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Dear Anita

CP10/29 Platforms: Delivering the RDR and other issues for platforms and nominee-related services

This is the Financial Services Consumer Panel's response to CP 10/29 'Platforms: Delivering the RDR and other issues for platforms and nominee-related services'.

This is an important consultation, given the rapid pace of development in the platforms market and the impact platforms will inevitably have on the distribution of investment products. Research commissioned by the Panel indicates that assets held on platforms amount to around £110 billion and that the total potential market for platforms is between £1 trillion and £2 trillion. Assets currently held on platforms are therefore only 5-10% of the total potential market and this is clear evidence that the platform market is still in its infancy. The FSA should seize the opportunity to shape the platform market at this early stage of development to be fully in line with the Retail Distribution Review (RDR). This will produce the best outcome for consumers.

The Panel's response is from a consumer perspective. While we believe there will be considerable industry feedback to CP 10/29, we are keen to ensure good consumer outcomes are achieved in the platforms market and that the RDR principles are not compromised. We are concerned that the FSA has not been able to engage many other organizations representing consumers in this consultation exercise.

The Panel wishes to ensure that any kind of bias is eliminated in the retail distribution space and that the consumer is empowered to make informed choices. We would like to see a competitive market where choice, access and value for money are critical components. While we agree with many of the proposals in the CP and appreciate the time and effort the FSA has devoted to this rapidly developing market, we are disappointed at the onus placed on disclosure to achieve effective competition. In particular, we are disappointed that the FSA has opted not to stop fund managers and other product providers from making payments to platforms. Despite the arguments advanced, and given the variety of responses the FSA has itself received in response to this particular element of the CP, we remain unconvinced. We are anxious that bias will continue, to the potential detriment of consumers.

Platforms and the Retail Distribution Review

The Panel strongly supports the FSA's aims of the Retail Distribution Review (RDR) which are to have:

- 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 must not lose sight of these aims as it introduces changes into the retail investment market.

The Panel is concerned that the aims of the RDR are not being upheld by decisions taken in respect of platforms. 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 therefore favours banning payments (rebates) by providers, whether to platforms or to consumers. The cost of all services – fund management, platform administration and advice – should be the subject of an explicit charge for that service. This will ensure clarity and transparency as well as obviating bias against products with low charges, including straightforward products (as and when these are designated). This was the view the FSA took in DP10/2; we are not convinced by the arguments set out in CP10/29 for reversing that stance.

High fund charges

The Panel is concerned that consumers are not well served by the present market for investment products, which is characterised by a very large number of supposedly actively managed funds typically charging 1.5% pa, shared between the fund manager, platform and advisor. Many commentators are of the view that the benefits of active management of such funds, over and above the performance of the comparator index, do not compensate for the costs involved. Moreover, consumers as a class cannot do better than the market average performance - consumers as a class are of course what is relevant for both the FSA and the Consumer Panel. Accordingly, consumers may be expected in general to achieve better value for money in respect of investment in equities from portfolios that have substantial holdings of funds with low charges.

The FSA has expressed the view that they would be surprised if fund annual charges were maintained at their present level, expecting reduction to reflect the fact that the client will be paying the advisor separately, as required by the RDR (CP10/29 paragraph 3.23). Beyond this, there is the prospect that competition from index tracker and other products with low charges will drive down costs to consumers. Charges for actively managed equity funds are higher in the UK than in the US and have been rising over the past decade, suggesting a lack of effective competition.

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; and
- Amongst the platforms competing on quality and price to serve consumers.

Effective competition is hard to achieve in markets for financial services. It will be important therefore for the regulatory regime for platforms to facilitate effective competition so that consumers, aided by their advisors acting as their agents, can achieve better returns from their savings. Currently, it is difficult to see from the consultation how and where the drivers for better consumer outcomes will emerge. There is no evidence that disclosure of extensive and complex information of charges to consumers has helped consumers in the past. On the contrary, such information causes consumers to be more disengaged and they are likely to miss out on critical information. This is the opposite outcome to what was intended.

Access to advice

If the platforms market is developed to benefit consumers, as outlined above, we are confident that platforms will contribute to the widening of access to advice. This is essential given the expected reduction in number of financial advisors from January 2013 coupled with the likely increase in demand for advice.

Responses to specific questions posed by the FSA

The Panel’s responses to the specific questions in the Consultation Paper are set out below.

Q1: Do you have any comments to make with regard to our definitions of a platform service and platform service provider (contained in Appendix 1)?

We have no comment on the definitions suggested. We are, however, concerned with the idea that the primary function of platforms is to provide administration services. This unduly plays down the benefit to consumers in that a platform permits the consolidation of all investments into a single administrative framework, allows easy valuation and assessment of asset allocation, as well as ready switching between investments on the same platform. Potentially, a platform that incorporated all suitable asset classes from the whole of the market would facilitate competition that would reduce costs and enhance value for money for retail consumers. We would regard as a good consumer outcome a situation in which the large majority of consumers holding investments via platforms held all their investments on a platform well suited to their requirements.

We remain concerned that advisers may select platforms that serve their interests well but do not necessarily deliver optimum consumer outcomes.

Q2: Do you agree with our proposal to read across our rules on product providers to platforms in relation to facilitation of payment of adviser charges?

We agree that it makes sense for platforms to have the same requirement as product providers to facilitate adviser charging.

Q3: Do you agree with the rules and guidance we have proposed in relation to the standards we expect from an adviser when using a platform and providing advice?
Q4: Do you have any comments on the proposed guidance, on the use of platforms and the independence rule, in Annex 5?

We agree generally with the FSA’s approach. However, we think it would be desirable to aim for a market outcome in which most consumers could see all their investments on a single platform or, if deemed more appropriate, on the most relevant platforms, selected by their advisors as suitable for their clients' purposes and risk profiles. This aim would be facilitated by the banning of rebates paid by providers to platforms.

We understand that the FSA believes that an independent adviser will have a range of tools at his discretion to offer 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.

Q5: Do you agree with our proposals for platform remuneration? If not, please explain why setting out the effects of our proposal and what should be done instead, and why.

The Panel does not agree with the FSA's proposals to continue to allow fund managers and other product providers to give rebates to platforms.

We note the FSA's arguments as articulated in paragraphs 1.6 and 1.7 of the CP Executive Summary. However, we remain sceptical that the FSA's focus on improved payments disclosure to clients and impartiality in the presentation of products on platforms (paragraph 1.8) will compensate adequately for the decision to allow rebates. We remain concerned about bias. As a result, we believe good consumer outcomes will be compromised.

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. Although we believe the extent of potential disruption to industry is still to be evidenced, we accept that industry may need time to adjust their business models and would be willing to see a suitable transitional period for changes to be made. We are also anxious that new, potentially more consumer-focused platform solutions should be given space and scope to emerge.

We believe that the FSA's proposals will:

- prevent transparency and clarity of relationships and charges for consumers;
- restrict consumers' access to a full range of investments;
- work to the detriment of more effective competition; and
- fail to eliminate product bias, which has been a fundamental aim of the RDR.

These issues are discussed below.

Transparency and clarity of relationships and charges

The use of platforms has been increasing and 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. It has been challenging for the Panel to understand the present position. The FSA's exposition of the basic features of platforms and the associated market has lacked clarity, which may be why consumer organisations have failed to engage with the consultation exercise. We believe that the generality of consumers would find it difficult to comprehend the implications of a typical current 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.

The Panel believes that 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.

Access to a full range of investments

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 Exchange Traded 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, as the FSA has recognised (CP 10/29 paragraph 3.6). Accordingly, the FSA originally and rightly proposed to ban payments from product providers to platforms, so product charges and platform charges are separated and charges are unbundled (DP 10/2, Chapter 3).

Effective competition

Because most platforms are invisible to consumers, and many consumers remain at a disadvantage in terms of empowerment in the financial services industry, we doubt that consumer demand for low cost, good value for money products would be sufficient ‘pull’ to ensure they are placed on platforms. In a situation where advisers and platform operators and providers hold the balance of power, we remain concerned that consumers will again lose out, in terms of product choice and good consumer outcomes. The FSA’s proposals make it likely that advisors will put their clients on a platform most suited to the advisors than the clients.

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. Unbundled charges received support from over half those who responded to the DP and from two thirds of fund managers as well as from the Consumer Panel. Nevertheless, in CP 10/29 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. The main reasons motivating the FSA to reverse its stance appear to be:

- An anxiety that consumers might end up paying more, apparently because present unbundled charging (wrap) platforms tend to be more expensive than bundled fund supermarkets;
- The three largest platforms administer 80% of the total assets on platforms and primarily use the provider pays model. Banning this would cause major disruption in the market; and
- An insurance policy (or 'bond') may 'wrap' a range of underlying funds (as unit-linked policies often do) but there is no similar ban upon the insurance company being paid by the fund providers to be part of the wrap - a form of 'pay to play' arrangement. So there could be a distortion whereby a platform with an identical range of funds available as exists within an insurance wrapper must charge the client, but the insurance company can be paid by the fund provider.

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

Nevertheless, 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. Ideally, consideration of the necessary changes to platforms would have started earlier to allow synchrony with the changes to advisor charges. In the present circumstances, however, it may not be unreasonable to allow the existing provider rebates to platforms to continue for a further year or two, before full unbundling of charges is required.

The FSA should carry out research to assess the possible disruption to the market. While key industry players may well view this as an inevitable consequence, we believe a more robust assessment of the consequence of change needs to be undertaken.

There would be a need to review the position of insurance bonds. 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 (CP 10/29 paragraph 3.13). Insurance bonds combine term insurance and investment, which offers no advantage to consumers over the separate products. Moreover, such bonds have typically been sold with high commissions to advisors, the cost of which is born by the customer – a good reason to unbundle charges. 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.

Q6: Do you agree with our proposal to ban the rebating of product charges in cash to retail clients across all retail investment products when advice is being provided?

Yes, we do. As already stated in the answer to Question 5 above, 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.

The Panel therefore agrees that cash rebates from fund managers or other product providers to retail clients should be banned, but disagrees with the FSA's proposals to allow rebates in the form of additional units. Payments of additional units would prevent transparency and clarity of charges to consumers. Such payments would also result in a proliferation of share classes which would increase cost and complexity to consumers and not allow easy comparison of performance.

Q7: Do you agree with our proposal to extend the scope of ensuring all firms acting as nominee companies offer re-registration in specie?

The Panel supports this proposal. Re-registration is required to:

- allow for consumers needing to move platforms as their requirements change;
- recognise that the platform choice being adviser-led and hence a change in adviser may lead to a change in platform;
- allow consumers to move away from advisers with vertically integrated models;
- deal with the situation that some platforms do not allow direct business even where the consumer decides he no longer needs an adviser
- allow consumers to move from a platform if the adviser or platform is not delivering; and
- assist consumers who are "orphaned" from an adviser following the RDR.

Q8: Do you agree with our proposal that re-registration should be carried out in a reasonable time and do you have any feedback as to what might be reasonable for particular wrappers and assets?

The Panel supports this proposal.

There are a number of areas where good consumer outcomes or limiting consumer detriment relies on re-registration being carried out easily, quickly and cheaply. Re-registration is currently very labour intensive and the industry will need to work hard to build technology solutions that can deliver these goals. The solution will dictate the timescales and a fair charge for re-registration. The FSA should set targets both for the immediate post RDR solution with an ultimate goal that may potentially need longer to be delivered.

Q9: Do you agree that the new definition 'intermediate unitholder' incorporates all relevant firms?

The Panel welcomes the proposal to define "intermediate unitholder" to include other firms such as ISA & SIPP providers and stockbrokers. This is important because otherwise providers might adjust their business models to escape some of the requirements placed on platform providers or might avoid the regulation by becoming unauthorised businesses.

Q10: Do you agree with our proposal to introduce a requirement for intermediate unitholders to pass on information provided by authorised fund managers to end investors?

The Panel supports this proposal. We welcome all initiatives to encourage investors to exercise their voting rights. We believe there may be opportunities for platforms to facilitate the collective exercise of voting rights via organisations that consumers might nominated to represent their interests. We would like this possibility to be kept under review. The Panel would like to see steps taken to ensure that individual investors can exercise their voting rights. We do not believe such measures should be delayed – as noted above, the platform industry is in its infancy and the costs of implementing such changes to deliver this desirable consumer outcome are consequently much lower than they would be in the years to come.

Q11: Do you agree that we are allowing an appropriate level of flexibility by requiring intermediate unitholders to have appropriate systems and controls to either exercise voting rights on the instruction of investors, or to facilitate investors' exercising of rights?

In its response to DP10/2 the Panel asked the FSA to make these proposals and we support the approach in CP10/29.

Q12: Do you agree with our proposal to require intermediate unitholders to provide aggregate information when requested by authorised fund managers?

The Panel supports this proposal. It is essential for fund managers to access details of their underlying investors in order to understand the likely cash flows on their funds.

Q13: Do you have any comments on the cost benefit analysis?

The Panel has no detailed comments on the cost benefit analysis. However, the potential benefits to consumers from the development of platforms are considerable, provided decisions at the present time are well judged. Our view is that the long run benefits from a more competitive market for retail investments are likely to outweigh the short run costs arising from changes to the current business models of the platforms, investment funds and other providers.

Yours sincerely,

Adam Phillips
Chairman