thresholds – see Figure 26.
Figure 26 - Illustrative example of applying the model

<table>
<thead>
<tr>
<th></th>
<th>RED</th>
<th>AMBER</th>
<th>GREEN</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CF30 numbers per segment</strong></td>
<td>&gt;10,000</td>
<td>&gt;5,000</td>
<td>&lt;5,000</td>
</tr>
<tr>
<td>Equivalent to c.45% of population</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>CF30 Concentration within segment</strong></td>
<td>&gt;2,000</td>
<td>&gt;1,000</td>
<td>&lt;1,000</td>
</tr>
<tr>
<td>(Highly Concentrated under OFT measure)</td>
<td></td>
<td></td>
<td>(Unconcentrated under OFT measure)</td>
</tr>
<tr>
<td><strong>Overall New Flow</strong></td>
<td>&gt;£20bn</td>
<td>&gt;£10bn</td>
<td>&lt;£10bn</td>
</tr>
<tr>
<td><strong>New Flow Concentration within segment</strong></td>
<td>&gt;2,000</td>
<td>&gt;1,000</td>
<td>&lt;1,000</td>
</tr>
<tr>
<td>(Highly Concentrated)</td>
<td></td>
<td></td>
<td>(Unconcentrated)</td>
</tr>
<tr>
<td><strong>Product Market Share within each segment</strong></td>
<td>&gt;50%</td>
<td>&gt;25%</td>
<td>&lt;25%</td>
</tr>
<tr>
<td><strong>FCA Complaints volumes</strong></td>
<td>&gt;50,000</td>
<td>&gt;15,000</td>
<td>&lt;15,000</td>
</tr>
</tbody>
</table>
The above schematic is designed to illustrate how a regulatory authority could begin to analyse the existence of complaints hotspots within the overall market. Although the RAG ratings are illustrative rather than formally synthesized through statistical cluster...
analysis, attaching a value judgement on individual metrics helps focus attention in a risk-based manner, which is consistent with most regulatory approaches (Benson, 1998).

The model works by highlighting conduct hotspots arising from complaints data. The reader is able to review the Complaints data RAG with a view to focussing on higher volume categories and then identify those segments within which that particular product category is sold most within (using the market share). Taking the process a stage further, the reader can then quickly ascertain the segment profile in terms of the CF30s operating within the segment and then the size of the segment in terms of flow. The potential for weak competition to exist within the segment and potentially acting as a driver of detriment / enabler of agency issue to be magnified can be assessed through the HHI Concentration indicators assigned to each segment.

Taking the above data for example, the following points can be elicited:

1. Based on 2014 FCA Data, pension complaints are flagging as RED. There were in excess of 52,000 complaints arising from this (broad) FCA category.

2. Scanning along, we can see that the dominant market share for products in the pension’s category lies squarely within the Small IFA category.

3. Its overall New Flow contribution in respect of the RDR sector is very high, as is the number of CF30s active in the sector. However, the power for individual firms to exert undue competitive influence is very low, with low concentration levels of firms by CF30 and New Flow.

4. Developing this quantitative indicator analysis further, we can see from the FSCS narrative that an increase in firm failures has arisen in respect of SIPPs. The small FA segment is very strong in terms of overall SIPP market share and
coupled with the financial profile of such firms (low capitalised, adviser owned) we can see from the pen portraits, there could be a systemic risk emerging in this sector. Further analysis could be conducted on qualifications within the segment) as a proxy for increased competence when advising on SIPP products).

In respect of other categories and segments, we can make the following model derived observations:

- Within the same pensions category, we can see relatively high market shares by Corporate Advisers. With a concentration which is higher and fewer active firms and CF30 advisers, the cost/benefit for regulatory intervention in this sector may be higher.

- Mutual fund complaints are approaching a level towards RED and market shares are quite high within the non-advised sector, which is highly concentrated. With commission still available within this segment, this could be an indicator of rising risk.

The results of this exercise provide some interesting points in respect of being able to assess the results of the RDR intervention. These are as follows:

- The model only covers the “as is” market analysis yet the complaints figures have latency which will relate to a potentially different previous market structure. The model cannot be regressed easily, due to limitations in market share data.

- The model has related limitations due to categorisation, scope and taxonomy issues within the available complaints reporting data. Cash ISA complaints are enormous yet cannot be directly attributable to individual segments as lie
outside the RIP Product Sales Data. Likewise, there are high levels of concentration in adjacent markets such as Trustee DC pensions and Income Protection, yet these fall outside the RDR market changes. FCA firm categories do not align neatly.

- The FCA PSD contains statistics for Non-Advised sales yet these are not captured within the Complaints Data gathered by FCA and the FOS. With high levels of concentration and increased sales evident since around the introduction of RDR, this is a gap.

- The presence of such a large volume of individual firms, active across a wide range of products, within the small FA segment, muddies the picture somewhat. Whilst this sector provides the greatest volume, the risk per firm is low and the analysis indicates these firms are operating on an Independent basis. These firms are less likely to engage in marketing agreements such as those that resulted in Sesame being fined and have no commercial links to provider firms. The main potential areas of agency issues are therefore absent. Those that remain centre on charging models and the potential for regulatory costs and increased liabilities to increase pressure on a limited capital base. Where professionalism aspects result in poor competence for certain product categories (like SIPPs) there is an increased risk of consumer detriment, as such firms could fold and leave customers with the FSCS as their primary safety net.

- The summary picture at this stage is that the segmentation model helps improve an understanding of the presence of drivers of detriment, including those specific to the market failure analysis of RDR, across the distribution
landscape. However, there is insufficient granularity to enable a clear assessment of RDR success to be made on this alone.

6.7 Trust analysis

The market failure analysis which was undertaken ahead of the proposal for the RDR contained reference to poor levels of trust. As we have seen, trust is cited as an externality or spill over (Stieglitz) impacting adversely on the market for retail investment advice (Llewellyn, 1999). With this in mind, an objective of the study is to establish to what extent trust has improved since the introduction of RDR. A secondary objective was to establish to what extent the model developed could play in enabling progress of Trust within the overall distribution landscape.

The primary method for assessing the progress of trust levels was to review the research undertaken by the regulator and other bodies. From the literature review covered in an earlier chapter, this focussed on three sources:

1. FSA & FCA commissioned studies
2. The Financial Services Trust Index (FSTI), created by Ennew & Sekhon and taken forward by Devlin
3. Ancillary studies by the CII and UK Government, as well as the Edelman Trust Index

The literature supports early findings that measuring trust differs between entities. For example, a sophisticated framework for understanding the nature and determinants of trust and trustworthiness was developed by the Financial Services Research Forum. Briefly, this framework proposed that trust exists on two levels. Base level trust
(identified as cognitive trust) relates to the extent to which an organisation can be relied on to do what it says it will do. Higher level trust (named affective trust) relates to the extent to which the organisation is concerned about the interests of its customers. In the opinion of the FSTI authors, organisational trustworthiness, which is defined as the extent to which consumers perceive that an entity is worthy of their trust, is the prime determinant of consumer trust in financial services institutions. It is determined by consumer perceptions of the institution in certain key areas, namely communications, shared values, integrity, ability/expertise and benevolence.

In summary, the FSTI offers a much more comprehensive approach which references distinct elements, in comparison to other sources. It collects data for seven types of financial institution being Banks / Building Societies / General Insurers / Life Insurers / Investment Companies / Credit Card Companies and most pertinently for this study; Brokers / Advisers.

Given the in depth nature of the FSI results, it has been assessed as the most valuable in obtaining an understanding of trust levels throughout the RDR period. The following pages (Figure 28, Figure 29, Figure 30 and Figure 31) set out the results of the FSI study throughout its half yearly “waves” of data collections. A comparative discussion covering the other two sources is then presented.
Figure 28 - Overall Trust levels across FS through each wave of the FSI longitudinal sample

Note: Taken from the FSTI slides – (Nottingham University CRBS, 2015) Accessed June 2015

Figure 29 – Higher Level Trust Index

Note: Taken from the FSTI slides – (Nottingham University CRBS, 2015) Accessed June 2015
Figure 30 - FSTI Overall Trust Over Time

Note: Taken from the FSTI slides – (Nottingham University CRBS, 2015) Accessed June 2015
The overall consumer trust level of 75.02 suggests that on average, respondents moderately trust financial services institutions. According to the data, base level (cognitive) trust is significantly above high level (affective) trust which is what would be expected under Ennew & Sekhon’s original framework where cognitive comes before affective. It seems reasonable to state that consumers have more comfort in the reliability of firms than they are convinced about how well firms have their interests at heart.

Furthermore, the FSTI states that Brokers/advisers have consistently received the highest ratings on trust and trustworthiness throughout the entire period (from 2008...
This is followed by Investment Companies, General Insurers and Building Societies.

The data indicates that Banks, Credit card companies and Life providers have the lowest indicators of trust in 2014 and this is consistent with the long term. Comparative analysis with the results of the FSI data in 2005, 2006, 2007 and 2008 suggests a high degree of consistency in levels of customer trust throughout the period preceding RDR. Although Brokers and advisers are consistently the most trusted entities, they experience a marginal decline in 2009. This could be as a result of the global financial crisis.

At a general level, the data suggests that RDR actually had a small negative impact on levels of trust in brokers and advisers. The recent trend data for Higher Level Trust, which shows how much customers feel that the entity in question has their true interests at heart, also shows a significant narrowing of the gap between brokers and the rest of the financial services sector.

The report’s author – Prof James Devlin - noted that this could well as a result of more explicit payment disclosure for advice which adversely impacts the emotional connection between clients and their agents. This however could be challenged by the NGM study into customers’ post RDR interactions with Advisers which seems to indicate a low level of awareness of fee payment structures (FSRM, 2014; NMG, 2014). This is an area worthy of future study.

Turning to the survey undertaken by the CII’s Personal Finance Society, we can see that its methodology is not as sophisticated by the FSTI approach. It is still operating within the traditional category of asking customers simply whether they have trust and confidence rather than deriving a trust score from constituent elements of cognitive
and affective trust. The PFS approach was simply to ask 2,000 customers in December 2013. In its defence, it focuses on retail investment products and prior surveys were carried out in 2013 and so it does have a measure of longitudinal reliability.

According to the PFS, nearly two thirds of respondents confirmed that trust and confidence has stayed the same but 15% confirmed their view that levels had decreased. In contrast, only 7% stated that results had gone up.

The PFS report also provided a useful insight into the dynamic of customers who had recently taken up a product and those who hadn’t. The overall differences were marginally less negative for those advised and for those who had purchased a product recently and those who hadn’t. The conclusion reached by the report was the former were only marginally less negative. This might suggest that overall trust is being driven by broader trends than personal experience of pensions and investments.

Further to this, the PFS survey asked a forward looking question which reinforced the emerging pattern of evidence that Trust levels had not really shifted. This is detailed in Figure 32 below.
In addition to the PFS survey, the main body of research commissioned by the FCA into trust was undertaken by Europe Economics (EE) as part of its 2014 post-implementation review. The focus of the trust part of the research was on increased professionalism rather than on obtaining an absolute trust measure. The report stated that “it is difficult to attribute any changes in levels of trust to RDR specifically” but went on to confirm an expectation of improved confidence and trust in the “advice market” as effects bed in (Europe Economics, 2014). However, any increased consumer trust and confidence in the market is not yet evident.
The focus on professionalism covered several aspects but essentially revolved around the concept of qualifications. The graph in Figure 33 below highlights the extent to which the position had improved.

Figure 33 - Proportions of advisers holding Chartered or Certified

Note: Taken directly from FCA Post implementation review (FCA, 2014)

Turning specifically to the question of trust, EE referenced the FCA study of adviser charging in December 2014 in confirming trust in financial advisers amongst those advised remains high. It relies on the 2014 Omnibus survey results for general population levels of trust in financial advisers. The graph in Figure 34 below refers:
Further to this, the shift since RDR was introduced has remained stable, at 34% of customers compared to 36% in 2014. It should be noted that the question asked was “affective” in seeking agreement as to whether “advisers make recommendations based on what they think are best for their clients” (FCA, 2014; EE, 2014). The graph below in Figure 35 refers.

Note: Taken directly from FCA RDR implementation review (FCA, 2014) accessed June 2015.
The case for EE’s conclusion that trust levels in the advice market will increase in due course, is based primarily on industry sentiment. Further to this, it offers some tentative evidence in the form of a reduction in adviser based complaints to FOS in 2014. However, as we have seen from the complaints analysis, the overall proportion of complaints in respect of non-advised is not fully tracked and that the general trend of complaints generally in the sector has been downward, with the adviser segment providing a very small proportion of large numbers.

The EE analysis also cites further contextual data such as the overall UK Consumer Confidence index changes, in support of a view that trust may increase with time. This has some merit in that the FSI data indicates an upward trend from 2008 however, when compared to the PFS data and Broker / Adviser data from FSTI, it is difficult to determine to what extent the changes in the advised market will be positive. Indeed, the FSI data indicates a slight “wobble” (Devlin, MM, 2014) post RDR.

Note: Taken directly from FCA Post Implementation Review (FCA, 2014) Accessed June 2015
The third and final strand of trust results review concerns that issued by the UK Government and FSCS, referencing the well-established Edelman Trust Index (Figure 36).

Of the latter, the FSCS report “Mind the Gap” which was issued in 2015, is the most recent. It cites the longstanding Edelman Trust Barometer (see Figure 37), which has tracked consumer trust in industries on a global scale for 15 years. The report indicates, through the narrative by Professor Nick Chater, that in respect of financial services, the UK is in 19th overall position from 27 countries surveyed. This places in context some of the earlier conclusions reached by Europe Economics and supports the data from the FSI surveys: the UK as a whole has a low baseline of trust in financial services generally.

This low baseline of trust has been recognised by the UK Government’s Office for Science, whose “Foresight” research paper of 2012 seems prescient. That paper offers yet another angle on the trust components, in that it demarcates between two types of trust. First, trust in the financial services industry and second, trust between participants in a financial transaction, that the parties will honour their side of the agreement. The paper makes the argument that erosion in public trust of the financial services system is part of a broader socio economic and technological trend. It states that “regrettably, but naturally, greater use of computers, and IT more generally, has been partly instrumental in the erosion of trust in the financial system by the general public”. That notwithstanding, it goes on to make the case that while tighter regulation can only be a partial substitute, trust is important for intermediation systems to operate effectively, stating “this makes it all the more important that all those involved in financial intermediation are aware of the dangers of such a loss of trust, and take every
care to retain and sustain their good reputation by their deeds as well as their words”.
(UK OSci, 2012).

Figure 36 – Trust levels between sectors in the UK – taken from Edelman Trust Index

![Bar chart showing trust levels between sectors in the UK]

**Note:** Taken directly from Edelman Trust index, accessed through FSCS Trust Report (FSCS, 2015)
Conclusion

It is evident from the results and literature review that there is no consensus in defining and measuring trust in the literature. Of the trust surveys relevant to financial services covering the period prior to and post RDR, the FSTI approach which deals specifically with relevant institutions and goes beyond simple Yes / No studies, is the most incisive. Its separation of trust components (cognitive; affective; trustworthiness) aligns with much of the feedback from the EE, FCA, PFS and FSCS research. Furthermore, it can be envisaged that the FSTI methodology could be applied. It is
clear that the UK in general has a trust issue in terms of its financial services sectors and it also is clear that financial advisers are more trusted than other institutions, such as banks. The case for a difference between advised and non-advised consumers also seems supported by the studies concluded however in terms of this study’s objectives; the least amount of trust evidence has been conducted or commissioned by the FCA in its post implementation review. The EE report of 2014 is optimistic about the direction of future trust and relies on a rising tide of consumer confidence and greater professionalism to make the case. However, the empirical basis has not yet been established.

A secondary objective of the trust results work concerned the extent to which the segmentation model could help drive a greater understanding of trust in the retail distribution landscape. Whilst the FSTI categories are very useful, in the current incarnation, they are quite broad and in basic terms, the category “Broker / Adviser” covers the vast majority of the firm segmentation model. However, in its sampling, the FSTI results do record the aggregate product recommended mix across the Broker / Adviser category. For example; PP was stated as being recommended by 61%; equity ISA 46% and so on. With this in mind, it should be possible to cut the sample further utilising the raw data to identify, through clustering or other means, broker profiles which match the segments. This could in turn be used to draw out difference in trust profiles between segments.

Similarly, the segmentation model as it currently stands offers limited applicability to the structure of consumer trust surveys conducted by Edelman, which has a single category for Financial Services, albeit segregated from Banking. The FCA Europe Economics analysis offers a similarly limited application, with its reliance on the
single question about “financial advisers”. Finally, none of the existing trust models cater for differing product segments, nor focus on types of firms such as Restricted vs Independent or Large FA versus Small FA. This is an opportunity for benchmarking suggested in the initial pilot study by Ennew & Sekhon (2006) and taken forward more recently by Devlin’s study of a “high performing advice firm (Devlin, 2014).

6.8 Overall conclusion to objectives relating to the model
This study is organised in two broad parts, with the development of distribution model and resulting assessment of how RDR addressed the economic “market failures” followed by an exploratory study into what customers value when interacting with financial services in order to identify differences or otherwise between that paradigm and the market failure model.

The first phase comprised four objectives and encompassed a number of individual exercises aligned to determining whether the economic concepts could be measured and determining their prevalence. It is therefore appropriate to try and draw together in summary form the most pertinent results and tentative conclusions from that work. The two tables that follow (Tables 25 & 26 respectively) detail the specific RDR assessment and the wider lessons to be learnt from the model and market failure theory learnings, respectively.
Table 25 - RDR Assessment by market failure theme

<table>
<thead>
<tr>
<th>Theme</th>
<th>RDR challenge</th>
<th>Evidence from this study</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agency</td>
<td>Is the Principal – agent problem resolved</td>
<td>N  • Network model persists although reduction in direct sales forces</td>
</tr>
<tr>
<td></td>
<td>Have conflicts of interest derived been eradicated</td>
<td>N  • Net flow model indicates actually lots of individuals market outside of RDR scope</td>
</tr>
<tr>
<td></td>
<td></td>
<td>N  • Commission has dropped from sales but product sales data does not point to increases in “low commission or nil commission” product recommendations like investment trusts. Bonds were already in decline</td>
</tr>
<tr>
<td></td>
<td></td>
<td>N  • Strong market power of “influenced distribution” such as SJP and Non-advised sales growth has balanced out the post RDR withdrawal of direct sales forces. Vertical integration growing</td>
</tr>
<tr>
<td>Information asymmetry</td>
<td>Are customers at less of a disadvantage / clearer on the landscape &amp; products?</td>
<td>N  • Financial capability has worsened based on MAS study</td>
</tr>
<tr>
<td></td>
<td></td>
<td>N  • Product landscape has increased in complexity</td>
</tr>
<tr>
<td></td>
<td></td>
<td>N  • New categories of advice and firm have not sunk home</td>
</tr>
<tr>
<td></td>
<td>Do customers engage with the market more?</td>
<td>N  • Advice gap identified by FAMR and reinforced by customer value study work</td>
</tr>
<tr>
<td>Externality – Trust</td>
<td>Do customers have more trust in the market and participants?</td>
<td>N  • Limited evidence to identify material improvements from RDR</td>
</tr>
<tr>
<td></td>
<td>Are less firms failing?</td>
<td>N  • Baseline levels of adviser trust continue to be high against other participants</td>
</tr>
<tr>
<td></td>
<td></td>
<td>N  • Professionalism (qualifications) have improved but no evidence links causally to trust</td>
</tr>
<tr>
<td></td>
<td>Is the profession attracting more advisers?</td>
<td>N  • FSCS levy data does not support an improved picture.</td>
</tr>
<tr>
<td></td>
<td>Has detriment reduced?</td>
<td>N  • Firm consolidation continues. Profitability study not possible due to data constraints</td>
</tr>
<tr>
<td></td>
<td></td>
<td>N  • Evidence from the model is static adviser CF30 volumes</td>
</tr>
<tr>
<td></td>
<td></td>
<td>N  • Long tail of sole traders indicates growing problem of succession. Backed by FAMR recommendations</td>
</tr>
<tr>
<td></td>
<td></td>
<td>N  • FCA Fines data doesn’t provide evidence of improving picture</td>
</tr>
<tr>
<td></td>
<td></td>
<td>N  • Complaints information from FOS and FCA supports challenge as to whether retail investment product sales generate as much detriment as bank and general insurance</td>
</tr>
</tbody>
</table>
## Table 26 – Determining Market Failure through the Model

<table>
<thead>
<tr>
<th>Challenge</th>
<th>Comments from this study</th>
</tr>
</thead>
</table>
| Is the data available for a model to be developed | Y • In its current form, a number of assumptions had to be made. This created the existence of some axiomatic conclusions (such as Risk specialists distribute more protection products)  
• There are significant taxonomy issues due to current regulatory reporting categories and a mis-match between FSCS, FOS & FSCS data |
| Is Net Flow always the correct metric? | N • Net Flow is a major indicator of the output from consumer decisions but there is a material gap covering advice given which did not involve a product. This is a gap in regulatory sales reporting which means it was correct for this study |
| Is segmentation helpful                | Y • Segmenting by a combination of product focus and nature of channel provides a reasonable basis for describing market participants  
• Combining pen portraits with hard data could be developed to refine segments  
• One drawback is that the nature of the distribution landscape is complex with overlap between products and differing regulatory regimes |
| Can the model be used to map indicators of detriment? | Y • The study shows that combining segment size, market power and complaints data can highlight higher risk sub-markets  
• Advice gaps can also be identified by looking at relative proportions |
| Can the model identify asymmetry?      | N • There is some weak differences in range and complexity of products by segment but no meaningful way to reflect the complexity of adviser models, prudential coverage and liability apportionment |
| Can the model identify trust deficits?  | N • The levels of qualifications could be mapped to individual segments to highlight potential shortfalls but there is no causal evidence of the link to trust  
• Given the variation in trust levels between brokers and providers, it could reflect rudimentary differences  
• Further work would be required to benchmark trust by segment. This could potentially be correlated to segments to identify shortfalls |
THE RETAIL DISTRIBUTION REVIEW

“A CRITICAL EVALUATION OF THE RETAIL DISTRIBUTION REVIEW”

JAMES McCOURT

A thesis submitted for the fulfilment of the requirements for the degree

of

Doctor of Philosophy

University of Edinburgh

2016

Part 2 (Chapters 7, 8 & 9)
7. RESULTS: OBJECTIVES 5 & 6 - DEVELOPING A CUSTOMER VALUE FRAMEWORK

7.1 Restatement of objective

This phase of the research project was exploratory in nature and was undertaken following the segmentation model based review of RDR that was set out in the previous chapter. The research was conducted is in the vein of establishing to what extent an alternative perspective could be developed to the market theory context which in itself originated from a recognition that model.  

This chapter deals with objectives 5 & 6 of this study, as set out in chapter 4. These are:

5. Develop a conceptual framework for articulating and measuring what consumers’ value within financial services.

6. Establish to what extent the market failure analysis approach is capable of delivering value to those who it seeks to protect, i.e. its consumers.

7.2 Summary of three phases

There were three distinct phases in the primary research, being:

1. Initial generation of the “customer value statements” utilising existing paid for research and facilitated workshops.

2. A qualitative primary research phase, whereby the statements were explored through focus groups of existing and external customers.

3. A refinement and validation primary research phase, whereby qualitative and quantitative research was employed to establish which statements really mattered to
customers and would increase trust or recommendations of product, providers or services.

This strand of research had its genesis in an early working hypothesis that the FCA RDR objectives were based on a limiting economic paradigm, centred on market failure theory. This would be explored through the use of the RDR as a case study, identifying areas where the initiatives based on related efficient competition and market equilibrium concepts had not seemingly addressed the core problem of customers not getting the desired welfare benefits.

That hypothesis was emboldened and further informed by the Financial Services Research Forum’s Trust Index reports which offered an opportunity to align the segmentation model work employed assess the RDR, with a more customer focussed “bottom up” approach.

The FSTI authors stated in 2009 that “this report details results only by broad category of institution. Individual organisations who are able to collect their own data to complement the main sample, will be able to undertake more fine grained analysis of their own performance according to both the characteristics of their customers and also the product categories in which they operate” (FTSI, 2009)

The initial phase of this research focussed on generating an initial set of statements that was felt would be reflective of what customers wanted from “financial services”. This category was consciously broad as at the initial stage, it was felt important not to channel or limit the study by focussing on adviser, provider, product or any other constraint.
As a starting point, previous internal Royal London and secondary research was reviewed by members of the Customers Service Committee in advance of an open, facilitated forum. This is detailed in Table 27 below.

Table 27 – Summary of sources reviewed

<table>
<thead>
<tr>
<th>Public sources</th>
<th>Internally commissioned research</th>
</tr>
</thead>
<tbody>
<tr>
<td>YouGov Trust in Pensions</td>
<td>ServiceTick reports (various)</td>
</tr>
<tr>
<td>Mintel Customer Annoyances</td>
<td>Members Accounts Research</td>
</tr>
<tr>
<td>Mintel Customer Service Expectations</td>
<td>Income Protection Definition Research</td>
</tr>
<tr>
<td>Mintel Complaints</td>
<td>Scottish Life Auto Enrolment Literature review</td>
</tr>
<tr>
<td></td>
<td>Scottish Life Welcome Packs review</td>
</tr>
<tr>
<td></td>
<td>Scottish Life At Retirement Research</td>
</tr>
<tr>
<td></td>
<td>Mutuality report, for Association of Financial Mutuals</td>
</tr>
<tr>
<td></td>
<td>Bright Grey Growing the Market</td>
</tr>
<tr>
<td></td>
<td>Bright Grey Protection Proposition Development</td>
</tr>
<tr>
<td></td>
<td>Financial Strategy Segments Customer Segmentation</td>
</tr>
</tbody>
</table>
Whilst the examination of the commission research was useful in setting the scene, the group’s attention was taken by the power from the Experian research which had been conducted to be leveraged from the segmentation modelling done earlier. Experian’s Financial Strategy Segments (FSS) is used by a large number of UK organisations in order to understand their consumers' financial behaviours and has recently been incorporated into the FCA’s own published “Spotlight” segmentation models (FCA, 2014). As can be seen from the extracts below, the FSS customer segmentation brought to life how different internal propositions attracted differing socio-economic FSS segments. These are set out Figures 38 & 39 respectively.

**Figure 38 & Figure 39 – Internal Customer Analyses**

![Internal Customer Analyses](image)
The concept of “not all customers are the same” was evident from the FSS segmentation analysis varied by internal business division. Prior to the formal session to generate the customer values, a preparatory exercise was undertaken by the Royal London Customer Insight team to map internal FSS mapped customers against the newly developed firm segmentation model. The graph below refers and provided further evidence that distribution focussed firms across the retail landscape had different customer profiles.

For example, within the RL pensions business, Private Client firms originating in professional services culture, typically had a larger segment of wealthy customers. This in turn – leveraging the segmentation model – would indicate that the product mix would comprise higher levels of discretionary asset management and offshore
bonds. Levels of trust, asymmetry and conflicts of interest at play could be very different from those in other segments.

The Non-Advised segment surprisingly had a high-ish profile of customers not as wealthy as other segments. Those in “essential economy” and “stretched finance” FSS segments could be susceptible to the effects of lower financial capability, which was established in the literature as higher in lower economic groupings. See Figure 40. Furthermore, the segmentation model indicates that whilst product ranges are narrower, focussing on SIPPs, the concentration power of a small number for firms in this sector, coupled with a commission model, could present a greater level of detriment risk than may have been expected.

Figure 40 – Customer analysis by segment based on FSS segments

CUSTOMER ANALYSIS BY SEGMENT FOR RL INDIVIDUAL PENSIONS
Various iterations of this exercise were played with individual informal groups, consistent with the advantages identified by Goldsmith, Marshall & Katzenbach of “establishing comfort” (2007). The advantages of having individual and ad-hoc sessions were that they, created a safe place to deepen knowledge, to establish comfort with the concept of customer segmentation, establish competence in the project grouping as well as allow individuals to express concerns about the project.

7.2.1 Initial generation of “Customer value statements”

The research study design incorporated an initial stage whereby expert member input was used to review the primary and secondary insight generated in the previous stage, in order to arrive at a starting set of customer value statements.

The context of the project group was very much “anti-jargon” and was positioned consistently by an appointed steering group as the voice of the customer. As stated in the methodology chapter, the Steering Group comprised the Group Executive Committee members of Royal London’s Customer Standards Committee, with all participants holding Senior Management Controlled Functions under the FCA Approved Persons regime.

Participants in the group work varied throughout the series of sessions and subsequent semi structured interviews but were selected from cohorts of professionals tasked with some element of fiduciary or consumer interest duties in their current role. For example, the With Profits Actuary has a statutory responsibility for the welfare of with-profits customers under the FCA Approved Person regime; the Head of Customer Relations has a role profile centred on dealing with complainants fairly in accordance with the FCA DISP rules. A key person was the Group Head of Insight who supported
facilitation and linkages to external and internal customer insight work such as net promoter and customer satisfaction surveys previously.

The initial brainstorming session was consolidated into a subsequent round of facilitated group work where each participant ranked their “top five” statements in order of importance.

Each member was asked to present his/her findings along with a short rationale for their selection. Following a break, the facilitator invited a discussion about similarities between suggestions. A discussion ensued referencing the results of the segmentation model work and how the FSTI data showed advisers seemed to be more trustworthy than providers. The relative lack of progress RDR in this regard was raised as was the FSA objective that “providers compete on products and not on commission” {derived from a statement by John Tiner}. The group also referenced early strategic analysis which promoted the concept of “customer experience” as a key differentiator in a world where charges were capped (following the workplace pensions legislation) and pressure was on capital from Solvency 2 and other forces.

At that stage, the group had departed slightly from the pure NGT technique and the facilitator suggested as a way of moving things along, the suggestions were organised into three themes. These were:

1. Being trustworthy
2. Being different in the market from other firms
3. Focussing on customer experience

A good discussion was held on this approach and it was agreed that the statements should be organised along a lifecycle schema, through the journey of a customer need, to product purchase, receiving a service and then being in an ongoing relationship.
This approach reflected the FCA “Conduct Pillars” which the business had recently formally adopted as part of its approach to managing conduct risk. The statements which had been clustered through the iterative “meta values” were then organised by the lifecycle approach. Similar statements were clustered together. Participants were then asked to vote on the final eight statements which were emerged. The schematic below (Figure 41) highlights how the original model was conceived during the first workshop.

**Figure 41 – The Initial CVS Model**

**THE INITIAL CUSTOMER VALUE STATEMENTS MODEL**
Further to the broad agreement within the working group, the results were written up and presented to the May 2014 steering group within the agenda of a full day Customer Standards Committee. At the meeting, the results were discussed and endorsed as a “good starter for 10”. These are formally captured as:

<table>
<thead>
<tr>
<th>Statement Title</th>
<th>Wording</th>
</tr>
</thead>
<tbody>
<tr>
<td>Service</td>
<td>Giving customers a service that continually delivers on what matters most to them</td>
</tr>
<tr>
<td>Brand</td>
<td>Communicating with customers in a candid, engaging and straightforward way</td>
</tr>
<tr>
<td>Support</td>
<td>Building ongoing financial education into the customer process</td>
</tr>
<tr>
<td>Membership</td>
<td>Providing tangible participation in profits for all our members</td>
</tr>
<tr>
<td>Responsibility</td>
<td>Committed to corporate responsibility and providing ethical investment options</td>
</tr>
<tr>
<td>Investment</td>
<td>Delivering better than benchmark investment performance at low cost</td>
</tr>
<tr>
<td>Philosophy</td>
<td>Creating propositions and implementing practices which are designed to maximise the number of claims we fully pay</td>
</tr>
<tr>
<td>Proposition</td>
<td>Only designing value For Money propositions that bring real value to customers</td>
</tr>
</tbody>
</table>

However, the following areas for developing the statements were raised by the group:

- The Head of Group Insight had reviewed the findings against existing detailed surveys and confirmed that broadly, our existing customer feedback supports the initial draft Model, particularly around Proposition, Service and Brand aspects.
• It should be acknowledged that these were initial statements “imposed” on customers rather than elicited directly from them.

• There are clearly areas which would benefit from further detailed commissioned research or insight due to their abstract nature (Membership, Responsibility, Support, possibly Investment).

• The Model has been written from our perspective and using our language. Some of the Customer Value Statements would benefit from clearer labelling (Brand, Proposition, Philosophy). The group recommended that it is re-written from the customer’s perspective in simple, everyday language. This reflected the literature on financial capability which indicated customer understanding of financial services jargon was a considerable barrier to customers engaging with providers (De Meza, 2008).

• We do not yet know the relative importance of the Customer Value Statements (CVS) and hence cannot prioritise effectively. Furthermore, a key consideration should be on the framing of the CVS, in line with the literature identifying the impact this can have on customer preferences (Levin et al 1998).

A challenge was handed back to the working group held to ask the group, after reflection, to progress these actions and also identify any additional CVS or gaps which would particularly impact on Trust.

Subsequent to this, the original generated list was reviewed alongside the following recommendation of an additional statement made to steering group covering “Track record/longevity”. This had been raised by Group Insight and had repeatedly
mentioned by customers as being important in research and had played well in rebranding research. The rationale for inclusion was provided as:

- Implies the company knows what it is doing (and hence can be trusted with your money)
- Implies the company will continue to be around for a long time – especially important for long-term investment products
- Linked to reputation (but a different issue to Corporate Social Responsibility) which is about the company having existed for a long time through challenging periods without acquiring a negative reputation, as opposed to the company proactively doing something good
- This theme doesn’t quite fit into any of the current Customer Value Statements
- Recommended wording endorsed by Steering: “I’m confident they’ll still be around when I need them”

Further to this, a sub-group comprising the Head of Group Insight, the author and three marketing communications consultants within the Consumer, Intermediary and Platforms division generated some amendments as set out in Figure 42.
Reflecting the iterative nature of this phase, another Steering session was held with the objective of focussing on the wider concept of Trust. This resulted in the core statement identifying the overarching objective to change from “Making Mutuality Meaningful” to “A company I can trust & recommend”.

At this point in time, Royal London had been in dialogue with the FCA in respect of developing its conduct risk framework. Through the sessions with the FCA Policy and Supervisory teams, it had become clear that a value chain approach was required in order to ensure that all stages of the customer lifecycle were accounted for. This resulted in an additional statement being created, provisionally titled: “Sales”. The accompanying wording was based on literature from the FCA “Applying behavioural
economics at the FCA” (FCA, 2013) which emphasised acknowledgement of framing, salience and other communication techniques to ensure information asymmetry was minimised. As a result, the wording was changed to “The information supplied enabled me to choose a product suitable for my needs”.

As a consequence the group decided by consensus to re-word the “Support” CVS to avoid overlap and enable focus more on ongoing education vs. point of sale literature and product understanding. *Support* now read as “They help me to understand my finances”. Figure 43 shows the updated CVS model.

**Figure 43 - Schematic of updated initial, internally generated CVS model**
7.2.2 Qualitative Customer Research Phase

The aim of this exercise was threefold:

1. To take the initial speculative CVS group and use them to generate a reaction from customers
2. From that, identify from the consumers’ perspective in the CVS coverage and appropriateness of the supporting articulation:
3. Calculate the relative importance the customer group place on each CVS in driving the overarching “Trust & Recommendation” objective

The research comprised of 12 x 1.5 hour focus groups, with the following attributes observed.

- Groups split by product
- Conducted across four locations – Glasgow, Leeds, London & Manchester
- RLG and competitor customers
- Advised & directly marketed customers

Participants were paid a £50 thank you (£55 in London) and recruited in line with brief contained in the Appendix 3. Individuals who worked in financial services or marketing were excluded and participants had to be the main decision maker in the home.

The focus groups were facilitated by Nunswood Consulting and conducted by experienced staff, working from a script of questions as set out in the Appendix 3.
Results

The focus group session comprised three facilitated stages, conducted using the skilled and expert facilitation of Nunswood researchers:

1. Collate the customer view:
   a. Starting from “critical incident” prompts, ascertain desired emotions such as how they feel currently about their adviser or provider and how they want to feel.
   b. Move to identifying desired experience needs using a "Wish list – for an ideal experience with your ‘x’ provider that will make you feel how you want to feel”.
   c. Step 3 – ‘Mapping’ emotions and needs with a deep dive in to ‘wish list’ attributes – using clean language and laddering techniques e.g. Why is that important to you? How does a provider demonstrate that?

2. Analysis: of the customer view
   a. Extensive content analysis of transcripts
   b. Use of the means-end chain framework to link tangible aspects of the customer experience (attributes), to functional and emotional customer benefits (consequences), and key customer values

3. Output: “Pure” Customer values
   a. Represented using the means-end chain model
   b. Duplicate attributes synthesized. All attributes represent the desired customer view – the reality of if / how firms could deliver against these was not considered at this point
The introductory question set generated a consistent response from the group confirming what the Trust literature review had posited. In broad terms, consumers of financial services and financial products were sceptical about the ability for individual firms to be different.

The extract from verbatim statements below in Figure 44 exemplifies this. Further examples of the verbatim as they related to the Means-End Chain Model are set out in the Appendix 1.

Figure 44 – Verbatim extract from the initiation of the focus group sessions

Using the means-end chain framework to analyse the verbatim quotes (as illustrated in Figure 44 above and contained in Appendix 3), we established that there are six overarching ‘pure customer values’ that are key to consider, in order to drive ‘Trust
and a Recommendation’ to use a firm or service. Table 28 below, sets out the full “chain” of concrete attributions which aggregate into the six Values.
### Table 28 – Means End Chain Analysis Results

<table>
<thead>
<tr>
<th>BOTTOM UP ATTRIBUTES</th>
<th>CONSEQUENCES</th>
<th>VALUES</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Concrete</strong></td>
<td><strong>Abstract</strong></td>
<td><strong>Functional</strong></td>
</tr>
<tr>
<td>Apologise and investigate my issue/ problem (no questions asked)</td>
<td></td>
<td>Take Responsibility</td>
</tr>
<tr>
<td>One consistent point of contact all the way through</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Give me the info. I need if I want to escalate/ make a complaint</td>
<td></td>
<td>Empathise</td>
</tr>
<tr>
<td>Ask questions/ respond in a way that shows you understand &amp; sympathise with me &amp; my situation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Explain the root cause of my problem &amp; the process</td>
<td></td>
<td></td>
</tr>
<tr>
<td>I decide when the issue is resolved</td>
<td></td>
<td></td>
</tr>
<tr>
<td>You tell me about aftercare support/ services</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deliver the outcome that I expected first time</td>
<td></td>
<td>Solve my problem</td>
</tr>
<tr>
<td>You give me a gift/ something I’m not expecting by way of an apology</td>
<td></td>
<td>Compensate me</td>
</tr>
<tr>
<td>The first person I speak to can answer any question I have</td>
<td></td>
<td>Knowledge</td>
</tr>
<tr>
<td>I have a designated account handler who understands me and my needs</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

271
<table>
<thead>
<tr>
<th>BOTTOM UP ATTRIBUTES</th>
<th>CONSEQUENCES</th>
<th>VALUES</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Concrete</strong></td>
<td><strong>Abstract</strong></td>
<td><strong>Functional</strong></td>
</tr>
<tr>
<td>You provide me with newsletters/ info. about what is happening in the market and tell me how this might be relevant to me</td>
<td>Guidance</td>
<td>I can get on with things myself</td>
</tr>
<tr>
<td>You explain the difference between your products &amp; services in an engaging &amp; clear</td>
<td></td>
<td></td>
</tr>
<tr>
<td>You give me examples based on other customers like me</td>
<td></td>
<td></td>
</tr>
<tr>
<td>You direct me to additional info./ support if I need it</td>
<td></td>
<td></td>
</tr>
<tr>
<td>You’re recognised by industry experts</td>
<td>Recognised ability</td>
<td>I know you have the best people working on my behalf</td>
</tr>
<tr>
<td>You’re recognised as long-standing experts by other customers like me (via WoM and customer reviews)</td>
<td></td>
<td>I know about you</td>
</tr>
<tr>
<td>You invest in experts with a good track record – and tell me about it (e.g. via newsletters with new employees/ employee of the month)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>End-to-end experience via 1 channel (I don’t have to switch)</td>
<td>Accessible</td>
<td>I can access my products from anywhere</td>
</tr>
<tr>
<td>Extended call times/ hours (including late evenings/)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>24/7 access to my accounts (online and via an app.)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>BOTTOM UP ATTRIBUTES</td>
<td>CONSEQUENCES</td>
<td>VALUES</td>
</tr>
<tr>
<td>--------------------------------------</td>
<td>-------------------------------------</td>
<td>---------------------------------------------</td>
</tr>
<tr>
<td>Concrete</td>
<td>Abstract</td>
<td>Functional</td>
</tr>
<tr>
<td>Landline number rather than 0844/45 numbers</td>
<td>I get answers to my questions quickly</td>
<td>Managing my product(s) feels like time well spent (not a chore)</td>
</tr>
<tr>
<td>F2F/ home visits are an option</td>
<td>Efficiency</td>
<td></td>
</tr>
<tr>
<td>Through to a real person based in the UK in under 2mins</td>
<td>You save me time &amp; money</td>
<td></td>
</tr>
<tr>
<td>Concise comms. with the essential information only</td>
<td>I have a better understanding of what things mean</td>
<td></td>
</tr>
<tr>
<td>No call centres</td>
<td>Clear</td>
<td></td>
</tr>
<tr>
<td>Plain English/ no jargon</td>
<td></td>
<td></td>
</tr>
<tr>
<td>I choose how &amp; how often we communicate (channel &amp; frequency</td>
<td>I only have to tell you something once</td>
<td>We're Partners</td>
</tr>
<tr>
<td>I am able to personalise my account (log-in details &amp; homepage</td>
<td>You save me time &amp; money</td>
<td></td>
</tr>
<tr>
<td>I have a named personal contact &amp; their direct contact details</td>
<td></td>
<td></td>
</tr>
<tr>
<td>You know who I am (you keep a record &amp; remember me</td>
<td>You save me time &amp; money</td>
<td></td>
</tr>
<tr>
<td>You know about me and my product history and provide me with personal options/ recommendations</td>
<td>I have a small but relevant number of options</td>
<td>I feel like a valued customer – I am a person, not a number</td>
</tr>
<tr>
<td>A range of alternative products which suit me</td>
<td>Relevant / Tailored</td>
<td></td>
</tr>
<tr>
<td>Loyalty benefits for being an existing customer</td>
<td>Rewarding</td>
<td>I get something back</td>
</tr>
</tbody>
</table>

PERSONALISATION "treats me as an individual and delivers a tailored experience based on me & my needs"
<table>
<thead>
<tr>
<th>BOTTOM UP ATTRIBUTES</th>
<th>CONSEQUENCES</th>
<th>VALUES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Concrete</td>
<td>Abstract</td>
<td>Functional</td>
</tr>
<tr>
<td>Clear T&amp;Cs, rates &amp; charges provided upfront</td>
<td>Transparent</td>
<td>I know how much I am paying and exactly what for</td>
</tr>
<tr>
<td>Open and honest about your bonuses/ commission</td>
<td></td>
<td>I am clear on who you are, what you stand for &amp; who I would be/ am associated with</td>
</tr>
<tr>
<td>You’re open and honest about where you invest</td>
<td></td>
<td>I believe that the company has my best interests at heart</td>
</tr>
<tr>
<td>You provide information on the historic performance of your products</td>
<td>Reputable</td>
<td>I am in control and have peace of mind</td>
</tr>
<tr>
<td>You take responsibility for educating young people/ young adults about Financial Services/ managing their finances</td>
<td>Responsible</td>
<td>I believe that the company has my best interests at heart</td>
</tr>
<tr>
<td>Competitive rates and products</td>
<td></td>
<td>I get what I am entitled to/ what I deserve</td>
</tr>
<tr>
<td>Existing customers offered the same ‘teaser’ rates as new customers</td>
<td>Fair</td>
<td>I get what I am entitled to/ what I deserve</td>
</tr>
<tr>
<td>Tell me about new products and services without me having to ask</td>
<td></td>
<td>I get what I am entitled to/ what I deserve</td>
</tr>
<tr>
<td>You safeguard my investments and offer me guarantees on rates/returns</td>
<td></td>
<td>I get what I am entitled to/ what I deserve</td>
</tr>
<tr>
<td>BOTTOM UP ATTRIBUTES</td>
<td>CONSEQUENCES</td>
<td>VALUES</td>
</tr>
<tr>
<td>----------------------</td>
<td>--------------</td>
<td>--------</td>
</tr>
<tr>
<td><strong>Concrete</strong></td>
<td><strong>Abstract</strong></td>
<td><strong>Functional</strong></td>
</tr>
<tr>
<td>Clear information on timescales, contacts, and levels of service provided upfront</td>
<td>Set my expectations</td>
<td>I know what to expect and when (and I can plan accordingly)</td>
</tr>
<tr>
<td>Regular &amp; proactive updates on the performance of my product(s)</td>
<td>Keep me informed</td>
<td>Your proactivity saves me time &amp; money and means that I don’t miss things</td>
</tr>
<tr>
<td>Do what you said you will in terms of timescales, contacts, and levels of service</td>
<td>Keep your promises</td>
<td>I get a ‘bonus’ / added benefit</td>
</tr>
<tr>
<td>Respond quicker and faster than you said you would</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Add an unexpected touch/ give me something I’m not expecting (e.g. welcome gift)</td>
<td>Go the extra mile</td>
<td></td>
</tr>
</tbody>
</table>
The focus groups elicited a number of “attributes” which aggregated through the “chain” to the pure customer values. At the review stage, several attributes were identified as duplicates. As a result of this synthesizing process, 42 key attributes were resolved in total, pointing to six “pure” values.

A subsequent group mapping session was undertaken to connect the “pure values” to the Customer Value Statements and to link the attributes to the CVS. This was done using a content analysis session, facilitated by Nunwood staff with a focus on having a framework to take forward and test with customers in the next stage.

The results of this were mapped and highlighted in the following Table 29.

Table 29 – CVS to Pure Value Mapping

<table>
<thead>
<tr>
<th>Customer Value Statement</th>
<th>Mapped “Pure Value” elicited from Means-End Chain</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payout</td>
<td>• Resolution</td>
</tr>
<tr>
<td>Service</td>
<td>• Easy</td>
</tr>
<tr>
<td></td>
<td>• Expectations</td>
</tr>
<tr>
<td>Comms</td>
<td>• Easy</td>
</tr>
<tr>
<td></td>
<td>• Expectations</td>
</tr>
<tr>
<td>Support</td>
<td>• Easy</td>
</tr>
<tr>
<td></td>
<td>• Expertise</td>
</tr>
<tr>
<td>Sales</td>
<td>• Personalisation</td>
</tr>
<tr>
<td>Product design</td>
<td>• Personalisation</td>
</tr>
<tr>
<td>Membership</td>
<td>• Personalisation</td>
</tr>
<tr>
<td>Investment</td>
<td>• Integrity</td>
</tr>
<tr>
<td>Responsibility</td>
<td>• Integrity</td>
</tr>
<tr>
<td>Track Record</td>
<td>• Integrity</td>
</tr>
<tr>
<td></td>
<td>• Expertise</td>
</tr>
</tbody>
</table>
The resultant CVS Model & related attributes could then be compiled. Figure 45 below illustrates this.

**Figure 45 – CVS Model aligned to attributes**

Due to the significant number of attributes applicable to “fixing things” and the prevalence of the Resolution pure value, a decision was taken at the Steering group to develop a new draft statement: *Resolution*. This was not articulated fully but nominated to be taken forward to the next phase of research.

In the quantitative research, we aimed to evaluate the impact each of the individual attributes has in driving the overall objective of “Trust & Recommendation”. Specifically; which areas or themes are potential differentiators (where financial services firms really stand out from the general low levels of positivity we see coming
through the literature). This was designed to tell us which specific themes should be prioritised in order to deliver the Customer Value Statements. This research also included a test of the impact of the statements themselves. These two streams of activity provided a platform to inform an analysis of the financial services landscape in order to take action to deliver best outcomes for customers, which they themselves can identify and engage with.

In terms of design, this phase consisted of 1,822 online surveys split across the following categories:

- 266 surveys of Royal London customers
- 1556 surveys with customers who had products or purchased services in the last six months split across six product types

The surveys were carried out by Nunwood Consulting using a script which had been informed by the prior focus group. Sufficient information was also obtained from participants in order to map them on to the internal FSS client segmentation model.

In order to ensure that we focussed on the correct aspects of CVS and linked back to the core overall objective we designed the study to specifically cover each nominated attribute, which in turn was associated with the respective CVS.

The importance of an attribute provided insight in three separate ways:

1. Analysing the impact for each on Trust
2. Analysing the impact on Recommendation (Using a Net Promoter Score)
3. And also asking respondents to state explicitly which of the CVS they feel are the most important to them.
The schematic in Figure 46 captures this:

Figure 46 – Schematic showing three VENN elements of research

In order to explore the relationship between the CVS set and the drivers of Trust and Recommendation, the results of the survey were subjected to regression modelling. Regression is a form of statistical analysis where we seek to identify the strength of relationship between two variables, typically measured by shared variance. Shared variance is important as it indicates the extent to which a high score on one variable will result in an increased likelihood of a high score in the dependent variable.

When performed with only two variables, this is called correlation analysis however, in this instance, where there were a number of Customer Value Statements to be
assessed against each of the dependent variables of Trust & Recommendation, it was necessary to try and unpick which of the shared variances are the most impactful on each element.

The specific technique undertaken was Shapley (Driver Importance) Value Regression. This technique has been chosen due to its superior capability of dealing with some problems like co-linearity, which arise through research data generated in studies like this one where customers are segmented into cohorts. For example, whether they are customers of Royal London, have specific products, have a financial adviser, and so on. It also has the advantage of being relatively stable and its results straightforward to communicate.

The Shapley value originated in game theory and can be expressed as the average expected marginal contribution of one variable after all possible combinations have been considered. In technical parlance, the Shapley importance determines what proportion of R-square from a linear regression model can be attributed to each independent variable. It is computed using a (weighted) linear regression with all of the independent variables.

It is therefore a form of additive regression i.e.;

\[ \text{Outcome} = \text{varA+varB+varC}; \]

The assumptions employed in this analysis were standard assumptions for any regression:

- Homoscedasticity, i.e. equal variance of variables
- Normal distribution of variables and errors
- High correlations amongst predictors which informs the use of Shapley Values
The Shapley Value was calculated across all possible combinations of Customer Value Statements (known as *predictors*). It estimated the net effects obtained via averaging over all possible combinations of the explanatory variables on the best fit linear regression model. In this instance, the explanatory variables were the “scores” (i.e. the % of customers percentage of customers who responded in strong agreement with each of the discrete assertions derived from the CVS); the product segments those customers were in (for example, customers who held a pension); whether the customer was advised or non-advised and finally their NPS score.

By giving an average estimate across these multiple iterations, the Shapley value results eliminates much of the order bias found in standard regression analysis, thereby mitigating the detrimental impact of multi-collinearity.

In terms of base populations, all but four of the segments contained in excess of 100 responses. Further details of the data sets can be found in Appendix 4.

The % scores seen in the outputs represent the relative impact of each variable, on the chosen CVS and also on the overall Trust and NPS scores, respectively. An attribute with a score of 10% within an NPS model, will therefore represent 10% of the total impact which that variables has over NPS. All attributes added together under a Shapley analysis add to 100%, which allows for ease of comparison.

The results of the regression model were provided as data tables and the calculations were assessed by in-house actuaries in order to validate.

The R squared scores for each CVS, which provide a general indicator of the strength of the modelled results, all returned values higher than 50%. From this and the validation work, it was felt that the modelling was robust enough in order to draw
inferences from the relationships which were observed. The data sets are provided within Appendix 4.

7.3 FINDINGS

The following sections step through each of the findings which were elicited from the data however these are summarised in Table 30.

Table 30 – Summary of overall CVS findings

<table>
<thead>
<tr>
<th>Finding</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Trust &amp; recommendation (Net Promoter Score (NPS)) have slightly different drivers</td>
</tr>
<tr>
<td>2</td>
<td>Drivers of both Trust &amp; Recommendation vary by product</td>
</tr>
<tr>
<td>3</td>
<td>There is little difference for Trust between Advised &amp; Non-Advised except for Service</td>
</tr>
<tr>
<td>4</td>
<td>There is some difference in drivers of Recommendation by advised vs non-advised</td>
</tr>
<tr>
<td>5</td>
<td>Some CVS can be classed as “core motivators”</td>
</tr>
<tr>
<td>6</td>
<td>Some attributes are more important than others</td>
</tr>
<tr>
<td>7</td>
<td>There were gaps in the model</td>
</tr>
</tbody>
</table>

7.3.1 Finding 1 - Trust & Recommendation (Net Promoter Score (NPS)) have slightly different drivers

Although we saw differences in driving Trust and Recommendation, the CVS statements were closely grouped around the central regressed “Fitted” line. This
means there is a close relationship in what drives both indicators. The Payout statement came out higher for Trust but we were mindful that the statement referenced to having empathy which may have pushed this into a more emotional measure. We also gathered from a review of verbatim answers concerning trust and recommendation that “Communications” as a statement is an enabler for a number of other attributes. Hence it carries more weight than its “importance” score alone. The linear regressed Fitted Line is set out below in Figure 47.

Figure 47 – Regressed Best Fit Line of Trust & Recommendation

The table below highlights how the Statements compared in respect of importance as drivers of Trust & Recommendation (Net Promoter Score).
As can be seen, Track record is the most important drivers of Trust and NPS using the responses but that the actual stated preferences reference Payout as the most important.

It is also interesting that Membership fared much lower across the results, highlighting the gap in understanding how mutuality can improve outcomes for customers.

7.3.2 Finding 2 – Drivers of Trust & Recommendation vary by product

Respondents were analysed by the products they stated they had recently purchased, which was in turn synthesized into the segmentation model categories. The results indicate that associations of CVS importance differed in accordance with the product held by customers and that this in itself differed between what drive ‘Trust and what drove Recommendation. For example, customers holding a Group Personal Pension highlighted the importance of Payout in contributing to greater trust and willingness to
recommend a firm. However, as a driver of trust, the investment performance was also very important for these people. This supports the view of higher level trust as something built up over time: simply that it requires a period between placing monies with a firm and then revisiting to see if has increased. This is reinforced by the results for the Track Record CVS. It requires a period of time to build up an experience. This is placed as more important across product holders for achieving Trust than for Recommendation as shown in Figure 48 and Figure 49 below.

**Figure 48 – Drivers of trust by product**

*DRIVERS OF TRUST: DIFFERENCES BY PRODUCT*

- **Annuity** – more importance on Payout than other CVS
- **Endowment** – more importance on Sales e.g. information supplied and clarity and Membership (in this case this means more loyalty benefits)
- **Group Pension** – more importance on Payout
- **Protection** – more importance on Payout (again, this includes the emotional indicator of empathy so it’s not solely about function)
7.3.3 Finding 3 – There is little difference for Trust between Advised & Non-Advised except for Service

The respondents were also cut into groups who had bought a product with advised and those who had responded to direct marketing or purchased a product from their own initiative. The results were broadly similar across all CVS which reinforced the view from the earlier focus groups that the role of financial advisers was of a lower level of interest than the actual services or product purchased.

The main difference that emerged from the analysis was around Service attributes. This was higher for the cohort of customers who had not purchased a product through an adviser. This is an interesting result as it perhaps reflects a view that once an adviser has been engaged, he or she acts as an ongoing agent for the customers. This was picked up by the working group as a potential area of further study. We could, for instance review the number of sales made internally through an adviser and check this
against the number of ongoing Letters of Authority held on file. It may throw up a discrepancy between belief and actuality, thereby indicating a level of overconfidence and perhaps “over-trust” with financial advisers. This could explain the persistent high levels of trust in the FSI results and also support its view that post RDR clarity may actually lead to lower levels of trust. Customers who actually understand such ongoing service comes at a cost may then have lower levels of emotional “affective” trust in their broker (see Figure 50).

**Figure 50 – Advised vs Non Advised Drivers of Trust**

![Advised vs Non Advised Drivers of Trust](image)
7.3.4 Finding 4 – There is some difference in drivers of Recommendation by advised vs non-advised

This can be echoed for the Recommendation drivers, although the results from the analysis (Figure 51) indicate that consumers who have been advised place more importance on Sales, Product Design & Investment. This result indicates that advisers have a role to play in raising awareness, and thereby financial capability, of the process of buying and comparing a product. The focus on Sales in particular indicates that advised customers engage more with the product literature than non-advised. This CVS had been added further to engagement with FCA on assessing conduct risk within the business and is focussed on point of sale and marketing literature.

Figure 51 – Advised vs Non Advised Drivers of NPS

- Advised consumers attach higher importance to Sales, Product Design and Investment
- Non advised attach higher importance to Service and Comm
7.3.5 Finding 5 – Some CVS can be classed as “core motivators”

The CVS results which were plotted onto the Fitted line between the Stated Importance and the Trust derived attributes were reviewed with a view to establishing if there were any that stood out as “key motivators”.

A grouping of five did emerge which are set out in Table 32 and Figure 52 below.

Table 32 – Core Motivating CVS

<table>
<thead>
<tr>
<th>Core CVS</th>
<th>Wording</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payout</td>
<td>They paid out what I expected and were sympathetic to my situation</td>
</tr>
<tr>
<td>Track Record</td>
<td>The way they run their business shows they will still be around when I need them</td>
</tr>
<tr>
<td>Resolution</td>
<td>TBC – Attributes “Empathy” / “Resolved”</td>
</tr>
<tr>
<td>Service</td>
<td>They are easy to deal with</td>
</tr>
<tr>
<td>Investment</td>
<td>I’m confident I will get a good return and the charges will be fair and clear</td>
</tr>
</tbody>
</table>
7.3.6 **Finding 6 – Some attributes are more important than others**

Analysing the discrete strength of importance respondents attached to individual attributes produced some marked differences between attributes.

The following extracts in Figure 53 detail this but the main points to be gained from this are:

- Within Payout, the need to keep claimants updated was a very strong preference (73%)
• For Investment, being honest about the level of charges was clearly very important (66%) and more important than switching or even being able to understand what strategies were employed.

• The Resolution CVS provided a balance of important attributes.

• Within Service and a number of other CVS, a tailored approach was cited as important.

Figure 53 – Attributes driving the CVS

INDIVIDUAL ATTRIBUTES: WHICH ATTRIBUTES MOST DRIVE EACH CUSTOMER VALUE STATEMENT

**TRACK RECORD**

<table>
<thead>
<tr>
<th>Attribute</th>
<th>Percentage of customers in the research that value this attribute</th>
</tr>
</thead>
<tbody>
<tr>
<td>They’re recognised as longstanding experts by industry experts and by other customers like me.</td>
<td>45.5%</td>
</tr>
<tr>
<td>They have been around for a long time and have a good reputation</td>
<td>37.7%</td>
</tr>
<tr>
<td>They are transparent and fair about employee’s pay and bonuses</td>
<td>16.8%</td>
</tr>
</tbody>
</table>
## PAYOUT

<table>
<thead>
<tr>
<th>Attribute</th>
<th>Percentage of customers in the research that value this attribute</th>
</tr>
</thead>
<tbody>
<tr>
<td>When making a claim or waiting for a payout, they would keep me updated on progress</td>
<td>73.7%</td>
</tr>
<tr>
<td>They would handle claims with empathy (e.g. for life assurance or critical illness policies)</td>
<td>17.8%</td>
</tr>
<tr>
<td>When making a claim on a critical illness or life assurance policy, they would offer extra support such as a second medical opinion</td>
<td>8.5%</td>
</tr>
</tbody>
</table>

## INVESTMENT

<table>
<thead>
<tr>
<th>Attribute</th>
<th>Percentage of customers in the research that value this attribute</th>
</tr>
</thead>
<tbody>
<tr>
<td>They are open &amp; honest about any changes</td>
<td>66.3%</td>
</tr>
<tr>
<td>It is easy to understand the performance of my funds</td>
<td>16.7%</td>
</tr>
<tr>
<td>They would tell me if my investment could be performing better, so I could take action</td>
<td>9.0%</td>
</tr>
<tr>
<td>It would be easy to switch investment funds if I wanted to</td>
<td>8.0%</td>
</tr>
</tbody>
</table>
### RESOLUTION

<table>
<thead>
<tr>
<th>Attribute</th>
<th>Percentage of customers in the research that value this attribute</th>
</tr>
</thead>
<tbody>
<tr>
<td>If something went wrong they would empathise with me and show they understand my situation</td>
<td>31.5%</td>
</tr>
<tr>
<td>If something went wrong they would apologise and take ownership for my issue/problem</td>
<td>30.3%</td>
</tr>
<tr>
<td>If something went wrong, they would allow me to decide when the issue is resolved</td>
<td>24.2%</td>
</tr>
<tr>
<td>If something went wrong, they would compensate by giving me a gift/something I’m not expecting by way of an apology</td>
<td>14.0%</td>
</tr>
</tbody>
</table>

### PRODUCT DESIGN

<table>
<thead>
<tr>
<th>Attribute</th>
<th>Percentage of customers in the research that value this attribute</th>
</tr>
</thead>
<tbody>
<tr>
<td>Their products are designed for people like me</td>
<td>37.9%</td>
</tr>
<tr>
<td>They provide competitive products</td>
<td>21.8%</td>
</tr>
<tr>
<td>It is clear what is guaranteed and what is not in my product</td>
<td>18.7%</td>
</tr>
<tr>
<td>They provide existing customers with the same deals as new customers</td>
<td>11.6%</td>
</tr>
<tr>
<td>I can tailor the product to my changing needs over time</td>
<td>9.9%</td>
</tr>
</tbody>
</table>
**SERVICE**

<table>
<thead>
<tr>
<th>Attribute</th>
<th>Percentage of customers in the research that value this attribute</th>
</tr>
</thead>
<tbody>
<tr>
<td>They would keep their promises in terms of timescales, and what they will do</td>
<td>26.4%</td>
</tr>
<tr>
<td>The first person I speak to would be able to answer any questions I have, and would be empowered to make decisions</td>
<td>23.5%</td>
</tr>
<tr>
<td>They would know who I am, keep a record and remember me when I contact them</td>
<td>11.7%</td>
</tr>
<tr>
<td>They have extended call times, including late evenings/weekends</td>
<td>9.9%</td>
</tr>
<tr>
<td>I am able to personalise my account online</td>
<td>9.4%</td>
</tr>
<tr>
<td>They provide freephone numbers for me to call them</td>
<td>7.5%</td>
</tr>
<tr>
<td>I have a named personal contact and their direct contact details</td>
<td>6.1%</td>
</tr>
<tr>
<td>I am able to see the person I’m talking to</td>
<td>5.6%</td>
</tr>
</tbody>
</table>
**COMMUNICATIONS**

<table>
<thead>
<tr>
<th>Attribute</th>
<th>Percentage of customers in the research that value this attribute</th>
</tr>
</thead>
<tbody>
<tr>
<td>They provide me with concise communications highlighting the key information that I need to know</td>
<td>23.2%</td>
</tr>
<tr>
<td>They communicate with me in plain English, with no jargon</td>
<td>22.4%</td>
</tr>
<tr>
<td>They proactively provide updates on the performance of my products</td>
<td>21.1%</td>
</tr>
<tr>
<td>They are clear on terms &amp; conditions and charges at all times</td>
<td>18.8%</td>
</tr>
<tr>
<td>I am able to choose how we communicate with each other (e.g. phone/email/online/post) and how often we communicate</td>
<td>14.4%</td>
</tr>
</tbody>
</table>

**SUPPORT**

<table>
<thead>
<tr>
<th>Attribute</th>
<th>Percentage of customers in the research that value this attribute</th>
</tr>
</thead>
<tbody>
<tr>
<td>They play a role in educating people about managing their finances and preparing for their future</td>
<td>51.5%</td>
</tr>
<tr>
<td>They provide me with information about what is happening in the market and tell me how this might be relevant to me</td>
<td>48.5%</td>
</tr>
<tr>
<td>Attribute</td>
<td>Percentage of customers in the research that value this attribute</td>
</tr>
<tr>
<td>----------------------------------------------------------------------------</td>
<td>------------------------------------------------------------------</td>
</tr>
<tr>
<td><strong>SALES</strong></td>
<td></td>
</tr>
<tr>
<td>It is easy to work out if the product is suitable for me, in terms of its risks and benefits</td>
<td>40.1%</td>
</tr>
<tr>
<td>They explain their products in an engaging and clear way</td>
<td>39.1%</td>
</tr>
<tr>
<td>I don’t have to switch from my preferred communication channel (e.g. phone /email/online/post)</td>
<td>20.8%</td>
</tr>
<tr>
<td><strong>RESPONSIBILITY</strong></td>
<td></td>
</tr>
<tr>
<td>They support local communities and charities</td>
<td>54.9%</td>
</tr>
<tr>
<td>When deciding where to invest, they take account of the ethical, environmental and social impact</td>
<td>29.0%</td>
</tr>
<tr>
<td>They are open &amp; honest about where they invest my money</td>
<td>16.1%</td>
</tr>
<tr>
<td><strong>MEMBERSHIP</strong></td>
<td></td>
</tr>
<tr>
<td>I receive loyalty benefits for being an existing customer</td>
<td>58.9%</td>
</tr>
<tr>
<td>They share their profits with their customers</td>
<td>41.1%</td>
</tr>
</tbody>
</table>
7.3.7 Finding 7 – There were gaps in the model

My analysis confirmed that the attributes for Resolution warranted this being captured as an additional CVS within the framework. Resolution was not fully articulated but the verbatim results (see Figure 54 and Appendix 1) and attributes suggest the following broad definition: “Turning a potentially poor experience into a great one”. The focus group results made it clear that customers expect problems in the industry – and expect it to be difficult to get problems resolved. Furthermore, the quantitative analysis shows the way problems are handled is a key driver of the customer experience, driving primarily Trust (it was 4th important) but also linked to Recommendation (7th). The initial group discussions focussed on this as an element of the Service CVS however in light of the strength of results in the research, a proposal (Figure 55) was made to Steering that this be considered a CVS in its own right.

Figure 54 – Verbatim Quotes

RESOLUTION – SUPPORTING QUOTES

- If a product is no longer performing, I would expect to be contacted and given recommendations
- If I’ve been through a horrendous process, I want some kind of compensation for my time and trouble
- There are some good people out there, who actually want to offer a fantastic service
- I’m always pleasantly surprised if anything goes well. It doesn’t happen very often does it?
- There’s no accountability is there...they are faceless
Figure 55 – Resolution Drivers

RESOLUTION
“TURNING A POOR EXPERIENCE INTO A GREAT ONE”

- This was identified in the qualitative research as a gap in our CVS
  - We had assumed this would be part of Service, but the qualitative research showed that this is a critical experience for consumers and may need to be given its own focus
  - The quantitative research has confirmed its importance: Resolution is a key driver of both Trust (4th) and to an extent for Recommendation (7th)

- We need to decide whether to make resolution a CVS in its own right

RESOLUTION
I feel a sense of achievement
I am reassured you can help and are doing/did everything you can for me
I understand what has happened/will happen, why, and who to contact
We have a mutual understanding
I get what I wanted/expected
I am put back in a better place than where I started
I get a ‘bonus’/added benefit

Take responsibility
Apologise and investigate my issue/problem (no questions asked)
One consistent point of contact all the way through
Give me the info I need if I want to escalate/make a complaint

Empathise
Ask questions/respond in a way that shows you understand & sympathise with me & my situation

Solve my problem
Explain the root cause of the problem & the process/your investigation
I decide when the issue is resolved

Compensate me
You tell me about aftercare/support/services
Deliver the outcome that I expected first time
You give me a gift/something I’m not expecting by way of apology
The 2\textsuperscript{nd} gap identified from the research was around tailored offerings, responses and treating customers as individuals. The working group defined this as: “I am treated as an individual and get an experience based on me & my needs”. The verbatim quotes in Figure 56 reinforce how important this is.

**Figure 56 – Personalisation Verbatims**

**PERSONALISATION – SUPPORTING QUOTES**

- I think the industry is so commission based I feel they want to sell to you, make their money then forget you. 
  - Endowment

- I used to be contacted by a person to start with. The emails can come later on to update me on how funds are doing. 
  - Private Pension

- They must have a relationship with me. I have three daughters with three imminent weddings – You know for them to ask “How are those three weddings getting on? Just means they recognise me.
  - Private Pension

- We’re just a number really. The first question they ask is ‘What is your policy number’? It’s never your name is it?”
  - Protection – Direct

- Speaking to one person, it just makes you feel, you’ve got that confidence there, haven’t you?
  - Annuity

- I feel valued and that for me is important – especially in this day and age.
  - Protection – Protection

- I can phone up and speak to one person. I’ve got one contact point with them – I don’t have to go through everything again. We have a rapport.
  - Annuity

- I feel in this day and age they need to make me feel more of an individual somehow.
  - Endowment

In terms of the attributes which were correlated with personalisation, eight were identified which originated in five individual CVS. Table 33 details this.
Table 33 – Importance of each attribute within corresponding CVS

<table>
<thead>
<tr>
<th>CVS</th>
<th>Attribute</th>
<th>Importance within CVS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Service</td>
<td>They keep their promises in terms of timescales, what they will do</td>
<td>26.4%</td>
</tr>
<tr>
<td></td>
<td>They know who I am</td>
<td>11.7%</td>
</tr>
<tr>
<td></td>
<td>I have a named personal contact</td>
<td>6.1%</td>
</tr>
<tr>
<td>Comms</td>
<td>I am able to choose how we communicate with each other</td>
<td>14.4%</td>
</tr>
<tr>
<td>Membership</td>
<td>I receive loyalty benefits for being a member</td>
<td>56.9%</td>
</tr>
<tr>
<td>Product Design</td>
<td>The products are designed for people like me</td>
<td>37.9%</td>
</tr>
<tr>
<td></td>
<td>I can tailor the product to my changing needs over time</td>
<td>9.9%</td>
</tr>
<tr>
<td>Sales</td>
<td>I don’t have to switch from my preferred method when I change product</td>
<td>20.8%</td>
</tr>
</tbody>
</table>
The schematic below in Figure 57 shows the context within the various attributes.

**Figure 57 – Personalisation Attributes**

THERE ARE 8 “PERSONALISATION” ATTRIBUTES, SPREAD OVER 5 CVS.
Further to discussion, it agreed that although personalisation was very important, the attributes cited varied in exactitude about what personalisation really meant. Given that it lived within so many other models, it was viewed as an enabler rather than an individual Trust driver.

7.3.8 Finding 8 - Membership & Responsibility offer little perceived value to consumers

The quantitative research confirmed that these two CVS have the lowest impact on both Trust & Recommendation. This was not initially flushed out from the Focus groups but analysis of the verbatims in Figure 58 indicates that Customers struggle to understand what these mean, and what benefits they offer to them. The working group felt this is more than a capability issue but possibly that a gap existed in financial services firms’ performance in these areas generally.

Generally a low level of understanding existed amongst a majority of both internal customers and customers holding other firms’ products. The majority of customers and non-customers did not spontaneously discuss CSR as important in driving trust and recommendation. Support in local community seems to have most resonance – supporting charities less so and this is deemed a more ‘personal choice’. There is an expectation that companies within financial services should be upfront about where they are investing – and this should be clearly accessible to all.
There is generally a low awareness of Membership, which is not top of mind for consumers and does not currently influence consumer decision-making. The term ‘member’ is generally preferred to ‘customer’ as it implies a more personal experience. However, being a member has mixed appeal due to a current lack of tangible experiential benefits to customers. Membership also implies a sense of ‘belonging’ and long-term relationship, which the research indicates underpins Trust. Tangible benefits such as ‘discounts’ or preferential rates are expected from membership or for loyalty. Some customers claim that ‘having a say’ also appeals, though it is unclear as to whether or not they would actually exercise voting rights. See Figure 59. The working group considered the very low take up of voting amongst Royal London’s 5.5m customers historically (less than 1%).
7.3.9 Finding 9 - Trust & Recommendation differs by segment

A small piece of analysis was conducted to map the quantitative results against the internal FSS customer segmentation model already in operation by the company. The FSS model developed internally was broadly that of the standard Experian FSS segments but as is common - such as with the FCA Spotlight segmentation model (FCA, 2014c), has been blended with internal metrics. The results indicated different segments of consumers had differing levels of trust and so a “one size fits all” approach may not be appropriate.

This is interesting and expands the literature and post RDR trust surveys that confirm some variance in trust by experience. For example, whether an adviser has been used,
whether a product has been purchased, whether in the UK, and so on. The chart below, in Figure 60, indicates this on a consolidated FSS category basis.

Figure 60 - Trust & NPS by segment

**DIFFERENCES BY SEGMENT**

<table>
<thead>
<tr>
<th></th>
<th>1 Struggler</th>
<th>2 Giver</th>
<th>3 Wanter</th>
<th>4 Worrier</th>
<th>5 Achiever</th>
<th>6 Contented</th>
</tr>
</thead>
<tbody>
<tr>
<td>NPS</td>
<td>-39</td>
<td>-31</td>
<td>-43</td>
<td>-44</td>
<td>-9</td>
<td>-25</td>
</tr>
<tr>
<td>Trust (9 or 10 out of 10)</td>
<td>19%</td>
<td>27%</td>
<td>19%</td>
<td>15%</td>
<td>40%</td>
<td>36%</td>
</tr>
</tbody>
</table>

The graph in Figure 61 articulates this difference further by showing how the FSS individual sub-categories of consumers plot against both Trust & Recommendation.

Figure 61 – Plotting FSS against Trust & Recommendation
Interestingly, when the data was cut amongst customers who held a product with Royal London, the most positive feedback was from Seasoned Economy, Traditional Thrift and Stretched Finances which contained high proportion of directly marketed or non-advised customers. Segments which were well represented in the intermediated business.

Consolidating Assets, Growing Rewards and Established Reserves were least positive overall.

This indicated some scope for further research to be undertaken to determine the role that a financial adviser plays in driving trust levels in financial services overall. The working group agreed a good basis for further study would be to run a Trust survey for both cognitive and affective Trust levels between advised & non-advised consumers from similar FSS segments. This may drive out if there is an “adviser effect”.

7.3.10 Finding 10 - The single focus of articulating and driving customer value should be on improving Trust

A dedicated working group session was undertaken to focus on the relative importance of Trust vs Recommendation. The latter was included as a commercial driver and arose from the early discussions focussed on brand but there was some consensus that the focus groups and quantitative results had subject which resonated with customers. The starting point for this was a review of the verbatim quotes. Further examples are in the Appendices two and three but a summary slide is shown in Figure 62.
Next, a summary of “Detractor” themes was produced which got to the heart of why customers don’t engage or don’t like financial services. This was built up from the initial focus group and then the quantitative attribute results. Examples are in Figure 63.
Further to this, the NPS detractor themes (see Figure 64) were examined and it was clear that communications on an ongoing basis were important, as was a trusted relationship.
What was surprising from the results was that a high proportion of customers (62%) who would never recommend any company would be unlikely to under any circumstances. The schematic below in Figure 65 illustrates this.
Trust was the proposed basis for taking the model forward because there is a qualitative argument to say; “I have to trust them before I recommend them”. Generally, trust is growing measure of business success (we see this across other studies and wider academic investigation.) c70% of detractors state they would never recommend which is a potential ‘unable to influence’ group. After further discussion, the group agreed by consensus that Trust should be the overarching objective for the firm and that the CVS model should be honed to focus on this, in the expectation that Recommendation - as a commercial objective - would be enhanced by being more trustworthy.
7.4 Concluding discussion

Due to the wide ranging and iterative nature of the process and resource constraints, some of the insights generated from the CVS could not be further explored with further consumer test. It was agreed from the Steering Group that further research should be undertaken to decide whether “Responsibility” and “Membership” remain as valid and independent CVS, given their low scores. The low score for these statements were a surprise and somewhat inconvenient for the sponsor of the research, given my status as an employee mutual insurance society. Furthermore these are not highly correlated with other CVS, meaning (from the customers’ perspective) there is no natural alternative home for them. This testing was planned for 2016.

An interesting emerging theme was the extent to which the Means-End chain analysis results were potentially aligned with the Cognitive / Affective articulations of trust in the literature (Ennew, 2007). The pattern that emerges from the attribute scores was that the interactions with a product or a provider had great impact on emotional (affective) attributes whereas perceptions of product, services and firms influenced cognitive elements. In order for all customers to ‘really trust and recommend’ an entity, they require significant exposure to the idea of the firm’s proposition from the offset and require at least some ongoing engagement with the experience, which is wholly positive or recovers to as positive state (through resolving an issue, for example). The illustration in figure 66 below helps to capture this:
In terms of this exercise and its applicability to the role of Trust with the RDR, there are some interesting points. The first concerns the FSA’s inability to establish what the drivers of trust were in the retail investment market. This exercise established the drivers of both Trust & Recommendation varied by product but that there were little difference between advised and non-advised. Setting aside the lack of initial benchmarking conducted by the regulator, it is reasonable to envisage that being aware of this from the outset would have enabled a more targeted approach to intervention to be applied. This is particularly true when it comes to the decision to treat non-advised intermediation differently from advised – with commission still allowable to be paid to the distributor. Using an informed trust lens may have enabled a specific product focus to be applied, such as banning commission for more complicated products, regardless of distribution channel.
Further to this, the existence of some CVS as “as core motivators” has a clear read across to the RDR’s intervention to raise trust. My research confirmed that customers focus on Payout, Track Record, Resolution, Service & Investment, rather than understanding the nature of advice (as Restricted or Independent) or the way that advisers get paid. It is interesting that there were no RDR rules concerning service levels and that there was no new product regulation (such as simple products) arising from the regulatory intervention. This is not to say there were not attempts to introduce a simple suite of products at various points (Devlin, 2012) but the lack of focus on product regulation is at odds with the customer viewpoint.

Finally, the assumption that tougher standards and higher qualifications for advisers would raise trust, was not established empirically by the regulator and has not been elicited from the attribute work as a direct driver of increased trust. The focus group work did raise the importance of expertise but this was more generally applied across the landscape, rather than focussed on customers dealing with advisers.
8. DISCUSSION

8.1 Overview

This chapter provides a discussion of the individual objectives of the study based on a reflection of the results of the research activity and the existing literature. It is organised by specific objective but within the context of a discursive narrative investigating the extent to which RDR was a success and whether the prevailing market focussed approach to regulation is appropriate to the welfare needs of the consumers in whose interest it acts.

8.2 Re-statement of Aims & Objectives

This study had two overarching aims:

A. To critically examine to what extent the role of a RDR has been effective as a public interest regulatory intervention, correcting the retail investment market failings identified by the FSA in 2006.

B. To determine if a non-market perspective can be established as an alternative viable basis for understanding interactions between individuals and financial services vendors.

Whilst separate, the aims have inter-dependency in that the rationale for an alternative (non-market) perspective only exists if there was some sub-optimality in the RDR intervention.

To drive towards the second aim, it was therefore necessary to explore the research questions relating to the first. This in turn led to the formation of two sets of objectives, which in very broad terms, reflect the chronology of the activities
undertaken. We can group these objectives into those most associated with Aim A (RDR focus) and those most pertinent to Aim B (alternative to market failure approach).

The specific objectives of the study were therefore:

Aim A

- Objective A1 - Develop a model for framing the distribution of retail investment products and related advised services within the UK.
- Objective A2 - Using the model, attempt to establish the nature of market power and agency in the retail distribution landscape and where, possible draw comparison to the pre RDR landscape, cited as “bust” by Callum McCarthy.
- Objective A3 - Leveraging the model and incorporating open source product sales, complaints and other data, attempt to establish to what extent conflicts of interest have been eradicated by RDR.
- Objective A4 - Utilise the model to establish the extent to which existing trust studies cover the market and establish to what extent it can be demonstrated that RDR has improved trust through improved professionalism.
- Objective B1 - Develop a conceptual framework for articulating and measuring what consumers value within financial services and where material gaps or non-alignment with the market failure model.
- Objective B2 - Establish to what extent the market failure analysis approach is capable of delivering value to those who it seeks to protect, i.e. its consumers.

8.3 **Aim A - Objective A1**

The finalised model which was built was characterised by organising individual firms into clusters against two factors which were elicited from using the concepts of New Flow and accounting for the number of CF30 Retail Investment Advisers extracted from the FCA’s financial services register. The two factors were (i) product
specialism and (ii) firm size and structure. Through this structure it was possible to start to apply some basic criteria and rules for clustering different entities active within the retail distribution landscape. The resultant segmentation model (henceforth described as “the model”) can be defined by its strengths and limitations.

Limitations of the model

i. Relies on disparate data and differing types and sources.

ii. It is judgment based rather than fully quantitative.

iii. Contained products and firms outside the retail investment advice market.

iv. The model does not take into account recommendations which do not lead to a product sale.

The majority of the individual limitations are derived from the first limitation. The model suffers from inconsistent and incomplete reliable granular information on the retail investment market. Starting with the FCA extract, it is not possible to state with 100% certainty the number of relevant, active CF30 individuals in the UK, at the end of 2014. This difficulty was expressed by the FCA’s own commission research into the advice gap, with Towers Watson simply ascribing a figure of 30,000, relying on Touchstone data. My analysis based on reviewing permissions came in at 29,031 which seems reasonable and acceptable for usage, as within 3% of contemporaneous estimate from matrix and within 8% of the FCA’s number issued in January 2014. Nonetheless, it remains a key known dependency and is one of several recommendations this study proposes as necessary to improve understanding and effective regulation.

Similarly, the model relied on subjective expert judgment to aggregate and allocate the flow of assets between and through the UK investment & pensions environment.
Although an aggregated stock flow and assets in circulation figure was calculated, this required a great deal of iterative de-duplication and cross referencing. The Touchstone, ABI, IMA & FCA data do not categorise sales in the same way. For example, FCA product sales data focusses on new cases whilst the ABI utilises an Annual Premium Equivalent. The situation is complicated by the use of product wrappers and provider types, of which there is no definitive taxonomy which stretches across key regulatory agencies such as FCA, TPR, FSCS, HMRC & FOS. For example, ISAs can be cash, stocks and shares or simply ISAs, depending on data sources. Also, the FCA does not capture platforms in its RMAR submissions which all firms are required to make and yet it was clear from this analysis and my own expert knowledge - from leading a platform business - that flows were considerable. Furthermore, firm classification types vary between industry trade bodies, which typically aggregate asset flows, and regulatory submissions. As a result, there is likely to be some error in the flow calculations. This is estimated, based on an anecdotal working group view, of around 10%. Overall, the data uncertainty leads to the second recommendation, which is to create a single version of (regulatory) product and provider categorisation.

The model also relied on subjective judgment to allocate firms into segments. Whilst some rules around business flows were rudimentary – such as a high percentage of offshore bonds, or whole of life – these were effective in delineating areas of activity that different firms focussed on. This has merit as it can be extrapolated into analysis of product complexity, consumer capability and so on. What was less certain was how to treat Networks and unregulated support services such as Simply Biz, which can have an influence on recommendations, creating drivers of agency issues which the model was designed to flag. Whilst a manual approach to allocating the underlying
firms, leveraged a very strong internal capability, it was clear from the resulting analysis that there may be overlaps between large firms and network. The reliance on subject matter expert input could be addressed in future studies by incorporating rigorous cluster analysis techniques, such as those underpinning financial services marketing. To date, clustering techniques have largely focussed on geographical clusters within the economic development field of public policy (Porter, 2000). However, studies such as Dardac & Boitan (2009) do show that clustering techniques can be applied in the regulatory context. Using eight financial indicators based on stock data gathered from banks’ balance sheet, they were able to “identify groups sharing similar features of the financial intermediation activity” (Dardac & Boitan, 2009.116). This is encouraging but it should be noted that subjective assessment cannot be removed entirely. Romesburg and others have pointed to the role that “reasoned analogy rather than by using formal statistical methods” (Romesburg, 2004) are still required to make inferences about the data sets.

The final limitation of the model (in respect of utilising judgment) concerned the Small F-A category. The initial CF30 analysis and existing knowledge made it evident that there would be a long tail of smaller firms and the access to commercial data for such firms was limited by resource and time in this study. There is a fundamental question as to how useful financial accounts for such firms are for commercial purposes, even if they were available. As a result, a decision was taken to focus on turnover & CF30 numbers and treat all that population as “not Controlled Advice (TA)” In theory, this could under-represent the size of the population of Restricted Advice in the UK, but it is not material given the profile of a sample reviewed through the pen portrait work, were all Independent under the FCA status. This was borne out
in the product study which showed a broad range of products being sold by firms in this segment. Finally, recent FCA data bulletins (FCA, 2016) confirm that its reporting overwhelmingly places the small financial adviser as independent. It is unlikely – but possible – that some of these adviser owned small firms would favour a restricted range of providers or such a narrow niche of customer that they would be classed as Restricted.

The decision was made to include Defined Benefit pension protection products and also extend the firm segmentation to include Employee Benefit Consultants. This was done with a view to reflecting what happens in practice in the UK, reflecting the life insurance and employer role in provision of financial products. Including life insurance products in particular was useful in that it brought out the volume of pure protection sales sold by CF30 individuals within their “Professional Investment Firms”. Likewise financial advisers will typically hold “Advising on pension transfer” permissions as part of the standard pack of permissions obtained from FCA. Furthermore, the use of a regulated adviser is mandated by legislation when considering a transfer of Defined Benefit pension benefits. This approach is supported in the literature, with the Europe Economics post implementation research including consideration of wider investment products that exceeded the narrow definition Retail Investment Products (Europe Economics, 2014). This model included non-advised sales which, it could be argued, are outside the scope of an RDR study. However, the role of non-advised sales maintains prevalence currently through reviews such as FAMR and discussions on an advice gap. Further to this, it brings out, this issue, when coupled with the leveraging of the model results discussed further on in this chapter, and supports a challenge to the overall scope of RDR and the prevailing market
analysis paradigm. The market in question does not work in isolation from other products and services which bear the hallmarks of a fuzzy cluster.

An internal challenge was raised early in the data gathering that firms which are less transactional – such as holistic financial advisers and those within professional services firms – may derive a large amount of revenue and exert market power through services rather than product sales. For example, lifetime cash flow planning, inheritance tax planning and placing existing life insurance policies in trust. There is a risk therefore that we are discounting the market power of such firms. This is a fair criticism and derives from a lack of data collected. There is no regulatory requirement to count items of “regulated advice” partly because the permissions categories focus on product related actions such as “advising & arranging investments”. This bias towards products is carried through into all the reporting sources and plays into a wider challenge on the RDR scope. Its reliance on a Retail Investment Product list as the prism through which activity is viewed sets the tone for the whole industry. There is some scope for this improving in that the RMAR records “ongoing Adviser Charging” levels but even this measure is inextricably linked to a product.

**Strengths of the model**

1. *New Flow is a strong metric for establishing influence within the market.*
2. *It can be overlaid with a number of indicators to bring the market to life.*
3. *It can provide a single version of the size of the market.*
4. *It provides a robust description of the flow of assets in the UK.*

Notwithstanding the considerable data reconciliation challenges, it was evident that once the model was in use that when linked to product data, it could be a powerful
descriptor of market dynamics. From this, it was possible to conduct proportion analysis based on product sales, complaints and potentially, customer insight metrics. A highlight of utilising the annualised flow of assets was to flush out the power and concentrated nature of the non-advised sector, which is still potentially able to accept commissions for products sold.

Given that it covers firm propositions and structure, it should be possible for analysis to be undertaken based on a wide range of market factors. For example, FCA thematic studies on certain product areas (such as SIPP or Retirement Income) or by firm sector (such as Appointed Representatives, vertical integration, professionalism - such as percentage of chartered financial planners in each segment – due to its spine of utilising a unique firm reference number and the linkage to product sales figures. Individual firm profitability figures can be mapped in order to track segment sustainability and it should also be possible to plot geographical concentration factors in order to flush out where advice gaps may lie.

The review of the data sources and various industry and trade body reports were synthesised on an exhaustive basis to remove duplication and double counting. For example, SIPP sales were cleansed so as not to reflect counting from aggregate platform groups, asset managers and FCA returns. It became clear once the Total Assets by Product model was confirmed that there was no equivalent calculation in use by the FCA, FSCS or any other regulatory body. The analysis confirmed the long term savings market (i.e. including cash ISAs) as having £3.4trn assets in circulation. This is a huge figure and the graph is reproduced below to illustrate how powerful and intuitive it can be.
By having gross assets set out in such a form, it should be useful for regulatory authorities to put in context just how much detriment is occurring. It is evident from the initial market failure analysis and the initial stab at shaping a solution in DP07/1 (FCA, 2007) that such a picture had not been constructed to such a degree. Figures for market size and contribution to GDP were referenced but not in a uniform manner (my analysis). It is possible that had this exercise been undertaken then, or had there been a similar model, market failure analysis may have resulted in a focus on a different segment or adopted a different approach. For example, using 2014’s picture, it would seem that Defined Benefit pensions or even cash ISAs offer a gross risk greater than that of Life Wrappers. By combining with the complaints analysis – particularly from bank related volumes, it would be possible determine if the net risk was outside of appetite.

The model confirmed that the volume of asset flow within the UK in 2014 was £143bn. This is also an enormous figure and, as per the previous point, indicates at a high level where the greatest potential for detriment, in terms of assets at risk, lies within the long term savings market. The DB category is actually much smaller than initially expected when the gross assets under management were formulated but, after review, project participants involved in corporate pensions recognised the flow of new monies as being into DC, with the overall trend of reducing DB provision evidenced in the prevalence of bulk annuity buy-outs (MM, 2015) and even government papers such as FAMR (HMT, 2015). The model also confirmed the size of the cash ISA market, which as we will see in the next section, is dominated by a concentrated non-advised sector, within which, the banking sector resides which generates a high level of complaints in its current accounts activities. Evidence of the analytical power of the
model can be found in the recent FCA market intervention within the cash ISA market subject to “sunlight remedies” of publishing of the best and worst rates for savers (FCA, 2015). The combination of product, segment, New Flow, complaints and FCA fines and thematic data, all point to a regulatory “hotspot”.

8.4 Aim A - Objective A2

The model which was developed contributed strongly to a good understanding of the retail landscape. Combined with the qualitative input of the project group, this study was able to gain a good grasp of what agency dynamics persisted and whether these were an improvement or not on the pre RDR distribution landscape. The examples of providers owning shares in Networks (such as Tenet, Openwork) and others being fully vertical (St James’s Place) versus the presence of “one man bands” struck a chord as potentially hinting at issues of influence, sustainability, competence and market power generally.

In terms of concentration of power based on product lines, it was possible to identify several concentrated “single product markets” using the HHI figure. The HHI figure in some segments is extremely high. This is obvious for some entities such as Trustee DC pensions sales where employee Benefit Consultants like AON, Mercer and a few others dominate (HHI 6,418). Given the size of assets in the existing DB market and the size of the flows within DC pensions due to AE, this felt like a segment worthy of regulatory examination. Indeed, this is the case with the FCA launch of a Market Review of Asset Management, which focusses on value chains and conflicts of interest in institutional pension sales (FCA, 2015). This data on its own does not indicate
significant issues within the market and it is worth noting that the activity in question was not a major focus of RDR. The market as it was described in Callum McCarthy’s speech and subsequent RDR focus, cited products such as Investment Bond sales as indicators of poor practice.

The model threw out some surprises in that, less obviously, in Personal pensions, Pensions Drawdown and Bonds it is the Small F-A segment exercising most power. However, this is a nuanced picture given the extremely un-concentrated nature of that segment by either number of firms or number of CF30s operating under the small firm criteria that was set. It is perhaps not accurate to define the overall market as concentrated due to the power exercised by this segment. In reality, as evidenced through my own pen portraits based on internal firm data, these firms typically do not act as Restricted advisers and outside of proxy buying power through support services such as Simply Biz, Threesixty and Bankhall and a disparate trade association – APFA – it holds no central standard setting mechanism with which to exploit its power.

The overarching picture that emerged from the analysis was a physical face to face retail advice market which was comprised of (i) not very many very large firms (ii) a small grouping of mid-size professional or holistic financial planning firms and (iii) 50% of the market up by a very large number of small “one man bands”. This structure adds a level of complexity to an already complicated product dynamic; where DB, protection & Cash ISAs are sold by these and non RDR scope distribution entities. A direct comparison to 2007 is not possible due to the fact that the model is based on firm data representing 2014 and that this didn’t exist to the same level of detail in 2007. However, there still is the ability to pick out a few key trends of physical adviser number based on the analysis in hand.
Market power in respect of physical advisers of the largest advisory firms is greater than 2007 and marked by controlled or influenced advice, rather than IFA. The top five firms make up 23% of available CF30 and St James Place dominates with over 3,000 CF30s. operating under a vertically integrated model. This is much more concentrated than the situation in 2007 when Oxera confirmed “in terms of market share, the top five networks, by turnover, had an estimated combined market share of 15.2% and the largest 25 networks (all IFA) had a combined market share of just 21%”. (Oxera, 2009.p14).

Within the model, the Controlled Advice segment has an HHI of 5,524, the highest of all advice segments, whilst all of the top eight firms offer in-house products or investment funds. This is marked difference from 2007, where advisory firms typically had no product manufacturing capability.

Turning to market power by asset flow, it is obvious that the CF30 influence, whilst material in aggregate, is individually less powerful on a pro-rated basis. The Controlled Advice segment distributes more New Flow per head of CF30 than Small F-A and the amount of Non-advised New Flow is significant, representing slightly more than 1/3rd of the entire asset flow. This trend is markedly different from 2007, as is borne out from the product sales data analysis which shows an inflection point in 2012 when non-advised sales for all RIP and RIP equivalent products, overtook those advised.

In terms of the market being as “broken” as in 2007, it is difficult to review on a like for like basis. The aggregate sales volumes by cases is lower than in 2007 and the results at a high level indicate support for a slight downward trend across the majority of RDR products, from the period since RDR was introduced, although this should be
caveated with the knowledge that mis-selling complaints can have a long period before crystallising. The long term trend however, is for aggregate RDR related product complaints to come down. It was not possible through this study to establish the extent to which adviser firms were failing at lesser rate than that at the time of the Gleneagles speech in 2006. At that time, the industry had witnessed the collapse of firms such as Inter-Alliance (merged with Millfield) and Berkeley Berry Birch, as well as heightened focus on product mis-selling with structured capital at risk and pension mis-selling scandals (FSA, 2006). A straightforward review of the FSCS levy limits by category yielded some inconclusive results due to the fact that the Investment Intermediation category includes client money holding entities, which when go bust, create larger effects on the FSCS deposit scheme than the claims made in respect of mis-selling complaints upheld against failed advisory firms. Nonetheless, the high level picture indicates that the levy in 2014 £1,141m is higher than the previous five years and almost double that in three of those years.

A final complicating factor is that it also includes Life & Pensions intermediary category, which has no direct read across to RDR scope. It was noted anecdotally that it feels like less firms are going bust and the project group noted a growing trend of consolidation however that initial discussion could not be leveraged into the model due to the complex way that such acquisitions are structured. For example, Succession Advisory Services requires acquired firms to operate under its platform vertical model but the individual firms are not formally owned by Succession until certain criteria are met. This means that within the data, such firms, may not be recorded by industry sources as closed / consolidated for many years. Furthermore, my analysis confirmed
that the FCA data did not track firms which failed versus those that engaged in an orderly wind down.

The lesson to be learnt from this is that “the market” is not homogenous and is arguable, not a single market at all. This was a point made by the Oxera on behalf of the OFT in its review of the FSMA 2000 “there is good reason to split this market into smaller sub-markets - for example, because the competition or risk and market failure indicators in Steps two and three point to markedly different conclusions” (Oxera, 2003,p17). This has implications for both of the broad aims of the study and the literature. First, it is possible that the limited scope of the RDR to one articulation of “the market” impacted adversely its ability to comprehensively address issues of agency. Small adviser businesses are still predominantly independent and large advisory businesses are not and/or increasingly involved in manufacturing. Self-employed advisers still exist and contingent charging models within vertically integrated business promote a product sale over other recommendations. Rather than focussing on developing a fiduciary standard, applicable to individuals, as in the US (Dept Labour, 2015) to “hardcode” the financial service firm or adviser’s role as an agent of the customer, the FSA focused on a range of subordinate rules (the COBS provisions) to provide checks and balances. In this regard, the over-riding judgment of RDR in terms of its impact on the structure of the market, is simply that issues of agency have simply changed in nature, rather than been eradicated.

There are implications for the second of the study’s wider aims too. The prevalence of agency issues as found in the post RDR modelling could be cited as examples of “Peltzman effects” after the economist who identified “off-setting” when regulation creates behaviours that alter the intentions of the laws. In other words, regulation can
simply “squeeze the balloon” (Leitzel, 2015, p.1). This concept is not unknown in the regulatory literature, it is the “mimicking, believing, undermining, operating and resisting” referred to by MacKenzie et al, (2007). Ring also employs the self-same analogy “push air out of a partially inflated balloon” (Ring, 2015, p.20) but goes further by citing the nature of other problems popping up as an indicator of performance and counter-performance. Taken on its own, the model analysis of agency and market power provides support for the idea that the regulator has “shaped its own reality” (Ring, 2015, p.20) but this on its own does not provide conclusive evidence to falsify market failure theory. Neither does it demonstrate that any use of the economic concepts of competition and market power is not correct. In the case of the RDR, it may be appropriate to cite the inappropriateness of the tools used and the narrow scope of the intervention as contributory to any failure to manage the risks arising from agency. In simple terms, if it was known in 2006 that “incentives matter”, was it not simply a failure of execution to not deal comprehensively with incentives operating across the landscape? Judging whether the pursuit of “efficiency” in RDR was flawed relies on incorporating the other aspects of this study, looking at conflicts of interest, information asymmetry and trust. These are explored further below.

8.5 Aim A - Objective A3

The overall conclusion provided by the exercise is that there are less obvious and less direct material conflicts of interest operating within the advisory sector. In this regard, RDR has been a clear success and there is a logical basis for assuming that all things being equal, advice to customers should improve. It also found that information
asymmetry had worsened, or at the very least had transmuted in nature but not been reduced.

The literature review conducted prior to this work highlighted that a key economic concept which underpinned the market failure analysis, and the market failure paradigm, concerned information asymmetry.

The starting point of the study was an understanding that financial capability, like trust, suffered from a relative lack of consensus around its definition and similar heterodox approaches to measuring it. The key concept within capability which this study identified concerned literacy.

The overriding conclusion gained from the summary review of regulatory efforts is that not much progress has been made since the FSA first engaged with pursuing what was a mandatory objective. Efforts to improve customer ability to understand the financial system through improved financial literacy never really progressed beyond the establishment of a baseline survey in 2006. Although much cited for its efforts in progressing an understanding of the “domains” of financial capability, the baseline was not repeated. It has offered only a handful of questions which have been taken forward, on a single occasion in 2013 by the successor body tasked with overseeing capability, the Money Advice Service. In terms of regulatory obligations, it is clear that the amendment to the FSMA - which created the MAS - served to reduce the FSA & FCA’s direct interest in improving the “buy-side” capability of consumers. However, there appears to be little clear results that indicate the FCA changed its approach to information asymmetry following the De Meza study finding that informational aspects were not primary drivers of poor financial literacy. Also, as can be seen from the three wave study from the Personal Finance Society, overall
awareness of regulatory changes had actually declined slightly in 2014 (29%) from the previous year for both unadvised and advised respondents. This indicates that even baseline knowledge of the regulatory intervention had dropped.

The overall picture is somewhat dispiriting and there is some merit in challenging the original view that asymmetry could be resolved through disclosure and similar regulatory tools. This directly challenges the regulatory consensus which existed at the time, which focussed on addressing information imbalances as a way to improved market power. As Ring has described, many attempts at this have been undertaken, all to no avail (Ring, 2004). This therefore is an example of the intellectual capture which is not necessary a result of private interests, as argued by Booth (2008) but more a reflection of the “intellectual zeitgeist” referred to by Lord Adair, originating from factors wider than expanding their own empire (Medinger, 1987; Ayres & Braithwaite, 1991).

This study indicated that the landscape has actually become more complicated with a range of complexities greater than that which existed prior to RDR being introduced. This is a clear example of the cure being worse than the disease, i.e. counter-performativity in action. For example, in advice types – we now have Simplified; Basic; Focussed; Generic regulated advice; Regulated personal recommendations (full advice). It is complex to the extent that the UK government is currently consulting as whether to amend the Regulatory Activities Order to simplify matters. (HMT, 2016).

In firm types, we now have Independent and Restricted (who can both recommend products from a reduced panel of providers, who may or may not have financial interest in their performance). Firms can be Independent for investments but still sell protection from a single insurer. In terms of remuneration, there are hourly fee,
packaged fee, commission offset, contingent charging; ad valorem charging; Adviser Charging.

Finally, in terms of Products, we now have Stakeholder; CAT standard Simple; a Retail Investment Product list which excludes cash ISAs, NS&I products, Insurances, Mortgages; Unregulated collective schemes (NMPIs); Occupational pensions; Credit products.

It seems clear that the RDR intervention has resulted in a changed market but the fact is that there is no evidence that it is simpler to navigate for consumers. This was borne out by its own limited study which indicated low awareness of when a fee was paid versus commission (Europe Economics, 2014). There is a case for concluding that the original scope of the initiative has simply pushed air out of the balloon rather than punctured it (Ring, 2015).

Turning to incentives that could drive the exploitation of information asymmetry, the eradication of commission has put product providers on a more stable footing, now that payments for intermediary advised product sales does not come out of the provider expenses but from the product itself. This Adviser Charging covers almost all occasions in the advised market, although it should be noted that Consultancy Charging - commission of another type - was only abolished due to intervention from the occupational authorities (DWP & TPR) in conjunction with a desire to ensure the Auto Enrolment reforms were successful. In a similar vein, it should be noted that the reduction in product charges for pensions which is commonly cited as being a result of the RU64 Stakeholder reforms, has been more markedly affected by the charge cap introduced by the UK government. The Stakeholder regulations limited pensions charges to 1.5% amc per annum whereas the charge cap is 0.75%.
Furthermore, in terms of dealing with the potential for conflicts of interest to be exploited, it was the OFT rather than the FCA which highlighted that group personal pensions was “one of the weakest buy-side markets seen in the UK” (OFT, 2013, p43). As a result, the ABI worked from the recommendations of the independent project board chaired by Carol Sergeant, looking at legacy scheme charges and, as a result, recommended the introduction of Independent Governance Committees. The FCA’s role in this is as the operational delivery mechanism, through amendments to its handbook (FCA, 2014).

This study found that conflicts persist, although in transmuted form. These revolve around the same basic concepts of remuneration, product and provider influence and regulatory arbitrage.

Taking the first element, we can see that the introduction of Adviser Charging has not resulted in the disappearance of competing interests, or to use the economic concept; agency issues. The qualitative aspect of this study involved the development of pen portraits which when used with the data, highlighted that drivers of agency issues remain.

The first is the self-employed model. This was cited in an FCA thematic review of firm remuneration in 2013 and, in its crudest form, can be a solely volume based generator of reward. Where firms have graded retention payment systems, this can place undue pressure to make a sale and is particularly harmful when there are no attendant controls to the quality of advice. In networks, this can lead to ARs operating with differing motives from the main firm, a manifestation of the Principal-Agent problem. The networks in the model such as Tenet and Intrinsic offer self-employed
models although it could be argued that small firms suffer from a similar problem, without the central compliance requirements imposed by management.

The second is contingent charging. This has been cited in national press such as the Daily Telegraph and concerns arrangements whereby advisers are only paid if a product sale is agreed. The FCA was also initially concerned, raising it as an issue in its first phase of disclosure testing in 2013 and then through comments made by the CEO Martin Wheatley (FCA, 2013; MM, 2014). This can create a bias towards a product sale rather than holistic financial planning such as placing products in trust or gifting assets for IHT. The payment is “contingent” on a sale. It has a greater risk when combined with vertically integrated firms with ostensibly low advice costs and more expensive product charges. The primary control on such a mechanism is the FCA rules that prevent sustained cross-subsidy between distribution arms and providers. Perhaps worryingly, the FCA picked up an action from the recent FAMR review to “clarify” this requirement in order to ensure undue barriers were not in place preventing greater provision of advice. This was seen as less prevalent in C-A / EBC / Holistic / Private Client segments and within the working group, only the St James Place business was identified as being in this category.

Third, is Ad Valorem charging, this is essentially when charges are expressed as percentage of assets advised upon or the size of a transaction. It was cited by FCA as opaque and counter to FCA handbook COBS 6 requiring charges to be expressed in pounds and pence where possible. The competing interest here is that it charges customers more for managing or advising on larger assets although adviser costs for such activity are based on largely fixed elements. There is subsidiary competing interest in that it incentivises advisers to focus on wealthier customers, thereby
contributing to an advice gap in certain customer segments. Finally, it rewards short term “up-risking” where clients are kept in growth assets when could be drawing down on their risk based assets. My analysis identified that this was common across financial adviser landscape and particularly in platform or wealth management sales but less prevalent in C-A / EBC / Holistic / Private Client segments.

Fourth, commission offset. Although the FCA has rules on cross-subsidisation it is still perfectly compliant for advisers to offset RDR advice related fees due by commission earned by the sale of pure protection products. Or when advisers gain a procuration fee for a mortgage sale. This also creates further complexity in client agreements and introduces a potential conflict around commission based sale for protection and mortgages. Somewhat confusingly, advisers can be Independent for RDR business and Restricted for mortgage and protection, as the Independent concept has not made it into the handbook. Insight from this analysis indicated that this is relatively common in generalist adviser segments such as Small F-A and Large F-A.

Finally, it is noted that it is still possible for firms to earn commission on execution only and non-advised sales of RDR products. The FCA’s 2014 review of online annuity brokers indicated potential issues with customer journeys and promotional materials which it cited as contributing to consumer detriment (FCA, 2014). This kind of arrangement was mitigated in part by the FCA’s banning of cash rebates in platforms which was seen as an inducement that would create a conflict of interest between asset managers, platform providers, advisers and their customers. That notwithstanding, it is still possible to earn commission through non-advised sales and with the advent of pension freedoms, this marries a conflicted model with a higher risk transaction (as defined by the FCA in 2015). This risk was actually called out by the
Financial Inclusion Centre in its response to the first discussion paper on RDR – DP 14/07 – where it drew attention to the limited scope and the potential for bancassurance and non-advised models to prevail in the new world (FIC, 2007).

This study undertook some analysis around product sales and critically reviewed the statements made in the post implementation review that bias had been reduced (Europe Economics, 2014). The analysis found a mixed picture with the overall conclusion that product mixes had not changed substantially as a result of RDR’s commission band, although the increase in professional attainment (Chartered Financial Planner status) does point to more competent financial planning skills (Personal Finance Society, 2015). Using the admittedly limited FCA product sales data, we found the overall trend from before the RDR period until now was for much less sales overall.

The EE report focussed heavily on Investment Bond sales and this is a theme picked up from Oxera work in 2009 which sought to identify what impact the RDR could have. There is no doubt that Investment Bond sales historically were associated with higher initial commission and it is reasonable to state that acted as a disincentive to apply diversification techniques to customer portfolios (CRA, 2006; FCA, 2007; FOS, 2012). However, this insight determined that the long term trend for Investment Bond sales from well before RDR introduction, was downward. Indeed the rate of decline for Unit Linked Bonds sales as a standalone category (95,066 in 2006 to 22,463 in 2010) illustrates the extent to which market behaviour was already changing before the January 2013 changes came in.
Furthermore, Unit Trust & ISA sales far exceeded those of Bonds consistently through the period, although ISA sales decreased markedly after the global financial crisis of 2009. Unit Trusts actually experienced an upturn following the introduction of RDR. Investment Trust sales within the overall context of the period, were, and remain negligible in terms of percentage of the sold product volumes. The vaunted Investment Trust sales figures are still tiny, although this could reflect a more complicated product which was traditionally the domain of stockbrokers and direct sales. The scandal around split capital investment trusts “zeros” in the early part of this century could also have contributed to an overall lukewarm response from the adviser community.

The FCA and associated literature is silent on provider bias yet this was a core part of the overall market failure analysis in 2006 (FCA, 2007). The fact that the RDR objectives incorporated a desire for “providers to compete on products rather than access to distribution” (FCA, 2011) confirms this. The model analysis has already demonstrated that influenced advice is prevalent in some segments but a key constraint remains the lack of central regulatory record of Independent vs Restricted status. Until it is easy to identify which firms operate on such a basis, enquiry will be fraught with difficult and information sources will be less reliable.

The potential for poor outcomes to result from provider bias is markedly less, however Europe Economics’ study in 2014 cited improved professionalism and it stands to reason that as advisers are remunerated from the customer, they have less interest in favouring one provider over another. The downward pressure on group pensions and investments generally is partially due to share class changes introduced by the FCA (“the sunset clause”) and the fact that moving a life based investment will cause
existing longstanding trail commission to cease, further creates a disincentive to “churn”.

The main competing interest that remains in respect of provider bias simply concerns the provider ownership of adviser firms and the prevalence of firms to develop manufacturing capabilities. The model indicated that firms like Towry, SJP, Succession, Intrinsic, Bellpenny, Fairstone and Tilney were all actively growing. Whilst the increased professionalism and developing compliance competence in such firms may reduce the chance of poor advice, it could be that an elongated period of cross subsidy (by spending heavily on recruiting advisers & marketing to customers) from product charges, simply creates a different kind of market distortion. This may be palatable from a regulatory perspective in that the potential for overall detriment may be low and it may be easier to supervise a few well capitalised vertical firms.

In summary, the study therefore confirms that conflicts do remain. Indeed, as recent as April 2016, the FCA was still concerned that providers were “subverting the spirit of RDR” through use of hospitality (FCA, 2016c) and also that it was concerned that material conflicts of interest had shifted to asset management. The Market Study initiated in 2016 highlights this, (FCA, 2016). It would seem that RDR has by and large, corrected the specific conflict of interest which existed in respect to commission based selling but that in doing so, it has created some unintended effects. These include advisory firms moving up the value chain, the growth of non-advised sales, and the retreat of bancassurance advice models (although this was a trend prior to RDR as branches closes {HMT, 2015). Yet the types of products sold have not changed and detriment analysis does not indicate that a material difference to consumer outcomes has emerged.
The emergence of such a range of unintended consequences does support a view that it is simply not possible to build a model of a market which is sophisticated enough to predict all the causal consequences that may arise. In fact, the presence of these new potential conflicts of interest which have arisen are examples of the kinds of actions and outcomes that Ring argues, exhibits counter-performativity (Ring, 2015, p19).

### 8.6 Aim A - Objective A4

As the research exercise extended into a review of Trust literature and attempted to establish to what extent it had improved since RDR, there was an emerging awareness of the limitations of the model in its current form, primarily due to a lack of systematic trust studies that could be fitted onto it.

The segments which had been developed worked best when combined through product based analysis such as revenue, complaints and so on. It was evident from the review of the Financial Services Trust Index, the Personal Finance Society, the FCA and the Financial Services Compensation Scheme studies, that there was no consensus on how to measure trust. Furthermore, there was little of it that could be aligned to a granular level of the segments in the model. Finally, none of the trust literature could be related to retail financial services advised on or products sold in the UK.

The exception to fairly limited data on trust in respect of RDR was the Financial Services Trust Index. This was a longitudinal study with its genesis in work Christine Ennew and taken forward by James Devlin which covered the period from before and after RDR. It provided a statistical basis for stating that financial advisers are more trusted than other categories of firms offering financial services or products. It also
provided applicable insight to the differences between higher level and lower aspects of trust.  

This stands in contrast to the rudimentary analysis offered by Europe Economics in its post implementation review of 2014. The case for EE’s conclusion that trust levels in the advice market would improve was based on an industry sentiment based assumption that professionalism in the form of higher qualifications would lead to higher levels of trust. (Europe Economics 2014).

Further to this, it reviewed the results of a single solitary question in an FCA Omnibus survey and compared this to 2010’s results. Finally, it provides some tentative evidence in the form of a reduction in adviser based complaints to FOS in 2014. However, as we have seen from the complaints analysis, the overall proportion of complaints in respect of advice is consistently very low compared to the wider market and so any swing is dwarfed by a market wide shift.

It is clear however that at a macro level, the UK in general has a trust issue in terms of its financial services sectors. This study sought to try and determine how well the model could help drive a greater understanding of trust in the retail distribution landscape. Although the overall applicability in its current state was limited, it was possible to see with the FSTI approach could be combined with the segmentation model to improve the precision of measuring trust. The FSTI statistics aggregate the product mix across the Broker / Adviser category and with this in mind, it should be possible to regress the data to identify, through clustering analysis based on the data compiled in the model, to create segment based trust scores which bring out cognitive and affective aspects.
It is possible to see how this could be used as a baseline for longitudinal studies. This would in turn, contribute to solving the problem of measuring regulatory performance, which is both pervasive and persistent (Coglianese, 2012).

In terms of RDR, the FCA’s market failure analysis was underpinned by a view that low levels of trust acted materially as a negative externality, preventing the market functioning efficiently as it could. It seems surprising therefore that a mechanism was not developed at that point to benchmark rising trust. The FCA recognises that measuring trust is complex (FCA, 2014) but even on a simple questionnaire basis, there seemed to be a lack of regulatory interest in asking consumers of financial services directly what they think. The input from consumers prior to RDR was confined to representations made on their behalf by the Consumer Panel and others.

Instead, the approach has been to point increased adviser expertise and better disclosure on the basis that these are drivers of trust. However, it was not evident from the literature that there is a clear relationship. Furthermore, the consumer based research conducted in this study highlighted that there were core drivers of trust but expertise was not cited as one. The limited evidence from the FSTI cohort following RDR indicates that increased disclosure could in fact, reduced affective trust (FSTI, 2015). This is possibly due to increased professionalism around disclosure of fees.

It was this lack of insight that provided a platform for the second strand of this study, which is the development of a customer value framework which approaches the subject of being trusted and recommended from a non-market theory perspective.
8.7 **Aim B - Objective B1**

The overall conclusion from the Customer Value Framework research was using the customer perspective to work towards a direct objective of increasing trust provides a more effective pathway to regulatory intervention than economic model is a valid way forward is offered for consumer protection and regulatory interventions to be more effective and less prone to unintended consequence.

An early finding from the focus group which was a surprise was the relatively low level of customer interest in financial advisers. This was a consistent thread of all the verbatim comments concerning performance of products and interactions with firms who provided products. The focus group and subsequent round of mixed telephone research comprised customers who had and who had not used an adviser. They could have been expected to throw up differences in approach or volunteered statements qualifying between advisers and firms. However, the direct question “do you trust financial advisers” was not asked, in order to avoid developing a narrative which simply reinforced the endowment effect shown in the trust literature: i.e. people who have advisers trust them more than those who don’t (PFS, 2014).

It was apparent however from the Means-End Chain attribute analysis that customers of financial services firms who had purchased products through an adviser, allocated more importance to CV statements concerning product design, product literature and investment, with less reliance on service. This is an interesting divergence from non-advised customers’ views who place service above all else and score lowly for attributes related to those factors. It seems to suggest, on a prima facie basis, that financial capability rises after interacting with a financial adviser and that due to the
high level of trust, concern about ongoing servicing drops because of a belief that the adviser is the customer’s agent and will “get things sorted”.

This poses an interesting question about the effect of RDR. The FSTI for 2014 tentatively pointed to greater disclosure of what is paid for and what is provided, could be leading to less trust in advisers, as customers increasingly realise that the adviser is running a commercial business and will only offer ongoing service if paid for it (FSTI, 2014). If that premise is correct, it directly challenges the FCA belief that greater qualifications and better recommendations will improve trust. It may actually lead to higher levels of financial capability but the indicators show only for those who engage or have engaged with an adviser. The segmentation model indicates relatively static volumes of advisers and so there is some regulatory comfort around potential for robo-advisers to fill an advice gap (FAMR, 2015). It will be interesting therefore to identify if capability and trust levels are dependent upon an adviser being a natural person.

As stated above, the work on identified CVS which were “core motivators”. It was possible to focus on these core motivators and dig deeper into how they impacted trust. As part of that analysis, we mapped the quantitative results against the internal FSS customer segmentation model already in operation by the company. This is analogous to the Spotlight segmentation model (FCA, 2015) the FCA already operates.

The results indicated that different segments of consumers do present differing levels of trust. A “one size fits all” approach to designing products, distributing them and servicing the customers is therefore not appropriate if the goal is to increase trust. This extends to regulatory interventions where one of the key objectives is to increase trust.
However, as Devlin highlights in a recent trade interview, regulatory mandated trust initiatives are seen as forced and the RDR could be classed in this category. “Consumers need to know that the people and organisations they deal with are making their own sincere and significant efforts to understand what trust means from a customer perspective. They need to feel they have a direct connection with their providers rather than one filtered through the paternalistic prism of a regulatory authority” (Devlin, 2016).

The natural conclusion to the work on ascertaining attributes, defining drivers and refining the customer value statements is to look to how it could be applied. My study showed that in working from the bottom up, using the means-end chain framework and aligning this to an organisational framework of 10 Customer Value Statements, it was possible to identify outcomes that customers valued from financial services. These were not necessarily the same outcomes that the FSA envisaged in adopting an economic market failure paradigm.

8.8 Aim B - Objective B2

The final objective of the study concerns the extent to which RDR supports the view that the market failure theory and economic rationale for intervening in retail financial services is fit for its public interest purpose.

A recurring conclusion from the various research exercises conducted in this study concerns information, both its availability and form. Another is the complexity of the landscape where people interact with financial services and products as they go about
their lives. Taking these together, it is unsurprising that we have found various unintended consequences such as new conflicts of interest, different forms of information asymmetry and little discernible change in levels of trust. This reinforces the primary criticism of using market failure theory: that it drives policies which could, in theory, perfect imperfect markets, regardless of whether it is possible in practice (Booth, 2008, p3). The transition of policy into practice implies that regulators have all the available information about the costs and benefits of all potential uses of economic resources. This study confirms that such a state does not exist. If it did, according to Booth, we would “have the basis for a planned economy, which is a completely discredited concept” (2008, p4).

The fact remains however, that the FSA sought to intervene in the retail investment landscape and did so on the basis that it was a failing market “In meeting our objectives in a manner consistent with the principles of good regulation, we have adopted a regulatory approach based on correcting market failure... (FSA, 2003).

As critics such as Coase have pointed out, there is little that can be learned from the study of theoretical optimal systems. However the results from this study do not directly challenge the reasonably straightforward notion that removing commission based sales of long term contracts would remove the inherent bias to churn. Care should therefore be taken that logical economic constructs such as conflicts of interest, information asymmetry and spill-over effects are not deemed irrelevant. As this study shows, the challenge is in controlling these once regulatory interventions take place.

This is therefore a basis for supporting the basic principle of incorporating other elements into the market context. Ring (2015.20) cites the inclusion of socio-
technological, psychological and social details as necessary needs to gain “any comprehensive analysis or understanding of the relationship of individuals and financial institutions in a modern economy” (Ring, 2015). This is clearly a tall order for any regulator to even start on.

The contention of this thesis is that it is possible to envisage a blended approach which maintains a market framework but accepts there is no such thing as a perfect market and that regulators can avoid the “information problem” by focussing more explicitly on what customer’s value. Instead of treating trust as an “externality” there is merit in pursuing this as a utility in its own right, as a source of welfare benefit.

For example, we know that a core driver of trust is “payout” yet RDR contained no provisions for product regulation. It is possible to imagine that a combination of incentives regulation (such as retaining commission or allowing sales from advisers with lower qualifications) with product regulation (in the vein of Simple products initiatives as reviewed by Devlin, 2014) would have the potential to satisfy that customer value whilst meeting the welfare need of having someone make provision for the financial future. Another example is service and resolution. Whilst there is provision within the FCA handbook for Systems & Controls, there is very little overt regulatory requirements around maintaining certain service standards such as fixing errors. This stands in contrast to the Central Bank of Ireland, whose Consumer Protection Code demands errors are rectified within 40 business days under a “comply or explain” basis (CBI, 2012). There is an argument to say that understanding the product (asymmetry) becomes less of an issue if the actual outcomes to the customer are safeguarded in regulation.
It is possible to envisage how this would work in practice in conjunction with the segmentation model we built in this study. If the FCA for example, had a segmentation model similar to the one created in this study; it could overlay the FCA Spotlight customer segmentation data on to it. Having a segmentation model combining customer and firm “clusters” would enable it to have a reasonable understanding of the drivers of trust in each segment and also the context in which each segment (or sub-market”) operates in. It would be able to understand which customers would be most susceptible to excess market power, non-advised vs advised relationships and complex products.

The potential for a model such as this to complement and improve the existing market analysis is highlighted in a recent report conducted for the FSCS in 2015. This too, cited trust as the determinant in improving consumer outcomes and utilised an approach which acknowledged the component nature of trust. It identified trust “gaps” and whilst these related to pre-generated financial services “issues” that customers were asked about (unlike this study which generated the attributes from the ground up), it does offer an endorsement of this approach.

In summary, the empirical evidence from this study has not provided sufficient evidence to support a wholesale rejection of using market failure as a basis for framing regulatory interventions. The detriment data is not strong enough due to latency and the FCA’s approach to documenting final notices is unsystematic (see Ring et al, 2014) so that it is simply not possible to identify significant changes to customer outcomes in either way.

However, the details from the review of the distribution landscape after RDR does highlight the fact that the results of some of its actions have been clearly counter-
productive. This may not quite be the statement that “economists makes the economy” that signals performativity (or counter-performativity for that matter) but it bolsters the position of the private-interest theory of regulation that regulatory interventions can be acting under their own agency, motivated by their own goals (Booth) and complicated by their own socio-technological baggage (Callon, 2006). However complicated the assemblages are though, the fact remains that these are goods and services that people pay for and describing the landscape as a market makes sense. This study offers a way forward to reconciling the human element, as stressed by Sandel, with *homo economicus* approach, present in the traditional market failure theory paradigm (Sandel, 2012). As such, it is in the direction of travel that the FCA itself recognises as important, and detailed in its first Occasional Paper; applying behavioural economics to regulation. That paper stands in contrast to the first Occasional Paper written for the FSA, which was David Lewellyn’s Economic Rationale for Regulation (FSA, 2000). However, the blended customer value approach advocated in this study goes further than applying “biases” to the theoretical model behaviour of classic economics. This approach is based on trusting customers to identify factors that matter to their own welfare which will enable regulators’ focus on how they bring these to bear in a landscape rather than a narrow artificial definition of a market.
9. CONCLUSION

9.1 Introduction

This study attempted to address two gaps in the literature; the ability of regulators to quantify the impact and track the benefits of their regulation in a rigorous manner and also the lack of an established substantial alternative framework to regulators’ inherent instinct to frame the interactions of individuals addressing their financial needs primarily within a market failure context.

9.2 Rationale for the study

The study acknowledges the effort by the FCA to honour the commitment made by its predecessor to a post-implementation review, the first of which was published in 2014, around the time this study was started. However, although it referenced measuring the high level objectives for the market the FSA had compiled by 2011, it did not contain the specificity of economic analysis that had underpinned the market failure analysis which prompted the FSA to announce in 2007 it was conducting a Review of Retail Distribution (FSA, 2007). That analysis references agency, asymmetry and externalities in line with economic rationale for regulation set out in the regulator’s founding philosophical documents. There was therefore a valid rationale for reviewing the changes which have taken place in the regulated retail investment market, through the lens of these economic concepts.

Within this context, it was identified early in the literature review that there was a lack of granularity of data covering the distribution landscape and that no consolidated picture of the landscape was available. It was therefore necessary to construct, through
an exhaustive and iterative process, a product and firm segmentation model. Establishing this model flushed out issues of taxonomy across products, firms and even individual market participants. Having this would assist with benchmarking changes arising from regulatory interventions and allow disparate data sources to knit more effectively. As a result of this lack of consistency, there has been no meaningful study of market power within retail financial services landscape. The most recent competition study, by the OFT, focussed on the provision of workplace pensions and this relied on data submissions by individual firms rather than a centrally available version of the truth (OFT, IPB, 2013).

Further to these issues, it was noted that the study of trust within financial services is a relatively underdeveloped area of regulatory interest. Indeed, with the notable exception of Ennew & Sekhon and Devlin’s work (2006, 2015), it is also relatively under-represented in the economic and regulatory literature. This is perhaps surprising, given the extensive and longstanding discourse on externalities by Stieglitz and others, and the huge interest in applying behavioural economics to practical settings.

This study was also necessary in order to contribute to the falsification process and subsequent refinement of the performativity thesis within economic sociology. The theory, developed by Callon in 1998 and taken forward by MacKenzie and Millo (2003) asserts that an economic theory, will not just describe and explain a reality, but through the agency of its proponents, seek to actually format that reality to fit the theory. By establishing how the economic model behaviours identified within the market failure analysis have been altered by the RDR, this study provides an empirical basis for testing Ring’s assertion that RDR was counter-performative (Ring, 2015). In doing so, it also contributes to the academic discourse on the extent to which
regulation is inherently a driver of public or private interests. Maintaining the
dominion of the market failure model in regulatory thinking, described as intellectual
capture, may be a form of subconscious private interest, acting on even the most
welfare minded of regulatory reforms.
Furthermore, in exploring how a “non-economic model” perspective regulation could
be developed, this research offered the potential to develop the theories of public /
private interest regulation with insights from the performativity thesis. The
introduction of an evidence based, real-world customer perspective on what a
functioning financial services environment should look like, could restrict the private
interest of regulators (albeit, perhaps an unconscious one) of bringing to life perfect
models of competition. This alternative perspective could act as a correcting
mechanism, helping to mitigate the risk of performativity and ensuring the welfare
improvements are centred on those who regulation is designed to protect.

9.3 Contributions to theory

This section sets out how this research exercise advances the field of economic
sociology by contributing to the literature on regulation, market failure and
performativity.

Performativity

The key contribution of this study to the performativity thesis is in its identification of
real world outcomes which challenge the neo-classical market model the RDR was
built on. This study asserts that information asymmetry is greater than before the
RDR was introduced and so provides support for argument for the existence of some
level of *counter-performativity*, as it is described by MacKenzie (2003). In his articulation, the way in which an economic model is formulated and applied in practice can result in a reality which impairs the model’s originating descriptive power. This is precisely what Ring proposes has occurred repeatedly since the first FSA attempts to use disclosure to reduce information asymmetry (Ring, 2015).

This study found that, across many areas of the landscape dynamics, there is more complexity in the products and the context in which they are distributed, rather than less.

It was found within the research there are several types of firms operating across various advisory and non-advisory basis, distributing products in a “fuzzy cluster”, from a set governed by differing conduct of business and investor protection standards. This is more than a taxonomy issue: it gets to the heart of the complexity of the financial services landscape.

This study also contributes to the literature on performativity by highlighting how difficult it is to conclusively establish and situate its presence in an entangled and complex environment such as financial services. As Sandel has argued, there is an overlap between the theory and the practice in financial markets, which complicates enquiry (Sandel, 2012). Furthermore, this study supports Mackenzie’s argument that far more empirical work is required to identify unequivocally instances of counter-performativity (Mackenzie, 2005).

The results from the model reinforce the difficulty in establishing undisputed evidence for the performativity thesis in complex arenas of human activity. The build phase and review of regulatory reporting highlighted that UK financial services regulation is heavily influenced by competing agencies and it was obvious from the model build
that insurances and occupational pensions play a part in the advisory world, primarily because that is how customers engage with their financial needs. This regulation can come from Europe, as in the case of the MIFID rules (which impacted RDR) or developed from primary UK legislation, such as the Regulatory Activity Order which allows for two types of regulated advice – generic and personal recommendation. This means that the regulatory rules are not aligned, cross over and in some case contradict each other: rules for insurance products are different from workplace pensions which are different for collective investments and so on. It is therefore not the market theory analysis specific to the RDR on its own which led to the increased information asymmetry; we should acknowledge the role that parallel regulatory and legislative developments played. To evidence the performativity of the UK financial services regulatory landscape, further analysis of all the ancillary and interdependent international regulatory developments - such as Solvency 2, Basel, IFRS and so on - would be required. This in itself provides strong support for the related concept of agencement, as created by Callon (2005,2007). The multifaceted regulatory interfaces, technologies of advice delivery and combination of products demonstrate that interventions such as RDR should be viewed as an assemblage of factors which will have their own agency.

**Market failure**

The key contribution this study makes to the understanding of market failure is primarily identifying and making the case for the role of *customer values* in its diagnosis. This is an expanded view from the narrow prevailing economic model and as it is derived from primary research with real customers, goes some way to
satisfying Zerbe & McCurdy’s assertion that the market failure model is limited by a poor empirical basis (Zerbe & McCurdy, 1999).

My primary research confirmed, through analysing the strength of attributes that customers value, that what matters to people is that the product and associated service meet their real life need. This is wider than the narrow market view of the RDR and emerges from a physical concern, such as having enough money in retirement. By its very nature this kind of question is complex and may require consideration of a number of financial products. For example, workplace pensions regulated by the TPR, paying off a mortgage which is governed through the Mortgage Requirements Directive, saving for the future through a Stocks & Shares ISA – regulated by RDR rules – and possibly arranging income protection from the financial adviser who can accept commission from a narrow range of insurers.

The scope of the RDR missed this in its narrow focus of a “retail investment market” and there is some evidence from the expansion of rules and various amendments such as share class conversion that the RDR has created, through its own agency, a more complex environment. This again may support the theory that regulatory interventions create their own reality and that this can never result in a perfect market (Booth, 2012). Customers have no greater capability to navigate this landscape. The baseline survey introduced by the FSA has not really been taken forward. Whilst there is some evidence that a national strategy for financial capability is finally getting off the ground with focussed events (Fincap, 2016), this is nine years since the FSA first articulated a desire to measure progress. This study contributed to the academic literature on competition by identifying through the telephone based survey that customers can actually value more complicated attributes such as product design,
investment strategy and clear product documentation without necessarily having the literacy to fully comprehend their nature. Having an adviser who they delegate this to, is key.

The market failure indicator of significant competing interest does seem to have led to a clear improvement in the market, being the banning of commission for advised sales. This addressed what was a systemic issue which had resulted in product providers chasing distributors and complex charges and becoming less profitability, ultimately going out of business and reducing choice for consumers (ABI, 2006). Those issues have dissipated greatly, although a different set of conflicts have emerged as a result of RDR. This is classic “squeezing the balloon” although the extent, to which it is reflective of resistance and avoidance identified by MacKenzie as a classic response to regulation, is unclear on the basis of this study (MacKenzie, 2007).

These conflicts persist as this study highlighted through the Sesame fine for “pay to play” in 2014 (FCA, 2014). That business is now focussed on the mortgage and protection “market” which reinforces the arbitrage / perimeter issues described above. However, its response is perfectly rationale: it is free to operate on a commission basis and with reduced regulatory liabilities such as capital and operational liquidity.

**Externalities**

The third economic concept the study tested was trust as a negative spillover effect preventing consumers from engaging more in the “market”. Although several trust related studies have been undertaken, this study found that these were fairly thin in content and relied on using simple questions. The exception was the FSTI index,
which this study leveraged in order to progress the development of a customer value framework.

This research study provided a basis for furthering the literature on the subject by identifying the core drivers of trust and, perhaps more pertinent, telling inconvenient truths. For instance, customers do not value “membership” as much as “payout” and that fixing something properly and providing a clear bonus or benefit means more to a customer than the clarity of communications. This is consistent with some wider areas of study such as the Blake’s paper for the Pensions Policy Institute, urging product providers do focus on simply getting people to retirement than trying to engage them in a discussion about how they get there. His analogy of refraining from asking passengers on a plane what flight path they want to take is a powerful one but serves to illustrate that the economic “cure “ to asymmetry - disclosure & increased literacy – is simply a bit of a pipe dream in the current financial services landscape. Regulatory priorities should be focussed on delivery rather than explaining the journey (Blake, 2008).

Regulation
Turning to the impact of the study on regulation theory, the key contribution made is in developing a real world and empirical framework for assessing the impact of regulatory intervention.

The model shows some evidence for what Weimar & Vining describe as “active government failure” where the outcomes arising from intervention are worse than if nothing had been done (2005, p206). The data from the RDR study supports this thesis when applied to some individual indicators such as asymmetry or even concentration
within some market sectors. However, as Keech, Munger & Simon noted, there is no definitive measurement of either active or passive government failure (Keech et al, 2012). By establishing a segment model like that in this study, capable of framing indicators such as detriment data or tailored trust scores, it would be possible to establish both ex-ante and ex-post measurement of regulatory interventions. Crucially, this could be done at a granular, sub-market level. This in turn creates opportunities for A/B testing of regulatory interventions rather than typical, estimates of cost / benefit. This approach is consistent with the aspirations as set by the OECD on measuring regulatory interventions (OECD, 2012).

The economic rationale for regulation has taken hold, albeit with a clear consumer protection focus, awareness of behavioural economics and acknowledgment of a need to consider other regulatory objectives (FCA, 2014). This in itself may be a form of cultural or intellectual capture or even group-think. The resultant risk is that all interventions centre around the “market failures” and concepts like agency, externalities and so on with no wider “step-back” to challenge whether regulation creates its own reality and simply seeds further market ‘failures’.

This is an extension of the question which asks whether regulation will result in reduced welfare, rather than increasing it (Booth, 2012). This study provides qualified support for Sandel (2012) about the applicability of market analysis but cautions that its purpose was not to observe the interactions between customers and financial services in an empirical study. My research exists primarily to examine the impact of market based policy interventions. Similarly, the sheer complexity of the landscape coupled with the presence of unintended consequences cautiously concurs with Ring’s
view that RDR exhibits features of “agencement” and there does seem to be an element of counter-performativity arising from the RDR (Ring, 2015).

However, it is acknowledged that concepts such as performativity, counter-performativity and agencement are controversial. As Silvast cautions, the notion that “the economy is embedded in economics rather than the society at large – may be somewhat disagreeable to many” (Silvast, 2014, p.24)

9.4 Implications for practitioners

The results of the research create implications for stakeholders interested in the practical application of regulatory theory within financial services. This obviously includes practitioners such as regulators, but also the individuals and firms regulated, as well as consumer groups concerned with welfare improvements and policymakers in government.

As a starting point, the research points to the value of having a visible basis for describing the UK retail financial services sales landscape. There are several benefits from developing such a segmented model and making it publically available. First, the increased transparency would promote trust in the regulator itself and assist stakeholders understand the perspective from which the FCA is operating, as well as highlighting the complexity and interdependencies that exist. This in turn would drive better and more informed consultation responses in the policy cycle and promote informed debate. Second, having a quantitative segment based model allows changes in the landscape to be captured in a holistic fashion. To paraphrase Ring, the results of regulatory action or even shifting socio-economic dynamics would show up as
depressions and expansions of segments in the “squeezed balloon”. Monitoring such changes in asset flows allows for more informed regulation and supervision. Third, by having discrete segments, regulators and other stakeholders would be able to leverage econometric analysis, competition indicators and detriment data to identify those “hotspots” which may require greater interventions. For example, observing a segment which is growing in terms of net asset flow, where concentration levels are high, product complexity is great and complaints volumes are also rising, could prompt proactive intrusive supervision. This is consistent with the FCA’s much publicised “judgment based, forward looking” interventionist approach (FCA, 2014) but crucially, the judgment would be evidence based and the articulation of the risk would be visible to all, creating greater consensus in the industry. Finally, it would be powerful in helping the market to mature in its own risk management, by enabling firms to understand which segments the FCA has them in, thus being clear about the risk metrics and competition / market indicators the FCA is employing. Firms would therefore be empowered to be proactive in managing the regulatory risk. For example, by reducing sales activity of complex products, undertaking customer insight to ensure they can demonstrate good levels of understanding, or even combining efforts under trade bodies to self-regulate in areas of potential conflicts of interest.

Independent of the need for a model is a pressing need to address taxonomy and classification issues across the regulatory architecture. Although the FSCS, FOS and FCA all work in dealing with different protections, they do not share the same approach to products, providers and types of customers. Effective analysis is therefore limited and by extension, regulatory oversight will suffer.
Efforts should be made to align the various retail product market under similar standards of behaviour, disclosure and financial protections. Whilst many European legislative initiatives are bound by law to be directly applied (such as regulations like MIFIR) the UK regulatory authority will typically have leeway to apply these in a way that fits local markets (under Directives). The FCA chose to gold-plate the MIFID standard into pensions and, on a similar basis, will have leeway under the IDD to apply a consistent approach. The central objective should be convergence so that customers who engage with any stakeholder to meet a financial need, do not face excess complexity or a range of different approaches.

Fourth, this study shows that conflicts of interest continue to exist. These could be addressed at their heart by introducing a formal fiduciary standard. This concept has been reviewed in the past, such as the recommendation in the Kay review (HMT, 2012) for the Law Society to look at this. Crucially, the resultant report deferred back to the FSA on retail investment advisers and focussed on financial intermediaries such as stock brokers and asset managers (Law Society, 2012). Having a clear and legally enforceable duty to put the customer above one’s own needs would remove the need for mitigants such as disclosure, suitability rules and so on. At present, there is a rule for investment advisers to “act in their clients best interest” (COBS 2.3) but this only applies to investment advisers and does not go as far as to subjugate internal economic interests to that of the client. Implementing and enforcing a fiduciary standard is not easy. Evidence from the UK Department of Labour’s recent efforts shows this (US Presidents Office, 2014) but there would be less concern over product provider ownership if all advisers were operating under such a standard and therefore acting as
agents of the customer. This would clearly demarcate from a non-advised sector where strong “caveat emptor” rules would be underpinned by fair use conduct rules.

9.5 Implications for future research

There are opportunities to take forward a number of themes and hypotheses from this exploratory study. A clear gap exists in the literature covering both trust and financial capability within the UK financial services landscape. In terms of trust, there is scope to expand the longitudinal work from the Financial Services Trust Index and apply it to a wider range of market segments and within different adviser segments. The hypothesis is that affective trust differs based on the type of broker / adviser encountered. A similar hypothesis to be tested empirically is that levels of affective trust displayed towards robo-advisers will be higher than that exhibited towards pure execution only channels and lower than that exhibited towards natural person advisers.

As stated earlier, the history of regulatory sponsored financial capability surveys in the UK is woeful and there is ample opportunity to address this. This exploratory study established that customers who had advisers valued more complex financial services concepts than those who didn’t, who focussed on levels of service. The hypothesis to be tested in this area is whether advisers play a role in educating customers about products or whether customers with advisers worry less about service as they anticipate the adviser doing this.

Finally, the review into RDR coupled with the research into what customers value raised questions about the overarching architecture of the UK financial services system
and the central assumption that regulation arises from the fact that financial products have different characteristics from other goods. However, the segmentation pen portraits and verbatim results of the focus groups and surveys revealed terminology akin to that of healthcare. Holistic and small financial advisers are anecdotally referred to as “GPs” and on a cursory basis, there seems to be similarities with the provision of medical care in the UK. Since RDR, financial advisers have to be members of an Accredited Body, similar in concept to the General Medical Council and have to meet annual fit and proper standards, similar to the revalidation process undertaken by medical doctors (GMC, 2014). Furthermore, they can be self-employed or employed and often act as a gatekeeper to more specialised services. Finally, they “prescribe” physical products to customers and are subject to conflicts of interest provision in respect of incentives from pharmaceutical companies. A key difference is the product licensing regime, with the National Institute for Clinical Excellence (NICE) acting as a filter and safeguard of customer outcomes. The hypothesis to be tested is whether having a separate product licensing body in the manner of NICE would free up supervisory agencies to focus on conduct of sales and provide an underpin of product reliability which is what customers most want.

### 9.6 Study limitations

The limitations of the segmentation model have been stated in the previous discussion but a consideration of the limitations of the study as a whole is necessary in order to provide context to the robustness of the conclusions.
Like the segmentation model, the customer value research was underpinned by a high level of judgment which originated from the working group participants and the Steering group, comprised of executives within the Royal London group of companies. The initial rough draft indicative Customer Value Statements (CVS) relied on creative input from subject matter experts as a means to get started. This created a potential for bias at the start of the study and to some extent challenges the subsequent rigour of the framework.

The contention from the author is that the origination of the CVS was grounded in a rigorous NGT process whose members were uniquely positioned to provide a basis from which to iteratively derive a model which could be applied in the real world. As industry experts who were also subject to individual regulatory obligation to protect customer interests, they were able to work within the NGT process effectively and also to ensure a focus of applicability was maintained. The objectives of the study were to explore the extent to which alternative perspective could be used to regulate financial services and having practitioner involvement, whilst risking intellectual capture, was essential to maintaining the focus on that element.

Evidence of the integrity of the iterative approach achieved through customer insight validation can be found in the removal and or amendment of some of these initiatives. Although outside the scope of this thesis, it should be noted that further rounds of research have been taken forward with various ranges of consumers and the model continues to evolve and integrate with customer segmentation and other insight initiatives. The research was as much about the attributes which customers elicited from the means-end chain work, as the CVS model that was formulated. The 42
attributes are a prioritised list of outcomes that customers value and in their own right, can be taken forward to be compared to specific results of interventions like RDR.

The use of Means-End chain framework creates a dependence upon expert facilitation but this was recognized from the outset and informed the decision to employ an expert outside agency.

A final limitation of the study is its structure. The decision to review the impact of RDR as a case study in market failure theory based regulation may have been a worthy topic to explore in its own right but the author sought to move the literature forward by exploring how a customer perspective could be brought to bear. This created a complexity to the logistical operation of the research work. Two distinct sets of resources were called upon and the extensive nature of the segmentation model build placed a time pressure on the customer value work.

The intention was to identify whether the market failure analysis would be complemented by the consumer value research and there is a risk in that in attempting to link the two, whilst commenting on a real world phenomenon like RDR, the clarity of the conclusions would be reduced. This is acknowledged with the hope that the exploratory nature of the thesis as a whole is taken into account. The principal was to inform the academic debate and provide avenues for further study, or even hypothesis that can be tested in a rigorous fashion.
APPENDIX 1: Verbatim quotes from Focus Groups

LOW LEVEL OF TRUST AMONGST DIRECT & ADVISED – Supporting Quotes

- "I've just a limited financial advice who I've grown up with. I know the advice is good so I know what I'm buying."
- "We're just a number really. The first question they ask is, 'What is your policy number?' It's never your name at all."
- "I don't feel anything! I just get a statement every few years. Glance at it and file it."
- "We just rely on them to do their job but we don't actually know what they are doing."
- "When they are investing the money that everyone has contributed, using people's savings and pensions, I feel that we have more of a say about things like this because we're members."
- "Just feel quite wary - I don't know who they are and never hear from them."
- "I feel our hands are tied. I suppose we have to just sit back and see them 'OK, someone else is dealing with it. They know what they're doing.'"
- "I trust RLG purely because my mortgage advisor recommended them. He's got 20 years experience so I just did as he told me to... I had no worries."
LOW AWARENESS OF ROYAL LONDON AMONGST GROUP BRAND CUSTOMERS  Supporting Quotes

"I didn't know I was a Royal London customer. I took my policy out with Brigitte, my husband, and it's life insurance for families. When we're 70, and we obviously started them years ago, they will cover me up to 85 now but they wouldn't cover him..."

"Well, it's been Scottish Life up until only a few years ago. To me, it's always Scottish Life. When you asked the question initially, I said Scottish Life, but it's actually Royal London, I suppose."

"They're a really old school, old fashioned. I thought, yes. One of our first financial advisors actually worked for the Royal London."

"I didn't know I was a Royal London customer. I guess it's only that I've not checked my statement."

"Actually, the only thing I know about Royal London, my pension is with them because my company chose that, but my father used to work to have Royal London. He had somebody come round to the house, like, every so often."

"As they didn't notify me to tell me they had changed. I just noticed it in the statements, and I had to phone them and say, "Who are you? Why?" They said, "We're the old Scottish Life.""
MEMBERSHIP - Supporting Quotes

"I don't feel as though I've got the relationship to be a member, you work, but it's been alright for me. At the minute I feel I'm a customer, but I could be a member." - Member

"It sounds good but means nothing unless there is a benefit to me." - Non-Member

"It feels sort of warm and inclusive." - Member

"When you're a member you kind of stick with it, and they value you as much as you do them. There's the feeling I get when you mention member." - Member

"Being a member doesn't appeal to me so to be honest, I just want a bit of discount." - Member

"When they are investing the money that everyone has contributed, like top people's salaries and profit, I feel that we have more of a say about things like that because we are members." - Member

"Well, I've realised now that I must be a member." - Member

"If you're a member, you belong." - Member

"I'm not because I've never been invited." - Member

"If it's owned by the people who are putting the money in, they haven't got to take the stakeholders' into account about decisions, have they?" - Member

CORPORATE SOCIAL RESPONSIBILITY - Supporting Quotes

"The money must come from somewhere. Now if a business is going to put their booties into it, I am surprised." - Group Annual

"It can't just be a fleeting statement and then they don't do anything about it." - Group Annual

"It's about what do they do in schools or in colleges or higher education to try and get younger people interested earlier on in their lives and the difference they can make to that. That is important. It's other providers that do that." - Group Annual

"As annual charitable donation from their profits would look better." - Group Annual

"I think they should make cause sort of company statement, what their values are, and what their agenda is." - Private Person

"They are looking at the environment. I believe when it's good for EP's going to come the mean, I'm not interested." - Endowment

"I think they say they do it purely to look good in the media." - Group Annual

"I think everyone's being quite cynical. It can't just be to draw me to a company or make me choose one over the other." - Member
APPENDIX 2: Verbatim focus group quotes relating to aspects of trust using “critical incident” recall technique

RESOLUTION

“Basically, we've booked our summer holidays with Virgin Holidays this year and another family were coming with us. So, my husband and I booked a villa, paid a huge deposit because we wanted to do it before the sale ended and then two days after we paid for it, they said that they could no longer come. This villa accommodated ten of us, and there's only me and my husband, and my son. Obviously, we paid a lot of money. I was fuming; so when I contacted them, the first thing I did was, I booked my holiday, and I literally just spilled it out, I didn't say a word. I just listened to everything being cut into my conversation. Once I'd finished, he was really compassionate. He was like, 'Ma Sinclair, I'm really sorry about that, we're here to help you.' Basically, he was saying from the start that it wasn't a problem. Don't see this as a problem, and although they kept me holding for what seemed like twenty minutes, they kept coming back to me, apologising for the delay. Finally, all was sorted, and then in the end, they totally rectified the holiday. Then, put us in a smaller accommodation; they used the offset of the bigger deposit needed for the bigger villa against our villa. So, we've got less to pay off now. Within, I would say, five minutes, I had an email confirmation of what was done, if there was anything else, the booking that I wanted to rectify. They upgraded our car because he told me it was in a dilemma... That was all confirmed by email within five minutes of the conversation. Then, I got an email just asking a few days later if everything was okay, I was happy with their service and I'd be happy to give feedback, which I was.”

“I ordered a pushchair from John Lewis for my elder, and they told me it was going to be here on, I think it was Friday, I made sure somebody was home for the pushchair to be delivered. It didn't come, so I phoned up, I did really over-exaggerate, because I could've waited an extra week for the pushchair, it wouldn't have been a problem. The mannerisms, the way, I spoke to her, she was really empathetic, but not sarcastic. Do you know what I mean? She was really understanding, she offered me 25% off my next order, and I got £100 back off the pushchair. Yes, and she kept saying to me, 'Are you happy with the way I dealt with you today?' She was quite warm and sort of felt like she felt my pain, but I don't know, her communication was fantastic, yes, not computerised or robotic, you know, like they have the same sort of thing. Oh, we can't help you anymore,' there's that silly thing, 'Give you, it's like a customised speech they give you. With this she sounded more like a mum. I suppose, it felt quite personalised, not reading off a script, she was really good.”
Drawing upon positive customer experiences across sectors generally, we start to establish the key aspects that truly drive trust and recommendation of a company...

**PERSONALISATION:**

Well, I changed banks last year. I took my main account from the high-street bank to Santander. I felt that the customer service at the high-street bank had deteriorated over recent months and possibly a couple of years, and also the interest rates were not attractive on anything with the current account or ISA. You know, it had come to next to nothing. So Santander were offering a 123 account, which I read up about, went online, took the savings and thought that sounds really good. We were treated like king and queen when we went in. Everything was explained to us, the girl that took us through it was excellent. You weren’t just an account number, you were an individual, and I thought that was really good and the benefits that came with the account, you know, were second to none for a current account. So we were really pleased with it. Sometimes it’s like when you work for a company and you can go from, you know, Mr Briggs to a payroll number. You’re just lost within a crowd. Well I thought that, you know, with Santander, hello there, there seemed like a genuine smile every time you go in branch and you know, as I say, when we actually opened the account on the day, it was just really good and it came across really genuine.

**PERSONALISATION **

Yes, I went to a restaurant, which is an Indian restaurant, the one not far from here actually. I’d never been there before until recently. I love Indian food. It’s a bit of a lot of Indian restaurants, I’ve been much keen to them all and I went to this one not too long ago. What I’d been experiencing until then was just on a different level compared to what I experienced when I went there. The one thing that really noticed, speaking to the staff, it was almost like they were absolute experts in their product and what they knew about their product. Every single thing on the menu, they could talk to you in detail about’s back and combinations of’s back and why etc. In that respect remember, before I’d even ordered anything, sitting there and going, wow, this guy knows his stuff, you know? So I thought that. The other thing was the place was absolutely packed, and I know sometimes when you go in a restaurant and the place is packed, you can feel less attention, server service, but it was the opposite. They made sure everyone felt like a VIP...

**RESOLUTION:**

I have a son who is four months old and four days before my due date I had a major food update, which took out half the house, which made me feel really panicked and worried, obviously stressed at the time. I spoke to my house insurance company and I got through to someone very quickly who gave me clear, safe advice. They gave me options as to what I could need rather than telling me what the options were. Very quickly afterwards I was passed through to a company they use who project managed our insurance claims. Each time I spoke to the same person who project managed the whole thing for me. He dealt with everything quickly. He didn’t pass on, he never once, he dealt with it himself in my shoes, in the sense that I think understood that obviously had a baby on the way, and it was safe. Afterwards he’s phone and check in with me regularly to see how things were going and obviously a lot of companies were talking to come together to do the work in the house like the plastering, the decorating. All different companies were coming and I didn’t have to phone any of them. He’d even check if the company had come to do the correct job and phone in afterwards and just say, was everything done? You know, how you wanted it done? Is everything okay if it wasn’t? If the phone and the time I was changing a nappy or my other little girl from school, then had call back at time that was convenient to me. He always greeted me with a personal question to me like ‘Did your baby go okay?’ You know, ‘How is your daughter now where got over her chicken pox’ or something personal to what I was going through at the time. My house insurance was actually due for renewal about two months after and it did go up, ever so slightly but not to be honest, even if it had gone up by £10 or £15, I still would have stayed with that company because I felt loyal and knew that I was getting a good service. I thought the company was very good and obviously it’s not something they can do for every customer. But I think the service that they’re very good at is when you mentioned thing, that did make me feel really valued. It was all dealt with as quickly as possible. It wasn’t convenient for me, I know, like I just go home from hospital and they wanted to put dryers and things into the house, then they’d do everything on my terms as and when I wanted it. It absolutely trust them now. I mean, if something like that was to go wrong again, as I said, I’ve just renewed my insurance with the same company even though it’s gone up slightly. I don’t doubt that I would receive the same service again.
Drawing upon positive customer experiences across sectors generally, we start to establish the key aspects that truly drive trust and recommendation of a company...

**PERSONALISATION:**

Well, I changed banks last year. I took my main account from the Halifax to Santander. I felt that the customer service at Halifax had deteriorated over recent months and possibly a couple of years, and also the interest rates were not attractive on anything with the current account or Isa, you know, it had come to next to nothing. So Santander were offering a 123 account, which I read about it, went online, took the offer and thought that sounded really good. We were treated like kings and queens when we went in. Everything was explained to us, the girls took us through it was excellent. You weren’t just an account number, you were an individual! And I thought that was really good and the benefits that came with the account, you know, were second to none for a current account. So we were really pleased with it. Sometimes it’s like when you work for a company, and you can go from, you know, Mr Biggs is a payroll number. You’re just lost within a crowd. Well, I thought that, you know, with Santander, I felt there, there seemed like a genuine smile every time you go in branch and you know, as I say, when we actually opened the account on the day, it was just really good and it came across really genuine.

**INTEGRITY:**

"Buddy, twelve months ago, last February, we were looking to buy another car. My story is about Arnold Clark. I had made up my own mind what kind of car I wanted, and looked on all the various sites to see which cars were available. I had three sites, or three sales places, that were suitable. We decided one Sunday we’d just go there and find a car, which was what the plan was. I went in the franchise, the first garage. I can’t remember the name of it. I think it was called "Arnold Clark", I think it was called "Arnold Clark", and then I’m sure we went, yes, it’s in the showroom. They could see that I was interested in cars, you know. Then the guy who offered us a car before we parked, and I could see him, yes, that I was interested in cars, and I could see him, yes, that I was interested in cars, and he said, "Okay, we’ll have a look.

**PERSONALISATION & EXPERTISE:**

"Mine was BMW, when they brought out the 6 Series. They had great customer service, the sales rep knew the knowledge, friendliness, plus they provided us a discount on top. Then I signed up for a subscription with BMW and they provided me a loyalty scheme and they gave us free tickets to Silverstone last year, so that was really good. The said you had to sign up, and if you wanted to sign up you get emails from us and we’ll tell you about the aftercare service, They just provided us, sometimes, to be honest, not what was expecting at all. The change is a probably more likely to stay with BMW now than before, when I was thinking of moving onto Mercedes or Audi. So, now I’ve got a loyalty scheme with them, I can see they’re providing me great customer service and they’ve got knowledge and expertise in their field. I feel differently now, because the service that I received from them, they’re not just telling me things just to lose me off or anything like that, plus they’re giving me a discount as well, they’re giving me like a 20% discount on top of what I was willing to pay. So that was really good.

**PERSONALISATION:**

"Yes, I went to a restaurant, which is an Indian restaurant, the one not far from here, actually, I’ve never been to before until recently. I love Indian food, I go to a lot of Indian restaurants, but I’ve never been in them all, and I went to this one not too long ago. What I’ve been experiencing until then was just on a different level compared to what experiences I’ve had there. The one thing that I really noticed, speaking to the staff, it was almost like they were absolute experts in their product and they knew about their product. Every single thing on the menu, they could talk to you in detail about couplings and combinations of couples, and they knew about that, I remember, before I even ordered anything, sitting there and looking, Wow, this guy knows his stuff, you know? So I liked that. The other thing was the service was absolutely perfect, and I know sometimes when you go to a restaurant and the service is poor, you feel less attention, server service, but it was the opposite. They made sure everyone felt like a VIP..."
Drawing upon positive customer experiences across sectors generally, we start to establish the key aspects that truly drive trust and recommendation of a company...

EASE  EXPECTATIONS

I've got a gas and electrical plan with them regarding white goods, everything in the kitchen, and they replaced a washing machine without any haggling. I told them the model number and they told me to go find something that I liked to replace it. I told them what the model number was, they didn't even quibble with the price and they got it delivered for me. Simple as that. I've never had a problem with anybody else, I've never stopped around because these guys just do a good job even though they're a very big company. There was just an email update, text updates for when my delivery was going to come. So I didn't have to spend a lot of time on the phone with them. They just updated you and you picked them up at your convenience.

RESOLUTION  EASE

I had a vacuum cleaner which I got a warranty with when I registered, but when I moved house, I thought I hovered too much rubbish up it, really, it broke. So I thought, well, I'll phone them up and see what they say. They just went through loads of options of what it could be and had me take it apart over the telephone. Then when nothing worked, they just said, 'Oh, no, we'll send you a new vacuum.' So they just sent me a brand new vac. They didn't ask to see anything, I thought, 'Oh, they might send someone out and have a look at it.' They didn't, just sent me a new vacuum. They didn't interrogate me and say, 'Have I dropped it down the stairs?' Have I done something I shouldn't? I've recommended them since to friends. I wasn't put through to a call centre abroad, it was somewhere in England. They were really clear about all the questions they asked. It got delivered within two days and they were just nice. If you phone a mobile phone company up, like, I was with Vodafone and they passed my service to no reason whatsoever. It took two weeks to sort out. I think I went from somewhere in India to Sweden, back to England and then all passed round the houses. No one could sort out my mobile phone. Even in stores, when I went in. I thought, 'Well this is a mobile phone company.' I phoned up about my vacuum and they sorted it out within a day.

Drawing upon positive customer experiences across sectors generally, we start to establish the key aspects that truly drive trust and recommendation of a company...

PERSONALISATION  INTEGRITY  EASE  EXPECTATIONS  EXPERTISE

We were building an extension, and we first looked at it about eighteen months ago. We got a local architect to come out. Anyway, we got them out about eighteen months ago, a husband and wife team. Initial consultation and chat, and then my husband and I decided to sort of put things on hold, but I didn't call them to tell them I was putting things on hold. I thought they'd be going ahead and do it. I called them again and explained who I was, and they didn't make me feel awkward or uncomfortable because hadn't called them all that time ago or whatever. They remembered who I was and, 'When can I come out and see you?' So we made an appointment, they came out to see us, but the most important thing for me was that they understood my husband and I as a family. They understood our goals and our plans. More or less everything that I was saying, they kind of, empathised with, they understood, they had two children as well, they understood the need for more space for this and that and the next thing. They made our goals into their goals, it makes sense. So their target or their goal for us was to get us a house that we wanted, to design the house. There was no pressure, we weren't rushed. They had been out to see us on five separate occasions before we decided on final drawings. So they didn't make me feel like, you know, we need to do this, we need to get this done. Yes, and I don't know whether it was because they were a couple, they were family and they were local so they kind of, understood. Secondly, I liked the fact that they were punctual. If they said they were coming at 4:00, they were there at 3:35. They did what they said they would do, so where I got tired and I see the first couple of drawings, we said, you know, we want that room changed to this, we want this, they did it. They had said, they would go to us, the email was there, and not only did they email, they actually came to the house and posted things through the door, you know, like, drawings so that we had them in A3 rather than looking at them. What really got it for me was, there was one kind of, design they were talking about. Architects obviously look at it differently, I'm just looking at, what room am I going to have? They're looking at the light and what comes in and all the rest of it. They were trying to describe these were, sort of, glass boxes that just put at the top of the roof or wherever for light, and I couldn't understand what they were talking about, couldn't imagine it, So they invited my husband and I and the kids to come to their house to see what they had. I just felt that was such a lovely touch. To me, I didn't look at them as being, I wasn't a client to them, it was more personal.
Drawing upon positive customer experiences across sectors generally, we start to establish the key aspects that truly drive trust and recommendation of a company...

- Ease
- Expectations
- Resolution
- Ease

”I’ve got a gas and electrical plan with them regarding white goods, everything in the kitchen, and they replaced a washing machine without any haggle. I told them the model number, and they told me to go find something that I liked to replace it. I told them what the model number was, they didn’t even quibble with the price and they got it delivered for me, simple as that. I’ve never heard of anybody else, I’ve never shopped around, because these guys just do a good job even though they’re a very big company. There was just an email update, text updates for when my delivery was going to come. So I didn’t have to spend a lot of time on the phone with them. They just pointed you and you picked them up at your convenience.”

”I had a vacuum cleaner which I got a guarantee with when I registered, but when I moved house, I think I delivered too much rubbish up it. Really, it broke. So I thought, well, I’ll phone them up and see what they say. They just went through loads of options of what it could be and had me take it apart over the telephone. Then when nothing worked, they just said, Oh, no, we’ll send you a new vacuum.” So they just sent me a brand new one. They didn’t ask to see it or anything. I thought, Oh, they must send someone out and have a look at it.” They didn’t, just sent me a new vacuum. They didn’t interrogate me and say, ‘Have I dropped it down the stairs? Have I done something I shouldn’t?’ I’ve recommended them since to friends. I wasn’t put through to a call centre abroad, it was somewhere in England. They were really clear about all the questions they asked. It got delivered within two days and they were just nice. If you phone a mobile phone company up, like, I was with Vodafone and they suspended my services for no reason whatever, it took two weeks to sort out. I think I went from somewhere in India to Sweden, back to England and then all passed round the houses. No one could sort out my mobile phone. Even in stores, when I went in. I thought, ‘Well, this is a mobile phone company,’ I phoned up about my vacuum and they sorted it out within a day.”
APPENDIX 3: Materials created in respect of Focus Group & Telephone Surveys

SURVEY MATERIALS

Qualitative Phase

Project Name: Royal London Group - CVS Model Validation Research

Project Number: 9782

Participant Questionnaire: 9 x 1.5 hour Focus Groups

Respondent Details:

TITLE: ___________________  FORENAME: ___________________

SURNAME: ___________________ 

ADDRESS: ___________________

POSTCODE: __________  ______

TEL: ___________________
MOBILE NO:

EMAIL

INTERVIEWER DECLARATION:

I hereby declare that this questionnaire has been completed within the MRS Code of Conduct and in accordance with their guidelines and with the instructions supplied to me. I have carefully checked the questionnaire and am aware that it is subject to quality control procedures.

Interviewer’s Name: _____________________________________________

Signature: ______________________________________________________

Date of Interview: _____________________________________________
Criteria

Groups 1, 4, 5, 7, 8, 9, 10, 11, 12

- To recruit a mix of Financial Service providers across all groups
- At least three respondents to be Royal London Group customers per group
  - Brands are: Royal London, RL Plus, Scottish Life, Scottish Provident, Bright Grey & CIS
- All to hold the relevant product as listed above
- All respondents to be the key / joint decision-maker for their product within their household

Within each group:

- 8 respondents – recruit 10 for 8
- Age, lifestage and SEG – to fall out
- Gender – 5 males, 5 females

Good morning/afternoon/evening. My name is....................... from an independent market research agency called Nunwood Consulting. We have been commissioned by Royal London Group to conduct some research into understanding consumer needs and experiences with financial service providers. It would involve you participating in a group discussion which will be led by one of our trained moderators. The session will last for approximately 1.5 hours and at the end of the session you may be invited to record a few short clips on film. The film will be used as a visual aid when we present Royal London Group with the results of this research. We may also use some short clips for an internal conference. As a ‘thank you’ for taking part we would like to offer you £50 (Glasgow), £50 (Leeds/Manchester), £55 (London).
We do hope you will be interested in being part of this research and we are sure you will find it an enjoyable experience. Market research such as this is not associated with selling; we are interested only in your views and opinions, and everything you say will remain confidential; unless you agree otherwise. Let me reassure you that your name & details will not be passed on to any third parties or used for any other purpose.

Q1 Would you like to participate?
Yes ........................................................................................................1 CONTINUE
No .......................................................................................................2 THANK & CLOSE

Q2 Please could you let me know whether you would be happy to be filmed if required?
Yes ........................................................................................................1 CONTINUE
No .......................................................................................................2 THANK & CLOSE

RECRUITER – Respondents MUST be happy to be filmed

Q3 Gender of respondent?

Female .....................................................................................................1 CONTINUE
Male ......................................................................................................2 CONTINUE

RECRUITER – Please recruit a 50:50 split
Q4  Do you, or does anyone in your family work in any of the following areas or organisations or have done so in the past?

READ OUT. CODE ALL THAT APPLY. CLOSE IF ANY APPLY

Advertising ........................................................................................................ 1 CLOSE
Journalism .......................................................................................................... 2 CLOSE
Marketing/PR ..................................................................................................... 3 CLOSE
Market Research ............................................................................................... 4 CLOSE
Banking / Financial Services .......................................................................... 5 CLOSE
None of the above ............................................................................................. 6 CONTINUE
OCCUPATION OF CHIEF WAGE EARNER IN HOUSEHOLD (PROBE FULLY):

__________________________________________________________________________

INDUSTRY WORKED IN (IF POLICE OR FORCES, PROBE FOR RANK /GRADE):

__________________________________________________________________________

QUALIFICATIONS/APPRENTICESHIPS/DEGREE (PLEASE SPECIFY IN FULL):

__________________________________________________________________________

NUMBER OF STAFF RESPONSIBLE FOR:

__________________________________________________________________________

A ......................................................................................................................... 1 CONTINUE
B ......................................................................................................................... 2 CONTINUE
C1 ......................................................................................................................... 3 CONTINUE
C2 ......................................................................................................................... 4 CONTINUE
D ......................................................................................................................... 5 CONTINUE
E ......................................................................................................................... 6 CONTINUE

RECRUITER – SEG to fall out naturally but code in respondent database
Q6a  Please can you confirm which age range you fit in to?

FLAGGED ON SAMPLE

17 years or below........................................1  THANK & CLOSE
18-24...............................................................2  CONTINUE
25-34...............................................................3  CONTINUE
35-44...............................................................4  CONTINUE
45-54...............................................................5  CONTINUE
55-64...............................................................6  CONTINUE
65 -74...............................................................7  CONTINUE
75 +...............................................................8  THANK & CLOSE

Q6b  Do you have any children?

Yes .................................................................1  CONTINUE
No .................................................................2  CONTINUE

Q6c  What are the ages of your children and are they living at home?

AGE ___  Living at home?  YES/NO
AGE ___  Living at home?  YES/NO
AGE ___  Living at home?  YES/NO

- Pre Family (Under the age of 35 years and no children)
- Young Family (All kids under 12 years old living at home)
- Older Family (All kids over 12 years living at home)
- Empty Nester/Post Family (Children left home or living at home but (over 18 years)

RECRUITER – Age & Lifestage to fall out but ensure that we have a good mix across all groups
Q7a Please can you let me know which, if any of the following products you may hold and who they are with?

<table>
<thead>
<tr>
<th>TYPE OF PRODUCT</th>
<th>PRODUCT DESCRIPTION</th>
<th>HOLD – PLEASE TICK</th>
<th>PROVIDER – WRITE IN</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual Pension</td>
<td>A pension you set up yourself (or with the help of a financial adviser) rather than through your employer</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Protection</td>
<td>A type of insurance that can pay out a lump sum if you die, a lump sum if you become ill or perhaps a lump sum or a regular amount if you have to stop work due to illness</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Drawdown</td>
<td>When you leave your pension money invested in the stock market and take (draw down) your income directly from your pension (rather than buy an annuity)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Endowment Policy</td>
<td>A type of insurance that pays out an amount at the end of a fixed time or if you die before then. Often people use these to pay their mortgage, e.g. an endowment mortgage</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Term</td>
<td>Definition</td>
<td></td>
<td></td>
</tr>
<tr>
<td>----------------------</td>
<td>-----------------------------------------------------------------------------</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investment</td>
<td>When you invest in the stock market, you might do it through a product such as an ISA, a Unit Trust or an investment bond, e.g. stocks and shares ISA.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Annuity</td>
<td>A type of insurance you buy with the money from your pension. An annuity pays you a regular income (e.g. every month or year) for the rest of your life.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investment Platform</td>
<td>A platform is used to invest in the stock market and is usually accessed through the internet. You can use the platform to invest in shares and funds directly or you can buy other investment products such as ISAs, Bonds and Unit Trusts.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Group Pension</td>
<td>A pension that was set up for you through your employer</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**RECRUITER** – Please recruit 10 respondents per group. Please recruit a mix of brands and include 2 or 3 Royal London Group brand customers per group.
Q7b And are you the key/joint decision maker regarding this product?

Yes ................................................................. 1 CONTINUE

No ................................................................. 2 THANK & CLOSE

RECRUITER – Respondents MUST be the main decision maker

Q7c Did you receive advice from a financial adviser when taking out this product or did you go direct to the provider?

Advice ................................................................. 1 CONTINUE

Direct ................................................................. 2 CONTINUE

Can’t Remember ................................................................. 3 CONTINUE

RECRUITER – At least half of each group to have received advice from an adviser

Q7d How did you take out this product?

Through an adviser ................................................................. 1 CONTINUE

Direct – over the phone ................................................................. 2 CONTINUE

Direct - online ................................................................. 3 CONTINUE

Direct – through the post ................................................................. 4 CONTINUE

RECRUITER – At least half of each group to have bought through an adviser

Q8 When thinking of other financial providers you deal with, which are the first ones that come to mind?

RECRUITER – All respondents must have interactions with other financial providers
RECRUITER - PLEASE NOW GO THROUGH THE 15 ALGORHYTHM QUESTIONS TO ESTABLISH THE RESPONDENTS SEGMENT AND RECORD THIS ON THE DATABASE

Q9 Now for a different kind of question. If you won the lottery, what would you do with the money and why?

WRITE IN BELOW. ALL RESPONDENTS SHOULD BE ARTICULATE AND CONFIDENT AND ABLE TO ANSWER THIS QUESTION IMAGINATIVELY

RECRUIT RESPONDENT

MAKE SURE THE FRONT PAGE DETAILS (incl. POSTCODE) ARE COMPLETED.

PLEASE GIVE RESPONDENT AN INVITATION LETTER TO CONFIRM AND SHOW THE LOCATION OF THE VENUE.

MAKE EVERY EFFORT TO OBTAIN A MOBILE PHONE NUMBER AS THIS WILL BE THE BEST METHOD TO CONTACT RESPONDENTS CLOSER TO THE TIME OF THE SESSION.
Thank you for taking the time to complete this survey about your financial products. We will use your feedback to improve our service to you.

This survey is hosted by Nunwood Consulting, a customer experience specialist based in the UK.

The information you give us will be treated with the strictest confidence and in accordance with the Market Research Society Code of Conduct. It will not be passed on to any other party and any personal details you provide will not be used in any sales or marketing activity.

**SCREENER**

S1. Which of the following products do you currently have? MULTICODE

<table>
<thead>
<tr>
<th>TYPE OF PRODUCT</th>
<th>PRODUCT DESCRIPTION</th>
<th>PLEASE SELECT</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Individual Pension</td>
<td>A pension you set up yourself (or with the help of a financial adviser) rather than through your employer</td>
<td>Close if quota reached</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>2 Group Pension</td>
<td>A pension that was set up for you through your employer</td>
<td>Close if quota reached</td>
</tr>
<tr>
<td>3 Annuity</td>
<td>An annuity pays you a regular income (e.g. every month or year) for the rest of your life. You buy an annuity with the money you have saved in your pension</td>
<td>Close if quota reached</td>
</tr>
<tr>
<td>4 Drawdown</td>
<td>When you leave your pension money invested in the stock market and take (draw down) your income directly from your pension (rather than buy an annuity)</td>
<td>Close if quota reached</td>
</tr>
<tr>
<td>5 Investment</td>
<td>When you invest in the stock market, you might do it through a product such as an ISA, a Unit Trust or an investment bond, e.g. stocks and shares ISA.</td>
<td>Close if quota reached</td>
</tr>
<tr>
<td>6 Endowment Policy</td>
<td>A savings product that pays out an amount at the end of a fixed time or if you die before then. Often people use these to pay their mortgage, e.g. an endowment mortgage</td>
<td>Close if quota reached</td>
</tr>
<tr>
<td>7 Protection</td>
<td>A type of insurance that can pay out a lump sum if you die, a lump sum if you become ill or perhaps a lump sum or a regular amount if you have to stop work due to illness</td>
<td>Close if quota reached</td>
</tr>
<tr>
<td>Don’t know</td>
<td></td>
<td>Close</td>
</tr>
<tr>
<td>None</td>
<td></td>
<td>None</td>
</tr>
</tbody>
</table>
S1a. Which provider(s) do you hold your *least fill on product from SI* with? (to identify competitor and RLG customers) MULTICODE

a) Royal London
b) Royal London Plus
c) Scottish Life
d) Scottish Provident
e) Bright Grey
f) CIS (Co-operative Insurance Services)
g) Caledonian Life
h) Royal Liver
i) United Friendly
j) Refuge Assurance
k) Phoenix Life
l) Aviva
m) Legal & General
n) LV=
o) Prudential
p) Scottish Widows
q) Old Mutual
r) Standard Life
s) Sun Life Direct
t) Other - OPEN ENDED _ CODED POST COMPLETE
u) Don’t know - close
S1b. For those customers who have an investment or pension at S1 Thinking about your <product from S1> with <brand from S1a>, are these held on an online fund platform?

**NOTE:** Fund platforms are services that enable investors to buy investments simply online and then continually manage those products/propositions on the online platform. These can either be managed directly with the investor or by their advisers.

Yes……………………………………………………………………1

No,……………………………………………………………………2

S1c. And please can you confirm which financial provider you hold that platform with? SINGLE CODE

<table>
<thead>
<tr>
<th></th>
<th>Code</th>
<th>Financial Provider</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Cofunds</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>(Fidelity) Funds Network</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Skandia</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Standard Life</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>James Hay</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Transact</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>SEI (UK)</td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>AJ Bell SIPPCentre (incl Youinvest, IMAS)</td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>Elevate (Axa, Elevate)</td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>Ascentric</td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>Nucleus</td>
<td></td>
</tr>
<tr>
<td>12</td>
<td>7IM</td>
<td></td>
</tr>
<tr>
<td>13</td>
<td>Alliance Trust Savings (ATS)</td>
<td></td>
</tr>
<tr>
<td>14</td>
<td>Aviva</td>
<td></td>
</tr>
<tr>
<td>15</td>
<td>Aegon</td>
<td></td>
</tr>
<tr>
<td>16</td>
<td>Zurich</td>
<td></td>
</tr>
<tr>
<td>17</td>
<td>Other (PLEASE STATE)</td>
<td></td>
</tr>
</tbody>
</table>
S2. And are you the key / joint decision maker regarding your <PRODUCT from S1>?

Yes .................................................................................................................. 1 CONTINUE

No .................................................................................................................... 2 CLOSE

S3. Which of the following products are you likely to consider in the next 12 months? (to identify potential customers with an assumption that respondents are in the market for these products not necessarily with RLG) MULTICODE

<table>
<thead>
<tr>
<th>TYPE OF PRODUCT</th>
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<tbody>
<tr>
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<tr>
<td>5 Investment</td>
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<tr>
<td>6 Endowment Policy</td>
<td>A savings product that pays out an amount at the end of a fixed time or if you die before then. Often people use these to pay their mortgage, e.g. an endowment mortgage</td>
</tr>
<tr>
<td>-------------------</td>
<td>--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>7 Protection</td>
<td>A type of insurance that can pay out a lump sum if you die, a lump sum if you become ill or perhaps a lump sum or a regular amount if you have to stop work due to illness</td>
</tr>
<tr>
<td>Don’t know</td>
<td></td>
</tr>
</tbody>
</table>

S3a. Which providers would you consider for a \(<product from S3>\)?

v) Royal London
w) Royal London Plus
x) Scottish Life
y) Scottish Provident
z) Bright Grey
aa) CIS (Co-operative Insurance Services)
bb) Caledonian Life
cc) Royal Liver
dd) United Friendly
ee) Refuge Assurance
ff) Phoenix Life
gg) Aviva
hh) Legal & General
ii) LV=
jj) Prudential
kk) Scottish Widows
ll) Old Mutual
mm) Standard Life
nn) Sun Life Direct
oo) Other - OPEN ENDED _ CODED POST COMPLETE

S4. Did you receive advice from a financial adviser when taking out the
<Product from S1> with <Brand from S1a> or did you go direct to the
provider?

Bought from a financial adviser (go to S5 – 1st bank of statements) ........................................ 1
Bought direct from the product provider (go to S5 – 2nd bank of statements) ............................ 2
Bought via my employer without advice ..................................................................................... 3
Bought via my employer with advice (go to S5 – 1st bank of statements) ............................... 4
Can’t Remember............................................................................................................................ 5

S5. If 1&4 at S4 – was this

An independent financial adviser ............................................................................................... 1
An adviser in a bank, building society or insurance company ..................................................... 2

If 2 at S4 – was this

Direct – over the phone .............................................................................................................. 2
Direct - online ............................................................................................................................. 3
Direct – through the post ............................................................................................................. 4
ATTITUDINAL SEGMENT STATEMENTS

ASK ALL
A1. The following is a list of statements that people have said about life in general. For each statement please indicate how much you agree or disagree with it, on a scale from 1 to 5 where 1 is definitely disagree 5 is definitely agree.

Please type in a value in the box provided:

<table>
<thead>
<tr>
<th></th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Definitely disagree</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5 Definitely agree</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a) Achieving greater success than my peers is important to me
b) I prefer to just let things happen than to think about them too much
c) I’m very happy with my life as it is
d) I prefer to do things myself rather than relying on other people
e) I associate the word 'risk' with the idea of 'opportunity’
f) I have difficulty deciding what to do about the future
g) I'm excited about the future
h) I insist on being organised in all that I do
i) I enjoy tasks that require me to be exact
j) Logic can solve any problem
k) It is important that a company acts ethically
l) People should provide for themselves and not depend on the government
m) It is important to respect traditional customs and beliefs
n) I am an optimist
o) Financial security after retirement is your own responsibility
THE ANSWERS TO THESE STATEMENTS DETERMINES THE SEGMENT. WE CAN SCRIPT THIS TO BE DYNAMIC ON THE SURVEY ALLOWING US TO QUOTA BY SEGMENT DURING FIELDWORK.

6 segments fall out naturally – minimum segments on priority segments: achievers, contented and givers

OVERALL KPIs

We are now going to ask some questions about your overall attitude towards

<BRAND FROM S1a> with regards to your <least fill on product from S1> Least Fill with a priority on RLG brands

Ask All

K1. NPS - Firstly, on a scale of 0 to 10, how likely are you to recommend <BRAND FROM S1a> to a relative, friend or colleague? (Note if needed: 0 is “extremely unlikely” and 10 is “extremely likely”)

Please hover over the scale to select your response.

SINGLE CODE

<table>
<thead>
<tr>
<th>0 - Extremely unlikely</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
</tr>
<tr>
<td>2</td>
</tr>
<tr>
<td>3</td>
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<tr>
<td>4</td>
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<td>5</td>
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<td>6</td>
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<tr>
<td>7</td>
</tr>
<tr>
<td>8</td>
</tr>
<tr>
<td>9</td>
</tr>
<tr>
<td>10 - Extremely likely</td>
</tr>
</tbody>
</table>

**NPS verbatim**

**Ask IF 0-6 AT K1**

**K1a. Would you ever recommend any financial services provider?**

**SINGLE CODE**

1. Yes
2. No

**DATA: ALWAYS REGROUP THIS SCALE AS FOLLOWS: 0-6 – DETRACTOR; 7/8 – PASSIVE; 9/10 PROMOTERS**

**OPEN RESPONSE**

**Ask IF 0-6 AT K1**

**K1b. What can they do to make you more likely to recommend? Please be as specific as possible.**

**OPEN RESPONSE**
Ask IF 7-8 AT K1

K1c. What can they do to deserve a higher score? Please be as specific as possible.

OPEN RESPONSE

Ask IF 9-10 AT K1

K1d. What is it that they do to make you recommend them? Please be as specific as possible.

OPEN RESPONSE

K2. – Trust - Taking everything into account with your <Product from S1>, to what extent do you trust <BRAND FROM S1a>?

SINGLE CODE

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>Do not trust at all</td>
</tr>
<tr>
<td>1</td>
<td></td>
</tr>
<tr>
<td>2</td>
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<tr>
<td>9</td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>Trust completely</td>
</tr>
</tbody>
</table>
K1b. What can they do to make you more likely to trust them? Please be as specific as possible.

K1c. What can they do to increase your trust in them further? Please be as specific as possible.

K1d. What is it that they do to make you trust them? Please be as specific as possible.

C1a. To what extent do you agree with the following in relation to <BRAND AT S1a>:

<table>
<thead>
<tr>
<th>0 – Completely disagree</th>
<th>1</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2</td>
</tr>
<tr>
<td>CVS</td>
<td>Question wording</td>
</tr>
<tr>
<td>-----</td>
<td>------------------</td>
</tr>
<tr>
<td>a)</td>
<td>Track record</td>
</tr>
<tr>
<td>b)</td>
<td>Membership</td>
</tr>
<tr>
<td>c)</td>
<td>Sales</td>
</tr>
<tr>
<td>d)</td>
<td>Support</td>
</tr>
<tr>
<td>e)</td>
<td>Comms</td>
</tr>
</tbody>
</table>

**Service**  They are easy to deal with, including how I can contact
them and how they handle any queries

f) **Payout**  I believe they will pay out what I expected and would be empathetic to my situation

g) **Investment**  I’m confident that I’ll get a good return on my investment

h) **Product design**  They design products for people like me

i) **Responsibility**  I believe they support local communities, charities and the environment

j) **Resolution**  When something goes wrong, I think they are (or would be) really good at putting it right

C1b. Please state how important the following are to you, in relation to <BRAND AT S1a>:

<table>
<thead>
<tr>
<th>0 – Not at all important</th>
<th>1</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
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<tr>
<td>4</td>
<td>5</td>
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<tr>
<td>6</td>
<td>7</td>
</tr>
<tr>
<td>8</td>
<td>9</td>
</tr>
<tr>
<td>10 – Extremely important</td>
<td></td>
</tr>
</tbody>
</table>
**CVS**

**Question wording**

a) *Track record*  
I see them as long-standing industry experts who will be around when I need them

b) *Membership*  
There are loyalty benefits, such as profit share, for being an existing customer

c) *Sales*  
The information supplied enables me to choose a product suitable for my needs, and the application process is straightforward

d) *Support*  
They help me to understand my finances

e) *Comms*  
I understand what they are saying and they keep me informed

**Service**  
They are easy to deal with, including how I can contact them and how they handle any queries

f) *Payout*  
I believe they will pay out what I expected and would be empathetic to my situation

g) *Investment*  
I’m confident that I’ll get a good return on my investment

h) *Product design*  
They design products for people like me

i) *Responsibility*  
I believe they support local communities, charities and the environment

j) *Resolution*  
When something goes wrong, I think they are (or would be) really good at putting it right
CA1. To what extent do you agree with the following in relation to <BRAND AT S1a>? We appreciate that there are many statements, but your responses are really important to us, so please answer them all.

<table>
<thead>
<tr>
<th>0 – Completely disagree</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td></td>
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<td>2</td>
<td></td>
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<td>8</td>
<td></td>
</tr>
<tr>
<td>9</td>
<td></td>
</tr>
<tr>
<td>10 – Completely agree</td>
<td></td>
</tr>
</tbody>
</table>
responsibility
They support local communities and charities
They are open & honest about where they invest my money
When deciding where to invest, they take account of the ethical, environmental and social impact

track record
They have been around for a long time and have a good reputation
They're recognised as longstanding experts by industry experts and by other customers like me
They are transparent and fair about employees' pay and bonuses

membership
They share their profits with their customers
I receive loyalty benefits for being an existing customer

sales
They explain their products in an engaging and clear way
It is easy to work out if the product is suitable for me, in terms of its risks and benefits
I don't have to switch from my preferred communication channel (e.g. phone/email/online/post)
<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Support</td>
<td>They provide me with information about what is happening in the market and tell me how this might be relevant to me. They play a role in educating people about managing their finances and preparing for their future.</td>
</tr>
<tr>
<td>comms</td>
<td>They communicate with me in plain English, with no jargon. I am able to choose how we communicate with each other (e.g. phone/email/online/post) and how often we communicate. They provide me with concise communications highlighting the key information that I need to know. They are clear on terms &amp; conditions and charges at all times. They proactively provide updates on the performance of my products.</td>
</tr>
<tr>
<td>service</td>
<td>The first person I speak to would be able to answer any question I have, and would be empowered to make decisions. I am able to see the person I'm talking to. They have extended call times, including late evenings/weekends. They provide Freephone numbers for me to call them. I am able to personalise my account online. I have a named personal contact and their direct contact details. They would know who I am, keep a record and remember me when</td>
</tr>
</tbody>
</table>
I contact them
They would keep their promises in terms of timescales, and what they will do

**payout**
They have a good track record for paying claims

*Only ask Protection customers* - They would handle claims with empathy (e.g. for life assurance or critical illness policies)
When making a claim or waiting for a payout, they would keep me updated on progress

*Only ask Protection customers* - When making a claim on a critical illness or life assurance policy, they would offer extra support such as a second medical opinion

**investment**
They are open & honest about any charges

*Only ask Pension and Investment customers* - It would be easy to switch investment funds if I wanted to

*Only ask Pension and Investment customers* They would tell me if my investment could be performing better, so I could take action

**product**
It is clear what is guaranteed and what is not in my product
I can tailor the product to my changing needs over time
Their products are designed for people like me
They provide competitive products
They provide existing customers with the same deals as new customers.

Resolution

If something went wrong, they would allow me to decide when the issue is resolved.

If something went wrong they would empathise with me and show they understand my situation.

If something went wrong they would apologise and take ownership for my issue/problem.

If something went wrong, they would compensate by giving me a gift/something I'm not expecting by way of an apology.

Demographics

Thank you for your responses. We have a final couple of questions to help us classify your answers.

ASK ALL

D1. What is your age?

DATA TO SHOW OPEN BOX

ASK ALL

D2. Are you…….? 

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Male</td>
</tr>
<tr>
<td>2</td>
<td>Female</td>
</tr>
</tbody>
</table>
ASK ALL

D3. And which of the following best describes the combined annual household income from all sources before taxes?

SINGLE CODE

<table>
<thead>
<tr>
<th></th>
<th>Description</th>
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</thead>
<tbody>
<tr>
<td>1</td>
<td>Less than £25,000</td>
</tr>
<tr>
<td>2</td>
<td>£25,000 - £49,999</td>
</tr>
<tr>
<td>3</td>
<td>£50,000 - £74,999</td>
</tr>
<tr>
<td>4</td>
<td>£75,000 - £99,999</td>
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<td>5</td>
<td>£100,000 - £149,000</td>
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<td>6</td>
<td>£150,000 - £199,999</td>
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<tr>
<td>7</td>
<td>£200,000 - £249,999</td>
</tr>
<tr>
<td>8</td>
<td>£250,000 or more</td>
</tr>
<tr>
<td>9</td>
<td>Prefer not to answer</td>
</tr>
</tbody>
</table>

D4. Postcode:…………..

D5. Which of the following categories best describes the position at work of the main income earner in the household?

- High managerial, administrative or professional
- Intermediate managerial, administrative or professional
- Supervisor; clerical; junior managerial, administrative or professional
- Student
- Skilled manual worker
- Unskilled manual worker
- Housewife / Homemaker – if single parent
• Unemployed

• Retired – state pension only (if private pension, please answer according to previous occupation)

• Housewife / Homemaker

• Prefer not to answer
<table>
<thead>
<tr>
<th>No.</th>
<th>Group</th>
<th>Location</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Drawdown</td>
<td>Leeds</td>
<td>17th February</td>
</tr>
<tr>
<td>2</td>
<td>Direct</td>
<td>Leeds</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Investment/Endowment</td>
<td>Leeds</td>
<td>18th February</td>
</tr>
<tr>
<td>4</td>
<td>Individual Pension</td>
<td>Leeds</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Platform</td>
<td>Leeds</td>
<td>19th February</td>
</tr>
<tr>
<td>6</td>
<td>Annuity</td>
<td>London</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Protection</td>
<td>London</td>
<td>24th February</td>
</tr>
<tr>
<td>8</td>
<td>Group Pension</td>
<td>London</td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>Investment/Endowment (2)</td>
<td>Glasgow</td>
<td>26th February</td>
</tr>
<tr>
<td>10</td>
<td>Protection (2)</td>
<td>Glasgow</td>
<td>26th February</td>
</tr>
<tr>
<td>11</td>
<td>Group Pension (2)</td>
<td>Glasgow</td>
<td>26th February</td>
</tr>
<tr>
<td>12</td>
<td>Members</td>
<td>Manchester</td>
<td>3rd March</td>
</tr>
</tbody>
</table>
APPENDIX 4: Data Tables from Regression
Base

1822

310

Overall

RLG

REGRESSED CVS STATEMENTS

I see them as long-standing industry experts who will be around when I need them
11.5%
There are loyalty benefits, such as profit share, for being an existing customer
3.9%
The information supplied enables me to choose a product suitable for my needs, and the application process is straightforward
10.1%
They help me to understand my finances
8.9%
I understand what they are saying and they keep me informed
8.6%
They are easy to deal with, including how I can contact them and how they handle any queries
10.6%
I believe they will pay out what I expected and would be empathetic to my situation
9.5%
I’m confident that I’ll get a good return on my investment
12.1%
They design products for people like me
11.4%
I believe they support local communities, charities and the environment
4.3%
When something goes wrong, I think they are (or would be) really good at putting it right
9.2%

Overall
I see them as long-standing industry experts who will be around when I need them
13.6%
There are loyalty benefits, such as profit share, for being an existing customer
2.7%
The information supplied enables me to choose a product suitable for my needs, and the application process is straightforward
7.8%
They help me to understand my finances
6.6%
I understand what they are saying and they keep me informed
8.2%
They are easy to deal with, including how I can contact them and how they handle any queries
10.0%
I believe they will pay out what I expected and would be empathetic to my situation
12.8%
I’m confident that I’ll get a good return on my investment
12.3%
They design products for people like me
10.7%
I believe they support local communities, charities and the environment
4.1%
When something goes wrong, I think they are (or would be) really good at putting it right
11.3%

Overall
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When something goes wrong, I think they are (or would be) really good at putting it right
10.8%

9.3%
4.5%
12.3%
9.4%
10.4%
10.8%
10.1%
9.0%
11.5%
4.3%
8.3%

RLG
12.9%
3.8%
10.0%
8.2%
9.8%
10.2%
12.0%
9.8%
9.5%
4.5%
9.3%

RLG
10.4%
7.0%
9.0%
7.6%
9.1%
10.3%
12.6%
10.6%
7.5%
5.5%
10.4%

1512

85

313

437

98

639

250

389
NPS
Competitor
Individual
Segment 1 Segment 2 Segment 3 Segment 4 Segment 5 Segment 6
s
Pension
11.8%
10.7%
13.0%
12.3%
10.3%
10.4%
9.1%
11.1%
4.1%
4.4%
5.6%
3.7%
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4.1%
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6.7%
10.0%
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6.8%
4.5%
9.4%
8.7%
10.0%
9.6%
8.2%
8.8%
9.4%
9.0%

390
Group
Pension
11.8%
3.9%
7.2%
8.2%
9.1%
10.3%
11.5%
14.7%
9.4%
4.3%
9.6%

Trust
Competitor
Individual
Segment 1 Segment 2 Segment 3 Segment 4 Segment 5 Segment 6
s
Pension
13.4%
9.5%
16.1%
13.4%
14.6%
12.8%
11.0%
14.0%
2.7%
4.4%
4.3%
3.0%
4.8%
2.7%
4.6%
3.8%
7.5%
5.5%
8.7%
6.5%
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12.7%
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11.5%
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14.0%
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4.3%
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5.9%
3.1%
5.6%
4.9%
4.6%
4.2%
11.6%
9.6%
10.9%
11.2%
10.0%
11.0%
11.9%
10.5%

Group
Pension
14.1%
2.5%
4.8%
6.3%
9.1%
11.0%
14.7%
11.3%
10.3%
4.2%
11.6%

Stated - T2B Rebased
Competitor
Individual
Group
Segment 1 Segment 2 Segment 3 Segment 4 Segment 5 Segment 6
s
Pension
Pension
10.8%
9.6%
10.8%
10.3%
9.7%
10.9%
11.7%
10.8%
10.9%
4.4%
3.6%
4.4%
5.8%
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4.9%
4.8%
8.9%
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10.8%
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13.5%
15.3%
14.5%
13.2%
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12.6%
14.7%
12.9%
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11.6%
11.8%
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12.7%
12.0%
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8.0%
8.4%
7.7%
7.1%
8.9%
7.4%
7.7%
8.8%
3.1%
3.2%
2.6%
3.6%
5.0%
3.5%
3.4%
3.2%
3.1%
10.8%
11.6%
11.2%
11.8%
8.4%
10.5%
10.9%
11.5%
10.0%

406

154
Annuity
8.7%
5.7%
13.2%
5.8%
8.9%
9.4%
8.7%
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Annuity
14.2%
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5.1%
7.5%
8.6%
13.7%
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10.5%
5.8%
9.2%

Annuity
10.4%
4.6%
10.8%
7.0%
9.4%
10.6%
13.3%
11.3%
8.2%
3.9%
10.6%

78

196

Drawdown Investment
13.4%
4.8%
10.5%
10.4%
10.7%
9.3%
7.6%
9.9%
8.8%
4.9%
9.6%

11.3%
4.8%
8.5%
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Correlation Analysis

I see them as long-standing industry experts who will be around when I need them
There are loyalty benefits, such as profit share, for being an existing customer
The information supplied enables me to choose a product suitable for my needs, and the application process is straightforward
They help me to understand my finances
I understand what they are saying and they keep me informed
They are easy to deal with, including how I can contact them and how they handle any queries
I believe they will pay out what I expected and would be empathetic to my situation
I'm confident that I'll get a good return on my investment
They design products for people like me
I believe they support local communities, charities and the environment
When something goes wrong, I think they are (or would be) really good at putting it right

| Correlation Analysis | I see them as long-standing industry experts who will be around when I need them | There are loyalty benefits, such as profit share, for being an existing customer | The information supplied enables me to choose a product suitable for my needs, and the application process is straightforward | They help me to understand my finances | I understand what they are saying and they keep me informed | They are easy to deal with, including how I can contact them and how they handle any queries | I believe they will pay out what I expected and would be empathetic to my situation | I'm confident that I'll get a good return on my investment | They design products for people like me | I believe they support local communities, charities and the environment | When something goes wrong, I think they are (or would be) really good at putting it right |
|----------------------|---------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------|
| I see them as long-standing industry experts who will be around when I need them | 1.00 | .411 | .648 | .813 | .656 | .697 | .711 | .680 | .733 | .522 | .790 |
| There are loyalty benefits, such as profit share, for being an existing customer | .411 | 1.00 | .518 | .557 | .442 | .422 | .374 | .423 | .398 | .565 | .479 |
| The information supplied enables me to choose a product suitable for my needs, and the application process is straightforward | .648 | .518 | 1.00 | .710 | .703 | .697 | .617 | .660 | .681 | .512 | .662 |
| They help me to understand my finances | .813 | .557 | .710 | 1.00 | .747 | .685 | .568 | .850 | .633 | .549 | .654 |
| I understand what they are saying and they keep me informed | .656 | .442 | .703 | .747 | 1.00 | .798 | .660 | .679 | .679 | .475 | .690 |
| They are easy to deal with, including how I can contact them and how they handle any queries | .697 | .422 | .697 | .685 | .798 | 1.00 | .692 | .680 | .706 | .479 | .731 |
| I believe they will pay out what I expected and would be empathetic to my situation | .711 | .374 | .617 | .568 | .660 | .692 | 1.00 | .793 | .725 | .445 | .736 |
| I'm confident that I'll get a good return on my investment | .680 | .423 | .660 | .650 | .679 | .680 | .793 | 1.00 | .752 | .504 | .720 |
| They design products for people like me | .733 | .388 | .681 | .633 | .679 | .706 | .725 | .752 | 1.00 | .515 | .732 |
| I believe they support local communities, charities and the environment | .522 | .565 | .512 | .549 | .475 | .479 | .445 | .504 | .515 | 1.00 | .615 |
| When something goes wrong, I think they are (or would be) really good at putting it right | .760 | .612 | .654 | .650 | .731 | .736 | .740 | .770 | .770 | .615 | 1.00 |
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