MS17/1.2: Annex 1

Market Study

# Investment Platforms Market Study

## Interim Report: Annex 1 – Market Overview

July 2018

# Annex 1: Overview of the investment platform sector

In broad terms, an investment platform is an online service that allows investors and financial advisers to buy, sell, hold and manage investments. In this annex we provide an overview of the investment platform sector and its participants.

There have been investment platforms in the UK for around 20 years, but they have grown in the last 10. The platform service provider market has doubled since 2013 from £250bn in assets under administration ('AUA') to £500bn. The increase is the result of both the growth in value of the assets held on platforms and of the inflow of new assets.

Platform users are on average older and wealthier than the general population, although there are significant differences between platform users, such as their attitude to risk and confidence when investing.

Platforms differentiate themselves through the depth and breadth of the products and services they offer. Some offer services specifically tailored to advisers (adviser platforms), others to the end customer (Direct to Consumer). Platforms can be stand-alone or part of a broader financial services offer.

Changes in individual market shares have been limited since 2013, but smaller firms have been gaining market shares. The overall market has become less concentrated. Three investment platforms have entered the market during the last 5 years. However, the AUA of new entrants represents a negligible fraction of the market.

## Introduction

1. In this annex we provide an overview of the investment platform sector and its participants to provide context for the market study. We explore:
   - what platforms do
   - platform customers
   - sector size and trends
   - the main differences between platforms
   - entry, exit and changes in market shares
   - main regulatory changes and trends

## What investment platforms do

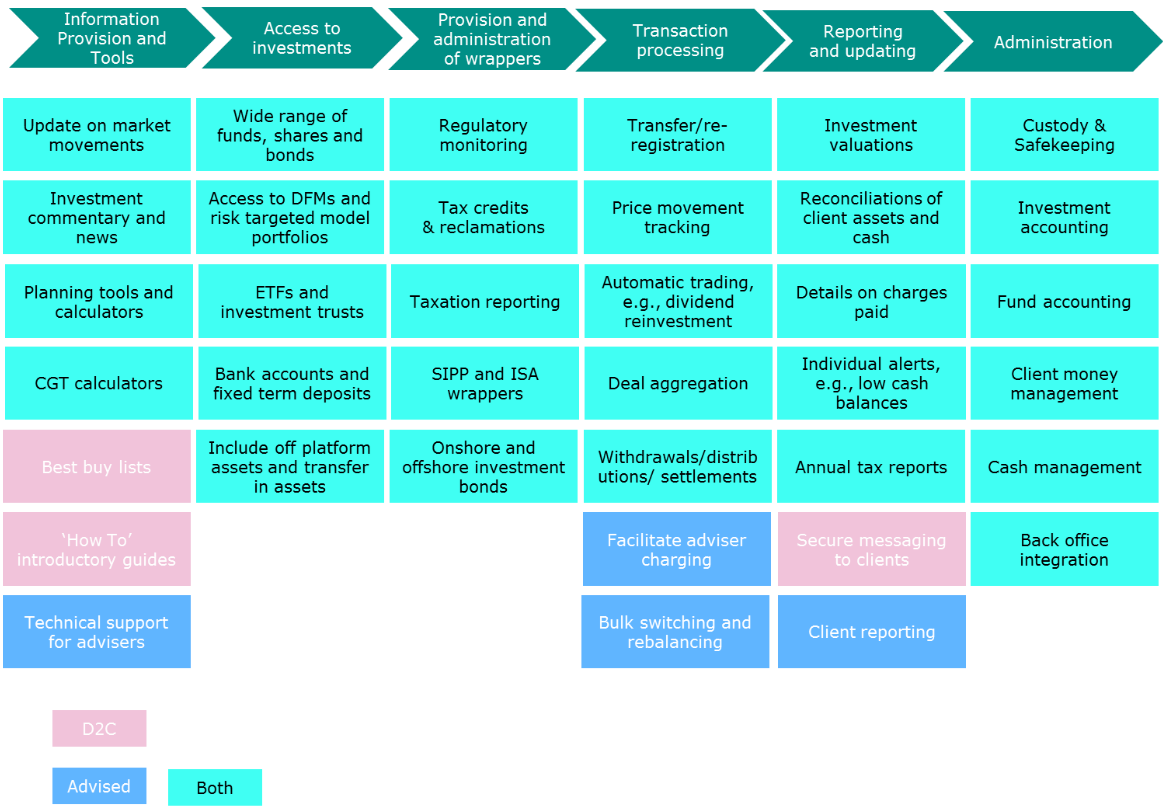
2. An investment platform is a service that allows investors to buy, sell, hold and manage investments. While investment platforms will invariably offer their services using an online portal not all services provided by an online portal will fall within the

FCA's definition of a "platform service".[1] Some asset managers provide their own online portals but these do not meet our definition because they do not give customers access to other providers' products. Generally, investors incur an additional cost on top of adviser charges when an adviser recommends they use a platform.

3. There are a several ways that platforms can bring value to investors and financial advisers. These include:
   - providing access to information and tools to inform and help with investment choices
   - providing tax efficient wrappers, such as SIPPs and ISAs
   - processing investment transactions, such as buying and selling shares and funds;
   - reporting on the performance and valuation of investments
   - carrying out administration functions, such as the payment of adviser charges

4. Figure 1.1 below sets out further details on the services provided by platforms.

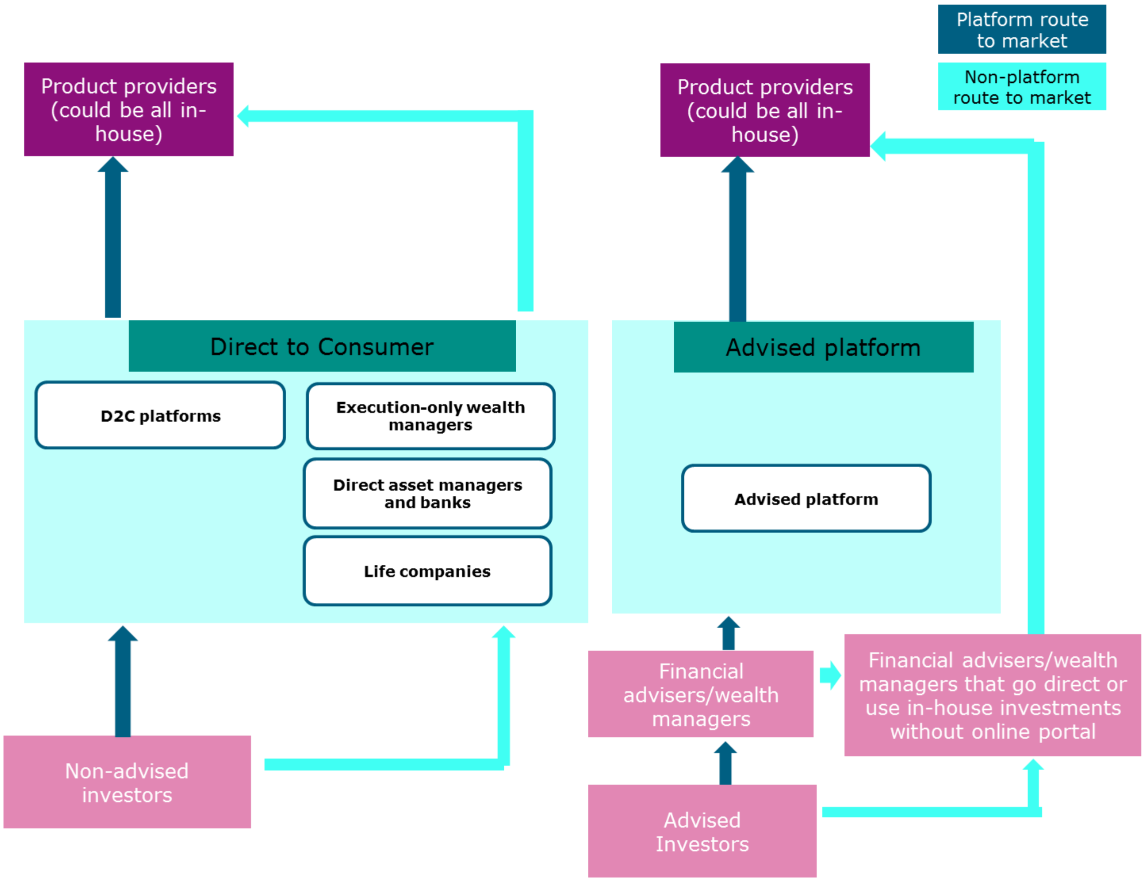
***Figure 1.1: Services provided by platforms***




5. Investment platforms are part of a wider distribution landscape, including wealth managers, insurance firms, banks and asset managers with a direct route to market.

[1] The FCA defines a platform service as a service which involves arranging, safeguarding, administering investments and distributing retail investment products which are offered to retail clients by more than 1 product provider. The service is neither solely paid for by adviser charges nor ancillary to the activity of managing investments for the retail client. See the FCA Handbook here: https://www.handbook.fca.org.uk/handbook/glossary/G2892.html

***Figure 1.2: Retail distribution landscape***




Source: FCA

6. Investment platforms have existed in the UK for around 20 years, but have become more prevalent over the last 10 years. Some evolved from 'fund supermarkets' and others from 'wraps.' Both fund supermarkets and wraps offered consumers and advisers access to a range of funds. Generally, wraps also gave access to a range of other investments, and often provided more services and functionality than fund supermarkets. Several D2C platforms evolved from the services provided by stockbrokers and wealth managers.

## Platform customers

7. Our consumer research found that platform consumers are on average an older and wealthier sub-set of the general population. The average household income within the general population is £41,000 compared to £67,000 for our respondents, and average household savings and investments within the general population is £53,000 compared to £260,000.[2] There is a higher proportion of men in both the broader retail investment market, and in the investment platforms market.

8. Figure 1.3 below compares advised and non-advised consumers based on our survey. On average, non-advised consumers have slightly higher income levels

[2] Please see Annex 2 for further details.

compared to advised consumers and lower total invested assets, but the differences are not stark.[3]

***Figure 1.3: Profile of investment platform users***

| | Total | Non-advised respondents | Advised respondents |
|---|---|---|---|
| Average age | 57 | 55 | 59 |
| Average total investable assets | £260,000 | £244,000 | £282,000 |
| Average held on platform[4] | £91,000 | £57,000 | £137,000 |
| Average household income | £67,000 | £71,000 | £63,000 |
| % retired | 36% | 33% | 40% |
| % male | 76% | 79% | 72% |
| % renting their home | 7% | 8% | 7% |
| % home owners (mortgage free) | 54% | 51% | 59% |

Source: FCA analysis based on NMG data, please see Annex 2 for further details.

# Sector size and trends

## Providers and platforms in the market

9. As of June 2017, we identified 43 service providers that meet our Handbook definition of a 'platform service provider'. 21 of them offer adviser platform services only, 18 D2C platform services and 4 both types of service. Some platform firms offer, or belong to a group that offers, ancillary and connected financial services, such as in-house investment funds and model portfolios or access to third-party discretionary investment managers. We describe these firms as being vertically integrated.

10. The 43 platform service providers offer 59 distinct platforms, almost evenly split between those providing services to advisers (27, 4 of which belong to a provider that operate in both segments of the market) and D2C providers (32, 4 of which belonging to a provider that operate in both segments of the market).

## Trends: total market, adviser and direct to consumer platforms

11. In June 2017, platforms had a total of £497bn of assets under administration (AUA), almost twice the amount registered at the end of 2013 (£254bn of AUA).[5] In all the years covered by our study, this increase was the result of both the growth in value of the assets held on platforms and of the inflow of new assets. Over the period

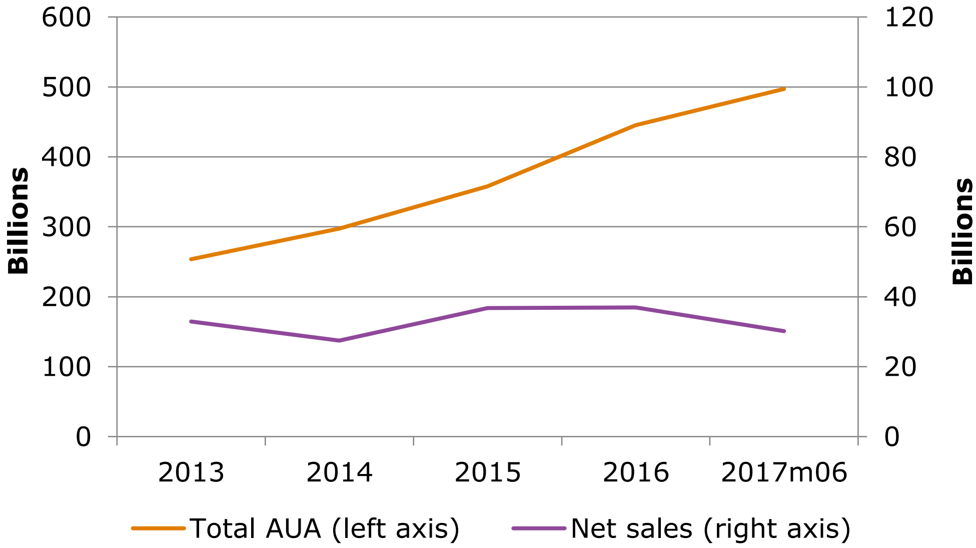
[3] See Annex 2.

[4] This is the 'sample' platform the respondent was primarily asked about in the consumer research.

[5] Figures reported are obtained aggregating platforms' responses to a request for information. Five platforms are missing from this sample, including both platforms operated by HSBC - a relatively large market player. The other 3 missing platforms, instead, are minor ones. In some cases, we do not have complete time series for platforms included in the sample. In particular, we requested year-end figures for total assets under administration (AUA) and total number of customers from 2013 to 2016 and June-end figures for 2017. The number of available data point varies (38 for 2013, 39 for 2014, 51 for 2015, 54 for 2016 and 2017). However, trends presented in this chapter are robust to the exclusion of the platforms that did not submit complete data.

covered by our study, net sales were higher than the growth in value of AUA already held on platforms, with the only exception being 2016.

***Figure 1.4: Total AUA and net sales trends***



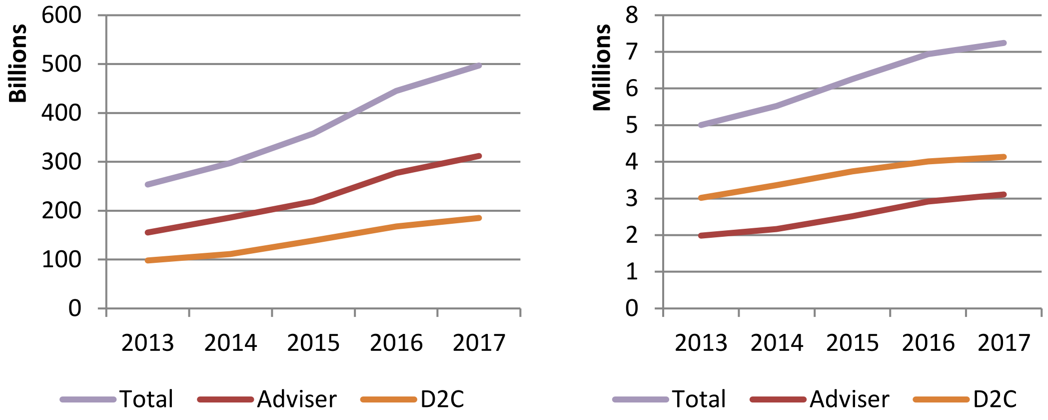

Source: FCA calculations based on firm data.

Notes: Totals obtained aggregating platforms' responses to the RFI.

12. The sum of the customer base of individual platforms in our sample increased by approximately 45% from 2013 to 2017 (20% from 2015). Some consumers use multiple platforms (multi-homing). These consumers are therefore double-counted in our figures. Nonetheless, the figures suggest significant growth in customer numbers. As of July 2017, almost two thirds of total platform AUA was held on adviser platforms and one third on D2C platforms. By number of customers the situation was reversed, with D2C platforms having more customers. Almost 1/5 of total AUA was held by the 4 providers that operate both a direct to consumer and an adviser platform.

13. Between the end of 2013 and the end of July 2017, total AUA on adviser platforms grew from £155bn to £312bn. Over the same period, AUA on D2C platforms reached £185bn from £98bn.

***Figure 1.5: AUA (left panel) and customers (right panel) by segment***




Source: FCA calculations based on firm data.

Notes: Figures from 2013 to 2016 refer to year-end stocks. Figures for 2017 refer to the stock at end of June. Totals obtained aggregating platforms' responses to the RFI. Figures should be considered indicative. In detail: totals do not include HSBC data (underestimation), ii) some smaller platforms could not provide complete time series (composition effect), iii) customer figures suffer from double counting due to prevalence of multi-homing. According to NMG research (Annex 2) 37% consumers use at least 2 platforms (multi-home) and, in particular, 14% of consumers multi-channel (that is, they use at least 1 direct and 1 adviser platform).

14. Firm responses to our Request for Information (RFI) suggested that the drivers of growth in the platform market include developments and improvements in technology, increasing demand for online access to investments from customers and advisers and, more recently, the pension freedoms.

## Measures of concentration

15. We studied the distribution of AUA across investment platforms in the advised and direct to consumer segments respectively. We have not conducted a formal market definition exercise. Instead, we looked at the level and evolution of concentration in the direct to consumer and in the adviser segments. Both segments have registered a reduction in concentration, as captured by C4[6] and HHI[7] metrics (see table below), but there are significant differences in market structure between the two.

***Figure 1.6: Measures of concentration HHI***

| | metric | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|
| Direct to consumer platforms | C4 | 79 | 77 | 70 | 67 | 67 |
| Direct to consumer platforms | HHI | 2457 | 2417 | 2154 | 2068 | 2132 |

[6] C4 is defined as the sum of the market shares of the 4 largest platforms.

[7] The Herfindahl-Hirschman Index (HHI) is a widely adopted measure of market concentration that takes account of the differences in the sizes of market participants, as well as their number. The HHI is calculated by adding together the squared values of the percentage market shares of all firms in the market. It can range from zero to 10,000, where higher values indicate higher market concentration, which suggests a higher risk of strong market power. The HHI is commonly used to pre-screen the likelihood of anticompetitive effects following horizontal mergers. To this aim, the Competition and Market Authority's Merger Assessment Guidelines (September 2010, CC2/OFT1254) indicate that a market with an HHI exceeding 1,000 may be regarded as concentrated and any market with a post-merger HHI exceeding 2,000 as highly concentrated. These thresholds are most informative for mergers, especially in a market where the product is undifferentiated and where competition between firms involves firms choosing what volume to supply to the market. Nonetheless, they can be used to get a general indication of the level of concentration in the adviser platforms and in the direct to consumer platforms segments. The scores for direct to consumer platforms would indicate a high level of concentration.

| | metric | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|
| Adviser platforms | C4 | 60 | 56 | 51 | 48 | 46 |
| Adviser platforms | HHI | 1141 | 1015 | 889 | 829 | 801 |

16. The direct to consumer segment is characterised by the presence of a large platform[8] which is reflected in the relatively high concentration measures for this segment. C4 decreased from 79% (2013) to 67% (July 2017), with no changes in composition or ranking among the top 4 firms. HHI, a measure of concentration that better captures the presence of large firms in the market, has decreased, but remains more than twice the value registered for the adviser segment.

17. In the adviser segment, instead, none of the top 4 platforms achieves a 20% market share. C4 decreased from 60% (2013) to 45% (July 2017), indicating a reduction in concentration. Furthermore, while the composition of the group of 4 platforms remained stable, we did observe (limited) changes in relative rankings.

## The main differences between platforms

18. We wanted to understand how platforms differentiate themselves from their competitors. We identified several ways in which they do this, for instance:

- whether they target their services to advisers (adviser platform) or directly to consumers
- the breadth of products, services and wrappers
- the market they target

### Adviser platforms vis-à-vis direct to consumer platforms

19. We reviewed the characteristics – including range of products, tools, services and strategies – of over 40 firms that fall within the FCA’s Handbook definition of a “platform service”. The firms in our sample fell into 2 broad categories: adviser platforms and D2C platforms.

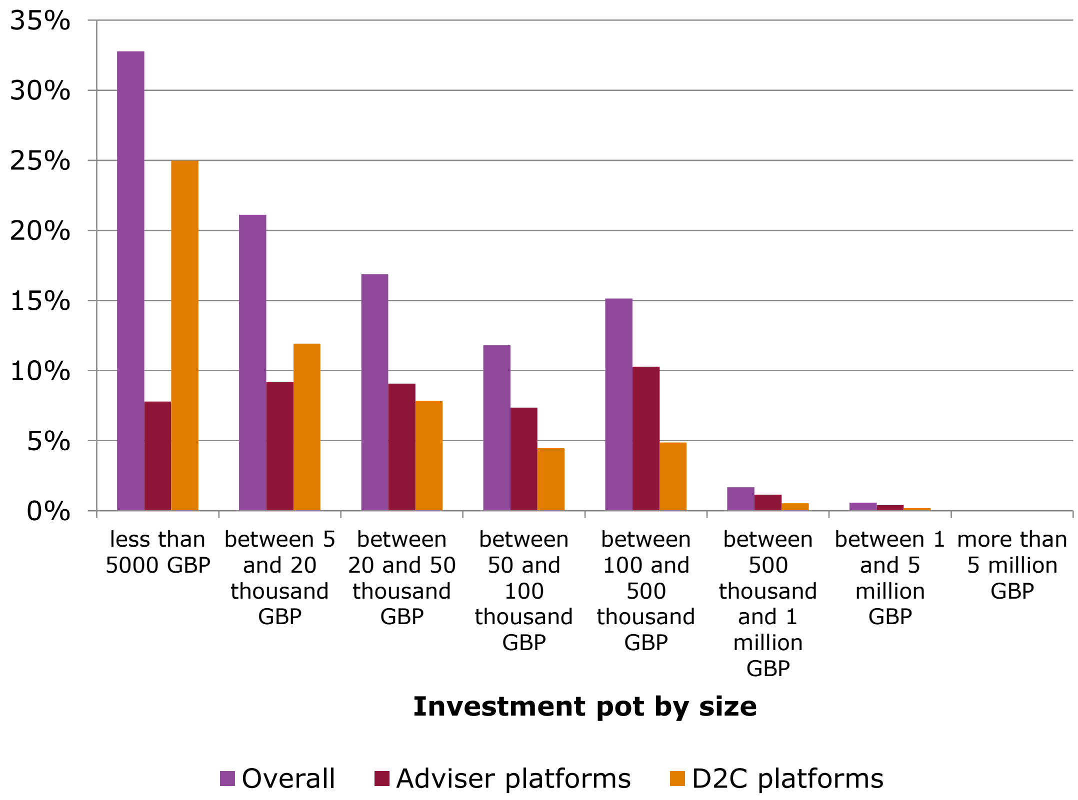
20. Adviser platforms provide services that help financial advisers manage and administer their clients’ investments. They may not encourage (or allow) customers who no longer have a financial adviser (orphan customers) to continue using their services.

21. D2C platforms are designed and marketed for investors who want to make their own investment choices. D2C platforms allow such investors to buy, sell and manage investment products.

22. We collected data at platform level on the number of customers by pot size. The distribution is presented in figure 1.7. We found that smaller pots predominate on D2C platforms. 67% of the pots on D2C platforms are smaller than £20,000 (54% for the market overall). The median pot size on adviser platform is higher, and falls in the interval between £20,000 and £50,000.

[8] Other than in this context (where the identity of the firm is obvious) we have adopted the convention not to name individual platforms in the analysis in this report.

***Figure 1.7: Pot size distribution (overall market and segments)***




Source: FCA calculations on platforms' data. Due to data quality issues, some platforms were removed from the sample. Data points plotted represent slighly over 95% of the total number of customers.

## Products, wrappers and services offered

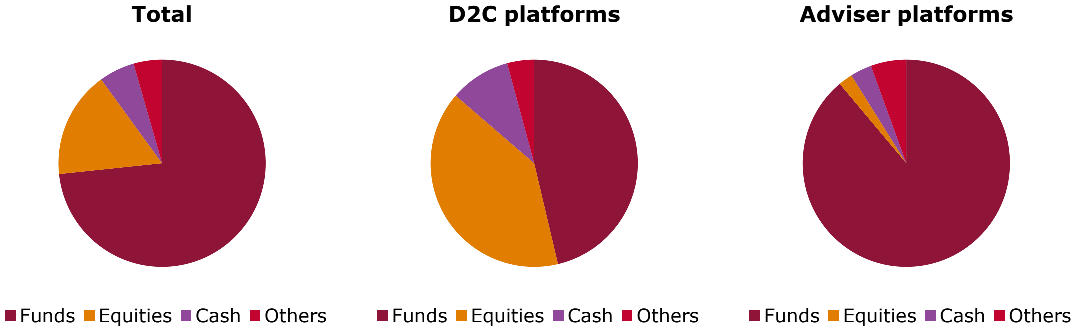
23. One of the key ways in which platforms (both adviser and D2C) differ from each other is in the range of wrappers, products, and services they offer. Some platforms offer a wide range, others much narrower. Platforms can give access to a huge number of investment products. They include funds, equities, bonds (both UK and foreign), Exchange Traded Funds (ETFs), hedge funds, property funds, Venture Capital Trusts (VCTs) and annuities. While funds are available on all platforms, equities are not. As part of the Asset Management Market Study we found that platforms generally prefer daily dealing funds, which are funds whose units or shares can normally be traded every working day.

24. In terms of the underlying investments held on platforms[9], at aggregate level, more than 2/3 of total AUA is invested in funds. Shares represent approximately 1/6 of total AUA. Proportions have remained broadly stable over the period of analysis.

25. AUA distribution by investment product significantly differs between D2C and adviser platforms. On D2C platforms, equities add up to two fifths of total AUA, almost on par with funds. Equities are much less on adviser platforms, where funds total approximately four fifths of AUA. The share of AUA held in cash is higher on D2C platforms than on adviser platforms.

[9] D2C and adviser platforms considered jointly.

***Figure 1.8: AUA distribution by investment product***




Source: FCA analysis of platforms' data.

26. Model portfolios are an increasingly popular product on platforms. A model portfolio is an investment product that consists of a basket of pre-selected funds. They allow investors to hold a diversified portfolio of assets without having to choose the underlying funds themselves. Model portfolios available on investment platforms can be developed by a third party (much like most other products), in-house by the investment platform, by other entities of the group the platform belongs to, or by advisers for their own clients (on adviser platforms – either by using the modelling tools provided by the platform or using their own ones).

**Wrappers**

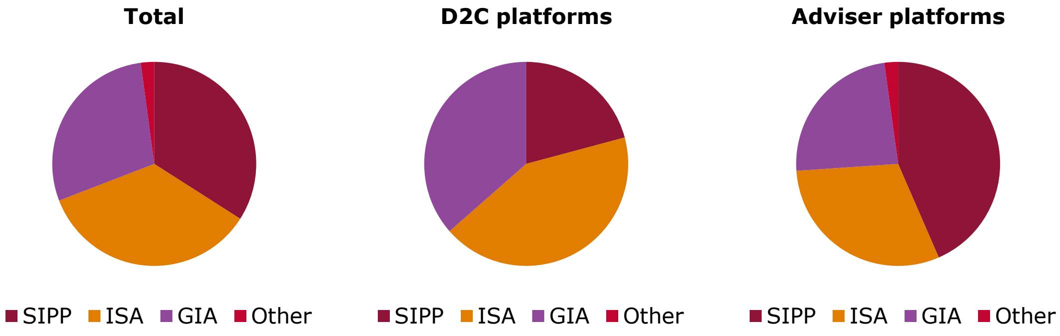
27. Investment platforms usually offer a General Investment Account (GIA), where assets are held unwrapped. Most platforms also offer investment products through tax efficient wrappers. They can give tax benefits to investors, usually in exchange for some limitations on their ability to add or withdraw assets from the wrapper. Examples include investments held in an Individual Savings Accounts (ISA) and their variants, such as Junior or Lifetime ISAs. Many platforms also offer access to Self-Invested Pension Plans (SIPPs).

28. Investment platforms can produce their own wrappers or can host them from third parties. Most platforms provide their own GIA accounts and ISA wrappers. Many also provide their own SIPP wrapper, but around one third do not, instead offering access to a SIPP provided by a third party.

29. At an aggregate level, total AUA held in wrappers on platforms is almost equally split between ISA and SIPP wrappers and GIAs. The proportion of AUA in ISAs has remained broadly stable since 2013, whereas SIPPs have grown and the proportion in GIA has fallen. The growth in SIPPs is likely to be related to the pension freedoms, introduced in 2015.

30. Approximately 2/5 AUA on platforms is held in ISAs, whereas 1/5 is held in SIPPs. On adviser platforms, approximately 2/5 of AUA is held in SIPPs, followed by ISA and then GIAs. The stock of AUA in SIPPs as a proportion of total AUA has been growing on both adviser and D2C platforms, but faster in the former segment.

***Figure 1.9: AUA distribution by wrapper***




Source: FCA elaboration on Platforms' data

**Services**

31. Investment platforms help consumers (and their advisers) manage their investments with a broad range of features and functionalities. Examples include:

- up-to-date valuations of investors' portfolios
- tools that analyse the asset allocation of a portfolio
- the underlying holdings that make up a portfolio
- the performance of the portfolio over a particular period of time against a selected benchmark
- the provision of investment comment and commentary
- dividend re-investment
- calculation of a Capital Gains Tax (CGT) liability
- the payment of income from drawdown accounts
- the production of annual tax reports
- some D2C platforms also offer 'best buy' lists to assist consumers with their choice of investment fund

## Target market

32. Generally, platforms told us they define their target client markets in broad categories, such as 'high net worth', 'affluent' or 'mass affluent'. D2C platforms often stated their target market was self-directed consumers. However, some firms did make a more detailed assessment of their target market, breaking it down by, for example, age, risk profile and trading knowledge. Adviser platforms targeted different segments of the adviser market, such as small to medium sized intermediaries, or digitally focused adviser firms.

33. Some investment platforms offer white-labelled versions of their service to other firms, including other investment platforms and financial advisers. 9 of the top 20 platforms by AUA do this, most of these being adviser platforms. In general, a white-labelled version is functionally identical to the branded version of the platform, but the buyer can use their own branding on it.

## Entry, exit and changes in market shares

34. Firms entering the market may compete to win business from existing market players, or may attempt to capture the new demand coming to the market.

35. Movements in individual market shares have been limited. However, smaller firms, taken together, have been gaining market shares and the market has become less concentrated. We also identified 3 investment platforms that have entered the market during the last 5 years (from 2012 to 2017): 1 adviser platform and 2 D2C. However, the AUA of new entrants is a negligible fraction of the market.

36. There has been entry into adjacent markets. Over the same time horizon, 5 firms that offer services comparable to platform services have started operating, for example, through offering online access to their own funds.

37. There has been some consolidation in the market. 2 major life insurers have acquired platforms and 2 platforms have acquired other platforms. Where firms have taken over other platforms, this has been seen as providing the firms with additional scale.

## Main regulatory changes and trends

38. In 2012 the Financial Services Authority (our predecessor body) introduced rule changes following the Retail Distribution Review (RDR) which require a platform service be paid for by a platform charge disclosed to, agreed by, and paid by the consumer.[10] This change was designed to remove product provider influence over the distribution of products and enhance competition by improving the clarity of charges and incentivising platforms to provide high quality services to consumers rather than product providers.[11]

39. The RDR also prevented rebates on platform fees being paid to consumers in cash. This was to stop these payments being used to disguise the costs of the platform charge. This means that any discount on fund fees must take the form of a rebate paid to the consumer in additional units or as a separate 'superclean' discounted share class.

40. The platform charging rules only apply to firms that provide a platform service as defined in the FCA handbook. In practice, this means that firms that provide an online portal through which consumers can only invest in the firm's own asset management products do not have to charge a separate platform fee from the asset management charge. Some of these non-platform service providers do, however, charge an explicit platform fee.

41. In January 2018 MiFID II introduced new requirements on firms carrying on MiFID investment business - which firms operating a platform may be doing. Firms providing a "platform service" (which is also MiFID business, eg the reception and transmission of orders) are required to present enhanced cost disclosures, assist product providers in their duty to ensure their products reach their target markets by providing management information, provide additional information on best execution, and, in certain circumstances, carry out an appropriateness test when a client is seeking to purchase a complex product.

[10] With minor exceptions to correct errors, deal with corporate actions, providing management information to product providers and payments for advertising (COBS 6.1E.7R).

[11] The platform charging rules in COBS 6.1E came into effect in April 2014 for new business, and in April 2016 after a two-year sunset clause for existing business.

42. The Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation has applied since January 2018. Since then, PRIIP manufacturers have been required to prepare and publish a stand-alone, standardised document, a Key Information Document (KID), for each of their PRIIPs. The KID contains information to help consumers compare investment products. Firms that advise a retail investor on a PRIIP, or sell a PRIIP to a retail investor, must provide the retail investor with a KID in good time before the transaction is concluded.

43. The Insurance Distribution Directive will apply from 1 October 2018. This will contain new rules that apply to intermediaries that distribute insurance-based investment products.

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