

CP 10/29 - LONG OVERDUE – BUT BEWARE THE HEADLINES... ‘THE DEVIL IS IN THE DETAIL’!

The FSA has finally published its Consultation Paper CP 10/29. The paper was originally expected in June/July and follows the Discussion Paper (DP 10/2) issued in March this year.

So, why the long delay and was it worth the wait? Well, as we have said before – and the FSA says in the Consultation Paper – there are potentially ‘complex issues’ and competing ‘differences of opinion’ to consider and to balance how best to achieve ‘good outcomes for consumers’ whilst also trying to provide an environment that allows the right Platform services to be developed.

There were 80 responses to DP10/2 and we believe that there was a significant amount of informal lobbying too. With the delay in producing this Consultation Paper, the deadline for responses is 17th February 2011.

The headlines are already in the Papers –

- ***“FSA U-Turn on Bundled Charges”***
- ***“FSA says advisers can use single platform to service clients”***
- ***“Platform reforms will cost £127m”***

The headlines are not wrong, but as with all these things, the devil is in the detail. Having looked through the paper, which is relatively short by FSA standards, we would summarise the following points:

Defining a Platform

The FSA has proposed a formal ‘Handbook’ definition for **Platform Service** and for **Platform Service Provider** (this can be seen in Annex A of the FSA paper).

In essence the FSA believes that Platforms provide:

- Administration Services
- A customer view of Consolidated investments
- A venue to invest
- A source of custody for some or all investments
- Fund Manager admin’ services (a point that is used to justify payments to Platforms)

The FSA has excluded Wealth/Private Client advisers that offer custody and certain reporting services from the definition where they do not have a Platform Charge and are remunerated **solely** by Adviser Charges. Wealth managers that do ‘use’ Platforms are subject to Platform rules. We believe that there may be some issues that require further clarification and that ‘interpretation’ of what this means is not unfairly exploited.

Adviser Remuneration:

As expected, Platforms can facilitate the collection of adviser charges but it must be done to the same standards as Product Providers - in line with the RDR rules set out in PS10/06. So, as expected, a Platform would need to obtain and validate instructions from a customer to pay an adviser. However, as previously suggested, there will be no formal obligation on the Platform to carry out 'decency tests'. The FSA would expect the adviser to take into account any potentially adverse implications of the payment method – such as cancelling units (that may incur CGT) – when remuneration is to be obtained.

Independence and the use of Platforms

The FSA has acknowledged that subject to the availability of 'vanilla' tax wrappers (which may not be as benign as they claim), appropriate qualification of segmentation suitability, along with due diligence on Platform selection and ensuring that there is no bias on meeting clients' needs, it MAY be possible to use a 'single Platform' for the majority of clients.

The devil of the acknowledgement by the FSA is in the detail and readers of the headlines should not ignore what this could really mean in practice.

Annex 5 of the Paper (not covered here in full) gives views and examples of what constitutes 'good' and 'bad' practice with regard to Single Platform use:

Using one Platform for all clients for all investments

The FSA state that they believe that this is **likely to be very rare** in the current platforms market, although as the market develops this position may change.

To stand a chance of doing this, the firm's **client bank** would have to be **clearly defined** as having a **similar range of needs and objectives** such that the firm's investment and service proposition – including the use of a particular platform - would be **suitable for all of them**. To do this, they would **not have any 'outlier' clients**. However, this is only likely to arise where the firm **screens out clients** for whom a Platform based service would not be suitable.

Using one Platform for all clients for most of their investments

This was felt to be a **more likely scenario** than the one above as, **even when there is a defined category of clients, there are probably still going to be 'outlier clients'** that are likely to need off-platform products. **The default Platform adopted would still need to be competitive** in terms of charges and features across the defined category of clients for this to be an appropriate approach. The acid test will be in the definition of the category/segment of clients and is unlikely to be 'all encompassing'.

Using one Platform for some of their clients

A firm may want to use a single Platform to offer a Platform based service to a **defined segment of their client bank**. Clients for whom this 'one' Platform service is not suitable should be handled differently (for example, using off Platform investments). However, it could be that other Platforms are as suitable as or more suitable than off Platform solutions and so it is likely that multiple Platforms will need to be considered to ensure the right customer outcome.

Any narrowing of Platform choice will depend on the degree to which the chosen Platform has a comprehensive range of Products and services.

Specific examples of ‘good and bad’ practice in Annex 5 should help to give context to the potential situations above.

Best Execution

The above obligation applies to Independent and Restricted advisers in respect of investments such as Collectives, Investment Trusts and ETFs. Advisers have to achieve the ‘lowest consideration’ – price **and cost of executing the order**. The obligation does not appear to need to be checked on an ‘order by order’ basis – but the ‘probability’ that it will be the best choice on an order by order basis is required and that conclusion needs to be regularly checked (at least annually). Dealing with multiple Platforms and/or multiple parties on an ad hoc basis may have higher costs for an adviser of executing an order than regularly using a single or limited source and so may have an effect on the judgment. However, using this view to ‘turn a blind eye’ to the need for regular checks would not be right.

Payments to Platforms and Consumers

The whole issue of charges, along with their transparency and clarity is still a subject of concern for the FSA.

The March DP raised the issue of Platforms receiving payments from Fund Managers and asked whether this should be banned. The majority of respondents agreed with the FSA proposal (especially Product Providers and Fund Managers) but a number of counter arguments have been made including a fear that stopping payments to Platforms alone would potentially distort the market.

The CP has concluded that there are some legitimate ‘administration’ cost benefits for Fund Managers using Platforms and so it is reasonable for Platforms to charge and be paid for these. However, the FSA does not want to see payments being made as a distribution or sales incentive charge. They also concluded that bundled charging could remain (for now) as the cost of bundled product pricing was often cheaper than unbundled. It will be interesting to see how comparatively better bundled charges will be than unbundled if the Platforms are only able to charge for admin’ costs in the future.

The argument that ‘transparency’ of bundled prices **can** be achieved without unbundling seems a bit tenuous in the absence of explaining how they would do so... The FSA plans to consult on the issue.

Non-advised business

Platforms will be able to receive payments from Providers and Fund Managers in respect of non-advised business.

Rebates from Product Providers to customers

The FSA had proposed removing the practice of Providers rebating product charges to clients in cash – they felt it was better that charges should be reduced. Despite a broadly equal split of opinion for and against, the FSA has concluded that it is right to remove the payment of cash rebates. However, it is not stopping the principle of rebates entirely and allowing discounts that may be negotiated by the Platform from Fund Managers to be passed on via a certain class of shares that have a lower AMC for the specific Platform.

The FSA believes that the effect of stopping cash rebating of charges should see lower AMCs being applied – we will have to see if this is the case or whether some of the charge is retained by the Fund Manager as profit.

Inducements provided by Platforms to advisers

The majority of respondents felt that it was fair to **stop monetary benefits being paid to adviser firms** and the FSA has concluded that there should be no payments from product Providers or Platforms. However, there was support for the continuation of **providing non-monetary benefits such as planning tools and training**. Some thought these benefits should be paid for by the adviser and there was concern about the objectivity of outcomes from Planning tools. The view is that there should be no bias within the support services that could have a detrimental effect on the customer outcome. Inducements will continue to be subject to COB rules (2.3).

The issue of **Shares and share incentive schemes for advisers** was felt by some to represent a **conflict of interest**. The FSA expects such **conflicts to be disclosed and managed** and has already taken enforcement action where it felt there was a failure of management and monitoring procedures.

Re-registration

- Full **re-registration** between and off-Platform **must apply from the end of 2012**. Progress has been made and this was acknowledged.
- In Specie transfers
- Transfers to be carried out in a timely way (to be defined).
- Re-registration capability should be part of the assessment criteria of Platform Due Diligence.

Capital Adequacy for LLIFs

Platforms are usually Limited Licence Investment Firms (LLIFs). The FSA had proposed that they be subject to Internal Capital Adequacy Assessment – **ICAAP** – criteria rather than the old Fixed Overhead Requirement (FOR). One of the key concerns is the ability of a Platform to **manage the costs of ‘winding down’** and in specie re-registration and the ICAAP measure was felt to offer greater security and risk mitigation.

The paper goes on to cover how to manage the **provision of information to investors, including access to voting rights** available through their investments. In addition there is an analysis of the expected costs of implementing (initial) and managing (ongoing) the proposals. We have not gone into more detail here as it is likely that those interested will want to examine the detail rather than read a précis.

Conclusion

In conclusion, the paper has a few areas where it has back-tracked on the original suggestions made in the DP, notably Fund Manager payments for administration and on allowing the continuation of bundled pricing. **Some readers may believe that the FSA is sanctioning the widespread use of ‘Single’ Platform** and in our opinion that would be an incorrect interpretation (we may be wrong though). Whilst it may be technically possible, we do not believe it to be practically possible other than in specific carefully defined and controlled circumstances. **The Paper is to be welcomed** as it moves the debate forward. However, **we do not believe that it has provided the clarity or certainty that was sought** by the industry and may in some cases have made the situation even more confused.