

## “An Idiot’s Guide” to the FSA Paper – Platforms PS 11/9

We have attempted to bring you a quick summary of the key issues arising from yesterday’s policy statement from the FSA.

So –let’s jump into our Idiot’s Guide, written so that even I understand it. Of course we also have some comments from some clever people and we’re grateful to platforms AJ Bell, Fidelity, Nucleus, Standard Life, Skandia and Transact for their additions. Clever comments in blue italics.

### Entrees

I guess the headline is that for a policy statement, there are not that many concrete answers and a paucity of detail. The ‘biggies’ ie banning both payments by providers to platforms and cash rebates to clients have been confirmed as desired outcomes...with no timeframes or detail. Still, we now have an endgame – and a welcome acknowledgement that 31 Dec 2012 is not a realistic timetable for delivery of these points.

Some amuses-bouches from some not always amused platforms:

*“While I am sure everyone would have welcomed greater clarity around the likely ban on all rebates to platform providers and on cash rebates to clients it seems like the direction of travel is now well established at Canary Wharf, ie the use of rebates to influence client outcomes is considered inappropriate, whether that influence is exercised at a platform or an adviser level. Today’s paper could certainly have gone further but as presented it is **a triumph for transparency** and for that alone, we welcome it.”* David Ferguson, CEO, Nucleus

*“The detail of the latest policy statement will be debated at length over the coming weeks but at first glance it appears that an already lengthy process has just got longer and this is **not great news** for customers, financial advisers or platform operators.”* Peter Mann, CEO, Skandia

*“Whilst my initial emotion when reading PS11/9 was one of **despair**, I remain hopeful that common sense will prevail, allowing both cash rebates and provider payments to platforms to continue, albeit with greater transparency. We will know very quickly who is right and who is wrong once the RDR comes into effect. Until then...“procrastination isn’t the problem, it’s the solution. So Mr FSA, procrastinate now, don’t put it off.”* [Ellen DeGeneres, US comedienne].” Andy Bell, CEO, AJ Bell

*“We welcome confirmation that an adviser can operate on a single platform for the majority of investment business, and the change to voting rights. However we are **disappointed** that the debate on payments to platforms and cash rebates has not been resolved.”* Ronnie Taylor, Retail Managing Director, Standard Life

*“The FSA have wholeheartedly failed to conclude this already drawn out consultation process. ...The challenge for all platforms will be that we now see the emergence of RDR II which will seek to ban cash rebates, will again look at all platform remuneration models and potentially broadens its scope. This is without resolving the issues on legacy which will now start in September. This is only just the*

*start of what will be an **ever amounting set of demands placed on platform operators**, which will make the market even more demanding.” Ed Dymott, Head of Commercial, Fidelity International*

*“Obviously, much of the limelight and attention will be focused upon the headline grabbing abolition of supermarket payments and deferral of the ban on cash rebates – neither of which gives us any comfort. On a purely practical level, it’s obviously **not at all helpful for the industry to have some of the key operating issues simply deferred**. We are keeping our fingers crossed and hoping that more time for argument will mean more chance of the right conclusions.” Ian Taylor, CEO, Transact.*

The most satisfied readers of this document – in terms of getting clear, reliable pointers as to where the ‘speed cameras’ are - should be advisers. Annex 3 answers all of the ‘old chestnut’ questions with useful illustrations of good and poor practice. If you read just one thing this week, advisers, I’d read this Annex.

## The Main Course

So let’s tuck into the main event and take a look at the headlines. Bon appétit.

- **Payments by product providers to platforms will be banned – just not sure when.**

This is basically all about bundled pricing – and the FSA are saying that they think allowing supermarkets to take payment from fund managers by way of rebate isn’t actually a great idea. So – in future, the old supermarket model is dead and buried. Platforms will have to charge a fee. When? Don’t know. Not before Dec 31st 2012.....

I suspect one cannot underestimate the impact the Consumer Panel report had here. This is a complete U-turn for the FSA. The next stage here will actually be a formal Consultation process – there has been one around the cash rebate issue but not on this. The research, the process, the feedback period all takes time.

This is why the cash rebate issue has been delayed. I don’t hear any signs of an about-turn here, and I hear that the regulator feels these two points are so aligned they need to be considered jointly. This feels right.

The industry reaction seems to be a slightly jaded acceptance of this point along with a disappointment that there is still no clarity around the detail or timeframes.

Not all accept the proposed abolition of bundled pricing. Andy Bell remains a firm advocate for bundled pricing and his views follow in an explosion of analogies! Keep up at the back!

*“To hijack and distort one of Winston Churchill’s famous quotes, “...the FSA can always be relied to do the right thing, once all other avenues have been exhausted.” Whilst “indecision may or may not be the FSA’s problem” [Jimmy Buffet singer and writer], in fairness to the FSA they are adopting the stance of the ancient Greek poet Phocylides, that is “giving no decision till both sides thou’st heard” and not just once!. **I fear a further consultation on cash rebates and provider payments to platforms is likely to create nothing more than a regurgitation of old arguments with little***

*common ground to be found between the Roundheads and the Cavaliers* . I sense that the agenda on both of these issues, which has undoubtedly influenced FSA thinking, has been driven more by competitive posturing than by any desire to achieve the stated outcomes of the RDR. Maybe the time has come to declare a ceasefire, put down the muskets and have a single representative body for platforms that can engage with regulators as a single voice?

Whilst a further period of reflection and contemplation on these two thorny issues is the right decision, my recommendation is that the FSA announces that they will not make any decision until they have allowed the RDR to bed in. **A period of two years post RDR, during which time the FSA could monitor the use of platforms, would maximise the probability that the correct decision is made, or even more importantly minimise the probability that the wrong one is made.**"

On a different note, Nucleus CEO David Ferguson is more welcoming of the move.

*"My initial reaction is that the FSA has drifted back towards the sentiment of March 2010's transparency-obsessed DP10/2 and that today signals the death of the 'platforms as distributor' model promoted by the fund supermarkets. **Where last November's CP10/29 backtracked, today's statement that the "proposed rule COBS 6.1E.1R requires the platform service provider to clearly disclose the fee/commission it arranges to accept from third parties such as fund managers"** sharply favours unbundled, transparent pricing.*

*In a post-RDR world where the adviser is indisputably being paid by the client for advice (rather than by a provider for distribution), the delivery of the client outcome must be owned by the adviser. Where advisers were once in the provider distribution chain, providers now find themselves in the adviser supply chain, a very different place in which the adviser is obliged to assemble the components of the client proposition in a manner consistent with the objectives, ethics and values of the IFA firm. It is now impossible to see how a platform that considers itself a distributor (and is therefore infused with potential bias) can sensibly form part of that supply chain as any changes to that platform's commercial arrangements may disturb the client outcome."*

- **Execution-only platforms will also have to disclose fees or commission from a third-party.....but they'll still be able to get them (for now)**

*"XO platforms must abide by the rules surrounding disclosure to clients of any fees or commission received from third parties."*

Part of the future work on the whole rebate issue will look at XO platforms – and it's not a given that they will be able to continue to take cash rebates but for now they can; the FSA have just been clear on the level of disclosure that is expected.

If I were a William Hill kind of person (I'm not but I did do a very good boxed trifecta once at the Melbourne Cup!), I would put money on the FSA including XO platforms in the broader ban of payments by product providers to platforms in the future as they conduct more research in this area, but that is idle musing .....however look at the footnote on p.22 which should make XO operators re-assess their revenue models.

This is one area where it feels as though some green-eyed, greedy monsters have been 'squealing' to teacher. Hargreaves-envy feels very evident here and competitive posturing has set an agenda which feels more and more inevitable with every publication.

We would support better disclosure but feel that the non-advised platform market (and probably bank and restricted advice platforms of the future) suit a bundled pricing model.

- **Some ISA plan managers are defined as a platform – as are some execution-only brokers.**

We have written before in our D2C research about how some more traditional stockbroker models have been quietly re-inventing themselves as platforms, with the addition of mutual funds and tax wrapper capability.

*“ISA managers are included as they are providing a service of funds from more than one product provider. This means that for ISA managers falling into this category will mean they must present products without bias and must disclose to clients any fees or commission it accepts from any third party.”* This is a relevant thought for fund managers with a direct book, trying to work out how they play in this newly reinvigorated non-advised market. More fund manager platforms?? Hmmmm.....

- **The FSA likes the idea of adviser charges being facilitated by a platform.**

*“We consider that the payment of adviser charges from a cash account on platform is potentially a good way of increasing transparency of adviser charges for a client.”*

Additionally it confirms that *“an ongoing adviser charge can only be paid if the client is receiving an ongoing service or from a regular payment product”*.

This does raise a very thorny question for the platforms.....what is their responsibility if a client contacts them directly to say they no longer wish to pay their adviser? They will need to stop these payments – those are the client instructions, but where do they then house or move them? Post 2012, as the amended charging structures are rolled out, it is likely there will be a not insignificant number of such calls. The whole orphan client question is an awkward, grey area which will spike in 2013. Yuck.

- **Advisers – don't just look at one platform over another, but also look off-platform**

On reading the paper, the biggest emphasis for advisers seemed to be on off-platform assets. The usually quietly spoken FSA was practically shouting this off the page. Think about off-platform stuff too, Mr IFA!!

*“Advisers should understand the importance and use of platforms and take responsibility for that advice on an individual basis and that that platform is suitable. It must be demonstrated why using a*

*particular platform, the due diligence of one platform over another and whether off platform is more suitable”.*

We think the winners here are those life companies which have a platform – but have also announced they are building a common web portal for advisers to access off-platform products as well as the wrap. Aviva and Standard Life spring to mind.

- **Single platform use is OK if justifiable– but it clearly makes the FSA a little uncomfortable AND IFAs will need to use a platform which includes non-rebate stuff too**

The FSA get that using one platform makes commercial sense for an adviser. They do understand these benefits. They also understand it is about more than just cost. The paper highlights one of the key benefits of a platform is the aggregated view of client holdings, and states the more platforms an adviser firm uses the more this is diluted.

However, a firm with a wide range of clients should not choose one platform service provider but it is the responsibility of the adviser firm to judge, which and how many platforms it needs to service its clients.....each *“personal recommendation to invest via platform must be suitable.”*

Nucleus boss Ferguson comments *“On independence and platforms, it has always seemed unimaginable that a single platform can ever meet the requirements of all clients, a point the regulator has helpfully clarified in today’s paper (most notably in Annex 3). What has become clearer today is that this is even less imaginable for bundled platforms: “an independent firm faces significant challenges in complying with COBS 6.2A.4AR and COBS 6.2A.4BG if they exclusively or extensively use a platform that only features products which pay the platform a rebate”. More positively, those wrap providers operating on a truly open basis, beyond the influence of kickbacks from fund managers will particularly welcome the news that the FSA is not seeking an outcome in which advisers create an artificial spread of investments to meet the independence rule. Indeed the regulator points out the potential inefficiency for IFA firms in using more than one platform. It looks like pragmatism reigns and independent firms will be able to use a single platform provided the requirements of individual clients have been appropriately considered. This can only be very good news for advisers seeking to run efficient practices.”*

Although we agree with David’s views here, it’s very hard to get any comment which is not influenced by the author’s business model. We observe that – in practice – most advisers do use more than one platform. Having a preferred platform and other options for clients described by the FSA as ‘outliers’ has always felt like a sensible solution to us.

All issues about single platform usage typically stem from restricted products (tax wrappers) and costs – so really what the FSA seem to be saying is that advisers should use specific product providers (stand-alone) for more esoteric stuff OR for small, straightforward clients; use a cheaper platform with no fixed fees/minimums for smaller clients with a range of funds and wrappers and then whatever feels best and most competitive for more complex clients. Off-platform; a

supermarket and a 'posh' platform?? Now some providers will argue they can tick all three boxes and if they can, then that's great.

We also note again that although cost is a factor, it is certainly not the only consideration. Stability, service, access to investments, timely execution...the list goes on.

A bit of a shot in the guts for the supermarkets as the FSA clearly state that it thinks a firm *"faces significant challenges in complying with [Conduct of Business Rules] if they exclusively or extensively use a platform that only features products which pay the platform a rebate."* This won't be news for the big guys and practically speaking, by the end of 2012, we think this clause will have been made redundant as business models are adapted accordingly.

This is picked up in a comment from Ed Dymott, Head of Commercial, Fidelity, *"We welcome the introduction of improved transparency and disclosure, and are more than comfortable with the requirements for 2013 which actually will simplify the implementation - especially with unbundled pricing and ETFs amongst other things to come."*

Good news for Vanguard, ETF providers and IT providers. It's now certainly If, not When.

- **Cash rebates from product providers to clients will be banned**

Cash rebates announcements will be made when the payments by providers to platforms analysis has been completed and the rule changes will not come into force until after 31<sup>st</sup> December 2012.

Put simply, the FSA were worried about advisers 'pegging' remuneration to these rebates. *"We felt it was telling that some firms argued that a cash rebate was necessary to fund the adviser charge, as this is precisely the sort of behaviour we would be concerned about."*

I think that the FSA don't really believe that simple disclosure works – the platforms haven't been great at this before and platforms were a sub-section of the industry that spawned amongst claims that the services provided were 'free' or carried 'no charge'. My sense is that the FSA have felt great frustration at how platforms across the board have typically made charging structures difficult to understand.

It also feels like there's a real mission here to get the public headline rates of fund management charges down. Whether net fund management costs will actually come down remains to be seen.

We're grateful to Tim Boyce, Partner of solicitor firm Osborne Clarke, for his legal view. No-one at WHSmiths knew what we were on about.

*"The FSA's decision to ban cash rebates to consumers will not come as a huge shock to platforms or advisers. **Where there is a disparity in cash rebates for different products, there will always be a potential for product bias, which is anathema to the aims of the RDR.** The FSA has therefore taken the chance to intervene in the platform industry while the market is still relatively immature.*

*Platform providers will now be looking at the alternatives to cash rebates, such as additional units or share classes. This will undoubtedly lead to some short term inconvenience and uncertainty, while*

*the FSA firms up its thinking. However, platforms have been prepared for this and we expect their growth in the market to be largely unaffected.*

*Similarly, despite protestations most, if not all, fund supermarkets will be ready for the changes to charging structures. Some, including Skandia, Fidelity and Cofunds, developed their unbundled offering when the FSA first raised this as a possibility in November 2010. There will of course be considerable cost implications for platforms in adapting to the FSA's change in position. However, fund supermarkets will remain competitive; particularly those that use this as an opportunity to extend their offering by including ETFs and other products traditionally the preserve of wraps."*

Skandia's Peter Mann sounds a note of quiet disappointment about timeframes but has been a lone voice in supporting unit rebates for some time now:

*"The confirmation from the FSA that it remains desirable to ban cash rebates is welcome but it is disappointing that firm rules have not been confirmed. Whilst we are ready to implement either cash or unit rebates **I believe that unit rebates are the best option for customers.** Investors use platforms to invest in funds, not cash, so it follows that a discount that is negotiated by their platform operator should be credited back into the fund rather than the cash account."*

*I agree with the FSA that the decision will have a significant impact on the business models of platform service providers and so it is right to give it careful consideration. However, **a significant delay is not welcome and it appears that the timetables for the Retail Distribution Review and platform consultation have been de-coupled** which I am not sure is in the best interests of customers."*

Transact CEO Ian Taylor rightly observes the lack of any detail to support these decisions.

*"... our chief concern with PS11/9 is much more to do with what it does NOT say. **At a very fundamental level, the paper, and the process that has surrounded its production, shies away from practical, factual, detail.** This is a significant problem because it's the detail that makes the world go round. How, for example, can a paper like this not mention capital gains tax on unit rebates?"*

*Agreeing the big picture is all well and good, but paying no attention to the detail is not. Ignoring what you have been told about the detail is worse. **At times, it seems that the recipe for PS11/9 was to take some agreeable principles, add a large helping of regulatory opinion and bumper-sticker sloganeering and then garnish with just a pinch of facts.** As we have said all along, a critical step in the process has to be the separation of facts from opinions. Not making this distinction is the failure of this process and the failure of this paper."*

- **TISA has widespread support in setting service level standards for the re-registration SLAs and to automate the process.**

The FSA will not be setting the rules until post-implementation review work has been carried out. If that suggests that fund managers or others are causing unnecessary delays they will consider additional rules at that stage.

The FSA do not believe that banning cash rebates will lead to a proliferation of share classes. In simple English, bigger platforms today get a bigger cash rebate than the tiddlers. If the FSA stop this

party, then the bigger platforms (it is argued) will fight for their competitive advantage and get a cheaper share class than the small guys. This then has a knock-on effect on re-reg from Platform Big to Platform Small, for example, as different share classes could be involved.

I think the FSA are understating how various players will fight for a competitive advantage (for their benefit, not necessarily the client's) – their view that a platform can still allocate extra units to the client is a purposefully naïve Sister Mary view of a more Mae West world ie the competitive advantage is usually pocketed by the platforms, not paid on to the client.

We ain't seen the end of this one yet as fund managers digest this paper and platforms re-assess their charging models.

- **The FSA have backed away from paper mountains and approved emails as a means of sending investors fund reports and changes**

This feels really sensible. The FSA are quite sanctimonious in using the term 'junk mail' in horror, but show me one investor other than Warren Buffet who doesn't chuck this stuff straight in the bin. Cavalier attitude.....or the truth?

However, they did stop short of allowing investors to opt-out of this which is a shame.

A spokesperson for Standard Life commented, "We are in favour of allowing and encouraging underlying investors to exercise their voting rights. **We believe that giving customers the opportunity to opt-out of receiving this information would have been a more sensible approach, this would have met both the needs of the customer whilst minimising the additional cost.**"

What has actually been decreed is that this information can be provided electronically and "We have amended our proposals to allow notification on a quarterly basis of short-form fund reports published in that period."

Feels like a good compromise.

## **(Just?) Dessert(s)**

So – there you have it.

At the stage where so much of the thinking is done (at least around the destination, if not the journey) then to dwell on the destination feels futile. Bundled is out; and cash rebates are out. This will probably make for a clearer and better platform world in 10 years' time but there will be lots of mess and detail to wade through before we get there, and an estimated ongoing annual cost of nearly £50m to the platforms. Phew.

Philosophically we question the approach of trying to impose a 'perfect' solution on an old market with awkward mechanisms and horrible legacy issues. The LSE have published a lot of work on how imperfect markets actually create good outcomes for customers which is a very different view of the world.

Andy Bell touches on the issue of competition: *“As we are only talking about adviser platforms (and not execution only platforms), I genuinely believe that **the responsibilities placed on advisers by the RDR and the market forces at work in what is now a very competitive platform market will obviate the need for regulatory intervention on these transparency and pricing issues.** Platforms will very quickly adapt to provide what advisers require to remain compliant. Most advisers I speak to fully understand the different business models within the platform market and are well capable of understanding and explaining the impact of provider payments to platforms to their customers in the context of the absence of an explicit platform charge. Any notion that cash rebates will be used to disguise adviser remuneration remains fundamentally flawed. If ultimately the way platforms continue to operate post RDR compromises the RDR principles in any way, shape or form then the FSA can act swiftly and the platform industry cannot say it wasn’t warned.”*

More broadly, we worry that the platform regulatory landscape has been set as these beasts are still at such an early stage of development. Some 80% of adviser platform assets reside in a bundled home today. Platforms representing the other 20% have fought against this model, aided by the view of the Consumer Panel. But as the direct to consumer platform market expands, the employee platform market swells under auto-enrolment and banks and restricted advice models come into play, we believe that bundled pricing would in fact be the best solution for these channels which could eventually represent 95%+ of consumer assets on platform.

On the issue of platform definition, the exclusion of those services which are “ancillary to the activity of managing investments for the retail client” would read very strangely to observers from other platform markets, such as Australia or the States. After all – what are these platform things all about!?! This reflects the ongoing obsession with tax wrapped products in our market and also suggests a lack of a competitive threat felt by fund managers and platforms today when it comes to the plans of discretionary managers. Were they more concerned, they would have fought this definition more. We think this is probably complacent. Ultimately groups such as Charles Stanley and Close Brothers could be very competitive and will inevitably deliver investment outcomes on platform. This gives then some wriggle room.

In summary – we’re kind of getting there but it feels quite painful, it’s taking forever and were bundled pricing and cash rebates really that bad? We’d have gone down the disclosure road ourselves. Still – moves towards transparency and greater investment choice are good outcomes.

Ho Hum, rather than Boo Hiss would be our view on this Policy Statement which – on reflection – doesn’t feel like it has really moved anyone on at all. We just wonder if competitive forces and the need for platforms to make development decisions will actually mean that by the time firm rules are decided and published, they will be largely redundant after all?

Holly Mackay

MD, The Platform

2 August 2011

The views presented here are personal opinions only and should not be relied upon for any decisions without further discussion. IFAs who want to discuss platform adoption, selection and ongoing use should contact Emma Napier at [emma@theplatform.com](mailto:emma@theplatform.com) Platforms, providers and fund managers should contact Freddie Findlater at [freddie@theplatform.com](mailto:freddie@theplatform.com) Office number (0207) 449 9080.