# Finalised guidance

# FG18/3: Changing clients to post-RDR unit classes

April 2018

## Introduction

1.1 This guidance sets out what we expect from firms that are involved in the transfer of fund investors from pre-Retail Distribution Review (RDR) unit classes[1] to post-RDR unit classes. This guidance replaces the guidance in FG 14/4 on the same subject.

1.2 We are setting out our approach as a result of a number of queries from stakeholders and some evidence of uncertainty in the procedure to adopt when converting clients to the new unit classes.

## Background

1.3 The implementation of the RDR rules on adviser charging[2] and related rules for platforms have resulted in new unit classes (widely referred to in the industry as 'clean' unit classes) in authorised collective investment schemes. These post-RDR 'clean' classes bear a lower annual management charge (AMC), excluding the portion of the charge that was formerly rebated to advisers, in line with the RDR ban on commission payments.

[1] The term 'unit class' is used throughout this document. References to 'unit' within the FCA Handbook apply to both units in an AUT and an ACS and shares in an ICVC. This document shares that referencing, so references to 'unit class' also include 'share class' in respect of an ICVC.

[2] PS10/6: *Distribution of retail investments: Delivering the RDR - feedback to CP09/18 and final rules*: http://www.fca.org.uk/static/documents/policy-statements/fsa-ps10-06.pdf (March 2010)

1.4 In the case of platforms, Policy Statement 13/1[3] referred to the introduction of clean unit classes and announced the banning of payments to platforms from product providers. These particular rules came into force on 6 April 2014 for new business, with the rules for legacy payments coming into force on 6 April 2016. Changes to 'legacy' business require platforms to have access to clean unit classes or to be able to pass on any continuing payments they receive from providers[4] to clients in full in the form of small cash rebates or unit rebates (COBS 6.1E.10R and 6.1E.11G).

1.5 A rule and guidance, setting out how the rules made in April 2013 apply to legacy business in relation to cash rebates to clients, were made on 27 February 2014 and came into force on 6 April 2014 (the same date as the rules made in April 2013).[5]

1.6 We have found that there is some uncertainty over whether a conversion to a clean unit class should be treated in the same way as a switch involving cancelling the existing units and issuing new units. Questions have also arisen about

- whether conversions can happen in bulk rather than individually
- if conversions can happen without the express consent of the client
- whether advice is needed
- the role of advisers in the conversion process, and
- whether a new disclosure document (e.g. a Key Investor Information Document (KIID) for a UCITS scheme) needs to be issued to the client before conversion.

1.7 This guidance answers these questions.

## 'Converting' unit classes

1.8 Various mechanisms exist to facilitate the move from one unit class to another. It is our understanding that in most cases, the move to clean unit classes will be accomplished by converting units (replacing one unit with another of a different unit class). The holder of the units has a right to request conversion from one class to another, as established in COLL 6.4.8R. The AFM may have a right to require the unitholder to convert to another class if certain conditions are met, as explained below.

1.9 We would expect the AFM, when undertaking a unit conversion, to have regard to the relevant tax regulations. Under those regulations[6], an exchange of units in a single

[3] PS13/1: Payments to platform service providers and cash rebates from providers to consumers: http://www.fca.org.uk/static/documents/policy-statements/ps13-1.pdf (April 2013)
[4] Reference to payments from providers to platforms in this guidance do not include payments by providers to advisers in the form of trail commission or facilitated adviser charges, as the platform simply acts as a conduit for these payments to advisers. The payments banned from 6 April 2014 were those payments previously paid by the provider and retained by the platform.
[5] Instrument 2014/16 - http://media.fshandbook.info/latestNews/FCA_2014_16.pdf . Feedback on the replies to the consultation in CP13/9 is contained in Handbook Notice 9: https://www.fca.org.uk/publication/handbook/fca-handbook-notice-09.pdf

transaction might have capital gains tax implications, but this will not usually be the case where the client receives only new clean units of the same fund with the same rights as before but a different AMC.

## Conversion procedures for nominee arrangements

1.10 We would expect any AFM or other firm (e.g. platforms or discretionary investment managers) undertaking or facilitating the conversion of units to clean unit classes (and any firms providing advice to clients regarding conversions) to consider a number of points before proceeding, as set out below.

### *Client's best interests rule and Principles for Businesses*

1.11 COBS 2.1.1R (1) (the 'client's best interests rule') in the FCA Handbook states:

'A firm must act honestly, fairly and professionally in accordance with the best interests of its client (the client's best interests rule).'

1.12 It is our view that under this provision and Principle 6 of the Principles for Businesses, a conversion initiated by the AFM, platform or other intermediary acting on behalf of a client should normally take place only if it is fair and in the client's best interests.

1.13 This would normally be the case where the clean unit class is exactly the same as the pre-RDR class, except for a reduced AMC. However, it is possible that this may not be the case if the reduced AMC, combined with any new platform charge (or other charges), will lead to an overall increase for clients. It is also possible, depending on the charging structure, that some clients may be better off and others worse off.

1.14 For retail clients, 'clear' disclosure of the platform charge is required in any event by COBS 6.1E.1R, which came into force on 6 April 2014.

### *Prior notification of a proposed conversion and treatment of investments where the client objects to conversion*

1.15 To mitigate the risk that some clients may be worse off, firms should ensure in all cases that clients have sufficient notification of, and information on, the proposed conversion to enable them to seek advice or make an informed decision on whether to transfer their investments to another platform.[7] The notification should include information on whether there is likely to be an overall increase in charges for clients, as a result of the reduced AMC combined with the new platform charge (or other charges).

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[6] The Collective Investment Schemes (Tax Transparent Funds, Exchanges, Mergers and Schemes of Reconstruction) Regulations 2013, SI 2013/1400

[7] Under COBS 6.1G.1R, such transfers must take place when requested by the client 'within a reasonable time and in an efficient manner'.

1.16 If a client objects to the conversion, their investments can continue to be held in the bundled class if the AFM is willing to continue to offer this option. However, payments from providers that (prior to 6 April 2016) were retained by the platform now have to be passed to the client in full, in the form of small cash rebates or unit rebates. If a nominee does not intend to offer clients the option of remaining in pre-RDR classes and receiving unit rebates, it should be made clear to the client that this is not an option open to them.

### *Approach to be adopted by nominees*

1.17 A 'unitholder' is defined in our Handbook[8] as 'the person whose name is entered on the register (of unitholders)'. When the underlying investor uses an intermediary such as a platform, that firm's nominee is the registered holder of the units, so the COLL rules permit the nominee to exercise any right to convert from one class to another.

1.18 We expect nominees to ensure the client is given prior notification that the conversion will take place and is given sufficient time to consider other options. For example, the notification could state that the conversion will take place unless the client objects within a reasonable specified timeframe (where retaining the current class is offered as an option) or notifies the firm that they wish to sell their investments or transfer to another platform. Such a notification should be made in a manner appropriate to the nominee's ongoing dealings with the client. For example, if a nominee deals with the client primarily by electronic communication, such as email, the notification should be made by this method.

1.19 Nominees should bear in mind any notification, disclosure or other contractual requirements that may exist in their contractual relationship with the client or the client's chosen financial adviser, concerning the nominee arrangements. This guidance contains our position on conversions, but firms should also bear in mind that the conversion will also be subject to any contractual arrangements firms have agreed with the underlying investor.

## Conversion procedures for direct unitholders

1.20 The COLL rules envisage authorised fund managers undertaking a mandatory conversion of units if

- the circumstances in which mandatory conversions will take place are set out in the prospectus of the fund[9], and
- the client's best interests rule is satisfied.[10]

1.21 If the prospectus does not refer to mandatory conversion, the AFM can amend it to allow such conversions of units. The AFM would need to consider how this change to the

[8] http://fshandbook.info/FS/glossary-html/handbook/Glossary/U?definition=G1233 .
[9] COLL 4.2.5R 5(d)
[10] COBS 2.1.1R (1) and PRIN 6

prospectus would be treated under COLL 4.3 (Approvals and notifications) to ensure unitholders were properly informed about possible mandatory conversions in future.

1.22 To satisfy the second condition, we expect AFMs to send the relevant unitholders a notification of the planned mandatory conversion, with a notice period of reasonable length (not less than 60 days), to enable them to redeem their units if they do not wish to be converted and to alert them to alternative options, if available.

1.23 The AFM can proceed with the conversion if:

- by the end of the notice period, it has not received alternative instructions about the units affected by the proposed conversion, and
- the AFM is satisfied on reasonable grounds, having considered, in particular, the costs to unitholders associated with the old and new classes of units, that the conversion will not result in detriment to the unitholders concerned.

1.24 An AFM should not make other changes to investors' rights as part of a mandatory conversion to a cheaper but otherwise identical class.

## Advice on conversions

1.25 Some questions have focused on whether a conversion would constitute advice. For nominees, issuing a notification that a clean unit class exists to which it is proposed to convert all existing clients' holdings, explaining (where this is the case) why it is in the client's best interests, does not constitute advice.

1.26 For the AFM, notification to direct unitholders that a clean unit class exists (without a specific recommendation to convert to that class) does not constitute advice. Similarly, prior notice of a mandatory conversion is not advice. If the client is given such a notification, they then have the option to seek advice on the matter.

## Advisers and their role in the conversion process

1.27 If the client is investing in a fund as a result of the recommendation of a financial adviser and that relationship still exists, then that adviser may have a role to play in the conversion process.

1.28 Legacy payments to platform providers came to an end in April 2016 (unless passed on in full to clients in the form of small cash rebates or unit rebates).

1.29 Additionally, we would encourage platforms and product providers to engage with a client's financial adviser in good time when considering converting holdings to clean unit classes, so the financial adviser has an opportunity to discuss the conversion with their client as appropriate.

## Providing a new disclosure document when converting to clean unit classes

1.30 There have been some questions about whether a conversion from a pre-RDR unit class to a clean unit class requires a new disclosure document, such as the KIID, to be provided to the client for the new unit class under COBS 14.2.1R(7).

1.31 Where the move to clean unit classes will be accomplished by conversions, we consider that a new disclosure document, such as a KIID, would not need to be provided as long as

- the firm has taken reasonable steps to assess whether the conversion is in line with the client's best interests rule and Principle 6 of the Principles for Businesses (treating customers fairly)
- in all cases where the conversion is initiated by the AFM, platform or other nominee, the client has been given sufficient notification of, and information on, the proposed conversion to enable them to seek advice or make an informed decision on whether to transfer their investments to another platform
- the notification includes information about whether there is likely to be an overall increase in charges for clients, as a result of the reduced AMC combined with the new platform charge (or other charges), and
- clients are given the option to request the KIID for the clean unit class, or advised how they can access the document electronically.