Investment Platforms Market Study
Final Report

Market Study
MS17/1.3

March 2019

How to respond

In this report we set out our final findings of the Investment Platforms Market Study.

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1 Executive summary

1.1 In July 2017, we published the Terms of Reference for our market study into the investment platforms sector. We published our Interim Report in July 2018 with interim findings and proposed remedies. We explained that we found that the market generally works well, but there are areas where it could work better. Having considered consultation feedback and carried out further work, we are now confirming our final findings and the remedies we are taking forward.

1.2 Investment platforms arrange, safeguard and administer investments on behalf of consumers and offer them access to retail investment products from a number of different providers. Consumers can use platforms to access information and tools to inform and help them with investment choices and can use them to make transactions, such as buying and selling shares and funds.

1.3 We launched this market study to explore whether consumers can make informed decisions about the choice of platform, the investments they choose on it and whether firms compete to add value for consumers. Platforms have the potential to use their scale to improve competition between fund managers. We wanted to further explore the impact that platforms have on the charges investors pay and any factors which may hinder platforms' incentives and ability to negotiate on behalf of their consumers.

1.4 Overall, we found that the market is working well in many ways for both advised and non-advised consumers. Profitability in this sector does not appear to be excessively high. We found that consumers who pay more typically get access to a greater range of non-price features and they are, overall, satisfied with their platform. Platforms also appear to help consumers and financial advisers make informed investment decisions which, taken together, suggests that platforms are competing in the interests of most consumers.

1.5 Despite these positive signs, it should be easier for consumers and financial advisers to shop around and more easily switch to firms that better meet their needs. Platforms should also be free to compete by negotiating with fund managers to get discounts on the funds available on their platform.

1.6 We summarise below our concerns and the package of remedies we are taking forward. Our remedies aim to ensure consumers and advisers can shop around and switch easily, at low cost, when another provider better meets their needs. So we propose to restrict exit fees by taking forward a cap or a ban. We also propose to introduce rules which allow consumers to switch their investments between platforms without having to cash out (take the investment out as cash). In 2020/21 we will review the industry's progress in making the switching process more efficient and helping consumers access comparable charging information. If progress is not made then we will consider further intervention.

Background

1.7 Consumers and financial advisers can use a platform to execute, review and change their investments in one place (our Handbook definition provides more detail). Platforms can also be a valuable source of investment information for consumers and advisers. While platforms encourage asset managers to compete for business, efficiently execute trades and pass on interest rates on cash holdings, they can also have an impact of the value consumers get from their money.

1.8 Investment platforms are a relatively new but significant and growing distribution channel. In our Interim Report, we found that the investment platform market had doubled since 2013, from £250bn to £500bn assets under administration (AUA). More consumers are using platforms. There was an increase of around 2.2 million more retail customer accounts between 2013 and 2017.

1.9 There are 2 main types of investment platform. Direct to Consumer (D2C) platforms are used by consumers without the help of a financial adviser, while adviser platforms are chosen by advisers but are paid for by consumers.

1.10 Platforms should compete to offer services which add value and meet the expectations of retail investors and financial advisers who may be acting on investors' behalf. In July 2017, we launched this market study to ensure this.

1.11 We looked at whether consumers can choose a platform that best meets their needs and how competition is working when financial advisers choose a platform for them on their behalf. We then explored whether consumers can make informed investment decisions once they have chosen a platform and if the competitive environment incentivises healthy competition between platforms. We summarise our final findings and next steps below.

Shopping around between platforms

1.12 We found that charges could be more readily available and easier to understand to help consumers more easily compare costs when shopping around.

1.13 Consumers can find it difficult to shop around and choose a suitable platform based on price. Charging structures can be complex with many different fees and charges, with different language used to describe similar fees across platforms and pricing information is not always readily available, prominent or clear. This means consumers cannot easily take account of all charges, calculate the total cost of investing or easily compare different options.

1.14 In our Interim Report we said we did not intend to propose additional disclosure rules at this time. We said we would first assess the effect of firms implementing MiFID II requirements and any innovation in the way they present information on costs and charges.

1.15 There are some positive signs of the market addressing this. We found that platforms and comparable firms similarly offering consumers access to retail investment products through an online portal are innovating, such as by explaining or illustrating information by example scenarios.

1.16 The UK Platform Group (UKPG) has committed to take forward work with twin objectives to identify improvements to support consumer understanding and enable easier platform comparison including charges and the treatment of cash. We welcome and support this commitment and are not proposing further regulatory intervention at this stage.

1.17 We expect platforms and comparable firms to continue to make progress in making it easier for consumers to compare the costs of different options when shopping around. We will review progress in 2020/21 and then consider appropriate regulatory intervention if needed.

Switching platform

1.18 We still have concerns that consumers and advisers who want to switch platforms find it difficult to do because of the time, complexity and cost of switching. This is driven in part by difficulties switching between unit classes and by exit fees. Barriers to switching may result in consumers staying on platforms which no longer meet their needs or offer them poor value for money.

1.19 We therefore propose a package of remedies which focus on making the switching process more efficient, removing or reducing exit fees and enabling unit class conversion.

Making the switching process more efficient

1.20 Improving the switching process, including communicating clearly to customers who are switching their investments, remains a priority for us.

1.21 We welcome and support the progress industry is making to improve the switching process in the platforms, investments and pension sectors through STAR, a not-for-profit joint venture, to improve transfer times and customer communications. STAR is in the process of implementing a framework which sets expectations for end-to-end standards, customer communications, and provides oversight and transparency. We will review progress made by industry later this year and, if needed, again in 2020 and take further regulatory action if necessary.

Exit fees

1.22 We found that exit fees can act as a barrier to consumers switching to a platform that better meets their needs. Exit fees also add to the complexity consumers face when choosing between platforms. We know that firms bear costs for switching consumers but many firms already recover these costs in ways that do not create a barrier to switching. We therefore propose to restrict exit fees.

1.23 We want to ensure any intervention we make achieves our aim of removing barriers to switching which, in turn, strengthens competition. Respondents to our Interim Report told us that, to achieve our aim, we need to consider the scope of any remedy, as platforms compete in a wider retail distribution market. So our current view is that this remedy should apply to platforms and firms offering comparable services.

1.24 Alongside this Final Report we are issuing a Consultation Paper inviting views on exit fees in three areas:

- how an exit fee should be defined
- the scope of the intervention
- whether the intervention should be a ban or a cap on such fees

1.25 We welcome feedback on the discussion points set out in CP19/12 by 14 June 2019.

Unit class conversion

1.26 In our Interim Report, we found that switching can be particularly difficult for investors who are in unit classes which have been created specifically for a particular platform. These platform-specific or 'superclean' unit classes are typically created as a result of the platform negotiating discounted fund fees with the fund manager.

1.27 Consumers may want to switch platform but keep their money invested in the same fund. But they may find they have no option but to cash out of their holdings if their new platform does not host the same unit class they were originally invested in. We asked for feedback on how to improve this part of the switching process for consumers, as cashing out involves time out of the market, and potentially leads to tax liabilities.

1.28 Following this feedback, we are consulting on rules on transfers of investments in the same fund from an existing to a new platform. The proposed rules would require platforms to offer clients the choice of whether to re-register the units at the new platform (ie an 'in-specie' transfer) or to sell their holdings and transfer the cash. If the client requests an in-specie transfer and the unit class on the ceding and receiving platform do not match, the ceding platform would be required to convert the investor's holdings to a unit class which the receiving platform can accept.

1.29 Our work suggests there are cases where new consumer assets arrive on platforms for investment in funds where equivalent, eligible superclean units are available, yet are not invested in these unit classes. Our proposed rules would require the receiving platform, as part of the transfer process, to give consumers the option to request the conversion of their units into a discounted share class where this is available to them.

1.30 Depending on the outcome of our discussion on exit fees, we may cap any fees and charges for in-specie transfers.

1.31 We welcome feedback to CP19/12 by 14 June 2019.

Advisers reviewing platform choices

1.32 We found that while advisers update the list of platforms they consider for new investments over time, the level of switching for clients' existing investments is low. The main reason is the length of time it takes to switch, due to the complex process and the lack of standardisation. Our switching remedies should help advisers switch their clients to alternative platforms that better meet their needs.

Competition between adviser platforms

1.33 Adviser platforms are chosen by advisers but are paid for by consumers. In 2017, they collectively administered £311bn. Adviser platforms generally compete to offer services that offer direct or indirect consumer benefits. When a client is no longer advised, there is a risk that competition for these clients is weak. We found, however, that platforms provide information and support to help them find a new adviser or to switch to a more suitable service.

Non-monetary benefits

1.34 We have found that platforms largely compete on the services they provide to advisers. We found that most of the services platforms offer advisers, directly or indirectly, benefit consumers. But we also found that some platforms may provide services to advisers which may inappropriately alter their incentives in conflict with their duty to act in the best interest of their clients. Where platforms offer something of benefit to advisers, they need to ensure that this complies with the detailed rules against inducements set out in COBS 2.3 and COBS 2.3A.

Orphan clients

1.35 Our analysis suggests so-called 'orphaned clients' – consumers who no longer have a financial adviser – are generally well-supported by platforms. But we expect platforms which charge their orphan clients additional annual fees to be able to demonstrate that they are treating customers fairly. We will be following up with firms to ensure this is the case.

1.36 In our Interim Report, we found that platforms do not proactively identify orphan clients by, for example, monitoring activity on accounts where the customer pays an ongoing advice charge. We were concerned that orphan clients can suffer harm if they are paying for an advice service they no longer receive. Having considered feedback to our Interim Report, our final view is that to treat customers fairly, advisers are responsible for notifying platforms when a client contract ends. Platforms that are concerned that they are not receiving notifications from advisers should inform us.

Informed investment choices

1.37 We looked at the main investment choices consumers make on their platform – investing in funds, investing in model portfolios, holding money as cash on a platform and investing directly in securities. Platforms generally help consumers make informed investment choices. But there is room for improvement to make fund charges and the cost of holding cash on a platform more accessible so consumers can make informed decisions about what to do with their money. Platforms also need to ensure their order handling procedures and execution evaluations ensure good outcomes for consumers investing directly in securities.

Funds

1.38 More than two thirds of the total assets held on platforms in 2017 were invested in funds (collective investment schemes or alternative investment funds). We expect a well-functioning platforms market to make it easier for consumers to make informed decisions when choosing between funds. When platforms manage and promote their own funds, consumers should be able to fairly assess the value of these funds compared to the alternatives.

1.39 Some respondents said that vertically integrated firms have a strong incentive to promote their own products. But, there is insufficient evidence to indicate platforms are promoting their own funds in ways which would currently justify further remedies. Under our rules, vertically integrated firms need to manage their conflicts of interest. Stakeholders that have evidence that platforms are not doing so should contact us.

Model portfolios

1.40 Platforms are increasingly offering their own model portfolios. Model portfolios are typically made up of a preselected, diversified basket of funds. Platforms tend to offer a range of model portfolios, with different target levels of risk. We found there has been steady growth in the use of model portfolios, with in-house model portfolio investment increasing from £5bn in 2011 to £38bn in 2017. We also found that consumers who use these model portfolios tend to be less active platform users, younger and less affluent.

1.41 In our Interim Report we found that the information platforms provide about similarly labelled model portfolios made it difficult for consumers to compare them. We also found that similarly labelled model portfolios expose investors to different underlying assets and volatility of returns. We were concerned that this inconsistency made it difficult to compare model portfolios offered by different platforms. Respondents broadly agreed with our findings but told us that inconsistent and non-standardised terms were a wider problem than just platforms' model portfolios.

1.42 While we are concerned about consumers' difficulties in comparing model portfolios across platforms, recent regulatory change will improve the information available to investors who choose model portfolios constructed as funds. Taking this work into account, we do not think it is the right time to consider further remedies to standardise disclosure for these portfolios. We will, however, be conducting a review of the outcomes of RDR and FAMR in the financial advice market during 2019. It will look at whether consumers can make informed decisions and, particularly, whether consumers can make informed choices between model portfolios across the retail investment sector. Our findings will support that review.

Investing in securities

1.43 Platforms account for a large share of the retail equity market, and two-fifths of total AUA on D2C platforms in 2017 was in directly owned equities, almost the same as funds. Our further analysis confirms our view that some platforms can improve their order handling procedures and carry out more comprehensive best execution evaluations to achieve better outcomes for retail clients.

Cash

1.44 In our Interim Report we found that there was approximately double the amount of cash held on Direct to Consumer platforms (8.8% of AUA) than adviser platforms (3.9%). We wanted to further investigate how consumers are holding cash on platforms, how much they hold and how engaged they are with their cash holdings.

1.45 We found that a large proportion (43%) of the cash that consumers hold on platforms is held in pension wrappers. 9% was in drawdown products, 32% non-drawdown Self-Invested Personal Pensions (SIPPs) and 2% in Group Personal Pensions (GPP). Our Retirement Outcomes Review found that a third of non-advised drawdown consumers are entirely in cash, and estimated that over half of these were at risk of losing out on income in retirement by being in cash. To address this harm, we have proposed new rules so that drawdown consumers must make an active decision to invest wholly or predominantly in cash, and that firms should warn them about the potential risks of doing so. If our wider work on pensions identifies further harms arising from cash holdings we will consult on further proportionate interventions.

1.46 The remaining cash that consumers hold on platforms is in General Investment Accounts (GIA) and Stocks and Shares ISAs (ISA) (22% and 35% of the cash held on platforms, respectively). These consumers typically make an active decision to hold cash, at least initially. We found that 75% of the cash in GIA and ISA wrappers is either newly invested or is in accounts that have been actively traded in the last 2 years. This suggests that these consumers are reasonably engaged. Firms also told us there are good reasons why consumers might want to hold cash on a platform outside their pension wrapper. So we are not taking forward specific remedies to tackle cash holdings in GIAs and ISAs.

Entry, expansion and commercial relationships

1.47 The feedback we received confirms our interim findings that barriers to expansion – particularly customer acquisition – are more significant than barriers to entry into the platform market. We have seen relatively little entry into the platforms market in the last 5 years. But there has been entry and expansion by asset managers which distribute directly to consumers via an online portal and by firms offering online investment services such as automated advice. Our switching remedies should help reduce barriers to expansion by helping firms win customers from their rivals when their proposition better meets consumers' and advisers' needs.

1.48 Platforms should be free to enter, expand and compete by negotiating with fund managers to secure discounts on fund charges. We looked at the commercial relationships between platforms and fund managers to see whether these may affect their incentives and ability to negotiate.

1.49 On average, discounts are small – around 8bps – and the amount of AUA in discounted funds increased slightly over 2013-2017. Of the largest 100 funds in 2017, 33% have no discounts on any platforms, and the average discount was around 8bps and the largest was 38bps. Larger platforms which have greater influence over investor choices tend to be more successful in negotiating more, and larger, discounts. These trends indicate that platforms are under some competitive pressure to negotiate with fund managers. This trend may grow as, under MiFID II, consumers get information about the total cost of investment.

1.50 We found, however, that some platforms have commercial arrangements with fund managers which may affect how funds on other platforms are priced (similar to so-called 'wide most-favoured nation' clauses[1]). In principle, such arrangements have the potential to restrict competition, although we have not determined the ultimate

1 We define most-favoured nation clauses in footnote 17 on p.54

effect of these arrangements. Firms need to ensure their arrangements comply with competition law and we will be following up with firms.

Next steps

1.51 To improve the way in which platforms compete in the interest of investors:

- In 2020/21 we will review industry progress in making charges – including disclosing the interest rates and charges paid on cash – more accessible and comparable for consumers shopping around. We will then consider appropriate regulatory intervention if needed.
- Alongside this Final Report we have published a Consultation Paper on unit class switching and a discussion on exit fees in the retail investments distribution market. We welcome feedback on our CP by 14 June 2019. Please send responses to cp19-12@fca.org.uk.
- Later this year, and again if needed in 2020, we will review progress industry has made to improve the switching process, including customer communication. If there has been no progress then we will consider further action.
- We will review whether firms have due regard to the interests of their orphan clients.
- The RDR/FAMR post-implementation review, due to begin later this year, will explore the relationship between advice and discretionary services. Our findings will support this review.
- Firms need to ensure their arrangements comply with competition law and we will be following this up with firms.

Our final findings and position

	Consumer journey			Competitive environment	
	Shopping around between platforms	Informed investment choices	Switching	Competition between adviser platforms	Entry, expansion and commercial relationships
Findings	Consumers who pay more generally get more non-price features Consumers have low awareness of charges. Even those that are price sensitive can find it difficult to choose a lower cost platform Costs and charges are hard to find and not directly comparable between platforms	Platforms help consumers and financial advisers make informed investment decisions It can be difficult for consumers to shop around on fund charges Consumers may be unable to understand and compare model portfolios Most of the potential harm from money held in cash - lost interest and lower returns - comes from cash held in pension wrappers	The time, complexity and costs of switching can prevent consumers and their advisers switching to another firm Overall switching rates are low, partly because consumers are satisfied	Orphan clients are generally well supported by platforms, but some platforms charge additional fees Platforms effectively communicate with orphan clients to help them switch or find a new adviser Firms seem to understand their responsibilities when offering advisers non-monetary benefits	Profitability in this sector does not appear to be excessively high Customer acquisition can be a barrier to expansion Commitments to not offer lower fund charges on competing platforms could weaken competition
Our position	We expect industry to continue to make progress to help consumers more easily compare charges when shopping around	Our Retirement Outcomes Review remedies aim to improve outcomes for some consumers holding large cash balances in drawdown	We support STAR's work to improve the switching process. We will review progress made by firms and intervene if necessary We are issuing a consultation paper discussing ways to restrict exit fees We are consulting on rules to make it easier for consumers to switch platform without having to cash out	Platforms should consider their propositions for orphan clients, including whether current pricing practices are fair We will review if firms are treating orphan clients fairly, and proceed with supervisory action if appropriate Firms should continue to consider whether the non-monetary benefits they offer or receive are permissible under the FCA's inducement rules	Our remedies to enable switching should help consumer acquisition Platforms should ensure their commercial arrangements with fund managers comply with Competition Law
	In 2020/21 we will review progress by industry to make all charges accessible and comparable				

2 Our final findings and position

Introduction

2.1 In this chapter we explain why we conducted the study, its scope, what we investigated and our interim findings. We explain the consultation process, developments since the Interim Report and the purpose and structure of the Final Report.

Why we launched the market study

2.2 On 17 July 2017, we launched our market study into the investment platforms sector by publishing our Terms of Reference. We wanted to use the market study to further assess the potential competition issues outlined in the Asset Management Market Study Interim Report and in our 2017 Retail Investment Sector View.

2.3 In particular:

- the range of charges consumers have to consider can be unnecessarily complex. We wanted to assess if consumers and advisers can make informed decisions about whether to invest through a platform, which products to choose and whether firms compete to add value for consumers
- platforms have the potential to use their scale to increase competition between fund managers. We wanted to further explore the impact platforms have on the charges investors pay and any factors which limit platforms' ability to negotiate for their consumers

Scope of the market study

2.4 We define a platform service as one which involves arranging, safeguarding and administering investments and distributing retail investment products from more than 1 product provider. A platform is neither solely paid for by adviser charges nor is it ancillary to the activity of managing investments for the retail client.

2.5 When we launched the market study, we recognised that platforms are part of a wider distribution sector which includes wealth managers, insurance firms, banks and fund managers with a direct route to market. Some of these firms offer similar services and functionality as platforms, providing consumer access to retail investment products through an online portal. Similar to platforms, they may also help investors make investment decisions by offering tools to assess their risk profile and find investment products.

2.6 So our analysis also considered the wider distribution sector to assess whether the issues that apply to platforms also apply more broadly. The study therefore included where relevant:

- platforms as defined by the FCA Handbook
- asset and wealth management firms and the asset management and wealth management arms of retail banks and life insurance companies which offer access to retail investment products through an online portal. We call these firms 'comparable firms' in our report and explain in the following chapters the scope of our sample.
- intermediaries, including financial advisers and discretionary wealth managers, who use intermediated platforms to access different retail investment providers for their clients
- product and wrapper providers that use platforms to distribute their products
- technology providers that platforms outsource services to
- fund ratings and data providers whose information platforms use and distribute

2.7 We have also considered the broader distribution environment when considering the remedies we want to take forward.

The topics we investigated and our interim findings

2.8 The market study focused on the topics we set out in our TOR, outlined in Figure 2.1 below. Respondents to our TOR highlighted that the value platforms offer retail investors also depends on how well their stockbroking services execute trades on their behalf. Following this feedback, we also considered how platforms approach their best execution requirements.

Figure 2.1: Topics explored through the Investment Platforms Market Study

Evidence we gathered

2.9 Our interim findings were drawn from multiple pieces of analysis including:

- consumer research including 48 interviews and an online survey of over 3000 platform consumers to understand the investment journey for advised and non-advised investors
- quantitative analysis of consumer preferences and choices
- financial analysis of how platforms generate revenues, the relationship between platform costs, key firm characteristics and platforms' operating margins
- econometric analysis of what determines the size of fund discounts
- quantitative and qualitative analysis of 40 platform and 21 comparable firms' responses to our information request. We used the responses to assess a range of market features including the services offered by platforms, prices, market shares and entry/exit
- analysis of 166 financial advice firms' responses to an information request

2.10 We also met with over 50 stakeholders throughout the study including platforms, comparable firms, technology providers and industry groups.

2.11 Following the publication of our Interim Report we gathered further evidence and insight and conducted further analysis, including:

- 4 roundtables with industry participants
- analysis of over 60 responses to our Interim Report
- analysis of cash balances data from 10 Direct to Consumer platforms
- analysis of exit fees and the costs to platforms when a consumer leaves. The sample consisted of 23 platforms and 7 comparable firms.
- analysis of how firms' costs and charges communications have changed since our Interim Report. The sample consisted of 33 websites in total.
- discussions with 6 adviser platforms to understand how they treat their orphaned clients
- analysis of 19 platforms and 7 comparable firms' data to better understand the relationship between exit fees and the costs to platforms when a consumer leaves
- analysis of two-month RSP trading data which included transactions with a total value of £7 billion

The purpose and structure of the Final Report

2.12 This Final Report summarises and responds to the feedback to our Interim Report and finalises both the findings and the remedies.

2.13 This Final Report is structured as follows:

- **Shopping around:** How consumer preferences and behaviour affect competition by looking at how consumers shop around and choose platforms. We also looked at whether consumers and advisers face significant barriers to making informed choices. We set out our findings and remedies in Chapter 3.
- **Switching platforms:** How consumer preferences and behaviour affect competition by looking at whether consumers and advisers face barriers to switching and if this means some platforms struggle to compete. We set out our findings and remedies in Chapter 4.

- **Competition between adviser platforms:** What factors advisers prioritise when choosing, reviewing and recommending their clients switch platforms, the reasons why and whether platforms consider the end investor when competing to win business from advisers. We set out our findings and remedies in Chapter 5.
- **Informed investment choices:** Whether consumers are able to make informed investment choices when choosing between funds, model portfolios and deciding whether to hold cash on a platform. Our analysis included the impact vertical integration has on the way platforms promote their in-house funds. We outline our findings and remedies in Chapter 6.
- **Entry, expansion and commercial relationships:** Whether there are barriers to entry and expansion in the sector which might prevent platforms from competing on the price, quality and value for money of their offering. Our analysis includes the impact vertical integration of fund managers with platforms has on stand-alone platforms' ability to compete. We outline our final findings in Chapter 7.

3 Shopping around between platforms

Consumers need to be able to easily access, assess and compare information on non-price features and how much it will cost them to invest through different platforms and comparable firms.[2] If consumers can shop around, they can drive competition between firms which, in turn, benefits all platform users.

We considered how easy it is for a consumer to shop around and choose a platform based on both price and non-price features. In this chapter we summarise our findings.

We have found consumers have low awareness of charges and many do not know the charges they pay. Consumers, including those who are price sensitive, can find it difficult to shop around and choose a suitable platform based on price. They cannot easily take account of all charges, calculate the total cost of investing or easily compare different options because:

- charging structures can be complex with many different fees and charges
- the language used to describe similar fees differs across platforms
- pricing information is not always readily available, prominent or clear, for example, it is often located in different places on a platform's website
- it can sometimes be difficult to find component price elements (including, but not limited to, fund charges, interest paid on cash and exit fees)

Ensuring consumers have access to comparable information about platform charges to help them more easily shop around remains a priority for us. We are, however, aware of a number of relevant factors:

- firms have recently embedded MiFID II changes to costs and charges disclosure
- since our Interim Report we have seen some improvements in how firms provide this information to consumers
- there is some appetite in industry to reduce complexity and review terminology to promote greater transparency

Given this, we do not propose further regulatory intervention at this time. We:

- welcome and support the work industry stakeholders have proposed to reduce price complexity, and improve the availability and clarity of information on costs and charges on websites
- will review progress in 2020/21 and we will then consider appropriate regulatory intervention if needed

Introduction

3.1 Consumers need to be able to easily access, assess and compare information on platforms' non-price features and how much it will cost them to invest through different platforms. If consumers can shop around they can drive competition between platforms which in turn benefits all consumers.

2 This includes asset management and wealth management firms and the asset management and wealth management arms of retail banks and life insurance companies which offer access to retail investment products through an online portal.

3.2 This chapter presents our final findings on the ability of consumers to shop around. It:

- summarises our findings taking account of responses we received to the Interim Report
- provides information on further analysis we have conducted
- sets out proposals for next steps

Consumers' ability to shop around

Findings

3.3 Consumers value platforms' non-price features, including the breadth of investment choices and information platforms make available about investment options. We do not have concerns about consumers' ability to compare platforms' non-price features. Most platform tools and services are available for consumers to view before registering and some platforms offer demo accounts to trial the platform.

3.4 But we do still have concerns about consumers' ability to shop around on the basis of price. In this section, we summarise our findings about the complexity and transparency of costs and charges when investing using a platform.

Shopping around and awareness of platform charges

3.5 Consumers previously told us that when they are choosing a platform they value both price and non-price features. They gave access to lower charges as the main reason for switching platforms (32%). We found that platform fees vary. For example, charges on £5,000 invested in a stocks and shares ISA can vary from 20 bps to 240 bps, with a potential £650 difference in returns over a 5-year period, assuming a 5% compound annual growth rate (CAGR).

3.6 So, it is important that consumers understand the charges they will, and do, pay. Consumers choosing a platform for the first time must be able to easily shop around and compare charges when they choose a platform. Existing customers should be able to accurately assess whether switching to another platform that meets their needs will save them money (see Chapter 4 for proposed switching remedies).

3.7 Despite the importance of platform charges, for non-advised consumers our consumer research found:

- fewer than half (44%) research more than one platform when choosing one
- jointly with breadth of investment choices, consumers said charges were the most important features when choosing a platform (39%), but
- fewer than half (43%) of consumers said they researched charges when choosing a platform, with 14% saying it was difficult to find the relevant information
- even those that are price sensitive can find it difficult to shop around and choose a lower-cost platform, and
- most that attempt to estimate how much they pay in platform charges made significant errors

3.8 We found therefore many consumers have low awareness of the charges they pay.

Charging structures

3.9 Most platforms have a large number of different fees and ways of setting prices. Platforms charge based on the amount invested and how often the consumer uses platform services. Charges can also be quoted in absolute terms (in pounds) or as a percentage of the investment amount. The use of different language and terms for similar charges can make it difficult for consumers to identify and compare similar fees across platforms. For example, we found at least 11 different terms used to describe a platform fee. These included 'investor fee', 'service fee', 'quarterly payment fee', 'account charge', 'custody charge', 'ongoing platform fee', 'product administration fee', 'annual charge', 'monthly charge' and 'annual commission'.

3.10 Generally, respondents supported our Interim Report findings. They recognised that there are unnecessary structural pricing complexities as well as inconsistency in terminology and disclosure of costs and charges information. This makes it difficult for consumers to shop around.

3.11 In the Interim Report, we recognised that different charging structures can reflect different consumer needs and patterns of use. However, for consumers to be able to find the platform with the charging structure that best reflects their needs, prices need to be clear, transparent and easily understood. There is an opportunity for the industry to review the number of charges and the terms used for similar charges and to consolidate and standardise some of them to support greater consumer understanding and decision-making.

Innovation in making charges clear and prominent

3.12 We said that information on costs and charges is not always readily available, clear or prominent. But we recognised that firms were in the process of improving the information they give consumers to help them shop around between platforms. We said we would assess progress made between our Interim and Final Reports.

3.13 Following the Interim Report's publication, we assessed how a sample of platforms and comparable firms (15 adviser, 12 D2C and 6 comparable firms – 33 websites across 26 firms) give information on costs and charges on their websites to consumers who are shopping around.[3] For the purposes of this analysis, comparable firms included a sample of wealth management and asset management firms that offer access to retail investment products through an online portal. Our assessment considered how firms present specific pricing information on their websites. This included exit fees, fund charges and information on cash balances.

3.14 We are encouraged by the way some firms are innovating in the way they present costs and charges information on their websites, across both D2C and advised platforms. Since our last review we have seen improvements in how this information is provided to consumers.

3.15 For example, across two thirds of the sample we saw examples of charges presented in a way that helps consumer understanding and so will enable them to shop around more effectively. This included:

- charges explained or illustrated with the use of example customer scenarios
- comparison tables to show variations across example customer scenarios or the impact on returns

3 This was not a review of point of sale disclosure or a review of compliance with MiFID II requirements.

- tools that allowed consumers to personalise costs and charges to their specific needs and circumstances
- infographics, videos, charts and graphs to visually help consumers' awareness and understanding of charges
- helpful explanations to describe what the costs and charges are
- presenting information on different types of costs and charges in one place

3.16 We considered how near the information about costs and charges was to firms' homepages. We found that the information was 2 or fewer clicks from the website homepage for 4 out of 5 firms. In contrast, for 1 out of 5 firms, the information was 3 or more clicks from the homepage.

3.17 Finally, we found it difficult to find the pricing information for a small number of advised platforms. While improvements in the way costs and charges are presented are likely to be more helpful to D2C consumers, advised consumers should also have access to clear information about costs and charges.

3.18 Overall, it can still be difficult for consumers to find all the relevant information to assess the cost of investing through a platform. Costs and charges information is often shown in different areas of the website or not displayed clearly and prominently. In our sample, we did not identify any platforms where all relevant costs and charges information was displayed in one place. In summary, there remains significant scope for improvement.

3.19 We did not look at MiFID II compliance as part of this study but firms should refer to our recent MiFID II costs and charges disclosures review findings which sets out examples of the practices we will be expecting firms to improve on to comply with MiFID II costs and charges rules.

Consultation feedback on our proposed remedies

3.20 Our Interim Report asked whether firms were innovating in the way they present information to improve comparison of charges, whether there were any barriers to innovation and if additional disclosure remedies were needed to ensure consumers can compare platform charges. We also asked whether the role of third-party intermediaries – such as price comparison websites – should be enhanced.

3.21 Respondents had mixed views about how to improve consumers' ability to shop around and how far we needed to intervene further.

3.22 Some respondents argued that further disclosure rules would create unintended consequences. Half of respondents said there were problems in ensuring like-for-like comparability due to the range of business models, complexity of pricing structures and the different ways consumers use investment platforms. Some respondents said there is a trade-off between simplicity and fair pricing, with some respondents arguing that activity based pricing, although complex, means that consumers only pay for the services they receive.

3.23 Some respondents also highlighted that different disclosure regimes apply to different regulated products and distribution activities that platforms and their competitors undertake. They argued that any additional platform-specific disclosure remedies could put platforms at a competitive disadvantage compared to their competitors. Finally, stakeholders were concerned that remedies encouraging consumers to focus on price would result in consumers not taking account of valued non-price features or services.

3.24 Most respondents also said we should give firms time to embed the MiFID II requirements before we considered further remedies. MiFID II requires firms to calculate and disclose aggregated charges both at the point of sale and afterwards. Respondents suggested it would be too early to act now, while firms continue to consider their wider costs and charges disclosure strategies, with innovation likely following.

3.25 But other respondents thought industry should work more closely with consumer groups and with us to standardise language. A small number of respondents supported a range of alternative possible remedies. This included support for developing a simple industry standard fee calculator, using 'heat maps' to compare charges across the market, standardised infographics, investor profile examples, a requirement to present the effect of charges over a longer time period (5-10 years) and a Tech Sprint to help develop solutions.

3.26 Some respondents said we should provide guidance on existing rules, namely MiFID II, to ensure firms interpret and implement them consistently across the market.

3.27 Finally, respondents said third-party intermediaries faced some practical challenges in ensuring accurate and fair comparisons for consumers. This may partly explain consumers' limited use of price comparison websites as a source of information when shopping around and choosing a platform. But they also told us that third-party intermediaries should have access to the information they need to present market comparisons. Some respondents expect open banking principles and Application Programming Interfaces (APIs) to evolve naturally in the sector. We are aware of at least one platform that is using APIs.

3.28 As part of broader feedback to the Interim Report, one respondent suggested that we should explore whether advisers should be required to pay the platform fee, instead of consumers.

Our final position

3.29 All firms need to comply with existing costs and charges disclosure requirements, many of which are relatively new. We believe this is not the time to introduce further changes. We acknowledge and welcome the initiatives of different firms and trade bodies to consider how to make this information simpler, clearer and more readily available to consumers who are shopping around.

3.30 Over the course of this study, we have seen firms taking encouraging steps to improve the provision of information about costs and charges on their websites. We welcome this.

3.31 The UKPG has also committed to take forward work with twin objectives to identify improvements to support consumer understanding and enable easier platform comparison. The scope of this work includes:

- establishing whether there is enough commonality to agree and define a set of labels for the more frequently occurring charges
- agreeing a common model for describing and disclosing the treatment of interest on client cash and for calculating its effective cost to clients
- exploring the feasibility of reporting fund (and other underlying asset) charges more explicitly in paper reports and online
- exploring the advantages of different charging strategies. This includes the benefits of 'simplicity' (with as few charge components as possible) and the 'fairness' advantages of more complex charging, such as pricing based on number of transactions etc.

3.32 We expect platforms and comparable firms to continue to reduce complexity, and improve the clarity and availability of information on costs and charges to better support consumers when they shop around. In addition, our MiFID II costs and charges disclosures review findings sets out the practices we will be expecting firms to improve on to comply with MiFID II costs and charges rules.

3.33 When considering how they communicate charges to consumers when shopping around firms may want to take into account:

- the findings from this market study as well as our previous research, including our Smarter Communications and Occasional Paper No. 32
- whether presenting all costs and charges information in the same place helps to improve the visibility of charges
- ongoing monitoring and testing of how effective disclosure is. Doing so provides opportunities to assess and demonstrate the positive impact of changes in the way information is presented on consumer understanding
- engaging with us, as we can provide design and testing support with our behavioural economics team, or via our Innovation Hub

3.34 In 2020/21 we will review industry progress in making charges more accessible and comparable for consumers who are shopping around. We will then consider appropriate regulatory intervention if needed.

3.35 We do not propose to require firms to make data available to enhance the role of third party intermediaries such as price-comparison websites. However, we still consider that further comparison tools would benefit consumers when shopping around.

4 Switching platforms

Consumers' ability to move to a platform that better meets their needs and preferences is a key driver of competition. We looked at whether consumers and their advisers face barriers to switching which could result in consumers staying on platforms which no longer meet their needs or offer them poor value for money.

In this chapter we summarise our findings. We found:

- low levels of switching (without an adviser) of c.3% per year
- 7% of non-advised consumers tried to switch platforms but failed to do so due to barriers in the process
- advisers also rarely recommend that consumers switch existing investments across platforms and some charge a fee for switching on top of their ongoing advice fee
- barriers to switching include the time taken, the complexity of the process, and costs, including exit fees

Improving the efficiency of the process, including communicating clearly to customers who are switching their investments, remains a priority for us. To improve the efficiency of the switching progress in the interests of consumers:

- industry – through STAR – is currently implementing its framework which sets expectations for end-to-end standards, customer communications, and provides oversight and transparency. Along with the Department for Work and Pensions (DWP) and The Pensions Regulator (TPR), we support these steps by industry to improve the switching process
- we will review industry progress later this year and, if needed, again in 2020 and take further regulatory action if necessary

To reduce other barriers to switching, alongside this final report we are consulting on:

- measures to restrict exit fees to reduce financial barriers to switching
- a requirement that platforms should provide unit class conversions to support consumers' requests in a way that minimises barriers to switching

Where advisers charge for switching platforms, they need to be able to demonstrate that any additional charges (over and above ongoing advice fees) are fair.

Introduction

4.1 In the Interim Report we said we wanted to make the switching process easier for consumers who want to move to a platform that better meets their needs and preferences. In this chapter, we explain our findings and proposed next steps on:

- improving the switching process
- exit fees
- unit class conversion
- advisers recommending a platform switch

Improving the switching process

Findings

4.2 In our Interim Report, we found that switching between platforms can be expensive, complex and time consuming, which discourages consumers from switching. Overall, we found low levels of direct (non-advised) consumers switching – around 3% per year.

4.3 Switching platforms involves several steps. Each of these steps can involve several stages and delays at any stage can have a cumulative impact on the switching process. Our analysis of switching data found that the time taken to complete the process varies considerably. We found that it generally takes a couple of weeks to a couple of months, with some switches taking much longer.

4.4 A notable 7% of 'direct to platform' (non-advised) consumers had tried to switch platforms but failed to do so in the last three years mainly due to the time involved, the complexity of the process and exit fees. So we are concerned that consumers face significant barriers to switching to firms that are better able to meet their needs or offer better value for money. Firms also told us that switching can be burdensome and inefficient for the industry too, and can prevent firms from winning business from their competitors.

4.5 Our analysis found that barriers to switching are driven by a combination of factors. This included electronic systems not being universally adopted across the market, the number of third parties involved and some product specific issues.

4.6 Respondents generally agreed with our findings that the current process is often inefficient. They highlighted that switching can be particularly difficult when consumers and advisers switch between different investment products or are switching between platforms and other retail investment distributors (comparable firms).

4.7 Overall, we think that industry can reduce both the actual and perceived barriers to switching. This would give consumers and advisers more confidence to switch which would encourage more competition between platforms, benefitting all consumers.

Consultation feedback on our proposed remedies

4.8 In our Interim Report we acknowledged the industry efforts to improve the switching process through TRIG. We hope to see industry progress in the following areas:

- improved standards for transfer and re-registration times from an industry-agreed maximum timescale for each step in the switching process
- clearer customer communications from the receiving provider at the start of the switching process, explaining the transfer process, timelines and giving a point of contact for any questions or complaints
- publication of transfer times data so consumers and third parties can compare platform performance

4.9 TRIG published an industry framework in June 2018. This set expectations for end-to-end standards, customer communications, and provides oversight and transparency.

4.10 Since publishing our Interim Report, we have closely followed TRIG's progress to implement the Framework:

- In October 2018, TRIG appointed a not-for-profit joint venture 'STAR' to develop and oversee the Framework's implementation and monitoring
- STAR formally launched as a standalone entity in November 2018
- STAR has appointed a Chair and is in the process of setting up a Steering Committee
- STAR has been recruiting member firms who have signed up to implement the Framework

4.11 We asked for feedback on whether the FCA had a role in supporting the industry initiative and how we might undertake it. We also asked for views on the effectiveness and proportionality of introducing remedies including 'sunlight remedies' which would shine a light on firms' switching times, or of setting minimum standards for transfer times.

4.12 Nearly all respondents to our Interim Report thought we should continue to support this industry initiative. The UKPG has said its members will be encouraging making assets portable across the retail financial services industry by continuing to support STAR and TRIG's framework.

4.13 Just over half of respondents suggested we also take additional steps to improve the switching process. Suggestions included that we:

- Publicly support firms' adoption of automated transfer systems.
- Take a more interventionist approach such as introducing 'sunlight remedies' or mandating switching times. There were mixed views as to the likely effectiveness/proportionality of these proposed remedies.
- Adopt a more focused supervisory approach to ensure firms deliver 'prompt and efficient' switches in accordance with the rules, such as taking a 'comply or explain' approach or setting of enforceable standards.
- Develop an investment switching service similar to the current account switching service.

4.14 Some respondents also said that any remedies would have limited effect if they were only applied to platforms (as defined by the FCA Handbook). This is because consumers transfer assets to and from similar non-platform firms. These respondents argued that any requirements should apply to all firms transferring or re-registering a client's assets. Others stated that firms should focus on improving the transfer process, requiring firms to invest in technology.

4.15 Respondents said that platforms do not always have control of the end-to-end transfer process, which would make mandated reporting of switching times difficult. They said it could be misleading to present meaningful information to consumers about the performance of platforms, in isolation from third-party performance, but presenting a complete picture could be too complex.

Our final position

4.16 We support STAR's aims and work. Their framework is aligned with our desired outcomes to improve the customer experience, reduce how long it takes to complete transfers and ensure consumers can move to a better value platform that meets their needs more easily. DWP and TPR have also welcomed STAR's appointment and progress.

4.17 Given progress and direction of travel to date, this industry initiative may prove the most timely, proportionate and cost-effective remedy to improve outcomes for consumers. We are hopeful that STAR will deliver benefits and support outcomes for consumers across retail investment more widely.

4.18 Nevertheless, we remind firms that they must comply with our rules to execute re-registration requests 'within a reasonable time and in an efficient manner'. Firms should also pay due regard to the FCA Principles and ensure they treat customers fairly and act in the best interests of their clients when completing transfers and re-registrations.

4.19 In complying with the existing rule and Principles we encourage firms to continue taking steps to address the underlying drivers of barriers to switching. For example, our evidence shows that the use of electronic transfers can reduce the time it takes to complete the switching process compared to paper-based transfers.

4.20 We will review progress made by industry later this year and, if needed, again in 2020 and take further regulatory action if we do not observe more efficient switching or that switching has not become easier for consumers and advisers. This could include revisiting our rules requiring prompt and efficient transfers and sunlight remedies.

Exit fees

Findings

4.21 In our Interim Report, we found that exit fees create a barrier to switching. They were one of the 3 biggest actual and perceived barriers to switching and the main financial cost of switching for consumers. Exit fees also contribute to the complexity that affects consumers' understanding of costs and charges. Our consumer research found that consumers most commonly cited exit fees as quite or very difficult to understand (26% of consumers). Only 10% of consumers believed exit fees applied at the time their platform was chosen.

4.22 Since publishing the Interim Report there has been some reduction in the number of platforms charging exit fees, but just under half of the top 20 platforms (based on AUA) still charge them.

4.23 Following our Interim Report, we have sought to better understand the relationship between exit fees and the costs to platforms when a consumer leaves. We therefore gathered data from a sample of firms made up of 23 platforms across 19 firms, and 7 comparable firms. For the purposes of this analysis, comparable firms included a sample of wealth management and asset management firms that offer access to retail investment products through an online portal.

4.24 Our analysis found that firms incur costs when a consumer leaves, but firms differ in how they recover these costs. Some recover the costs through headline charges which do not create a barrier to switching. Others recover costs by charging an exit fee, and some of these appear to be more than the actual cost of exit.

4.25 We also assessed a sample of 33 websites (15 adviser, 12 D2C platforms and 6 comparable firm websites across 26 firms) to see how they presented information on exit fees on their websites. Our assessment found that nearly half of firm websites did not provide clear information on exit fees, including whether they applied any, on the main costs and charges page or document. Just over half did. Please see Chapter 3 for further details on our costs and charges analysis.

4.26 Overall, our findings lead us to conclude that exit fees create a barrier to switching and that firms can recover the costs of exit in ways which do not dampen competition.

Consultation feedback on our proposed remedies

4.27 In the Interim Report, we asked for feedback on the likely effectiveness, proportionality and any unintended consequences of a ban on exit fees. We also invited views on the scope of any ban to reduce barriers to switching. For example, whether any ban should extend to product-level exit fees.

4.28 There was mixed support for a potential ban on exit fees. Almost half of respondents supported a ban compared to half of respondents who did not agree that a ban on exit fees would reduce barriers to switching.

4.29 Nearly a quarter of respondents raised concerns about the proportionality and fairness of a complete ban, with a number citing the costs to firms of carrying out switches.

4.30 Over half of respondents gave possible unintended consequences to a ban. They included:

- A waterbed effect, where other charges increase as firms look to recoup lost revenue.
- Cross-subsidisation, where all consumers effectively bear the cost of switching equally, rather just those who actually switch. A number of industry respondents, and a small number of consumer respondents, said that this would be unfair.

4.31 Almost three quarters of respondents said that any ban should also include product-level exit fees, compared to just over a quarter who did not.

4.32 Almost half of respondents felt that the scope of any ban should apply more broadly than just to platforms. This was most widely defined as 'all client asset holding firms – to include fund managers, wealth managers, life assurers, employee benefits companies and platforms'. A small number of respondents specifically noted the risk of distorting competition in the market and adding further confusion for consumers if a ban was applied to platforms (as per the FCA Handbook definition) and not the broader market.

Our final position

4.33 We still think that there is a strong case for addressing platform exit fees for new business, as they act a barrier to switching and reduce firms' incentives to deliver better services for all consumers. Exit fees also add complexity to platform charges, making it more difficult for consumers to compare different platforms.

4.34 We are inviting views on a potential policy intervention on exit fees in the Consultation Paper published alongside this report. Our view is that a ban on charges is likely to be more effective than a cap in removing the barrier to switching and increasing firms' incentives to deliver better propositions, but we welcome views on whether the intervention should be a ban or a cap on such fees.

4.35 By addressing a main barrier to switching we expect an increase in competition in the market and positive outcomes for consumers:

- Consumers who do switch would find it less expensive to do so. Those who may have been deterred from switching previously because of the cost may now switch to a better deal.
- An increased ability to switch should have a positive effect on competition across the market. In these circumstances all consumers will benefit, not just those who switch.
- As only one of the top 3 barriers, any restriction on exit fees will not address all of the problems with switching on its own. However, the remedy is an important part of a broader package of changes to improve the switching process and transfer times, which should have an overall positive impact on consumers' ability to switch to a firm that better meets their needs.
- Measures to restrict exit fees will also reduce barriers to firms acquiring customers, including smaller firms or new entrants.

4.36 We know that enabling switching, whether in specie or by cashing out, has transactional costs. Many firms currently recover these costs through the platform fee, which ensures that there are no additional fees from exit that create a barrier to switching or add unnecessary complexity to firms' charging structures.

4.37 Firms that currently charge an exit fee may respond to restrictions on exit fees by recovering these costs through higher ongoing platform charges. In this case, consumers who do not switch would pay for some of the costs of those who do. However, as, on average, exit fees in 2017 only accounted for 0.2% of firm revenue, we expect the extent of any increase to be limited. Further, by reducing the barriers to switching, and so increasing firms' incentives to deliver better services, all consumers should benefit.

4.38 We also recognise, along with respondents, that we need to consider which firms should be included for any final remedy. Platforms compete with comparable non-platform firms. Our consumer research found 13% of non-advised consumers considered investing via a non-platform proposition when they shopped around and our qualitative consumer research confirmed that consumers are not always clear if they have invested via a platform or a comparable firm. Given this, any ban or cap may have limited impact and/or could have unintended consequences in the market if limited to the FCA Handbook definition of a platform. We also recognise that consumers may pay product-level exit fees, although neither competition between retail investment product providers nor product-level exit fees are part of this work.

4.39 To ensure that the remedy effectively addresses the harm, creates consumer benefit and does not distort competition we are publishing a Consultation Paper alongside this Final Report with a discussion that sets out the options for:

- how an exit fee should be defined
- the scope of the intervention
- whether the intervention should be a ban or a cap on such fees

4.40 We invite all stakeholders to respond to the discussion in our Consultation Paper. Please send your responses to cp19-12@fca.org.uk by 14 June 2019. We will then consider all the responses and may issue a consultation later in the year.

Unit class conversion[4]

Findings

4.41 Clean unit classes were created following the RDR and do not contain adviser charges as part of the OCF. Platform-specific discounted (or 'superclean') unit classes are typically created when a platform negotiates lower fund charges with a fund manager. Superclean unit classes are the same as 'clean' unit classes except the price (AMC/OCF) is lower. While this lower OCF benefits eligible consumers, these bespoke unit classes can make switching more difficult.

4.42 When a consumer invested in superclean units wants to move their investment in the same fund on to another platform, all the necessary parties should work together to deliver the re-registration and, if necessary, unit class conversion of the client's investment. That is, it should be possible for the consumer to transfer on an in-specie basis, without having to sell and repurchase units in the same fund.

4.43 For a conversion to happen, the platform needs to send a request to the relevant fund manager and the fund manager executes the conversion. We are aware that most fund managers appoint third-party transfer agents to handle relationships with consumers and platforms and the process can require iterative data sharing and reconciliation between the various parties involved.

4.44 But not all platforms facilitate such a conversion, instead requiring either:

- That the ceding platform sells the units in the original unit class at a given valuation point. They then buy units in the new unit class at another valuation point. Some platforms wait until the selling transaction is settled, which takes several days, before buying the new units. Others do it across one valuation point, which reduces, but doesn't eliminate, consumers' time out of the market. The ceding platform then transfers the new units to the receiving platform.
- That the ceding platform sells the units in the original unit class and transfers the assets as cash. The receiving platform then rebuys the holdings in the new unit class.

4.45 In both these cases, consumers may lose money as they are exposed to the risk of market movement, unnecessary transactional costs and potentially having to pay tax. Our consumer research has also shown that these can act as a barrier to switching for some consumers. Our quantitative research showed 21% of D2C consumers who had tried and failed to move platform gave 'other' barriers to moving platforms as a reason. They gave as reasons, that they would have to sell and rebuy their holdings as the new platform would only accept cash rather than transfers of the fund, and also the tax implications from selling units.

4 We use 'unit class' throughout this report to be in consistence with the 'FG18/3: Changing consumers to post-RDR unit classes' guidance and we refer to the same problem identified as 'switching between share classes' in our Interim Report.

4.46 Around a third of respondents said many platforms are reluctant to facilitate conversions. So we wanted to better understand what drives different transfer practices. Firms told us that industry has tried to improve conversion efficiency by working towards standardisation and automation of unit class conversions. However, this is still not widespread. We heard that platforms and fund managers are not motivated to fulfil conversions due to the costs and manual interventions involved. Many conversions still require manual monitoring, the application of conversion ratios which fluctuate daily, and platforms to check the work of transfer agents by reconciling individual consumer accounts.

4.47 The transfer process involves not only platforms but also fund managers. Our rules give unit holders the right to request unit class conversions, as long as this does not conflict with prospectus provisions. Therefore we expect fund managers caught by this rule to fulfil conversions upon request. There is currently no rule requiring platforms to act on a request from a consumer to convert.

4.48 Our work also suggested that there are cases where new consumer assets arrive on platforms for investment in funds where equivalent superclean units are available (and for which the consumer is eligible), yet are not invested in these unit classes. If a consumer does not actively request conversion of their investments into such units they may remain in the more expensive unit class.

4.49 In conclusion, we have found that platforms not facilitating in-specie transfers and unit class conversion can create a barrier to switching for consumers. Platforms do not currently have a strong enough incentive to facilitate these transfers and associated conversions. Platforms may also be failing to take adequate steps to manage the risk that new or transferring-in clients end up in disadvantageous unit classes where equivalent, but cheaper, units are available in the same fund.

Consultation feedback on our proposed remedies

4.50 In the Interim Report, we asked for views on whether we should require ceding platforms to convert the investment into a unit class available on the receiving platform to enable in-specie transfers to take place.

4.51 Most responses supported this kind of intervention. Some firms said that fund managers may not be prepared to allow the receiving platform to list the unit class offered on the ceding platform. Because of this, they said our original proposal may not be deliverable. Some respondents suggested instead that ceding platforms should be required to convert the customer to the common clean unit class available to all platforms.

4.52 A small number of respondents argued that mandating the option of in-specie transfers will increase firms' costs, for example because it will require platforms to also carry the standard versions of their superclean unit classes. However, we understand that platforms with superclean unit classes generally have access to standard unit classes to take on new consumers.

Our final position

4.53 Having considered respondents' feedback, our view is that there is currently too weak an incentive for platforms to request and facilitate in-specie transfers and associated unit class conversions.

4.54 So we have decided to consult on new rules requiring:

- platforms to offer consumers the choice of transferring units in-specie where the same investment fund is available in both the ceding and receiving platform
- the ceding platform to take the necessary steps to bring about conversion of the units which the receiving platform can accept for an in specie transfer, where the client's investments via the ceding platform is in units of a class not available for purchase in the receiving platform
- the receiving platform to offer consumers the option, as part of the funds transfer process, to convert units into discounted units, where they are available for investment by the consumer

4.55 We also expect platforms, if receiving transfer requests, to meet the COBS 6.1G requirement to 'execute the client's request within a reasonable time and in an efficient manner'. So we do not consider it appropriate for firms to accumulate individual consumers' requests in order to perform bulk conversions.

4.56 We anticipate that our proposed rule(s) would remove one of the barriers to switching for consumers who may have been prevented from doing so. It would also make the process more efficient for those who would have switched anyway. So we expect the remedy to have a positive impact on consumers who want to move their assets to another platform, which will also improve competition across the market.

Advisers recommending a platform switch

Findings

4.57 In our Interim Report, we found that although advisers consider it worthwhile selecting new platforms for new investments, they rarely recommend moving existing investments from one platform to another.

4.58 About a quarter of advisers also told us it was difficult to switch assets between platforms. Almost half told us that they were likely to charge clients an extra fee for switching, on top of any ongoing advice fee, to cover the costs of administrating the switching process and of providing advice (a platform switch is an 'advice event' which requires advisers to assess suitability and provide a suitability report).

4.59 We concluded that the work that an adviser needs to do, and the cost to the client, can act as a barrier to advisers reviewing whether their clients would benefit from switching platforms. Advisers that do carry out reviews may also conclude that switching is not in the interest of the client due to the complexity of the process and the associated administrative costs outweighing any benefits provided by an alternative platform. How far this is a barrier depends on the actual and perceived complexity of the work in each case.

4.60 Advisers may also find it harder to easily assess the costs and benefit of a switch in more complicated cases, such as when a client holds more complex or esoteric investments across a number of different products or wrappers. They may not recommend switching when the gains from switching are marginal and if they cannot be confident that it will be hassle-free for the client.

Consultation feedback on our proposed remedies

4.61 In the Interim Report, we asked if we should provide guidance to clarify our expectations for advisers that are reviewing whether their clients should switch platforms.

4.62 Many respondents agreed that there are significant costs in switching a clients' existing assets to another platform. Some respondents said they would welcome further guidance that sets out our expectations for adviser-led switching. For example, 1 respondent said that guidance would help firms to understand the level of information they need to give customers and could provide clarity on how an adviser can assess value for money. Other respondents said additional guidance would not be useful.

4.63 Two respondents suggested that the issue of whether advisers should charge for a platform switch should be considered if the FCA conducts further work on competition in the financial advice market as it one of the key barriers to switching for advised customers.

Our final position

4.64 We consider the main barrier to switching is the time and complexity of the switching process itself. So we do not propose to issue additional guidance setting new expectations for advisers when reviewing whether clients should switch platforms.

4.65 Although an assessment of suitability in each individual case is needed, suitability assessments (and reports) need only cover the main changes in the services proposed where this is part of an ongoing advice service.[5] We expect this to be straightforward in less complex cases, for example, where a client holds mainstream funds in an ISA.

4.66 Advisers need to be able to demonstrate that their charges are fair, and our broader switching remedies should help to reduce costs. If ongoing advice charges do not cover the costs of assessing the benefits of switching, advisers need to be able to justify this.

Conclusions and next steps

4.67 Our work on switching has shown that the barriers consumers and advisers face can be significant, and this justifies our intervention to improve outcomes. To make the switching process easier for consumers and advisers:

- Alongside this Final Report we have published a Consultation Paper on rules on transfers of investments in the same fund from an existing to a new platform and a discussion on exit fees in the retail investments distribution market. We welcome feedback on our CP by 14 June 2019. Please send responses to cp19-12@fca.org.uk.

5 Article 54(1) of MiFID Org Reg provides that: "Where an investment firm provides a service that involves periodic suitability assessments and reports, the subsequent reports after the initial service is established may only cover changes in the services or instruments involved and/or the circumstances of the client and may not need to repeat all the details of the first report." ESMA guidelines state that "The principle of proportionality in MiFID allows firms to collect the level of information proportionate to the products and services they offer, or on which the client requests specific investment advice or portfolio management services."

- Later this year and again if needed in 2020, we will review progress industry has made to improve the switching process, including customer communication. We will consider intervening further if progress is not achieved.

5 Competition between adviser platforms

Platforms competing to win business from finanical advisers should be competing by offering services that offer direct or indirect benefits to advisers' clients and do not distort advisers' incentives when they consider which platform to choose. When a client is no longer advised, there is a risk that competition for these clients is weak as the client no longer has an adviser considering whether they are on the platform that best meets their needs.

In this chapter we summarise our findings on platforms' treatment of orphan clients and non-monetary benefits.

We found that platforms have appropriate policies and procedures for identifying orphan clients who may suffer harm if they are paying for advice they no longer receive. We agree with consultation feedback that it is advisers' responsibility to notify platforms when they are no longer advising a client.

We also found that although some orphan clients may face some restrictions in the services they can access, we are reassured that platforms:

- provide orphan clients with information on any restrictions or limitations, as well as information on alternative options
- support clients to find a new adviser or switch to a more suitable platform if it is in their best interests to do so

A few platforms also charge additional fees for orphan clients. Some platforms told us that these charges are fair as they reflect the cost of providing additional services. But we are concerned that in some cases these charges may not reflect additional services and can be used as a way to encourage orphan clients to find a new adviser, or switch to an alternative platform.

For non-monetary benefits, firms appear to understand their responsibilities to ensure they neither provide nor accept inducements. Whether any particular non-monetary benefit to an adviser amounts to an inducement depends on the circumstances, for example whether the benefit meets the conditions to be deemed as designed to enhance the quality of the service to the client and does not impair compliance with the firm's duty to act honestly, fairly and professionally in the best interests of the client.

Overall, we do not think it is proportionate or appropriate to introduce new requirements to address these issues. However:

- Platforms should consider their broader propositions for orphan clients, including any additional charges. They should pay due regard to their interests and treat them fairly. We will review whether firms are doing this, and proceed with supervisory action if appropriate.
- Platforms and financial advisers need to continue to consider whether the non-monetary benefits that they offer or receive are permissible under our rules against inducements.

Introduction

5.1 In our Interim Report, we found that adviser platforms largely compete on the services they provide to advisers. Most of the services that platforms offer advisers benefit consumers either directly or indirectly. But we found that some platforms may provide services to advisers which may inappropriately alter their incentives, contrary to our detailed rules on inducements and to firms' general duty to act in the best interest of their clients.

5.2 We also highlighted some concerns regarding the treatment of so called 'orphan clients'. These are consumers whose investments were originally placed on a platform by an adviser but who are no longer advised. We were concerned that orphan clients may face restrictions in the platform services they receive or pay more for these services without reason.

5.3 We were concerned that platforms may:

- Not identify orphan clients. These clients may therefore suffer harm if they still have advice fees deducted from their investments on the platform but no longer receive any advice.
- Not offer orphan clients services that meet their needs.
- Charge orphan clients unfair additional fees.

5.4 Since the Interim Report, we have spoken to firms about these issues and considered their responses.

5.5 In this chapter, we summarise the further work we have undertaken, the feedback we have received on our proposed remedies, and our findings on adviser platforms. We cover:

- identifying orphan clients
- orphan client propositions
- orphan client charges
- treatment of non-monetary benefits

Identifying orphan clients

5.6 In our Interim Report, we found platforms were not proactively monitoring whether or not their clients continued to have a relationship with an adviser. We suggested that it is important that platforms identify orphan clients so that they can check whether clients should continue to pay adviser charges which the platform collects on the adviser's behalf. We sought feedback on whether platforms should be required to periodically check whether a retail client's existing instruction remains valid.

Findings

5.7 Following our Interim Report, platforms told us that advisers typically notify them when a relationship with a client has ended and so the risk of them collecting advice fees from clients who are not receiving an ongoing service is low. This is largely because:

- advisers have a responsibility not to charge an ongoing adviser fee unless they are providing an ongoing service
- advisers are typically required, under platforms' terms of business, to notify platforms when a relationship with a client has ended
- some platforms have additional controls in place to identify orphan clients

5.8 Examples of additional controls include:

- Platforms monitoring for suspiciously high fees or one-off fees, to ensure advisers are not wrongly charging their clients.
- Monitoring adviser firm permissions against the FCA register. If an adviser firm using the platform lost (or cancelled) their advising permission, the platform would identify this, investigate, and cancel adviser fees where appropriate.
- Monitoring customer accounts where there is little or no activity over a period of time (longer than 12 months). The firm then contacts the adviser or customer to confirm if the relationship still exists.

5.9 Overall, we are reassured that existing controls sufficiently reduce the risk of material harm to consumers. We remind platforms of the risk they could enable the collection of adviser charges when there is no ongoing service.

Consultation feedback on our proposed remedies

5.10 In the Interim Report, we said we would look at the merits of requiring platforms to identify whether a client has been actively using their service. Although 1 respondent supported a potential requirement on platforms to check account activity, most raised concerns about this particular approach.

5.11 Platforms did not agree that they should have an obligation to proactively monitor account activity to identify orphan clients. Both advisers and platforms, as well as trade bodies, noted that it is the regulatory responsibility of advisers to stop adviser charges (COBS 6.1A.22R) and not to receive fees without providing an ongoing advice service. A common argument was that it should not be the duty of a platform to check whether another regulated entity is complying with their regulatory responsibilities.

5.12 Many respondents also suggested that account activity alone is not enough to decide whether an advice service continues to be provided. For example, a client may be advised on several accounts held across different platforms, some of which have more active investment strategies than others. Similarly, advice on off-platform investments may be paid for via platform-facilitated adviser charges. Re-assessing risk profiles, updating fact-finds, reviewing wills, and mortgage provision are also examples of off-platform adviser activity that can be paid for through the account held on a platform.

5.13 A number of respondents suggested there could be unintended consequences if platforms were required to check that customers are getting advice after any defined period of inactivity. For example, a few respondents suggested this could lead to a risk of 'activity trades' whereby advisers could be encouraged to transact on an account (incurring costs) simply to provide evidence of an ongoing service, even if a transaction is not in the client's best interest.

Our final position

5.14 After discussions with a number of platforms, and having considered firms' responses to our Interim Report, there appear to be existing controls that sufficiently manage the risk of orphan clients continuing to pay advice fees.

5.15 We agree that advisers already have an obligation to ensure that they are not receiving advice fees from clients they no longer have a relationship with. We also expect advisers to inform platforms where their relationship with a client has ended. This should be in accordance with platforms' terms of business. It is also important that regulatory responsibilities and accountability is not blurred and we agree with industry respondents that the responsibility for identifying orphan clients lies primarily with advisers.

5.16 We think that it is not proportionate or appropriate to introduce new requirements on platforms. But there is still a risk that platforms could be used as a conduit to enable adviser charges when no ongoing service is provided. So we encourage platforms to consider whether they have effective and appropriate controls in place to identify orphan clients.

Supporting orphan clients

5.17 By their nature, adviser platforms are primarily designed for use by financial advisers. In our Interim Report we said that orphan clients are unlikely to be well served by staying on adviser platforms, as their ability to access and alter their investments is usually restricted. We also said that we found that a minority of platforms did not have an orphan client process and suggested that platforms could do more to get orphan clients to find a new adviser or switch to a D2C platform.

Findings

5.18 Since the Interim Report, we have considered stakeholder feedback and have spoken to a number of adviser platforms, to better understand their approach to supporting orphan clients. Platforms typically engage with new orphan clients a number of times in the first few months after their relationship with their adviser ends. These communications include:

- explaining any limitations of the 'orphan' options, including how much access they have to platform features
- explaining that the client can nominate a new adviser or switch to a different option, including moving to another platform provider
- helping orphans find a new adviser
- using dedicated phonelines to help orphan clients

5.19 Platforms told us it is not always in an orphan client's best interests to switch to a different platform. If the existing platform, for example, allows them to hold products that they would have to cash out if they switched to a D2C proposition, a switch may not be in their interests. Similarly, an advised platform may allow the investor to continue to hold existing investments at lower cost when compared to D2C options.

5.20 Platforms also told us that they do not overly restrict the functionality of options available to orphan clients. These clients can usually still make new investments and access valuations, although this is sometimes limited to a dedicated telephone service, rather than online. Only 1 platform prohibited adding new funds. Where restrictions exist, platforms offer what seems to be a reasonable justification. For example, to limit orphans' ability to invest in complex products, or to remove access to third-party discretionary services, which are only available on an advised basis.

5.21 We also found no evidence that orphan clients face additional barriers to switching to a new platform compared to clients with advisers or those on D2C platforms. Adviser platform policies often mean orphan clients are likely to be better informed about their options to switch, and better supported than customers using D2C platforms.

5.22 Finally, platforms told us that orphan client status tends to be temporary, with many taking prompt action to find a new adviser or leave the platform.

Consultation feedback on our proposed remedies

5.23 In the Interim Report, we suggested that platforms could do more to help orphan clients find a new adviser or switch to a D2C platform. We said we would consider whether we should use new or existing rules to achieve this objective.

5.24 Adviser platforms that responded said that it was not always in orphan clients' best interests to switch to a D2C platform. They pointed out that platforms have limited ability to force customers to switch platform, as this could constitute advice. Adviser platforms also did not want to force orphan clients to switch without their consent.

Our final position

5.25 Overall, we agree it may not be in a client's best interests to switch to a D2C platform, particularly as orphan clients do not appear to face prohibitively restrictive services. Platforms also showed they have appropriate processes for communicating with orphan clients and giving them options to switch or help to find a new adviser.

5.26 It is important that adviser platforms, particularly those without D2C offerings, have appropriate policies and practices in place to explain orphans' options to help them make informed decisions. This conclusion applies to service levels, not orphan client charges, which we discuss in the following section.

Orphan client charges

5.27 In our Interim Report, we found that some platforms charge orphan clients extra fees and that these fees seem high compared to any additional administration cost for serving them. We said that we were interested in firms' explanations of why, in some cases, orphan clients are being charged more.

Findings

5.28 Since publishing the Interim Report, 2 firms have stopped charging orphan clients additional fees, while another firm has indicated that it is currently reviewing its charging structure. Currently, a small number of platforms charge their orphan clients extra fees on top of the standard platform fee. So we have revised our previous estimate of the extra fees orphan clients pay, down from a total of £1.2m a year, to a total of £450,000 a year.

5.29 Some firms told us they charge orphan clients more to reflect the additional costs of servicing them. Other firms suggested that additional charges are designed to create an incentive for orphan clients to either move to a new platform or to find a new adviser.

5.30 We asked both firms that do and don't charge additional orphan client fees to set out the additional costs of serving orphan clients. Some firms said that there were no identifiable costs associated specifically with orphan clients. Others claimed that there was additional work in servicing them. We heard this work can include:

- extra support offered by platforms due to higher levels of client queries and requests
- some minor additional reporting to end clients, given the absence of an adviser
- further risks and protocols involved in orphans transacting, as well as regulatory oversight, as orphans transact on a self-execution basis. For example, some platforms carry out appropriateness checks and risk mitigation checks, such as verifying client signatures for transactions

5.31 When responding to our Interim Report, a large number of firms made similar points. They said that many client requests are processed by platforms' call centres which require extra staff time and resource. In some cases, staff may also have to execute manual transactions, as some platforms only allow orphans to place trades over the phone.

5.32 One platform stressed that a number of platform features that advisers use, such as bulk trading and reporting, deliver major back office efficiencies for platforms. In other words, customers that trade individually without advice are arguably more expensive to serve as they are not using these services.

5.33 In some cases, these orphan client activities appear to be extensions of services that platforms already offer either advisers, or end clients. For example, any additional reporting to end clients would not be substantively different to the platform's previous reporting when dealing with an adviser. Some respondents also suggested that charges are not always designed to reflect costs, but instead can be used to encourage orphan clients to find a new adviser or to switch platform.

Consultation feedback on our proposed remedies

5.34 In our Interim Report we said we would explore whether remedies which help raise orphan clients' awareness of additional charges, or prevent platforms charging these clients more than existing clients, would deliver better outcomes for them.

5.35 A few respondents stated that they support the proposed remedies. One of these said it would be unfair if the advice fee that orphan clients were previously charged has simply been swapped for a non-advice surcharge.

5.36 Some respondents disagreed with the proposed remedy of banning additional charges for orphan clients. As mentioned in paragraph 5.30, these respondents argued that orphan client fees are justifiable because they require more support than advised customers.

Our final position

5.37 We accept that there may be some additional costs for servicing orphan clients. But charging orphan clients more could be unfair where charges do not reflect costs and clients get the same services their platform already offers. They could also be unfair if platforms are using charges to encourage these clients to find another adviser or move to a different platform, when it may be in the best interests of orphan clients to remain on a platform (for example because they hold complex products).

5.38 Given that only a small number of firms currently charge additional orphan client fees, we are not introducing specific rule changes at this time. Instead, we will be following up with the individual firms that currently have these charges in place, and will intervene as appropriate.

5.39 Firms should consider their broader propositions for orphan clients, including whether current pricing practices are fair, and whether they need to either stop charging orphans more, or reduce these charges. As part of our follow up work, we will consider whether firms are treating customers fairly and have due regard to the interest of their orphan clients.

Treatment of non-monetary benefits

5.40 In our Interim Report, we said that some platforms may provide, and advisers may accept, services that might alter an adviser's incentives. Generally speaking, non-monetary benefits and other inducements are not permitted under our rules except where detailed conditions are met.

5.41 We suggested certain services, including the provision of white-labelled solutions and certain training for advisers, might be caught by our inducement rules.

Findings

5.42 Since publishing the Interim Report, we have had the opportunity to observe discussion and debate with industry stakeholders, particularly around the circumstances in which platform services can benefit end clients. It appears to us that platforms have a generally good understanding of the regulatory constraints on permissible non-monetary benefits.

5.43 Some respondents argued that bulk rebalancing offers benefits to end clients. One firm stressed that advisers cannot bulk rebalance without increasing costs. Outsourcing this service to platforms lowers costs for advisers and allows them to pass cost savings on to consumers.

5.44 Another respondent confirmed this point. They argued that rebalancing enables platforms to deal with groups of clients at the same time, rather than having to action each in turn which potentially creates a conflict of interest and could disadvantage some clients. Bulk rebalancing can also significantly reduce operational risk for both the adviser and the platform, ultimately benefitting the client. This is because it allows potentially 2 manual keying entry activities per client to be reduced to 2 entries across a group of clients.

5.45 A few respondents suggested that some types of training, such as generic training or training for exam preparation, does not benefit end clients and so should not be permitted under the relevant inducement rules. But others argued that other forms of training, such as training on the tools and features available on platforms, are allowed.

5.46 One respondent said that white-labelling offers a clear benefit to advisers but not necessarily the end client. During one of our industry round tables, one firm argued that, because of this, advisers should be paying for white-labelling. Other respondents suggested that white-labelling costs nothing to provide, and that there are clear benefits to end clients. However, they did not provide us with any further detail on exactly how this service benefits clients.

5.47 Overall, the feedback suggests that platforms understand our requirements and do consider the extent to which services offering any non-monetary benefit to advisers may or may not be permissible under our rules. The UKPG has said it will undertake further work to assess where the benefits of platform functionality accrue and whether any such functionality could constitute 'inducements', which are generally not permitted under our rules. We welcome and support this commitment.

5.48 Ultimately both platforms and advisers have a responsibility to consider whether they offer or receive services that might be a non-monetary benefit. If so, they should be able to demonstrate that these services do not offer inducements, as this would be contrary to our detailed requirements in COBS 2.3 and COBS 2.3A.

Consultation feedback on our proposed remedies

5.49 We did not ask for feedback on proposed remedies on the treatment of non-monetary benefits. Many respondents agreed that the existing rules on providing non-monetary benefits are clear and go far enough.

Our final position

5.50 Both platforms and financial advisers should continue to consider whether the non-monetary benefits they offer or receive are permissible under our inducement rules. The assessment of whether a particular service constitutes an acceptable non-monetary benefit will depend on the specific facts of each case. The detailed rules in COBS 2.3 and COBS 2.3A already include guidance, and respondents did not raise specific concerns. Given this, we do not propose to issue further guidance.

Conclusions and next steps

5.51 The existing requirements for advisers and existing platform controls should mitigate the risk of material harm from orphan clients paying for advice they do not receive. Platforms also appear to have appropriate processes for communicating with orphan clients and providing options to switch or help to find a new adviser.

5.52 We think that in some instances, charging orphan clients more could be unfair, particularly where charges do not reflect costs. We will review whether firms are treating customers fairly and have due regard to the interest of their orphan clients, and will intervene as appropriate.

5.53 Our discussions with platform providers, reinforced by the responses to our Interim Report, give us confidence that firms understand their responsibilities when offering non-monetary benefits to ensure they neither provide nor receive inducements. Firms need to continue to assess non-monetary benefits to ensure they meet the detailed requirements of our rules and we welcome the work that the UKPG is taking forward.

6 Informed investment choices

Platforms play an important role in helping consumers make investment choices. Consumers value the range of investment choices that platforms allow them to access and use information they provide to choose and review their investments.

We considered how platforms help consumers make informed choices of funds and model portfolios, as well as information provided on keeping a cash balance. In this chapter we summarise our findings. We found:

- There have been some recent improvements in the way platforms present fund charges to consumers when they are shopping around. But it is still difficult for them to compare and shop around on fund charges.
- Vertically integrated platforms appear to make it clear that their in-house funds are part of the wider group. Our 2016 research found that in-house funds included on Best Buy lists on average did not perform better than those not included, but since publishing there has been a decline in platforms promoting in-house funds through Best Buy lists.
- When comparing across platforms, investors may expect similarly named model portfolios to be broadly substitutable. But we found this may not be the case as there are no industry-wide standards for risk-grading model portfolios. As a result, consumers may be unable to understand and compare options before buying.
- Some investment platforms could do more to improve execution quality and reduce costs for their customers.
- Our analysis suggests that much of the potential harm from money being held in cash – in terms of any lost interest and investment returns – comes from cash held in pension wrappers.

On balance, we have decided against further intervention at this time:

- As we note in Chapter 3, we support the industry initiative to improve the comparability of information about costs and charges. We will review the impact of this on disclosure of fund charges and cash interest rates in 2020/21.
- Firms must already actively manage their conflicts of interest when they promote their own products to investors, in line with our rules in COB 7.1, and we continue to monitor compliance with our rules.
- Our findings on platforms' model portfolios will inform our RDR/FAMR review.
- Our Retirement Outcomes Review remedies will improve outcomes for some consumers who hold inappropriately large cash balances in pension wrappers.

Introduction

6.1 As well as administering investments on behalf of consumers, platforms can help them make informed investment choices and to get a better deal on funds. So platforms have an important role to play in helping competition in investment markets work in consumers' best interests.

6.2 In this chapter we set out our findings on the ways in which they can do so by:

- presenting fund charges in a helpful way

- using fund promotions to help consumers choose investments
- providing model portfolios to consumers
- achieving and demonstrating the best execution results when dealing in securities
- ensuring consumers understand the costs of holding cash on a platform

Presentation of fund charges

6.3 More than two thirds of the total assets on platforms in 2017 were invested in funds. Our expectation is that a well-functioning platforms market should help consumers make informed choices between funds.

Findings

6.4 In the Interim Report we said that platforms could improve how they presented fund charges to consumers at certain points of the consumer journey. This would help consumers make more informed investment decisions and strengthen competition between fund managers.

6.5 Since publishing the Interim Report, we further assessed a sample of 33 websites (15 adviser, 12 direct to consumer and 6 comparable firm sites across 26 firms), to see how firms provide information about fund charges.[6] We found:

- where firms showed fund charges on their website, nearly two thirds of them mentioned fund charges on the main costs and charges page or document This compares to just over a third that mentioned them elsewhere on the website
- a few firms did not display any information about fund charges on the main charges page on their website
- of those that said that fund charges were payable, nearly all gave information on fund charges in percentage terms, compared to a few firms that quoted the charge in pounds and pence instead. Only 1 firm presented fund charges in both percentage and absolute terms.

6.6 On the basis of the practices we have seen, we think firms can improve the clarity and prominence of fund charges information. Firms should also take into account the findings of the MiFID II costs and charges disclosures review findings.

Consultation feedback on our proposed remedies

6.7 In our Interim Report, we asked whether firms were innovating to display costs and charging information in a way that helps consumers make informed investment decisions. We also asked whether additional cost and charges disclosure requirements were necessary.

6.8 Respondents' views were similar to those put forward on disclosing platform charges (see Chapter 3). Some argued that we should assess the impact of MiFID II before making further changes. Others argued that further disclosure remedies were unlikely to increase customer engagement and understanding. A few said any further regulatory change should not result in inconsistent disclosure across the industry, which could happen if we introduce platform-specific rules.

6 This was not a review of point of sale disclosure or a review of compliance with MiFID II requirements.

6.9 But some respondents were more positive about additional remedies. One respondent said firms are unlikely to make information about fund charges, and charges overall, more accessible to consumers for fear of looking more expensive than competitors.

Our final position

6.10 As set out in Chapter 3, we have taken into account recent regulatory change, positive steps taken by industry, and work taken forward by the UKPG to explore the feasibility of reporting fund (and other underlying asset) charges more explicitly in paper reports and online. Given all this, we are not taking forward further rules on disclosure of costs and charges at this time.

6.11 We expect industry to continue to make progress in helping consumers more easily compare the costs of different investment options. Firms may find our previous research including the FCA's Smarter Communications and Occasional Paper No. 32 relevant in designing any changes to the way they communicate. We will review progress in 2020/21 and will consider appropriate regulatory intervention if needed.

Promoting funds

6.12 Promoting funds is one way in which platforms compete to attract consumers to their platform. In our Interim Report, we looked at the ways in which platforms promoted funds to consumers to assess whether they can make informed choices.

Findings

6.13 Platforms are no longer remunerated by commission from fund managers. The main financial incentive to promote investment products now is the expectation that promotions will drive flows onto the platform, which will increase revenue from platform fees. Platforms that are vertically integrated also have an incentive to promote their in-house funds to consumers.

6.14 Such promotions could help consumers to choose between investments. But promotions could also cause consumer harm. For instance, platforms that have 'in-house' funds have an incentive to promote them over third-parties' alternatives. The incentive for platforms to increase the revenues they earn via in-house funds may be stronger than the incentive to increase revenues by promoting the best funds for their customers. Consumers could as a result end up being steered toward worse investment choices.[7]

6.15 Our 2017 Occasional Paper explored whether Best Buy lists, which shortlist funds the platform considers to be better than other funds in a certain investment category, add value for investors. Part of the analysis looked at the prevalence given to in-house funds on Best Buy lists and whether in-house funds perform as well as alternative funds on the platform.

6.16 We found that Best Buy lists appear to help investors pick well-performing funds. Best Buy list funds outperformed non-Best Buy list funds overall, but in-house funds

7 Another type of harm than can arise is if platforms that don't have in-house funds are at a disadvantage in such a way that competition would not work effectively. The implications of vertical integration as a barrier to entry and expansion are discussed in chapter 7.

included on Best Buy lists on average did not. Since conducting this analysis, the number of firms including in-house funds on their Best Buy lists has reduced.

6.17 We also reviewed whether firms made it clear to investors that their in-house funds were affiliated with the wider group, and found this to be the case. Respondents highlighted that vertically integrated firms face a strong incentive to promote their own products, but we did not receive evidence of fund promotions which could unduly influence investor choice.

Our final position

6.18 We recognise that vertical integration may create a material risk of conflict of interest. Under our rules, vertically integrated firms need to manage their conflicts of interest.

6.19 Best Buy lists have an impact on consumer choices who are likely to expect funds included to be 'best in class'. We expect Best Buy lists to be constructed on an impartial basis.

6.20 In addition, we believe that MiFID II and the work taken forward by UKPG will help to further reduce the risk of harm. Clearer information on costs and performance would make it easier for consumers to assess – for vertically integrated firms – whether an in-house fund that is being promoted is preferable to a third-party fund.

Providing model portfolios

6.21 In our Interim Report, we found that around 17% of non-advised consumers use platforms' model portfolios rather than selecting their own investments. There has been steady growth in the use of model portfolios[8], with in-house model portfolio investments increasing from £5bn in 2011 to £38bn in 2017.

6.22 Given their growth, we examined the role of model portfolios. Our two main areas of focus were whether consumers are able to choose products suitable for them and compare amongst those.

Findings

6.23 In the Interim Report, we found that similarly labelled model portfolios often have exposure to significantly different underlying assets and therefore experience different volatility in returns. We highlighted that there is potential harm if unhelpful naming conventions, and inconsistent disclosure, resulted in consumers making poor investment choices.

6.24 Respondents to our Interim Report agreed that there was an inconsistency and lack of industry-wide standards for risk-grading model portfolios. Different types of model portfolios have different disclosure requirements. Model portfolios can be structured as funds (which are 'unitised') or as discretionary services (which are 'non-unitised')

8 'Model portfolio' here is defined as risk-targeted, multi-asset portfolios that, for a given level of risk, retail customers may view as substitutable. This includes portfolios both structured as funds and non-unitised portfolios with off-the-shelf asset allocations (e.g. Centralised Investment Propositions). We acknowledge that the term 'model portfolio' can be used to refer to bespoke, personalised portfolios. As we do not consider bespoke portfolios as substitutable with off-the-shelf model portfolios, these were not evaluated.

which are subject to different disclosure regimes, and this, to some extent, explains difficulties making comparisons between them.

6.25 Respondents also told us that the inconsistent risk-grading affects the wider retail investment industry, rather than specifically affecting disclosure for investors in platforms' in-house model portfolios.

6.26 Several advisory firms suggested that consumers accessing model portfolios on an advised basis should benefit from their adviser helping them to compare and choose between different suitable investment options. For non-advised consumers receiving discretionary services the same suitability rules apply. These consumers, however, need to initially compare and choose between model portfolios.

6.27 So it is particularly important that non-advised consumers who purchase model portfolio discretionary services can access information to help them make informed choices. In 2018, our review of automated investment services found that many model portfolio discretionary services had inadequate disclosure and suitability processes. We have since followed up with supervisory action which resulted in firms improving these processes.

Consultation feedback on our proposed remedies

6.28 In the Interim Report, we asked for feedback on remedies which would require firms to use standardised terminology to describe their model portfolios strategy and asset allocation. We also suggested that model portfolios could face the same disclosure obligations regardless of structure, helping consumers to better understand risks and compare model portfolios.

6.29 We received responses from advisory firms, platforms and industry bodies, which included the following themes:

- Remedies should extend beyond platforms and aim to ensure consistent disclosure across the asset and wealth management industry more generally.
- 'Model portfolio' is a broad term which covers significantly different investment strategies. Some suggested that requiring model portfolios to use standardised language, which consumers rely on to form a view on the underlying risk of the investment, means they could be unaware of the diversity of strategies. One firm also suggested that, instead of standardised language, the focus should be on encouraging investors to evaluate model portfolios by reviewing the underlying investments, performance and other available information.
- The current implementation of our rules on clearer investor communications outlined in PS19/4, and the adoption of PRIIPs Key Investor Documents is expected to improve the quality and comparability of fund information. As such, the implementation of this should be reviewed before considering further remedies.
- Several advisory firms highlighted that while model portfolios structured as discretionary services do not have the same disclosure requirements as funds, they still face extensive regulatory requirements. They suggested that the costs associated with additional requirements for enhancing comparability could lead to discretionary service providers exiting the market.

Our final position

6.30 For model portfolios structured as funds work is currently underway to improve the disclosure and comparability of information. We will wait until our changes are fully adopted before taking forward any further remedies.

6.31 Though there has been substantial growth in the past five years, the amount invested in non-advised discretionary services remains only a small fraction of the model portfolio market. Given this, we think there is currently limited scope for harm, and additional requirements to enhance comparability between funds and discretionary services are currently not proportionate.

6.32 Our RDR/FAMR post-implementation review, due to begin later this year, will explore discretionary services further, including whether consumers can access the information they need to make informed choices between services. Our findings will support this review.

Investing in securities

6.33 Platforms account for a large share of the retail equity market. Two-fifths of total AUA on D2C platforms in 2017 was in directly owned equities, almost on a par with the AUA held in funds.

6.34 Platforms are required by our rules, as set out in COBS 11.2, to take steps to obtain the best possible results for their clients when executing trading orders. The execution factors to consider are price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of an order. This means that they should operate efficient trading processes, secure competitive prices on behalf of their investors and communicate their approach to investors.

Findings

6.35 Since publishing our Interim Report, we have conducted further analysis of Retail Service Provider (RSP) trading.[9] This work reinforces our initial view that investment platforms should do more to ensure that their trading systems are effective and suitably robust, and they should also provide more clarity to consumers on how their orders are handled.

6.36 Many platforms are reliant on the RSP system (and, in some cases, on a single RSP) to execute transactions. In the Interim Report we said that over 90% of listed security transactions were carried out through the RSP system, rather than through stock exchange order books.

6.37 As the price platforms achieve could be significantly affected by the way platforms arrange their trading systems and carry out dealing instructions, we have further assessed the execution quality delivered by platforms. We gathered further information on RSP trading and analysed how the prices being obtained by retail investors trading through RSP systems compare to the best prices available on the

9 When a consumer places an order through a platform connected to the RSP system, requests for quotes are typically sent to a number of RSP market makers either directly or more commonly via RSP hubs. The RSP market makers respond with a quote or reject the request. The RSP hubs collate the market makers' quotes and return them to the platform – either directly or through a third-party broker.

primary exchange (London Stock Exchange – (LSE)) and other trading venues at the time of execution.[10]

6.38 Our analysis showed that approximately 85% of the execution prices achieved by retail investors were at least as good as the prevailing best price available on the primary exchange (LSE). But when we also compare the RSP trading data with the best prices from all the available UK trading venues, rather than just the LSE, the percentage of orders that receive a price as at least as good as the best available price falls to 80%. Based on our sample analysis, we estimate that this could cost retail investors £195 million on an annualised basis. However, firms also need to consider the overall cost of trading including clearing and settlement.

6.39 Our review also found that the quality of execution varied considerably across the investment platforms in our review. In addition to price, the quality of execution delivered to clients is also affected by other factors, for example, the number of responses that quotes receive and time delays in the execution process.

6.40 Aside from achieving good prices, platforms also need to ensure that their systems allow consumers to trade in times of market distress. Market making firms are not obliged to supply quotes through the RSP system. So if platforms do not have contingent arrangements, consumers may not be able to trade in times of market distress. We believe that platforms need to set up their trading systems appropriately to consistently deliver high-quality executions, and this requires them to include other trading options outside of the RSP system.

6.41 Finally, we also commented in the Interim Report that, in our view, most platforms do not have robust best execution monitoring arrangements. Some rely on third parties to monitor best execution, but their effectiveness is sometimes undermined by the low proportion of trades reviewed or because the price variation tolerances were so wide that only the most significant execution anomalies would be identified. Again, we believe our further analysis strengthens our view on this, and underlines the importance of effective monitoring and oversight arrangements for trading activities.

Consultation feedback on our proposed remedies

6.42 Most firms commented that the rules on best execution are sufficient and said they already share enough detail about trade execution processes with clients. Some platforms highlighted that the FCA may need to further examine compliance with rules, provide additional guidance where necessary and make consumers aware of our rules.

6.43 The UKPG's members have each committed to review their trade execution policies and disclosure. We welcome and support this commitment and are reminding platforms of our requirements on best execution that apply to portfolio managers and firms who receive and transmit orders with other entities for execution. See COBS 11.2.A.

Our final position

6.44 The feedback we have received and our further assessment strengthens our recommendation in the Interim Report that platforms need to improve their order-handling procedures and conduct more comprehensive best execution evaluations.

10 The data set we reviewed consisted of around 2 million trades with a value traded of £40 billion over a two-month period.

This will in result in better outcomes for retail clients. This includes considering various execution methods as well as the RSP system.

6.45 Firms must take steps to obtain the best possible results for their clients when executing trading orders. We will review whether firms are improving this, and proceed with supervisory intervention as appropriate.

Holding large cash balances

6.46 In our Interim Report, we said that we found that large cash balances accrue on platforms, and significantly more so on D2C than adviser platforms (representing 8.8% and 3.9% of AUA respectively). We wanted to understand how consumers are holding cash on platforms and how engaged they are with their cash holdings.

6.47 If consumers are holding high proportions of cash on a platform for long periods of time this could be of concern. It could indicate that the cost of holding cash is not transparent to consumers, or could suggest that they are putting off investing due to inertia or other behavioural biases. Consumers could be losing out by either not earning interest or foregoing investment returns on cash.

Findings

6.48 To improve our understanding of consumers' cash holding behaviour on platforms, we requested further information on cash holdings from 10 platforms.

How and why consumers hold cash on platforms

6.49 We were primarily concerned about consumers who hold significant proportions of their assets in cash for prolonged periods, and who do so inadvertently. The information we had at Interim Report stage told us how much cash there is on platforms, and how much cash consumers are holding, as a proportion of AUA, on average.

6.50 We wanted to know more about how much of the cash is held in different types of wrappers and how long consumers hold cash.

6.51 Overall, our further analysis suggests that much of the potential harm arising from money being held in cash – in terms of foregone interest and investment returns – arises from cash held in pension wrappers. These account for a large proportion of the cash held on platforms and pension cash balances are significantly larger in absolute terms than non-pension accounts. We also found that only a small proportion of non-pension cash balances are in accounts that have not been actively traded. We have taken this to suggest that the majority of cash in non-pension accounts belongs to consumers who are engaged at least to some extent. We set out these findings in more detail below.

6.52 Our analysis showed that much of the cash on D2C platforms is in pension wrappers (43% of the cash held on platforms) followed by ISAs (35%) and GIAs (22%).[11] We also found that the average amount of cash held in pension accounts is much higher than in

11 Based on data from 7 of the 10 top D2C platforms as at end June 2018. Of the 43% in pension wrappers, 32% were in SIPPs 9% in drawdowns and 2% in GPPs. The ISA figures relate primarily to stocks and shares ISAs, because, as a proportion of cash held on platforms, a negligible amount relates to cash ISAs (0.1%).

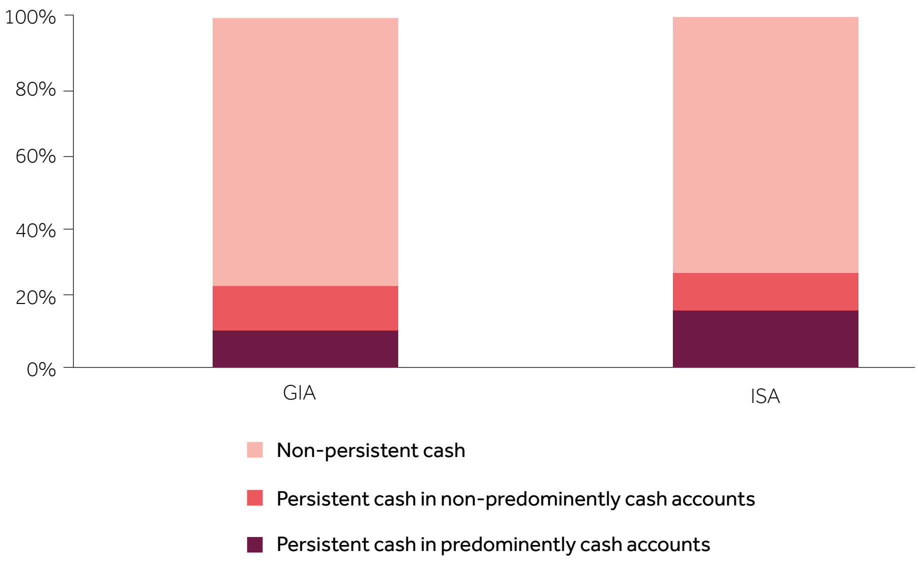
non-pension accounts (£31k and £17k in drawdowns and SIPPS respectively, compared to around £3.5k for GIAs and ISAs). Because cash held in pension wrappers is within scope of our Retirement Outcomes Review and our wider work on pensions, we focused our further analysis on the cash held in ISA and GIA accounts.

6.53 We looked at how many accounts have a significant proportion of cash, and how much of this cash was in accounts with limited trading activity (which could indicate consumers are holding cash for long periods of time). To do so we defined:

- Accounts as having a **significant proportion of cash** when more than 50% of the assets is in cash.[12]
- **Persistently held cash** as accounts that have either never actively traded[13] or have not been actively traded in over 2 years. This is because we assume that accounts that show no trading activity are unlikely to be reducing their cash balances.

6.54 We found that a relatively small proportion of cash is in accounts that both have a significant proportion of cash and persistently held cash: 11% and 17% of the cash in GIA and ISA accounts, respectively. We also found that only a small proportion of non-pension cash balances are in accounts that have never been actively traded, which suggests that the majority of accounts are held by consumers who are engaged at least to some extent.

Figure 6.1: Breakdown of cash in GIA and ISA accounts by persistency



6.55 Firms told us there are good reasons why consumers might want to hold cash on a platform outside their pension wrapper. For example, clients might want to hold their cash on a platform as the alternative low rates available elsewhere means there is limited additional interest to be gained from switching their money to alternative cash accounts. Alternatively, clients may want to invest at some point but are currently market timing, or are mitigating market volatility by drip feeding their investments.

12 Consistent with the approach taken in our retirement outcomes review analysis
13 We excluded "new money" i.e. accounts that have been funded in the last 3 months

Transparency of the costs of holding cash

6.56 There is a cost to firms of administering consumers' cash. Some firms told us that this administration cost is similar to that for other assets. To recoup these costs, D2C platforms typically retain some or all of the interest on cash, although some may instead, or in addition, apply the platform fee on cash (none of the 12 D2C firms in our sample applied a platform fee to cash balances). So, although some firms derive large proportions of revenue from retained interest on consumer cash, it is partially a substitute for the platform fee on cash applied by other firms.

6.57 Firms have expressed different views on the best charging basis for cash custody. Some firms told us that charging the same platform fee on cash as for non-cash assets makes charges easier to understand. Another said it is more tax efficient for the consumer if firms cover their costs through retaining interest. Some argued that paying high interest rates on cash would encourage consumers to hold high cash balances or that they charge a platform fee to discourage clients from holding cash for extended periods.

6.58 Given the differing views and approaches taken by firms on client cash, it is important that the charges for cash held and the interest rates paid are transparent to consumers. Consumers can then shop around and place pressure on platforms to pass through interest and keep charges competitive.

6.59 We therefore carried out more analysis on how interest rates on cash balances are communicated to investors. There can be good reasons why firms are unable to state in advance what annual interest will be paid on consumer cash.[14] Our research found, however, that most D2C platforms clearly state information on cash interest on their main costs and charges webpage and document.[15]

6.60 The UKPG is working to agree a common model for describing and disclosing the treatment of interest on client cash and for calculating its effective cost to clients. We expect these developments should help consumers who want to hold cash on platforms make informed decisions about how much this will cost on different platforms.

6.61 We have observed higher interest rates on cash being offered to consumers since we started examining the issue in 2017, either through improved rates on cash balances or through the introduction of savings based products. We are encouraged by these market trends.

Consultation feedback on our proposed remedies

6.62 In our Interim Report we asked if our disclosure requirements could more effectively warn consumers of the costs and charges associated with holding cash balances and if there were any better options.

6.63 Firm feedback on disclosure was mixed. Those arguing against additional disclosure remedies said that firms should be allowed to fully implement MiFID II and our Retirement Outcomes Review remedies before introducing further remedies. Some

14 For example, because client cash must be placed on short term deposit, platforms do not necessarily know in advance what annual interest rate they will receive. So, platforms who pay all interest to consumers will only be able to disclose this fact or an indicative figure ex-ante rather than the actual rate consumers will receive.

15 We also explored this across the broader market, including advised platforms and comparable firms as part of the further analysis of costs and charges as set out in chapter 3 and the finding still holds.

felt that existing requirements to disclose the total platform charge to customers[16] are sufficient and that adding more detail to disclosure documents could make it more complicated for clients to understand.

6.64 Respondents also commented on whether there should be further prompts for those consumers with persistently high levels of cash. Some were in favour of a requirement to prompt consumers, while others expressed concern that prompts could amount to investment advice. Several firms said that they have initiated consumer prompts, although some found them to be ineffective.

6.65 Other respondents supported a variety of further disclosure remedies. They suggested some options, such as statements to the effect that cash is an unsuitable long-term investment or a 'percentage held in cash' indicator on the account dashboard. Others suggested showing the average base rate over the statement period which consumers could compare against the interest rate they receive from their platform.

Our final position

6.66 We expect our proposed rules to reduce the harm arising from cash held in pension drawdown accounts. Our work on non-workplace pensions is also assessing whether competition is working well in the market for non-workplace pensions and whether or not there is a need to go further to protect consumers.

6.67 For non-pension holdings, the consumer journey is different and has less potential for harm than for pension holdings. Non-pension consumers typically make an initial choice to hold their money as cash and are less likely to accumulate persistently high cash balances. Our rules on unit class conversions (see chapter 4) should reduce the amount of cash consumers bring on to a platform when switching.

6.68 As set out in Chapter 3, we are pleased to see the UKPG working to agree a common model for describing and disclosing the treatment of interest on client cash and for calculating its effective cost to clients. We acknowledge that new disclosure rules have recently been implemented and we will review progress in 2020/21 and we will then consider appropriate regulatory intervention if needed.

6.69 All these factors, together with the results of our further analysis and the feedback we received, lead us to conclude that the potential for harm from persistent large cash holdings on platforms outside pensions products is not significant enough to warrant FCA intervention at this time.

Conclusions and next steps

6.70 We did not find evidence of harm arising from the way in which platforms promote funds, and so do not plan to take specific action in this area at this time.

6.71 Firms must take steps to obtain the best possible results for their clients when executing trading orders. We will review whether firms are improving in this, and proceed with supervisory intervention as appropriate.

16 COBS 6.1E.1 R

6.72 We are not proposing particular disclosure remedies for model portfolios, since work is currently underway to improve the disclosure and comparability of information. We will wait until our changes are fully adopted before taking forward any further remedies for model portfolios structured as funds. The advised part of the market will be examined in the RDR/FAMR review, due to begin in 2019. Our work will support this review.

6.73 On cash, our main area of concern is pension accounts and we expect that our proposed rules will reduce consumer harm. We will review progress made on the presentation of the interest paid on cash in 2020/21 and will then consider appropriate regulatory intervention if needed.

7 Entry, expansion and commercial relationships

Challenger firms are an important source of competitive pressure for established businesses, as well as bringing new ideas and innovation in the interests of consumers. In markets where challengers cannot enter or grow, established firms tend to be less responsive to customers, less efficient and less innovative.

We considered whether firms can challenge incumbent platforms by entering the market and expanding to compete for, and win, customers. In this chapter we summarise our findings.

Consumers benefit when platforms negotiate discounts on investment charges from fund managers, and platforms should be free to negotiate. So we also assessed whether platforms are free to compete by placing competitive pressure on fund managers. We found:

- On average, discounts are small – around 8bps – and the amount of AUA in discounted funds increased slightly between 2013 and 2017. Of the largest 100 funds in 2017, 33% have no discounts on any platforms, while the average discount is around 8bps and the largest is 38bps.
- Larger platforms and those which have influence over investor choices tend to be more successful in securing a greater number of, and larger, discounts.

This suggests that platforms are under some competitive pressure to negotiate with fund managers. This trend may grow as consumers access information about the total cost of investment under MiFID II.

But we found some commercial arrangements between platforms and fund managers where the fund manager commits, or is incentivised, not to offer lower fund charges on competing platforms. Such arrangements could have a negative impact on competition and constrain platforms' ability to negotiate.

Our work on barriers to entry and expansion in the market has not shown evidence of harm that would lead us to intervene on these specifically. Difficulties in customer acquisition appears to be the biggest barrier to expansion. Our switching remedies should help reduce barriers to customer acquisition and facilitate competition on its merits.

While we have not fully assessed the impact of commercial arrangements between platforms and fund managers, we remind firms of their obligations under Competition Law.

Introduction

7.1 This chapter presents our final findings on whether firms are able to enter the market and expand by competing for, and winning, customers. We cover:

- whether firms are free to enter, expand and compete by exerting pressure on fund managers to give discounts on fund charges
- our assessment of other barriers to firms entering or expanding

Fund discounts

Findings

7.2 In the Interim Report we set out our findings on whether platforms and similar firms are able and willing to compete by negotiating a competitive price on fund charges.

7.3 We found that some platforms secure discounts on fund charges, and this creates benefits for consumers. However, not all platforms negotiate fund discounts, and fund discounts are generally small (the average discount is around 8bps and the largest 38bps). Discounts are concentrated on the largest platforms, making it potentially harder for smaller platforms to compete, a point raised by a few respondents.

7.4 To some extent, this is to be expected. Fund managers would rather offer discounts to larger platforms capable of attracting larger flows to their funds. But we found evidence of commercial arrangements between platforms and fund managers where the fund manager commits not to offer lower fund charges on competing platforms – an example of 'most-favoured nation' clauses (MFNs).[17] These provisions could create an explicit constraint on the prices a fund manager can set for its own funds across different platforms. We also found schemes which appear to incentivise fund managers not to offer lower prices to other platforms as part of the broader commercial relationship.

7.5 These provisions and schemes (together referred to as MFN arrangements) could have a negative impact on competition in the following ways:

- If the funds in question cannot be offered at a lower price elsewhere, this may reduce other platforms' ability to negotiate a discount, because any discounts would need to be matched on the platform which has the MFN with the fund manager, increasing the cost to the fund manager of giving the discount. The overall effect would be that fund managers' incentives to discount their fund fees are reduced, to the detriment of investors.
- Linked to this, such arrangements could also make it more difficult for other platforms to enter the market or grow their market share, as they would be unable to use discounts on the funds in question to attract customers.
- If funds cannot be offered more cheaply on other platforms, this may allow the platform which has the MFN to increase its fee above that of its competitors. The more funds available at the lowest price and the more popular these funds are, the more likely it is that the platform can increase its platform fee, particularly if consumers fail to take into account the total cost of investing. With a simultaneous increase in the platform fee, consumers may not end up with a lower total cost of investing.

7.6 Only a small number of respondents commented on MFN arrangements. Those that did largely expressed a view that such arrangements are not widespread. We heard no specific evidence of firms being denied more favourable pricing terms due to MFN arrangements their competitors have with fund managers. A few respondents also said that these arrangements should be considered part of normal negotiation dynamics, and may lead to positive outcomes for consumers in the form of lower prices. They

17 In essence, Retail Most Favoured Nation (MFN) clauses limit the ability of the supplier of a product to offer better terms (such as lower prices) through another sales channel than those that have been agreed with the party requiring the MFN clause. Such clauses can be wide in scope, applying to sales through any other channel, or narrow, applying to sales through the supplier's own channels only

emphasised the importance of the specifics of such arrangements in evaluating their impact.

7.7 Some respondents also highlighted that the way in which discounts are usually made available – through the introduction of superclean unit classes – can make switching more complex. We explore these concerns in Chapter 4.

Feedback on remedies

7.8 We did not consult on remedies in this area in the Interim Report and firms did not provide any further feedback on potential remedies.

Our final position

7.9 We found some MFN arrangements in this sector, but few concerns were raised by fund managers and platforms during our market study and the arrangements do not appear to be widespread.

7.10 We have not determined the ultimate effect of these MFN arrangements. However, MFN provisions have been found in other contexts to have the potential to restrict competition.[18]

7.11 The impact of MFN arrangements will depend on the relevant legal and economic context. We note in general terms that in the case of investment platforms, they could, for example:

- raise barriers to entry or expansion for platforms and firms competing with platforms (if they are unable to obtain sufficient fund discounts to attract customers)
- soften competition between platforms and firms competing with platforms (if they reduce the incentive or ability for platforms to seek discounts)
- soften competition between fund managers (if they reduce pricing pressure)

7.12 So we are reminding firms of their obligations to self-assess their commercial arrangements for compliance with competition law.

7.13 We recognise negotiated fund discounts through superclean unit classes can create a barrier to switching, potentially making it difficult for firms to compete. As we set out in Chapter 4, we are therefore consulting on a rule which would require platforms to facilitate unit class conversations if requested by consumers.

Other barriers to entry and expansion

7.14 In the Interim Report we looked at whether there are other barriers that may prevent competitors from entering or expanding in the platforms market. The possible barriers we examined were economies of scale, technology, customer acquisition, the

18 See, for example, the Competition and Market Authority's market investigation into private motor insurance, its market study on digital comparison tools, and its investigation (not yet complete) under the Competition Act 1998 into most favoured nation clauses relating to a price comparison website for home insurance. In 2015, the Düsseldorf Higher Regional Court upheld a decision by the German Bundeskartellamt that HRS.com's MFNs relating to online hotel bookings restricted competition.

cost of complying with regulation and the vertical integration of platforms with fund managers. We set out our findings on each of these below.

Findings

7.15 In our Interim Report we found:

- **Economies of scale:** a weak negative relationship between average costs and scale, suggesting some economies of scale. There were, however, examples of small firms with low costs comparable to costs at large firms, suggesting scale may not be necessary to compete.
- **Technology cost as a barrier to entry and expansion:** no evidence that larger scale means significantly lower technology costs. New entrants, if they choose to outsource, can incur technology as a variable cost which facilitates entry. But costs do not necessarily fall as the firm expands which may weaken incentives to expand compared to firms with proprietary technology.
- **Customer acquisition:** consumers tend not to shop around and switch platforms and many rely on brand when choosing a platform, suggesting that customer acquisition is likely to be a barrier to entry and expansion. This was supported by our analysis of marketing costs, where we found that larger platforms tend to spend proportionally more on marketing, and thus much more than smaller platforms in absolute terms.
- **Regulation:** the costs of complying with regulation did not appear to fall disproportionately on smaller firms. Firm responses to our data request did not raise specific regulations as a barrier to entry or expansion.

7.16 Respondents did not raise concerns about potential barriers created by scale, technology costs or advertising expenditure, which supports our view that our interim findings hold. In relation to difficulties in customer acquisition we acknowledge, based on the comments we received, that the barriers to switching – which we outlined in Chapter 4 – could make it difficult for firms to win business from their competitors.

7.17 Most firms in this sector are vertically integrated (three quarters of our sample) with a fund manager. We explored the relationship between vertical integration and financial performance.

7.18 We found some differences between vertically integrated and stand-alone firms' financial performance, particularly related to costs. We found higher cost per AUA for vertically integrated firms compared to stand-alone firms. We also found that vertically integrated firms had broadly similar revenues to stand-alone platforms and that there was no identifiable pattern in revenue growth.[19] In terms of profitability, 1 in 5 stand-alone platforms had a negative operating margin in 2016 compared to 9 out of 15 vertically integrated firms. Overall, our financial analysis highlighted that it is possible to operate a stand-alone platform at a profit. Based on that evidence, we did not propose specific remedies.

7.19 Several respondents raised concerns about vertical integration between platforms and fund managers. Some of these concerns were related to potential conflicts of interest that vertical integration can create when promoting in-house funds. We set out our findings in relation to this in Chapter 6. Those concerned said that vertical integration could make it possible for firms to operate at a loss in the platform market as a means

19 Vertically integrated firms did not grow a higher rate than stand-alone firms (33% and 40% revenues CAGR 2013-16).

to attract business on higher-margin funds, which would create a barrier to entry or expansion for other firms.

7.20 While some respondents expressed concerns that vertical integration could create obstacles to effective competition, we did not find evidence that vertical integration might be creating barriers to entry and expansion, and heard no further concrete evidence of harm. We therefore have no grounds to think we need to propose remedies in this area.

Feedback on remedies

7.21 We did not consult on remedies in this area in the Interim Report and firms did not provide any further feedback on potential remedies.

Our final position

7.22 We also looked at whether firms with propositions that consumers value can challenge incumbent firms by entering the market and gaining market share. Of the areas explored – the impact of scale, technology, regulation, vertical integration and customer acquisition – we see customer acquisition as the biggest barrier to expansion. Our remedies to facilitate shopping around and switching should help reduce barriers to entry and expansion and make it easier for platforms to compete to win new customers. We do not see the need for any other remedies to reduce barriers to entry and expansion in the platforms sector.

Conclusions and next steps

7.23 For competition to work well, firms need to be able to enter the market and compete. We found that competition between firms has led some to secure discounts on fund charges from fund managers. While we found that the discounts are concentrated on the largest platforms, which may make it harder for smaller platforms to compete, we found no clear evidence of harm to consumers.

7.24 We have also found some MFN arrangements in this sector. Depending on the relevant legal and economic context, MFN arrangements have the potential to affect competition adversely. So we remind firms of their obligations to self-assess their commercial arrangements for compliance with competition law.

7.25 Our work on barriers to entry and expansion in the market has not shown evidence of harm that would lead us to intervene on these specifically. However, as discussed in Chapter 4, we support the industry initiative to improve the switching process for consumers (STAR) as well as the work being taken forward by the UKPG (Chapter 3). The remedies detailed in earlier chapters to improve the ease with which consumers can shop around and switch between platforms should make it easier for firms to compete.

Annex 1
Abbreviations used in this paper

AMC	Annual Management Charge
AMMS	Asset Management Market Study
API	Application Programming Interface
AUA	Assets Under Administration
bps	Basis points
CAGR	Compound Annual Growth Rate
COBS	Conduct of business sourcebook
CP	Consultation Paper
D2C	Direct to Consumer
DWP	Department for Work and Pensions
ESMA	European Securities and Markets Authority
FAMR	Financial Advice Market Review
FCA	Financial Conduct Authority
FG	Finalised Guidance
GIA	General Investment Account
ICVC	Investment Company with Varying Capital
ISA	Individual Savings Account
KID	Key Information Document
KIID	Key Investor Information Document
MFN	Most Favoured Nation
MiFID	Markets in Financial Instruments Directive
OCF	Ongoing Charges Figure

PRIIPs	Packaged Retail Insurance-based Investment Products
RDR	Retail Distribution Review
RSP	Retail Service Provider
SIPP	Self-Invested Personal Pension
TOR	Terms of Reference
TPR	The Pensions Regulator
TRIG	Transfers and Re-registration Industry Group
UCITs	Undertakings for Collective Investments in Transferable Securities
UKPG	UK Platform Group

We have developed this work in the context of the existing UK and EU regulatory framework. The Government has made clear that it will continue to implement and apply EU law until the UK has left the EU. We will keep the proposals under review to assess whether any amendments may be required in the event of changes in the UK regulatory framework in the future.

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Pub ref: 005889

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