Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

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Dear Sir/Madam

Financial Services Consumer Panel response to MS17/1.2: Investment Platforms Market Study Interim Report

This is the response of the Financial Services Consumer Panel (the Panel) to the Investment Platforms Market Study Interim Report.

The FCA found that, although consumers placed high importance on charges when choosing their platform, very few understand the charges they incur or that they exist at all. 80% of consumers cannot estimate their annual platform charge, and this knowledge is lower for the advised consumers.[1]

Incredibly, in the face of this evidence, the FCA has concluded that the platform market appears to be working well for both advised and non-advised consumers.

There is an urgent need for innovation in the way costs and charges data are collected and presented to consumers, and to replace industry jargon on risk with something consumers will readily understand. The FCA needs to ensure that firms have the tools to deliver cost transparency.

We also note that a duty of care on providers could materially change the outcome for orphan clients.

Yours faithfully

Sue Lewis
Financial Services Consumer Panel, Chair

[1] https://www.fca.org.uk/publication/market-studies/ms17-1-2-annex-2.pdf

FCA Questions

Q1: Are you aware of specific innovations that display costs and charging information in a way which facilitates consumers making informed investment decisions?

There is a digital dashboard, ClaritEx, which covers the DB and DC markets. This provides an overview of costs and charges as well as underlying detail. Not all consumers will want to drill down to specific trading costs but the line items should be standardised so consumers can clearly see how their portfolios are managed.

The FCA should also consider whether the templates and framework for collecting costs and charges data developed by the FCA industry and stakeholder Institutional Disclosure Working Group (IDWG) can be used to improve transparency for retail investors as well.

Although those templates are primarily intended for pension fund trustees, investment fund boards could also benefit. The FCA should consider issuing guidance to authorised fund boards to use the IDWG templates. The FCA should create incentives for firms to standardise cost disclosure.

We also think the FCA could hold a specific Tech Sprint devoted to looking at ways to use available technology and data analytics tools to improve costs and charges disclosure. The existing framework does not appear to be working.

Q2: Bearing in mind the existing costs and charges disclosure Requirements (found in, for example, COBS 2.2.1R and COBS 6.1.9R (for non-MiFID business) and COBS 2.2A.2R, 6.1ZA.11R and COBS 6.1ZA.12R (for MiFID business), do you think additional disclosure remedies are required to ensure that consumers are able to compare platform charges? If yes, what should those further requirements be and why do existing disclosure requirements not go far enough?

Yes, given the findings in this study and the FCA's Asset Management Market Study.[2] The FCA should be more prescriptive on the form and content of disclosures in pre-sale and post-sale documents. A consumer cannot make an informed decision about which investment platform to choose, or whether it is worth switching, if they do not have access to standardised, clear and comprehensive price and non-price product features.

The MiFID II singe charge disclosure is a helpful start but the FCA will need to do more to assess whether MiFID II and the FCA's COBs rules create consistency across products and providers. For example, do the rules deliver complete cost information to consumers? Does the aggregate amount include third party charges and is it clear how costs impact performance?

The Panel is concerned that the FCA found that as many as 35 different 'contingent charging' areas imposed by some providers.

Will MiFID II address the different practices among providers which include wrapper and platform fees, third party hosting and administration fees, etc? If there is a range of contingent charging that providers can leave out of the MiFID II aggregate cost disclosure then existing regulations will not help.

[2] https://www.fca.org.uk/publication/occasional-papers/occasional-paper-32.pdf

It is still in firms' interest to make it difficult for consumers to have a complete understanding of costs and their impact on returns.[3]

The following factors indicate additional disclosure remedies are required:

- The FCA found that 60% of consumers incorrectly over or under-estimate their platform charges by at least 50%.
- A notable proportion of advisers find it difficult or very difficult to compare the costs and characteristics of products such as funds and wrappers.
- There is lack of price transparency and pricing practices among providers is varied (especially among D2C providers) with different headline platform fees, wrapper charges, transaction fees, retained interest on cash and other charges.
- There are many consumers on platforms which are expensive for their pot size which implies that consumers do not understand costs and charges, or have been unable to compare them to find the best deal.

Consumers use price (along with brand and product choices) as a primary comparator when the information is available. Given that platforms differ on price, the FCA must remove any obstacles to consumers having this information in readily accessible format.

Q3: Are there any practical challenges, negative effects or limitations of innovations to enhance the comparability of charges and, if so, are there ways in which these could be overcome?

Extracting costs and charges data quickly and at low cost continues to be a major practical challenge for the asset management sector, which relies on legacy systems. Given the lack of incentives to change, regulation is needed. The FCA's suggestion in 4c would help.

Q4: Do you think that:
a. third party intermediaries currently face barriers to placing competitive pressure on platforms?
b. the role of third party intermediaries should be enhanced in an effort to improve competitive pressures on platforms and, if so, how?
c. a requirement on platforms to provide third party intermediaries with more data or open data solutions is a good way to enhance their role in an effort to increase competitive pressures on platforms?
d. there are practical challenges or negative effects of enhancing the role of third party intermediaries through introducing a requirement on platforms to provide them with more data or open data solutions. If so, how could these be overcome?

The Panel supports the proposal set out in clause (c).

Q5: Are there any alternative ways to enhance the comparability of charges investors incur when investing through a platform?

The report notes that the complexity of comparing charges and charge is "compounded by inconsistent language", referring to the range of terms used to describe the platform fee.

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[3] Ibid '*Carlin (2009) finds that firms might have an incentive to make their charges more complex or less transparent to reduce competitive pressure*.'

For example, the list of terms for 'platform fee' includes 'investor fee', 'service fee', 'quarterly payment', 'account charge', 'custody charge', 'ongoing platform and product administration charge', 'account administration fee', 'annual charge', 'monthly charge' and 'annual commission'.

There is no obvious justification for this and it creates unnecessary complexity and confusion for consumers. Yet it is not addressed in the remedies. The FCA should work with the industry to define simpler terms and mandate their usage.

Q6: Are you aware of specific innovations that display costs and charging information in a way which facilitates consumers making informed choices between investment funds?

See our response to Q1.

Q7: Do you think additional disclosure remedies are required to ensure that consumers are able to compare fund charges on a platform? If yes, what should those further requirements be and why do existing disclosure requirements not go far enough?

See our response to Q2.

Q8: Are there any practical challenges, negative effects or limitations of innovations to enhance the comparability of fund charges on a platform, if so, are there ways in which these could be overcome?

No comment.

Q9: What impact do the commercial arrangements we have identified have on fund managers' incentives, on consumers and on competition?

The research found both positive and negative impacts arising from commercial arrangements. Nevertheless, transparency is a big issue here.

We would urge the FCA to examine in greater detail the conflicts of interest inherent in the vertical integration model and how it impacts consumers.

Despite extensive research, it is still unclear how far platforms are able to put downward pressure on fund management charges. In particular, where a vertically integrated business includes fund managers, platforms and advisers, how much incentive is there for the business to push down fees charged by other fund managers?

Measures to help consumers who may be building large cash balances without knowing about interest, charges and potential lost investment returns

Q10: What are the reasons why D2C consumers have significantly higher cash balances than advised consumers?

As implied in Annex 5, D2C platforms especially are not doing enough to make investors aware of the effect of maintaining significant cash balances.

While holding large sums in cash can make sense in the short term, investors need to be made aware of inflation risk, and the potential for platform charges to reduce or wipe out interest payments.

The FCA should do more research to understand why D2C consumers hold large cash balances. There could be gender effects, for example, or people may be put off by the complexity of investment charges.

Q16: As set out in paragraph 9.18 there are a number of existing rules which require platforms to disclose information that is relevant to a consumer holding a cash balance. Given the high proportion of cash balances:
a. how could the relevant disclosure requirements be made more effective at warning consumers of the costs and charges associated with holding cash balances?
b. do you think there are better alternative options which could make consumers aware they are holding cash balances and the charges associated with doing so?

The FCA's further research in this area should include testing of different types of statements explaining the effect of holding assets in cash, particularly the high cost of holding money on a platform. A duty of care on firms could help here, as firms would have to demonstrate that consumers understood the consequences of holding cash.

Measures to make it easier for investors and advisers to switch platforms

Q17: Is there a role for the FCA in reinforcing the industry initiative to improve transfer times and, if so, what should this role be?

Yes. The Transfers and Re-registration Industry Group (TRIG) has made good progress. But while some platforms and providers have proved willing to work on improving transfer times and the associated systems - ensuring their technology is sufficiently up-to-date and robust for the purpose - others have been less prepared to do so. For example, research earlier this year by the Lang Cat found that not one platform is yet able to offer fully digital straight through processing (i.e. where there is no need for 'wet' signatures).[4] By contrast, members of the Australian 'Super' can transfer funds simply online; the deadline for transfers is three days.[5]

The FCA should be more proactive on this. Requiring platforms to provide a prompt and efficient service to enable a retail client to move to another platform sends out the right message. However, the accompanying handbook guidance would need to spell out what a 'prompt and efficient' service looks like so the regulator could intervene if expectations were not met.

Q18: What is the likely effectiveness and proportionality of:

a. **The possible remedies outlined in this section which are intended to make switching easier and increase the competitive pressures operating in the platform market?**

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[4] https://www.professionaladviser.com/professional-adviser/opinion/3030406/a-matter-of-when-not-if
[5] https://www.australiansuper.com/superannuation/consolidate-your-super

The NMG research found that consumers generally need to experience significant and sustained problems with a platform before they consider switching. The FCA is right to be concerned that 7% of those who attempted to switch were unable to do so, with the time involved, exit fees and the complexity of the process being the main (actual and perceived) barriers.

The FCA should require firms to monitor switching experiences (which few platforms currently do). This is particularly important in the D2C sector. The FCA should also require firms to publish data on transfer times to facilitate comparison and incentivise platforms to make improvements. As it stands, it seems firms are merely *expected* to do more.

b. FCA measures that are intended to improve the switching times and processes by, for example, introducing remedies to shine a light on firms' switching times or setting minimum standards for transfer times?

The FCA clarify what sufficient progress would look like and what the minimum requirements should be for different wrappers and products. Remedies should reflect the fundamental differences between the D2C and advised markets. The customer has little or no influence on platform decisions or outcomes in the advised sector, and proposals about communication and disclosure need to reflect this.

Q19: What should be the scope of a remedy to ban exit fees (i.e. should the ban apply to platform fees only, or also e.g. product-specific fees)?

Exit fees do not appear to benefit consumers and can be a barrier to competition.

There are differences between the D2C and advised sectors. Can a platform that doesn't levy exit fees on advised investors fairly justify doing so on direct investors? How can the range of exit fees in the direct market be justified (where some don't levy any but others charge between £10 and £25 per line of stock)? Would it create confusion if exit fees were banned on platforms but still allowed elsewhere in the investment and insurance market? If so, should the FCA widen the scope and consider a ban on exit fees across the entire industry?

The FCA should build a better understanding of these dynamics, and the extent to which a ban on exit fees would cause unintended consequences. It may be that much better and more upfront disclosure of exit fees is a more proportionate response (given that one in four investors said exit fees were hard to understand, according to the NMG work), or the FCA may consider whether there is a case for retaining a fee to cover the reasonable administrative cost of a transfer out.

Q20: Would there be any unintended consequences associated with any of the possible remedies outlined in this section which aim to make switching easier? If so, how could these be overcome?

No comment.

Q21: What costs do advisers incur when reviewing whether they should switch their clients to an alternative platform and then executing a switch?

No comment.

Q22: Would guidance on our expectations for adviser switching be useful? If so, what do you think this should cover? If not, what alternative remedies could achieve our aim of ensuring the costs of switching adviser platform are proportionate?

Yes. However, this would have to be based on a more detailed picture of the relationship between fees and the additional work needed to satisfy suitability requirements. The wider issue is the general reluctance of advisers to move existing clients when they have appointed a different platform for new business. If one platform is deemed most suitable for new clients, what is the rationale for not shifting existing clients across?

The paper recognises certain obstacles here - most obviously the problem of switching between share classes - but the FCA should make clear to advisers that platform choices should be determined by the interests of the consumer and not of the business. And certainly, where a consumer chooses to switch, the process should be straightforward.

Measures to help orphan clients

Q23: What is the likely effectiveness, proportionality and unintended consequences of the remedies listed above (A-C)?

The Panel has raised concerns about the lack of fairness in treatment of orphan clients with the FCA on previous occasions and welcomes the proposals. The study found over 400,000 orphan customers with over £10bn of assets on platforms, with this figure rising. The fact that some people are paying advice fees through their platform without getting any advice is egregious and unacceptable.

Remedy A proposes to address price discrimination between orphan and existing clients. But while additional charges for orphans are significant and increasing, only a minority of platforms actually impose them. The logical step is to ban such charges unless the relevant platforms can justify them. If the additional charges are to remain in place the FCA should require platforms to demonstrate that they are making it clear to these customers that charges are increasing, what their specific alternatives might be (perhaps requiring express consent for the charges before they are imposed) and facilitating easy switching. The FCA should also consider whether a fixed administrative fee would be fairer than a percentage.

Arguably, platforms also benefit from consumer confusion between the products and platform. NMG found that many respondents defaulted to talking about their products (SIPP, ISA) rather than their platform.

Remedy B could go further. As an example, the technology is available for platforms to provide a low-cost D2C-type service specifically for orphan clients, either as a stopgap while the consumer is between advisers or as a more long-term solution. This service could offer information, guidance or advice, and would address the problem of orphan clients having to transact on an execution-only basis, which can result in consumers paying extra fees and taking extra risk. There could still be a modest charge, but it would be in return for a specific service.

Remedy C is unsatisfactory. One year is too long to allow consumers to continue paying for advice that they are not receiving. The duty should be on the advisers and the platforms to provide adequate disclosures and notifications to consumers. See further feedback in response to Q25.

The remedies outlined here don't account for business models. The rise of vertically integrated (VI) platform/investment/advice businesses may facilitate the development of interim orphan services and improved communication between different components of the investment and advice process. This is an opportunity for firms to demonstrate how vertically integrated firms are in the best of interests of consumers.

Q24: Should remedies A-C apply to orphan clients only or other groups of consumers?

The same principles of fairness should apply for other groups.

Q25: Would platforms face any practical challenges in introducing remedies A-C above?

Remedy C: Many advisers use multiple platforms. This makes it difficult for a platform to know if a particular client is still receiving advice but with their assets on a different platform, or if they are, in fact, an orphan. This must be the adviser's responsibility. Similarly, the NMG research found that over a third of respondents have two or more platform arrangements. It is more common for consumers to invest new money on a new platform than transfer money from one platform to another. This should be considered when defining and seeking to account for orphan clients.

The FCA needs to establish whether consumers are staying on platforms as a preference, or because of barriers to moving.

Measures to help consumers who may be exposed to unexpected risk levels

Q26: We welcome views on whether the issues we have identified with in-house model portfolios are likely to apply across all types of model portfolios and also exist in model portfolios offered by wealth or asset managers.

Some of the issues relating to model portfolios reflect those highlighted in the Panel's research on the robo-advice sector,[6] where we found that while investors generally understand the language used during the risk profiling process, they were less able to understand the portfolios allocated to them or the link between the risk profiling and its output.

The platforms study similarly found inconsistencies in the labelling and descriptions of risk-rated portfolios and refers to 'woolly' risk descriptions for in-house fund ranges. The risk of investors being shoehorned into unsuitable risk profiles or asset allocations needs to be addressed across platforms, automated advisers and model portfolios in general. However, the suggested post-analysis remedies seem timid in the context of the findings in the

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[6]https://www.fs-cp.org.uk/sites/default/files/final_panel_position_paper_online_investment_and_advice_services.pdf

interim report. For example, the FCA found that in "portfolios where the name implies medium risk, including words such as 'moderate' or 'balanced', the allocation to bonds varied substantially from less than 5% to over 60% and similar variation was found with allocations to equity".

This issue goes beyond labelling. A 2015 study by Finametrica identified serious flaws in the risk assessment tools used by D2C providers[7]. It found that one in five consumers using self-assessment risk tools were at risk of being guided into an unsuitable investment portfolio. The next market downturn will deliver a nasty shock for investors with unsuitable portfolios. The proposed follow-up analysis therefore needs to tie in closely with the work being carried out on risk profiling tools as part of the suitability review.

Q27: What is the likely effectiveness, proportionality and unintended consequences of the remedies that would:
a. apply current performance and risk disclosure obligations for funds onto model portfolios?

This would be sensible. In the D2C market in particular, there are model portfolios with similar risk-rating labels and descriptions that contain funds and asset allocations that vary widely, not least in terms of volatility. The priority should be to provide much greater transparency about model portfolios in terms of risk, charges and possible outcomes. As it stands, the average D2C investor cannot be expected to have the time, knowledge or expertise to assess and compare different model portfolios.

b. require firms to use standardised terminology to describe their strategy and asset allocation, including formalising definitions such as cautious, balanced and adventurous?

As we said in our 2016 report, the FCA should issue guidance on how risk profile descriptions and investment choices are presented in a way that is consistent, easy to understand and promotes good consumer outcomes. This applies right across the investment sector, including platforms, automated advice services, DFMs and wealth managers. While standardising language and terms on charges, investments and risk makes sense, standardising labels such as 'cautious' and 'balanced' would be unwise, given how subjective they are. These terms, however they are used, simply don't account for the complexity of investment risk.

A possible alternative approach was identified in the 2016 thematic review on Meeting Investors' Expectations (TR 16/3).[8] It found that while most fund providers disclosed the key risks in their funds, several failed to clearly explain the consequences of risks. But the paper also picked out good practice examples, including a table in one prospectus setting out the risks to which each fund was exposed in a way that made it easier for investors to choose investments with appropriate risk profiles. Applying the same template to model portfolios would be more complex, but the disclosure and presentation principle is the right one.

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[7] https://www.ftadviser.com/2015/12/18/investments/discretionary-management/red-flag-raised-about-robo-advice-risk-assessments-Ujrg8wJsBel295Y2e1ikyM/article.html
[8] https://www.fca.org.uk/publications/thematic-reviews/tr16-3-meeting-investors%E2%80%99-expectations

Addressing potential non-compliance with our rules

Q28: To what extent do existing rules go far enough in making platforms' trading practices transparent to retail investors?

The interim report looked at VI primarily through the lenses of discounts and promotions. However, there is still a need for a wider analysis of VI business models and whether the commercial relationships between platform providers and fund managers deliver value to consumers.

This would also need to address the range of different VI models and how they compare with non-VI models. To what extent are investors aware that the portfolios or funds they are being offered are from providers within the same chain? How is the adviser incentivised to offer those funds or portfolios above external funds?

If the FCA is serious about ensuring platforms' trading practices are transparent to investors, it should consider a broader study of the growing VI model. This needs to be examined in much greater detail if we are to understand the extent to which those business models promote transparency and avoid conflicts of interest.

Consumers should be able to understand cross sector relationships between insurance, banks and asset managers and how fees are earned throughout the value chain.