

Altus Ltd Response to CP10/29

Executive Summary

Altus is pleased to see that the FSA has listened to the comments it received on DP10/02 and incorporated some important changes into this latest platform Consultation Paper. On the whole this is a better set of proposals than the previous incarnation but some important issues remain.

The most widely debated of these issues has been the proposal to ban cash rebates to the end investor which has provoked strong responses from several in the platform community. Altus believes that the root cause of the problem lies in the tension between two competing FSA aims in relation to platforms.

On the one hand it seeks to remove bias by stopping the flow of cash from provider to adviser but on the other hand wants to see platforms exert competitive pressure on the cost of investments. The first of these aims has led to the proposed ban on cash rebates to investors whilst the latter is most easily implemented by just such payments to the investor.

Interesting as it would be to speculate on the cause of this paradox and why it appears not to affect other industries, what is required is a pragmatic solution for retail investments. The ideal outcome would be that distribution costs get stripped out of AMCs leaving rebates to reflect just the commercial buying power of the platforms and there are already signs that this could happen. Several fund managers have signalled their intention to reduce their charges by 50bps as a result of the RDR and if that means rebates in the region of 25bps then we would suggest there is no practical need to ban payment of this rebate to the investor.

Whilst this may not give the certainty of outcome the FSA would like, it may be that this type of compromise is actually what is required at this point for RDR to work at an operational level.

Introduction

As an enterprise architecture consultancy specialising solely in Financial Services, Altus has extensive experience working with clients in the LP&I sector including platform service providers. With practical involvement in both system and business issues throughout the sales process we welcome this opportunity to respond to the FSA's latest consultation paper on the Retail Distribution Review.

Our focus is primarily on the operational aspects of financial services and we have sought in the following sub-sections to answer those questions raised in CP10/29 where we feel our experience and expertise particularly qualifies us to do so.

Response to particular questions

Q1: Do you have any comments to make with regard to our definition of a platform service and platform service provider (contained in Appendix 1)?

It is good to see the FSA reflect the changing shape of retail financial services with these new definitions but we think they may need to be incorporated more widely into other parts of COBS for consistency. For example the reasonable non-monetary benefits table in COBS 2.3.15 currently defines rules for product providers which will presumably extend to platform service providers in future.

We would also point out that by allowing a couple of exceptions to the baseline definition of a platform service (presumably aimed at excluding private client investment managers from the net) that the FSA may open the door to some providers attempting to side-step the regulatory intent.

Q2: Do you agree with our proposal to read across our rules on product providers to platforms in relation to facilitation of payment of adviser charges?

We certainly agree that the same rules should be applied to both platforms and product providers but there remain several practical difficulties with those rules for whoever seeks to apply them.

First there needs to be clarification on disclosure relating to provider-facilitated adviser charging; does the impact of adviser charges on investment performance need to be illustrated and, if so, who by and how? Control over the level and timing of charges sits squarely with the consumer and their adviser which would make it virtually impossible for platforms (or providers) to produce accurate illustrations.

Second there needs to be more clarity around tax treatment of provider-facilitated adviser charges. In CP09/18 the FSA implied that it would be possible (and even beneficial) for a consumer to pay adviser charges from their pension pot due to the tax relief available. The HMRC (in RPSM09106040) seems to state that this is only possible in relation to pension advice but how are providers meant to establish the nature of the advice to which an adviser charge relates?

It is quite conceivable for a consumer to build an investment portfolio where, due to penalties on fixed term investment products, their pension is the only viable place from which to facilitate adviser charges. The tension between HMRC authorised payments rules and the FSA position in CP10/29 on clients best interests (section 2.6) seems to make it extremely difficult to facilitate adviser charging in such cases.

Q3: Do you agree with the rules and guidance we have proposed in relation to the standards we expect from an adviser when using a platform and providing advice?

It is hard to fault the logical purity of the proposals but, at a practical level, it is difficult to see how an adviser firm could comfortably demonstrate compliance with the requirements for independence without incurring substantial cost and making their service uneconomic for many consumers.

This may simply mean that “independence” becomes a gold standard accessible only to the most affluent clients and that restricted advice becomes the de-facto standard for the mass market - and de-stigmatised as a label in the process. Whilst there is nothing inherently wrong with this scenario, we do wonder if a very broad restricted sector will mask wide variances in just how restricted adviser firms really are and whether some more graduated labelling might be preferable.

Q4: Do you have any comments on the proposed guidance, on the use of platforms and the independence rule, in Annex 5?

Same answer as for Q3.

Q5: Do you agree with our proposals for platform remuneration? If not please explain why setting out the effects of our proposal and what should be done instead, and why.

Altus is pleased to see the FSA acknowledge both the administration role platforms play and the competitive pressure they can apply on behalf of investors.

We therefore agree with the decision to allow payments from product providers to platforms to continue in recognition of these factors. Any other approach would, we believe, lead to a proliferation of share classes with negative consequences for transparency, re-registration and costs all round.

Q6: Do you agree with our proposal to ban the rebating of product charges in cash to retail clients across all retail investment products when advice is being provided?

Having established that fund rebates are the most practical way to implement the buying power of platforms and assuming that at least some of the benefits should pass to investors, Altus is surprised by the proposal to ban cash rebates to platform clients.

At a headline level it seems odd that, of the current platform charging models, it will be the relatively transparent unbundled versions which will be casualties of this approach whilst more opaque bundled supermarket charging is allowed to continue.

The explanation given in the paper seems to be that advisers may mislead clients into believing that the cash rebate pays for their charges but it is difficult to see why the suggested alternative of rebate units could not be similarly misrepresented. If the FSA is seeking to achieve some kind of equivalence with the changes in PS10/6 by banning cash payments then it may wish to consider whether rebate units could look like the 100+ percent allocation rates which have been banned.

The requirement on firms facilitating the payment of adviser charges asks firms “to not unduly influence or restrict the charging structure and adviser charges” that an adviser firm can use; preventing the use of a cash rebate resulting from the increased purchasing power of a platform to support payment of advice charges (where so chosen by the client) seems contradictory.

Whatever the reasoning behind the proposal to ban cash rebates, there are some serious operational consequences with the suggested alternatives. As we pointed out in our response to the earlier Discussion Paper, the introduction of additional share classes will be a serious impediment to the FSA's own objective of allowing in-specie re-registration between platforms and we would urge the FSA to discourage their proliferation.

Rebate units at fund level are a more practical solution but we suggest the FSA should consider more prescriptive rules on how they operate. Current arrangements for operating rebates between platforms and fund managers are varied with both parties calculating the sums due according to their own view of the agreement. With different interpretations on using average holdings, snapshot dates, specific prices, valuation frequencies, the treatment of transferred holdings, etc. it is not surprising that the results often disagree.

Whilst the FSA is probably not too concerned about the current potential for commercial dispute between fund managers and platforms as the result of this arrangement, we believe they should be more worried if the same mechanism is used to deliver better investment terms to investors. Under present arrangements an investor could receive different rebates for an identical investment on two platforms solely due to these operational differences.

Altus believes that investors should have the same clarity and consistency over how fund rebates are calculated (and how they are treated for tax) as they do for fund distributions. We therefore suggest that, rather than leaving the market to work it out, the FSA should regulate on how rebates are calculated to ensure fairness for all investors.

Q7: Do you agree with our proposal to extend the scope of ensuring all firms acting as nominee companies offer re-registration in specie?

Altus does agree with the proposal to extend the scope of compulsory re-registration, otherwise there is a danger of some participants attempting to evade the intent of the RDR by re-badging their business. However, at the risk of repeating ourselves, we must again point out the continued tension between the FSA's re-registration intentions and the its statements on additional share classes.

Very simply; a proliferation of share classes is inimical to in-specie re-registration.

Q8: Do you agree with our proposal that re-registration should be carried out in a reasonable time and do you have any feedback as to what might be reasonable for particular wrappers and assets?

Altus has participated actively in the TISA re-registration initiative and we endorse the SLA standards developed by TISA.

We note however, that TISA intend their SLA standards to be non-binding, and there is some uncertainty over whether those standards will also apply to those not using the TISA-sponsored electronic re-registration processes. It is also unclear whether the standards are a target for the average case, or should apply to all cases.

Neither the TISA SLA paper, nor CP10/29, provides detail over how compliance with the SLAs and timely transfer requirement would be monitored. Altus feel that reporting on transfer processing performance should be mandatory, as the market alone may not be able to bring sufficient pressure to bear on providers to ensure that they meet their timely transfer obligations.

Q9: Do you agree that the new definition 'intermediate unitholder' incorporates all relevant firms?

Based on the stated objective of ensuring that beneficial owners receive the same information as if they had invested directly, then the definition does appear to cover all relevant firms.

Q10: Do you agree with our proposal to introduce a requirement for intermediate unitholders to pass on information provided by authorised fund managers to end investors?

The basic requirement to pass on fund manager information to investors is perfectly sensible. What seems slightly less reasonable to us are some of the technical constraints the FSA seeks to impose on how the information is communicated. Platforms are a technology solution aimed at investors who want to embrace the power of modern communications. At one point the paper seems to acknowledge this stating that it would be acceptable to send information to an investor's secure message area within a firm's website. But this seems to be contradicted later in the same section by a requirement to send information by post where the intermediate unitholder does not hold the investor's email address.

We hope that this apparent contradiction is an oversight by the FSA and that the use of technology to provide fund manager information to the investor is actually the preferred route. This would be much more aligned both to the way platform customers tend to operate and the FSA's own rules with regard to ISAs not to mention much more environmentally responsible.

Q11: Do you agree that we are allowing an appropriate level of flexibility by requiring intermediate unitholders to have appropriate systems and controls to either exercise voting rights on the instruction of investors, or to facilitate investors' exercising of rights?

Again this seems a reasonable requirement and one which could be well supported by technology in a platform environment. We would urge the FSA to encourage technology solutions rather than wholesale deforestation.

Q12: Do you agree with our proposal to require intermediate unitholders to provide aggregate information when requested by authorised fund managers?

This seems a sensible proposal and the information should not be too onerous for platforms to produce. It would also make sense to have a consistent data standard for the exchange of this information between parties and the FSA may want to consider how best to deliver this.