

Delivering the RDR: Platforms

Consumer Panel Position Paper

Introduction

Platforms are on-line services used both by financial advisers and individual investors to buy, sell, administer and monitor investment portfolios. Platforms are developing rapidly, with assets currently held on platforms totalling around £110billion – almost three times the figure of £40billion quoted by the FSA in 2007. But even £110billion is only some 5% of the total potential market, which is thought to be as high as £2trillion. Platform services and the way in which they are structured and paid for are likely to have an ever-growing impact on retail investors. The FSA must act now to ensure that any potential bias is eliminated and that platforms can deliver the range of products and services consumers need, together with transparent and clearly explained charging structures.

The FSA's consultation on how platforms should be regulated began with a discussion paper in June 2007, a second DP in March 2010 and specific proposals in November 2010, yet very few consumer organisations have engaged with the FSA's consultation process on platforms. This is probably because of the complexity of the topic, both from a commercial and technological point of view. The financial services industry has, however, already given considerable feedback and there is a risk that the interests of industry will prevail to the possible detriment of consumers.

The FSA acknowledges that establishing conduct rules for the platforms market is very difficult. Interestingly, industry opinion is divided with, for example, fund managers having different views to life offices. "Having a level playing field" has different meanings to different parties and, critically, key players seem to have fundamental differences over rebates.

By contrast, the Panel has a clear view of what the platforms market should look like from a consumer point of view. It is essential to eliminate bias in the retail distribution market and the consumer must be empowered to make informed choices. We would like to see a competitive market where choice, access and value for money are critical components.

It is crucial that the market develops to benefit consumers as well as industry. Although the platforms market mainly operates as business to business transactions, ultimately the consumer pays for all the services provided.

Key Messages to the FSA

1. Act now to shape the future platforms market

The FSA should act now to develop a market that is in the consumers' best interests. The platforms market is still relatively immature, but is developing rapidly. The FSA must therefore seize the opportunity to shape the platforms market at this early stage so that the objectives of the Retail Distribution Review are achieved. To do this effectively, however, requires the FSA to take more time to assess the market and to examine potential market disruption heralded by the industry if the FSA's current proposals are not adopted.

2. Ban rebates by providers

We disagree with the FSA's proposals to continue to allow fund managers and other product providers to give rebates to platforms. The FSA's proposals will prevent clarity of relationships and charges and fail to eliminate product bias. The aims of the RDR will therefore be undermined and consumers will continue to suffer detriment.

We believe that the cost of all services – fund management, platform administration and advice – should be charged for separately and paid directly by the consumer. This will eliminate an important source of bias in the retail distribution market and empower the consumer to make informed choices.

3. Stimulate effective competition in the market

The platforms market must operate in a way that stimulates effective competition between providers and between platforms to the benefit of consumers.

Consumers need easy access to low cost, value for money investments and these are not so readily available in a market where products paying higher rebates to platforms have a higher profile, and where the balance of power lies with providers and advisers.

Many consumers access investments through their advisors. The FSA's proposals make it likely that advisors will put their clients on platforms most suited to them rather than, necessarily, to their clients. This will not stimulate effective competition between platforms from the consumer perspective. It is difficult too to see how consumers engaging directly with platforms will be able to act as drivers for good outcomes such as access to wider product choice.

Background

In June 2006 the FSA launched the Retail Distribution Review. The aims were to develop:

- an industry that engages with consumers in a way that delivers more clarity for them on products and services;

- a market which allows more consumers to have their needs and wants addressed;
- standards of professionalism that inspire consumer confidence and build trust;
- remuneration arrangements that allow competitive forces to work in favour of consumers;
- an industry where firms are sufficiently viable to deliver on their longer term commitments and where they treat their customers fairly; and
- a regulatory framework that can support delivery of all of these aspirations and which does not inhibit future innovation where this benefits consumers.

The FSA began its consultation process on the regulation of platforms in 2007, but it was not until some three years' later that specific proposals were published. The Panel has been actively engaged in the debate, both with the FSA and other trade and consumer bodies.

Current Panel Position

Given its rapid growth and complexity, it has taken some time for the Panel to understand in sufficient depth the platforms market and the implications of platforms for consumers.

To aid our understanding and to provide additional insight, the Panel commissioned research by Bluerock Consulting Ltd on the implications for consumers of the FSA's proposals on platforms in CP10/29. The Panel defined six good consumer outcomes for research purposes:

- Consumers should have access to platforms
- Charges paid by consumers should be clear and understandable
- Information provided by consumers should enable them to make informed decisions
- Consumers should be given appropriate choices and there should be no hidden bias
- Service providers should have clear accountability to consumers
- Consumers should be protected when platforms cease trading

The research indicated some causes of potential consumer detriment which require to be addressed. Given the nature of the marketplace, the research focused largely on industry and market commentator interviews rather than direct consumer research. The results have, nevertheless, enabled the Panel to develop a deeper understanding of the platforms market in order to

formulate its response to CP10/29 and to articulate key messages to the FSA on behalf of consumers.

The three key areas of concern are outlined below.

Act now to shape the future platforms market

The FSA should act now to develop a market that is in the consumers' best interests.

The platforms market is still in an immature phase. The first platform was launched in 1999 and platform providers are still struggling to generate profits. Assets held on platforms amount to around £110 billion, but these assets represent only 5 -10% of the total potential market. This is changing rapidly, however, and over half of new retail investments are now placed on platforms even though consumers are frequently not aware that platforms are involved.

The FSA must therefore seize the opportunity to shape the platforms market at this early stage of development so that the objectives of the Retail Distribution Review (including clear disclosure of charges and a competitive market) are achieved. This will produce the best outcome for consumers.

Ban rebates by providers

The Panel strongly supports the FSA's Retail Distribution Review (RDR) that aims to rebuild consumers' confidence and trust in financial services. The FSA must not lose sight of these aims as it introduces changes into the retail investment market.

Given the Panel's commitment to fair outcomes in a market that serves all consumers, we are particularly keen to see:

- A level playing field for all retail investment products, with no provider, product or sales bias;
- Transparency and clarity of relationships and charges;
- Effective competition between product providers and amongst platforms so that consumers get better value from their investments and benefit from economies of scale and scope; and
- Straightforward, good value products made available to consumers with the aid of simplified advice.

The Panel's view is that the cost of all services – fund management, platform administration and advice – should be charged for separately and paid directly by the consumer. We therefore disagree with the FSA's proposals to continue to allow fund managers and other product providers to give rebates to platforms.

We believe that the FSA's proposals will prevent clarity of relationships and charges and fail to eliminate product bias. The proposals will also limit competition. Consumers will therefore suffer detriment.

These issues are discussed further below.

Transparency and clarity of relationships and charges

The use of platforms is becoming the main means by which independent financial advisors deal with their clients' assets. There is a variety of types of platform – in particular fund supermarkets and wrap platforms – and a good deal of complexity in relationships and charging mechanisms. Many consumers would find it difficult to understand a typical arrangement whereby the client pays the fund manager an Annual Management Charge (AMC) of 1.5%, the fund manager passes half this (0.75%) to the platform as a cash rebate, and the platform then pays the advisor 0.5% as commission.

Consumers also suffer significant charges in addition to those of the fund manager, platform and advisor. They pay for administration, audit and legal costs, as well as transaction costs, interest on borrowings, and entry and exit costs. Taken together, these can in effect double the AMC cost for an actively managed fund. These charges are not disclosed to the client and this lack of transparency causes serious consumer detriment because the true cost of the service is not evident.

An essential objective of the regulatory regime is clear disclosure of all charges born by consumers, clear specification of the purpose of such charges and the identification of the organisations providing services for which such charges are made. Bundling of charges detracts from transparency and clarity and should be banned as failing to meet the criterion of being 'clear, fair and not misleading'. Bundling does not encourage the demand for more effective competition.

Elimination of product bias

Unbundled charges would be consistent with the intention of the RDR in that it would remove an important source of product bias. Nevertheless, the FSA proposes to continue to permit fund managers to make payments to platforms for the administration services they receive, subject to improved disclosure to consumers and impartiality in the presentation of products. But disclosure is not a panacea and in particular, disclosure in itself is not a means of managing conflict and bias.

There is no good argument for permitting platform business models that are no longer fit for purpose in the post-RDR regulatory regime. Deferring to the interests of the current dominant platforms, that use the provider pays model, would not be in consumers' best interests, particularly when other more consumer-friendly models may be prevented from emerging.

We recognise that the product providers and platforms may need time to adapt their business models to unbundled charges, just as the advisors have

needed time to adapt to the new regime. It may be reasonable to allow the existing provider rebates to platforms to continue for a further year or two, before full unbundling of charges is required.

The regulation of insurance bonds needs to be reviewed. The FSA has said that should they consider a ban on producer rebates to platforms in the future, they would consider including rebating charges between fund manager and life assurers. The FSA could consider allowing a transitional period until the commencement of the PRIPS regime for insurance companies (expected by 2014) so that the same charging rules can be applied across the whole market at the same time to avoid market distortion.

Stimulate effective competition in the market to the benefit of consumers

We believe that consumers will benefit from effective competition:

- Between actively managed funds with high charges and passively managed funds with low charges;
- Amongst the actively managed funds, where consolidation of the very large number of such funds offers efficiency savings;
- Amongst the platforms competing on quality and price to serve consumers.

The Panel has long argued that consumers need access to low cost, value for money products and that the investment market, as currently structured, disadvantages products such as low cost tracker-type funds, National Savings and Investments and Investment Trusts. We had hoped the RDR would address this imbalance in product choice.

The arrangement by which the fund manager pays a rebate to the platform means that there is no incentive for platforms to hold funds or other investments that do not, or cannot, pay a fee. Such investments include low cost index tracker funds, exchange traded funds, investment trusts and National Savings & Investments products. This makes it difficult for such investments to gain access to the retail investment market and might undermine the objectivity of model portfolios provided by platforms to help advisors identify the most appropriate choices for their customers.

Because most platforms are invisible to consumers, we doubt that consumer demand for low cost, good value for money products would be sufficient to ensure they are placed on platforms. In a situation where advisers and platform operators and providers hold the balance of power, consumers will again lose out.

Competition between platforms

In our view, the FSA's proposals make it likely that advisors will put their clients on a platform most suited to the advisors than the clients. The FSA's

view is that, while an adviser may use a platform for a variety of purposes, he may continue to select other products from other sources to fulfil the independence criterion. While this may be possible, we believe the temptation will be for the adviser to concentrate on a particular platform(s) for reasons of cost/effectiveness and ease. This could be to the detriment of clients since this does not stimulate effective competition between platforms.

Conclusion

Clearly, platforms are here to stay, and will develop rapidly over the coming years. It is critical, therefore, that effective regulation, which leads to good consumer outcomes, is shaped and delivered. The Panel believes the FSA must seize the opportunity to regulate the platforms market in line with the objectives of the Retail Distribution Review. If fund managers and product providers are not banned from paying rebates to platforms, as proposed in CP10/29, then the aims of the Retail Distribution Review will be fundamentally undermined. More needs to be done to stimulate effective competition in the market. Investors should be able to access products such as low cost funds, National Savings & Investments and investment trusts.

The FSA needs to take time to understand fully the complexities of the market, before introducing proposals and rules which could undermine good consumer outcomes. It also needs to assess the actual amount of market disruption envisaged by the industry should its current proposals not hold sway. We are, therefore, calling for a further assessment and revised consultation paper in the light of our arguments.