

FSA's Discussion Paper 'Platforms: delivering the RDR and other issues for discussion'

Submission from The Association of Investment Companies

The AIC welcomes the opportunity to respond to the FSA's discussion paper on the role of platforms in relation to the 'Retail Distribution Review' (RDR). The AIC is the trade body representing some 344 closed-ended investment companies with £74 billion of assets under management.

The new independence standard for investment advice will broaden the range of products which advisers are required to consider. This should increase the focus on investment companies within the advisory community and lead to better representation of investment companies on platforms.

Appropriate regulation of platforms will help deliver the objectives of the RDR throughout the retail distribution chain. The FSA should introduce high standards and ensure they are consistently applied by all platform operators. A strong approach to enforcement will reinforce the message that product providers can no longer influence the provision of investment advice. This, in turn, should help build confidence in consumers and ultimately expand the demand for independence advice.

The new rules should allow commercial flexibility. The market is at a relatively early stage in its development and is likely to expand considerably. It is essential that the new regime can stand the test of time and deal with the different directions that the market may take.

The new regulatory platform regime should achieve the following key outcomes:

- advisers should give best advice to clients and their use of a platform should not influence the recommendations given;
- platforms should be funded by clients or advisers, not by product providers;
- platform operators should make clear disclosures about their services and costs;
- platform operators should be free to determine the nature of the services they offer (including whether or not to pass on information and voting rights);
- platform operators should not be allowed to impose unnecessary restrictions on the type or size of adviser charges that they accept;
- advisers should be able to compare different platforms offerings, and be able to demonstrate they have done so;
- there should be no restrictions on the number of platforms an adviser can use; and
- clients should be able to switch between platforms without incurring unnecessary costs or restrictions.

The AIC **recommends** that the FSA undertake periodic reviews of the platform market to understand how it is developing and to ensure that it does not advance in ways which are inconsistent with the RDR's objectives. This will indicate the extent to which the RDR is being implemented in the manner intended by the FSA. In particular, the review should consider the size and structure of the market to ensure that:

- there is sufficient competition so that the product range available allows advisers to demonstrate that they truly consider all related products; and
- loopholes do not enable product providers to inappropriately influence the quality of the advice given, for example by determining the composition of model portfolios.

Above all, the FSA should seek to ensure that commission bias is not replaced by platform bias. As the long path of reform to the remuneration of adviser charging demonstrates, once an inappropriate model of remuneration is embedded into a commercial system, it is difficult and time consuming to change this at a later date. However, the platform model is in an early stage of development and we would urge the FSA to take a robust approach to ensure that the new regime is structured for the benefit of consumers, and not inappropriately tilted towards the interests of product providers and advisers.

Detailed comments

Q1: Do you agree with our analysis of the issues related to platform remuneration?

The commercial model for platforms should not undermine the objectives of the RDR. Practices such as advertising on platforms and fees for enhancing the prominence with which products are displayed create the scope for product and provider bias and should not be allowed to continue after the implementation of the RDR.

Improved transparency should be a key objective of regulating platforms. Customers should be fully aware of the costs of using a platform and the precise nature of the services provided.

As discussed in question 2 below, the objectives of the RDR can best be achieved if platforms are not funded by product providers.

Q2: Do you agree with our preference to stop payments from product providers to platforms? If not, please explain why and how any alternative proposals would be consistent with the objectives of the RDR.

The AIC **agrees** that option C is the preferred route and that rules should be introduced to stop all payments from product providers to platforms. This removes the scope for conflicts of interest and is the most effective way of removing opportunities for product providers to influence the provision of

investment advice, for example through the choice of products available on platforms and the way in which they are displayed. It will prevent platforms from charging 'pay to play' fees and thereby open up distribution channels to more products. This is consistent with the requirement for independent advisers to consider a broader range of investments. However, higher service levels for advisers and consumers (with more products/product categories/services etc) could be charged at a premium.

Option C will ensure that platform charges are properly separated from product charges, thereby increasing transparency and enabling customers to have a clearer understanding of what they are paying for. Separate platform charges coupled with clearer descriptions of platform services will enable customers to make better comparisons between different platforms, increase competitiveness in the marketplace and potentially lead to lower costs.

Q3: Should any changes to platform remuneration also apply to non-advised business? Please explain your answer.

The AIC **recommends** that changes to platform remuneration should apply to non-advised business. Although the FSA has decided that advisers can continue to receive commission from product providers for non-advised business at this stage, the new standards applied to platforms should be comprehensive and apply to all business which is conducted through this medium. If different standards apply to different types of platform business, this could be confusing the clients and undermine the positive changes which are proposed for platform remuneration.

Q4: Do you agree with our analysis of what will be required to facilitate Adviser Charging through platforms?

The AIC **agrees** that, where platforms administer adviser charges, they should be required to offer flexibility in terms of the adviser charges which are administered. They should not be allowed to impose restrictions on the type or size of adviser charges that they administer so as to unduly influence or restrict the charging structure. For example, platforms should not be able to set a high minimum level (or potentially any restriction) on the amount of adviser fees that they will process through the cash account, as this may force an increase in adviser charges and create inappropriate incentives for advisers to use those platforms to the detriment of consumers.

The AIC also **agrees** that customers should have the ability to stop payments of ongoing fees from their cash account to an adviser.

The AIC does **not agree** that platforms should be required to obtain and validate client instructions. Where platforms receive instructions from advisers to process payments, they should be required to action them without further verification. If adviser instructions do not accurately reflect the payment charges agreed with the client, then there are already processes in place for dealing with such circumstances, for example if the adviser is making fraudulent transactions.

Adviser charges through platforms should be transparent. Customers should be fully aware of how much they are paying to use the cash account and how the cash account functions. We **agree** that it should be made clear whether cash account charges are explicitly deducted from the account or whether they are paid by retaining a proportion of the interest payable. We also **agree** that there should be clear disclosure of how fees will be paid if there is insufficient cash in the cash account.

The AIC **agrees** that platform operators should not be required to actively monitor the effect of adviser charges on products. The AIC raised concerns about imposing this requirement on product providers and was pleased to see that it was removed from the final rules.

Q5: Do you have any comments on the application to platforms of our intention to end product charge rebating?

The consultation paper identifies ongoing confusion as to whether product providers can continue to pass a proportion of product charges back to customers under the new RDR framework. Therefore, the AIC **agrees** that a new rule should be introduced to prevent product providers from deferring, discounting or rebating their product charges in such a way that they offset (or appear to) any adviser charges payable. Failure to do this will undermine the objectives of the RDR and prevent a clear distinction being achieved between product and adviser charges.

The FSA should consider whether transitional arrangements should be introduced to assist with the adoption of the new regime for existing business.

Q6: Do you agree with our analysis of the issues relating to inducements and our approach to inducements provided by platforms? If not, please explain why not.

Consumer interests would be undermined if platforms are able to operate as channels for commission or commission-like payments from product providers or to provide incentives that result in unnecessary switching of assets onto or between platforms. The threat of FSA enforcement action against breaches of its inducement rules will act as a deterrent against further violations. The FSA should draw the rules so that they can cover any potential new types of non-monetary benefits that may emerge.

The risk that conflicts of interest may arise should be reduced through improved transparency. The AIC **agrees** that the two areas for disclosure identified in the consultation paper, namely for platforms to provide a 'clear, fair and not misleading description' of their services and where an adviser firm holds shares in a platform operator, are sensible. The FSA should also consider how such disclosures are communicated to clients. For example, consumers will be more likely to appreciate that conflicts exist if the disclosures are set out in 'key features' documents rather than only displayed on a website.

Where a platform is owned or part owned by a product provider, the FSA should ensure that the inducement rules do not permit any form of incentive to be offered beyond direct financial benefits to advisers. For example, if platform charges are made on the basis of a percentage fee of funds under management, the rules should ensure that a lower rate is not offered for 'in house' products.

Q7: Do you agree with our analysis of the issues relating to platform use by adviser firms? If not, please explain why.

There should be no restrictions on adviser firms using single or multiple platforms. Advisers should not be obliged to use a platform facility at all. The FSA has set out clear rules for the provision of investment advice and it should be for adviser firms to decide the best way that they can execute their business within these rules.

COBS 6.1A.16 requires the adviser to take into account whether the advice given 'is likely to be of value to the retail client when the total charges the retail client is likely to be required to pay are taken into account'. Advisers should only direct their clients to a particular platform where the additional costs are justified by the additional benefits which are received. It follows that where an adviser firm uses a single platform, it should consider, for each personal recommendation, whether it is in the client's best interest for the transaction to take place on or off-platform. Furthermore, where an adviser firm uses multiple platforms, it should consider which of these platforms, if any, is most appropriate. Therefore, the rules already require advisers to consider the balance of platform cost versus service for each personal recommendation that is made. There is no need for regulation on the type or number of platforms that an adviser can use.

If there is any doubt that the use of platforms is not covered by COBS 6.1A.16, then the rule (and/or any associated guidance) should be altered to bring this service into the scope of the requirements of this rule.

Q8: Do you agree with our approach to the issue of re-registration?

The AIC **agrees** that it should be compulsory for platforms to allow assets to be re-registered off their platform. The AIC also **agrees** that the appropriate deadline for this is before the implementation of the RDR at the end of 2012.

The AIC **recommends** that the FSA adopts rules or guidelines setting out the minimum standards platforms must apply in relation to a request to transfer assets to/from a platform. It might usefully consider the approach taken in the banking sector. For example, BCOBS 5.1.5 states that "*A firm must provide a prompt and efficient service to enable a banking customer to move to a retail banking service (including a payment service) provided by another firm*".

If advisers offer their clients access to multiple platforms (see question 7), this may facilitate the process of enabling clients to change platforms to achieve a

better balance of cost and service to suit their needs. Unnecessary restrictions on re-registration should not be allowed to hinder this process.

Q9: What is your view of our assessment of the capital adequacy of platforms based on their categorisation as LLIFs?

The AIC has no comment to make on this issue.

Q10: What is your view of the services currently offered by platform operators to provide investors with information about their investments? Do investors receive enough information and do they receive it in good time?

Although the consultation paper primarily considers the provision of information and voting rights after the point of sale in relation to authorised funds provided on platforms, the following points apply equally to many other types of investments which are currently, or may in the future be, accessible through a platform. Investors in investment companies have a number of rights regarding receipt of information and voting on company issues.

Investors who want to exercise their information and voting rights should be able to do so irrespective of the manner in which they choose to acquire and hold their investments. However, this may not be a priority for all investors. For this reason, the AIC **recommends** that the FSA should continue to allow platform operators to offer a range of different options to the market in relation to the provision of post-sale information and voting entitlements in order to meet the differing needs of investors. Investors who want to play an active role with their portfolio can choose a platform operator which supplies the required information and offers a facility to exercise voting rights. Investors who have no interest in these services should not be obliged to use a platform which offers them routinely, potentially paying a higher price for services they do not want to use (this assumes that, going forward, platforms are funded by their clients as recommended by the AIC, see question 2). The AIC therefore **recommends** that no regulatory obligation is imposed on platform operators to pass on post-sale information or voting entitlements to clients.

The critical issue is whether platform operators provide sufficient disclosures about the services they offer, and their associated costs, so that advisers can recommend to their clients the platform which offers the best overall package which meets their investment needs. There is scope for improved transparency by platform operators in this area. Where these disclosures are given, they sometimes lack detail, are written in legalistic terms and difficult to locate. For example, they may form one element of pages and pages of detailed terms and conditions.

The AIC **recommends** that rules are introduced which require platform operators to disclose whether or not they offer the facility for clients to exercise their voting rights or to receive performance information from product providers. Where these services are available, the disclosures should be

made with sufficient clarity to enable the client to understand the precise nature of their rights.

Increased transparency would help advisers meet their obligations under COBS 6.1A.16. As discussed under question 7 above, this obligation requires advisers to consider whether additional platform charges are justified by the additional benefits which are obtained. Improved disclosure by platform operators of the facilities they offer, and the costs for obtaining these facilities, will assist advisers in considering how the balance between cost and service meets individual client requirements and will help to provide a better overall outcome for clients.

Increased transparency may also help to enfranchise shareholders who otherwise might choose platforms which do not facilitate the take up of their voting rights.

Q11: Do you agree that where platforms do not host funds with non-standard features or tax regimes, this could lead to poor outcomes for consumers? Please give reasons for your answer.

Platforms should host the widest range of investment products as possible. It is difficult to define 'non-standard' features. It is not clear that 'standard' products have necessarily benefited consumers in the past. If platforms avoid funds with non-standard features or tax regimes, this could have a detrimental effect on the quality of investment advice given to consumers. It is for advisers to make suitable investment recommendations taking into account the particular circumstances of individual clients. It is not for the platforms to determine which products may or may not be suitable, nor to assess the appropriateness of particular tax regimes or other product features.

Investment companies may be seen by platforms as being 'specialist' products but they can still meet the needs of retail investors. Their exclusion from platforms would mean that many advisers fail to give them due consideration and that clients may miss out on viable investment propositions. This is particularly a concern as platforms are expected to become an increasingly important channel for product distribution. The more flexible that platforms can be in the range of products they host, the greater the choice, and hence the better the quality of the investment advice received by clients.

The regime should encourage the widest range of products to be available on platforms – whether they are standard or not.

Q12: To what extent should platforms be required to give product providers information about the end investors?

Platforms should not be required to give product providers information about the end investors. In fact, platforms should be prevented from passing information on to providers unless they have the express permission of the consumer.

Q13: Are there any other issues that we should consider? Please provide details and, where relevant, suggestions on how these issues could be addressed.

The AIC has no comment to make on this issue.

Q14: What compliance costs do platforms expect to incur if the proposals discussed in this DP are implemented?

The AIC has no comment to make on this issue.

Q15: What costs, other than compliance costs could arise from the implementation of the proposals discussed in this DP? Please provide broad estimates of their magnitude.

The AIC has no comment to make on this issue.

Q16: What benefits could arise from the implementation of the proposals discussed in this DP? If possible, please provide broad estimates of their magnitude.

All relevant benefits have been identified in the consultation paper.

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For more information on the issues raised by this paper please contact:

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