Next time they'll be coming for you

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Brokers should pay close attention to the FSA's overhaul of the life insurance sector because they are next on the hit list.

What can general insurance brokers learn from life? Quite a lot actually, if they pay close attention to the regulatory overhaul of the life insurance sector, and its impact on independent financial advisers (IFAs).

Brokers and IFAs of course have their differences, with brokers working as general insurance intermediaries and IFAs rendering investment advice and financial planning services to individuals and businesses. But the parallels provide brokers with a stark warning about what their own future may hold.

The FSA, which regulates both brokers and IFAs, is currently carrying out a review of retail distribution – the RDR. The review, to be published in October, is an attempt to address persistent problems in the retail investment market.

It seeks to improve standards of professionalism, find more cost-effective ways of making advice available to a wider range of consumers, and improve consumers' understanding of what they are getting for their money.

While the FSA has said it has no current plans to apply the RDR to the general insurance market, the regulator has been heavily pushing the commercial insurance industry on the issues of commission disclosure, transparency and conflicts of interest – all key elements of the RDR, suggesting that a more formal implementation could follow at some point.

Industry response

Earlier this year the FSA published a discussion paper outlining plans for further regulation of the broker market. It outlined the option of making commission disclosure mandatory, and said it was worried that there is a lack of transparency.

The market has until 25 June to respond and, so far, the reaction from insurers and brokers has been mixed. Biba remains intent on a market-led solution for commission disclosure. But Steve White, head of compliance and training at Biba, concedes that the regulator could take any number of actions. He adds that there is no evidence that the commercial customer or retail consumer wants commission to be disclosed. But that has not stopped the FSA from bringing tough proposals on disclosure for IFAs, which start to come into force later this year.

One of RDR proposals for IFAs is to require them to differentiate between advice and sales. There would be a specific type of adviser allowed to provide advice, and a step-change in the standards required of them from the current levels.

General insurance is considered a more sales-based industry because it relies more heavily on commission. But brokers could move in the direction IFAs are headed, and develop stronger relationships with clients.

Under RDR, advisers at the top level would be independent, recommend products from across the whole market, and meet minimum professional standards. Also their levels of remuneration would not be determined by the product provider, as in the standard commission model.

Meanwhile on the sales side there would be non-advised services. Advisers who fall within this category could work within the current regulatory framework, but the FSA might introduce stricter guidance at some point.

Finally, advisers at the lowest level will be able to give basic guidance in a newly proposed information service. In the Thoresen Review,which reported in March this year, the Treasury investigated people's access to financial advice across the UK and made recommendations that those in need should gain free access to basic advice.

The advice service will not be regulated, but the FSA has partnered with the Treasury in order to implement the strategy.

For now, these proposals apply to investment IFAs only. But the ABI has already suggested that protection IFAs – who are often considered as transactional as general insurance brokers – could fall under RDR next, and be followed by brokers within five years.

Peter Chadborn, an IFA and protection specialist with Colchester-based CBK, says: "Initially, protection advisers were aware of RDR, but we were told it wouldn't affect us. Now, all of a sudden, it might. So that could happen in general insurance. It's like Treating Customers Fairly, in that it's far further reaching than we first envisaged."

Chadborn says that, as with general insurance, there is heavy reliance on commission when selling protection products such as life insurance. This is because protection has become heavily commoditised and is often sold online, having succumbed to the same price wars experienced by general insurers.

Additionally, there is no need to continually manage protection products as with investment products.

However, Chadborn is adamant that any type of intermediary can offer additional services that help justify either fees or commissions to customers. For example, he says he takes time to explain product features and not just price to his customers.

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>
> *Steve White, Biba*

Like broker firms, small IFAs are becoming harder to find. And for many of these IFAs, the way to survive is to scrap commission-based remuneration and move to fee-based advice enabled by a more holistic offering.

Obviously, it would be difficult for general insurance brokers to make their living on customer fees alone because general insurance is more of a commodity than investment products.

But under RDR, independent IFAs will probably still be able to accept commission provided that their remuneration was agreed with the customer.

Meanwhile, qualifications are another facet of the RDR that could extend to brokers. Currently, IFAs require a certificate in financial planning from the CII or the equivalent from another qualification body in order to provide financial advice. But the RDR wants to raise the minimum qualification to diploma level, which is equivalent to a first-year university degree. Advisers could then move on to advanced diploma level and chartered status.

Brokers have a similar qualifications structure with the CII, including a certificate of insurance, diploma, advanced diploma and chartered status. But they do not require a certificate to practise and they do not have to take their qualifications in a defined order.

A CII spokesman says: "A certificate would be considered best practice, but it's not a regulatory requirement. It will be interesting to reflect on the lessons from financial planners and consider the possibility of replication in mortgage and general insurance. I think it's a good idea, but it's premature."

Commission disclosure

The FSA’s discussion paper on commission disclosure in commercial insurance has three proposals: increased supervision and enforcement of existing rules; an enhanced version of the current regime with brokers providing more details of commissions when customers ask for it; and forced commission disclosure regardless of whether the customer asks for it.

Biba has made it clear that it does not want to see further regulation.

White says: “We don’t believe the FSA needs to mandate disclosure, provided brokers are doing three things: identifying and managing conflicts of interest; having a process in place to fully disclose their earnings if asked; and having a more transparent terms-of-business wording.

“Biba has already issued guidance and wordings on all three of these areas. If firms are doing all of those, then that would address the FSA’s major concerns and that should be the end of it,” he says.

But he adds: “The message to firms is simple, that if you don’t support an industry solution, then the regulator will mandate disclosure. The old way of doing things is not tenable.”

If the IFA market is anything to go by, a market-led solution is unlikely to be effective because many veteran IFAs have refused to change their business models after operating the same way for so many years.

But whether or not the RDR is eventually imposed on general insurance brokers, the parallels between brokers and IFAs cannot be ignored.

Disclosing commission to customers can make selling a product much tougher. But IFAs who have replaced a sales-based approach with a customer-led one are experiencing impressive jumps in turnover and sustainability, not to mention an improved professional image as a whole.

Even if brokers are not forced into commission disclosure, it is possible that adopting a similar approach to IFAs could help ensure the survival of smaller brokers. And larger brokers such as Jelf or Towergate – both of which have IFA arms – could streamline their businesses and boost profits.

In its RDR interim review, the FSA says: “The RDR must meet our desired outcomes for the investment market, but if the feedback and our own analysis suggest a wider application then that is something we will of course consider and discuss openly with the market.”

Perhaps it would be best to beat the regulator to the punch.

The changing face of the broker

Gary Horswell, managing director of Bristol-based Ntegrity, might just be building the Noahs Ark of the UK broker world.
Horswell is convinced that the FSAs retail distribution review (RDR), which is set to overhaul the independent financial adviser (IFA) market, will inevitably hit general insurance brokers.
And since founding Ntegrity in January 2007, Horswell has been building a less sales-focused and more value-led business Ã¢â‚¬â€œ a transformation at the heart of RDR.
We offer in-depth services and we are working on a range of risk management tools and claims operations, he says. The business was built with the expectation of having to disclose and justify what we do, and has services beyond provisional
insurance.
Having co-founded a broking arm within Hargreaves Lansdown, a successful listed company that also has a financial adviser offering, as well as setting up what is now Bristol-based Lockton, Horswell is familiar with all aspects of the intermediary market.
He says: There are two forces at play the FSA and the EU. The EU views the UK broker market possibly with suspicion and some envy. But it has certainly been prompting the FSA to revisit conflict of interest issues. And commission disclosure is wrapped up in that debate. So I think there is a high possibly of brokers going down a similar route to advisers.
In its interim report on the RDR, which is expected to be unveiled in October, the FSA says it wants to stop providers playing any part in setting adviser remuneration. Ideas included setting maximum

commissions and even a move away from commissions. The FSA suggests that providers could help monitor commission levels of advisers.
If advisers are forced to deal with consumers for remuneration, they would surely have to offer a better service in order to justify that remuneration Ã¢â‚¬â€œ particularly if they no longer accepted commission and instead charged customers fees.
Obviously, some of the RDR proposals would be difficult, if not impossible, to implement in general insurance, because it is an inherently more commoditised sector than investment.
But Horswell believes that any form of commission disclosure is bound to force brokers to improve their offerings. He also believes that further regulation coupled with consolidation could help ensure the survival of smaller brokers, because they would have to be more robust and entrepreneurial.
Consolidators are great because they are sweeping up those guys looking to sell anyway, or who have had enough of regulation,Â he says.