Financial Conduct Authority

Policy Statement PS13/1

Payments to platform service providers and cash rebates from providers to consumers

April 2013

Contents

In this Policy Statement we report on the main issues arising from FSA Consultation Paper 12/12 (*Payments to platform service providers and cash rebates from providers to consumers*) and publish the final rules.

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Abbreviations used in this paper

AMC	Annual management charge
bp	basis point
CBA	Cost benefit analysis
CP	Consultation Paper
EU	European Union
FCA	Financial Conduct Authority
FSA	Financial Services Authority
FSMA	Financial Services and Markets Act 2000
HMRC	Her Majesty's Revenue and Customs
MiFID	Markets in Financial Instruments Directive
MI	Management Information
PS	Policy Statement
RDR	Retail Distribution Review
SIPP	Self-invested personal pension

1. Overview

Introduction

1.1 We are setting out our rules for platform services, and providing our response to the feedback to our consultation.

1.2 In June 2012 we published Consultation Paper (CP) 12/12 *Payments to platform service providers and cash rebates from providers to consumers.* We consulted on changes to how platforms used by both advised and non-advised[1] consumers would be paid. We also proposed preventing platforms in the non-advised market from passing on rebates to consumers in cash and sought views on a possible read-across of platform rules on payments for services to non-platforms markets. We proposed to introduce the rules on 31 December 2013, provided that this allowed for a one-year implementation period before the rules came into effect.

Who is affected by this?

1.3 This Policy Statement (PS) will be of particular interest to:

- platform service providers;
- advisory firms;
- firms that provide services to, or receive services from platforms;
- firms that operate nominee companies that hold assets on behalf of investors;
- SIPP operators;
- life companies; and
- managers of collective investment schemes.

1 Non-advised transactions include those transactions carried out by consumers through platforms on an execution-only basis.

Is this of interest to consumers?

1.4 Consumers and consumer bodies will be interested in the proposed rules on how platforms will be funded. These are likely to change consumers' interaction with platform services and the way they pay for some platforms in the market. It could result in consumers paying for a service they had previously thought was free. The changes will affect both advised and non-advised transactions by consumers.

Context

1.5 The new rules will support our objectives of: securing an appropriate degree of protection for consumers and promoting effective competition in the interests of consumers.

1.6 One of the main outcomes of our rules will be to restrict the influence that product providers and platforms have on the promotion of one fund over another. This outcome is in line with our broader Retail Distribution Review (RDR) objective of limiting any adverse influence product providers have on distribution and aligning the interests of intermediaries to those of their clients more closely.

1.7 These rules promote effective competition in the market by removing product provider influence over the distribution of products and adviser remuneration and improving the clarity of services offered by firms to consumers. The distribution of funds will also not be influenced by rebates from product providers to platforms, and platforms will have to become more transparent about the services they provide to justify their charging structures to consumers.

1.8 FSA CP12/12 was preceded by Policy Statement PS11/9 *Platforms – Delivering the RDR and other issues for platforms and nominee-related services*. This set out a number of rules which would come into effect at the end of 2012.

1.9 We received 80 responses to CP12/12 from a broad range of stakeholders, including some from individual consumers. The FCA Board has now made the rules and guidance in relation to the proposals we consulted on in CP12/12, and we confirm the finalised position below.

Summary of feedback and our response

Payments to platforms and consumers

1.10 We are proceeding with our core proposal that requires a platform service to be paid for by a platform charge disclosed to, and agreed by, the consumer. However, some platforms suggested a number of charges that could still appropriately be taken from firms, including product providers. We agree with a number of these so have amended our rules to allow:

- payments for the work incurred correcting a pricing error by the product provider;
- payments for the work incurred in dealing with a corporate action by the product provider;
- payments for the work incurred in providing the product provider with management information regarding the consumers who are invested in the product; and

- payments in relation to advertising products on the platform.

Cash rebates for non-advised business on platforms

1.11 We are proceeding with our ban on cash rebates for non-advised platforms, in line with the ban previously consulted on in the advised market, to prevent these payments being used to disguise the costs of the platform charge. We are making clear that in both the advised and non-advised platform market this ban would not prevent consumers from being able to receive cash rebates which have a value of £1 or less per month for each fund held on the platform, as this would be unlikely to offset any adviser or platform charges. In addition, our rule banning cash rebates to consumers of advised and non-advised platforms would not prevent a platform from receiving a rebate from a fund manager in cash, provided this is passed on in full to the consumer in additional units.

Read across of the platform proposals to non-platform markets

1.12 We feel there is a strong argument for the application of similar rules to adjacent markets. This is particularly the case in the execution-only and self-invested personal pension (SIPP) markets. We will consider these markets as part of our ongoing work and will aim to consult later on any rules, where necessary.

Platform service definition

1.13 We have corrected the *platform service* definition to clarify that those execution-only firms that white-label a platform or also provide custody services are captured by the *platform service* definition. The policy intention to include such firms within the scope of the definition is reflected in PS11/9 as well as the cost benefit analysis. To ensure that there are no unintended consequences as a result of this correction, we will be consulting shortly, following the publication of this Policy Statement.

The European Union (EU) legislative framework

1.14 As explained in CP12/12, the Markets in Financial Instruments Directive (MiFID) limits the scope of Member States to apply additional requirements to certain areas. We said we would discuss with the European Commission (the Commission) the need for a further notification under Article 4 of the MiFID Implementing Directive.

1.15 Having spoken to the Commission, the UK will now make a formal notification to the Commission. A copy is enclosed here as Appendix 2. This sets out the circumstances in which our rules will apply to MiFID investment firms when they do business in the UK.

HMRC

1.16 HM Revenue and Customs (HMRC) Brief 04/13[2] published on 25 March 2013 sets out the position regarding the tax treatment of rebates from product providers and intermediaries to consumers (in both cash and units).

1.17 The tax position as set out by HMRC would appear to lend support to the industry move towards clean share classes and fully transparent pricing. Transparent pricing would benefit consumers and also avoid the potential for consumers facing any undesirable tax consequences. It reinforces the position that fund prices remaining at levels, typically with an annual management charge

2 www.hmrc.gov.uk/briefs/income-tax/brief0413.htm

(AMC) of 1.5%, which allow for a proportion to be rebated to the consumer, could give a potentially poor outcome for consumers from a tax perspective.

1.18 Given the tax treatment of rebates as clarified by HMRC, it may be more efficient for fund prices to strip out most or all of the rebate built into fund prices. Consumers could then buy a share class with no rebate or a minimal rebate, since they would be paying upfront charges for advice and the platform service.

Equality and diversity

1.19 As noted in CP12/12, we have assessed the equality and diversity impact of our proposals and do not believe they will give rise to any equality or diversity issues. We did not receive any comments to contradict this view during the consultation process.

Next steps

Timing of the change

1.20 The rules will come into effect on 6 April 2014.

2.
Payments to platforms and consumers

2.1 This chapter covers the feedback received and our final position on how platforms in the advised and non-advised markets are to be funded and on cash payments to non-advised consumers. It sets out the timing for implementation of the rules contained in Appendix 1. Our policy direction on the potential read-across of similar rules to non-platform markets is also provided in this chapter. In addition, this chapter explains the amendment we have made to the *platform service* definition.

How platforms are funded

2.2 In CP12/12 we set out our intention to prevent platforms from being funded by payments from product providers. We stated that we were concerned these types of payments hindered the clarity of relationships and charges paid by consumers who accessed the services of platforms, either directly or through an intermediary. In particular, we had concerns that consumers could not make price comparisons between different platforms and, in some situations between different products held on the same platform. This made it hard to shop around and find the best deal or indeed the most suitable product or platform service.

2.3 We were also concerned that the way some platforms are currently funded could lead to product bias persisting in the market and restrict competition. Products offered by providers (often with lower costs) who are unwilling or unable to pay a rebate to the platform from the product charge have found it difficult to gain access to some platforms. In contrast, product providers willing to pay the highest amount may see their product given undue prominence on the platform.

2.4 The research we commissioned as a result of PS11/9 concluded that our initial concerns were justified for both the advised and non-advised platform markets. Consequently, we proposed to introduce rules that meant a platform service provider could not receive any remuneration for its platform service (or any other related services) except through platform charges agreed with and paid by the retail client.

2.5 In the consultation we asked:

> ***Q1:*** ***Do you agree with our proposal to require a platform service to be paid for by a platform charge disclosed to and agreed by the client?***

Responses to consultation

2.6 A large majority of responses agreed with our proposal, with a number agreeing that this would increase transparency for the end consumer (and the adviser). Support for this proposal was especially strong from individual consumers, who currently struggle to ascertain how much of their money is being used to fund the platform they use. Also, some of the responses highlighted the problem of consumer access to retail investment products that do not pay a rebate to the platform.

2.7 Other respondents agreed but suggested there should be a number of activities or services for which a platform could still charge a product provider. These included:

- payments for providing aggregation services, such as dealing, settlement, allocating distributions and custody;
- costs incurred dealing with pricing errors by a product provider;
- costs associated with corporate actions initiated by the product provider;
- listing and set-up fees for a new product on a platform;
- financial penalties to charge the product provider when service standards are not met;
- minimum administration costs when the product does not generate sufficient revenue for the platform; and
- payments for marketing.

2.8 A minority disagreed with the proposal. They argued that the current charging structures used by platforms that did not charge an explicit fee were to the benefit of the consumer.

2.9 Some respondents also wanted clarity on when a platform charge should become payable for products already held on a platform. It was suggested that any rules on when the platform charge should apply should mirror our rules relating to legacy business for adviser charging. Others stated that the rules set out in CP12/12, which would require a platform charge to apply to all business on a platform from the date the rules come into force, were too onerous and it would not be possible for platforms to make the changes required in time. Some respondents asked for clarity on whether platforms could still receive payments from advisers.

Our response

We continue to believe that the best way of improving transparency in the platform market and removing the potential for bias is by ensuring the consumer pays a platform charge to the platform for the service provided. Consumers currently pay for platform services, albeit in some cases through their annual management charge. Making this clear to the consumer should help both consumers and advisers to compare different platforms and make a value-for-money judgement on whether a particular service is suitable. It will ensure platforms design their offering with the consumer paying for the service in mind, rather than designing a service that best meets the needs of advisers or product providers.

Payments platforms can accept from providers

Nevertheless, the industry has made a reasonable argument that there may be some services that a platform could continue to charge a product provider for. In particular, platforms may sometimes incur unforeseen costs as a result of actions by a product provider that are essentially one-off in nature, such as correcting a pricing error or dealing with a corporate action. When these result in additional costs that are one-off in nature, the platform should be able to charge the provider directly for these. If these events do not occur, we would expect no payment to be made.

We believe it is important that product providers design products with the end consumer in mind. However, selling products through a platform can often mean that the product provider has no knowledge of the consumers buying their products. It is important that platforms are able to feedback good quality management information to the product provider. As a result, it is reasonable for a platform to be able to charge a product provider for this.

We can also confirm that it was not our intention to prevent payments made for advertising. However, we do not expect payments for advertising to be used to help a product provider gain access to a shortlist of funds, influence any ranking of products, or otherwise result in a channelling of business to that product provider.

We recognise that allowing the above payments gives rise to the possibility of abuse so that providers may still have the potential to influence distribution. However, we have made it clear in the Handbook text that we expect any charges made to be reasonable and proportionate, reflect the service being provided and not vary inappropriately between different product providers. If we see any abuse of the rules in this area, we will consider banning all types of payment between a product provider and platform service provider.

It was not the intention to prevent platforms being paid by intermediaries for any services they provide to an intermediary firm, and we have clarified this point in the rules.

Payments platforms cannot accept from providers

There were a number of other activities that we were asked to allow platforms to continue to charge product providers for. Some of these related to the core services that a platform undertakes for the consumer rather than the product provider. For example, the work involved in putting a fund on a platform is part of the core function of the platform and is part of what we expect to make up the platform charge. If we allowed platforms to charge product providers for this, it might become a 'pay to play' fee and restrict access to a platform for certain products. While platforms will not necessarily hold every product in the market, the products they do hold should be based on consumer demand and consist of products that may give a good outcome to consumers rather than being based on which providers are willing to pay a fee.

When a platform charge becomes payable

We consulted on rules that required all platforms to charge a platform charge for all business on a platform from 31 December 2013, regardless of when the business was placed through a platform. This approach would not have prevented platforms from passing rebates (in cash or units) to consumers for legacy business, which would ensure that consumers would not need to convert to a clean share class. However, as we set out in the Overview, the tax position of rebates, either in cash or units, would make this a potentially tax inefficient solution for consumers. We also accept the point that moving all consumers' assets to a platform-charging basis within a year from final rules being confirmed would be operationally challenging.

We are therefore extending the timescale for when a platform charge should become payable for legacy business until 6 April 2016. To avoid operational challenges for platforms as well as the potential for any undesirable tax consequences for consumers, we have included a transitional provision allowing platforms to continue to retain legacy payments from product providers for existing business on the platform, subject to a two-year sunset clause (expiring on 5 April 2016).

By 'legacy payments' we mean payments that relate to those retail investment products held on a platform before these rules coming into effect and which the platform is still holding when the rules are in force. These include regular savings products (where the amount invested does not vary) and any changes made through rebalancing as a result of instructions given before the implementation of the rules.

The transitional rules provide that the platform charge would only apply to new assets on the platform. Events that would trigger a move to the platform charge include when a fund on the platform is sold or changed. This revised approach would provide firms and consumers with flexibility to determine when to switch away from legacy assets. At the end of the two-year transitional period, however, platforms would not be able to retain any rebates for legacy business, but would have to be funded by platform charges only.

We do not agree with the principle that the legacy rules that are applicable for adviser charging should be read across to this market. The markets are different and we are applying rules to both execution-only and advised transactions.

Giving platforms three years from the publication of this paper to move all consumers to a platform-charging basis for all assets held on the platform gives sufficient time for an orderly transition to this new regime. We are already seeing share classes being launched with the adviser and platform fee stripped out, and we would generally expect to see consumers convert to such clean share classes, which would require a platform fee to be charged. If we allowed legacy commission to be paid indefinitely, this would create an unlevel playing field between platforms that currently charge an explicit fee and those that do not, together with any new entrants to the market, particularly given the tax position on both cash and unit rebates.

Payments and rebates to consumers

2.10 In CP12/12 we confirmed that, following the publication of PS11/9, we intended to prevent product providers from being able to rebate a share of the product charge to the consumer in the form of cash when an adviser was involved. However, PS11/9 did not deal with cash rebates when no adviser was involved, i.e. when the retail client bought investment products on a non-advised/execution-only platform. CP12/12 set out our intention to read similar rules across to the execution-only market.

2.11 Following the publication of PS11/9 we conducted research[3] on how consumers interact with platforms. The consumer research also looked at consumer knowledge and understanding of how platforms are paid. In particular, we wanted to assess consumers' understanding of the role of cash rebates.

2.12 The consumer research concluded that the concerns we had in the advised platform market were equally valid in the non-advised market. In CP12/12 we said that a lack of uniform standards could also distort competition between advised and non-advised platforms, which we considered were ultimately providing very similar services to the consumer.

2.13 Taking into account the findings of the consumer research, our view in CP12/12 remained that product providers should not be able to maintain prices at a level from which a cash rebate was routinely payable back to the consumer, whether that was through an advised or non-advised platform service.

2.14 In the consultation we therefore asked:

> ***Q2: Do you agree with our proposal that cash rebates to consumers for non-advised business should be banned, as well as those for advised business?***

Responses to consultation

2.15 A significant number of respondents continued to argue strongly that cash rebates should be allowed across all markets. A typical view put forward was that cash rebates were needed to fund the adviser charge. However, the majority accepted that if we were to ban cash rebates in the advised space, we should apply similar standards to the non-advised market to ensure a level playing field. A number of respondents raised issues around the tax treatment of unit rebates, claiming they were less efficient from a tax perspective than cash rebates. The tax position regarding both cash and unit rebates has recently been clarified by HMRC in its Brief 04/13.[4] Some respondents felt there was no need to ban rebates in cash for non-advised transactions, as the issue we had identified in the advised market, that the rebate could be used to offset the adviser charge, did not apply where no adviser was present.

2.16 During the consultation process we were asked by some industry representatives to provide a view on whether a minimal level of rebate paid in cash would be compatible with our policy objectives. Some respondents argued that allowing such a minimal level would significantly cut down the costs involved with dealing with rebates of small amounts, which could be operationally challenging to administer in units. It was also suggested in a number of responses that we should ban all rebates (both in cash and units) and that the way for fund managers to compete on prices would be through multiple share classes (that is offering different prices, through a separate share class) to consumers depending on which platform they invested through.

3 *The platforms market: consumer interaction,* June 2012, www.fsa.gov.uk/static/pubs/consumer-research/crpr87.pdf

4 See footnote 2.

Our response

While there were still a large number of respondents who felt cash rebates should be allowed across all markets, that was not the focus of this consultation process. We had already consulted on the cash rebate ban for advised business in CP10/29, published in November 2010, and confirmed this ban in PS11/9, published in August 2011. The focus of this paper was whether to read across a ban to non-advised business. Our rules banning cash rebates to consumers would not prevent a platform from receiving a rebate from a fund manager in cash, provided this is passed on in full to the consumer in additional units.

As a result of the queries raised with regard to tax issues we have spoken with the industry and HMRC. While providing a view on tax issues is a matter for HMRC, we will take into account, whenever possible, the tax position when setting policy. We do not consider that our policy position on rebates is less efficient from a tax perspective. Indeed the tax position as clarified by HMRC supports our view that maintaining product prices at a level so that a significant rebate is payable, either in cash or units, may lead to undesirable outcomes for consumers. This is because any rebates paid to the consumer (in either cash or units) outside a tax wrapper would create a taxable event for the consumer. Given that maintaining fund prices at levels with commission built in and then rebating a significant proportion of this to the consumer could be disadvantageous from a tax perspective, we would expect to see a significant move towards 'clean' (commission-free) share classes as consumers become aware of their existence and of the tax treatment of rebates.

We had consulted on a ban for cash rebates because they had the potential to cause confusion for consumers and make the platform or adviser charge appear free. They could effectively be used as a substitute for commission. Indeed, some of the responses to the CP argued that cash rebates should be allowed to continue as they were needed to fund the adviser charge. In CP12/12 we said that there may be certain instances where a cash rebate would be permitted, for example where the consumer has sold out of a fund. Another would be a cash rebate that is sufficiently small that it cannot be used to pay for the adviser or platform charge. A rebate paid back to the consumer that has a value of £1 or under per month per fund is unlikely to conflict with our policy objectives. We have added some guidance to the rules to confirm this point, and this would apply equally to advised or non-advised business.

There is no requirement for a firm to pay any cash rebate back to a consumer. However, there is a consistent view that this would help significantly with administrative processes. In the current market, where funds are generally priced with a significant rebate built in, a minimal level of £1 may be considered small. However, we have made clear in previous platform policy papers that we expect fund prices to be priced at a lower level, with adviser commission and the platform fee stripped out. At this lower level, we would expect that any rebate negotiated by platforms will be smaller and a minimal level of rebate in cash to be of greater significance.

Our policy on rebates does not impact on a firm's decision regarding multiple share classes. We have often been told by the industry that multiple share classes are not a viable solution. However, a small number of firms suggested that offering a limited number of different share classes may not be as costly or operationally difficult as many had previously suggested. Varying prices through different share classes may be a more attractive option given the recent clarification of the tax position. Our rules do not prevent product providers from varying the price of their fund to different platforms through multiple share classes. However, in this situation, firms would need to take account of our rules on re-registration and to present products in a way that is fair, clear and not misleading.

Timing

2.17 The Deloitte research[5] we commissioned into the business models of platforms, following the publication of PS11/9, indicated that firms that do not currently charge consumers a fee directly would need the most time to adapt to the changes. Accordingly, Deloitte estimated that the industry as a whole would need up to 12 to 18 months to be ready to implement the proposals. We also said in PS11/9 that we did not intend to introduce any rule changes in this area until after the introduction of the main RDR changes, which came into force on 31 December 2012. After taking account of the research findings, we proposed in CP12/12 an implementation date of 31 December 2013 for the changes highlighted in this Policy Statement.

2.18 In the consultation we asked:

> ***Q3:*** ***Do you have any comments to make on the proposed date for implementation of 31 December 2013?***

Responses to consultation

2.19 An overwhelming number of respondents felt that an implementation date of a year was reasonable. A handful of respondents felt this deadline was too long and that to maintain the momentum of the RDR we should bring these changes in sooner. A reasonable number felt this timescale was not sufficient and we should allow longer for the changes to come in, with changing systems to deal with unit rebates a common reason given. A number of firms suggested that any changes should coincide with the beginning of a new tax year, as this would be easier from an operational perspective.

Our response

We first set out our policy intention of banning platforms from receiving payments from product providers in August 2011. We confirmed this view in June 2012 and we have seen significant movements by the industry in developing explicit charging models. We therefore feel a year after publication of this Policy Statement is sufficient time for the industry to implement the changes. In light of comments from firms around the exact date coinciding with the new tax year, the rules will come into effect on 6 April 2014. As confirmed previously, the rules with regard to legacy payments would come into effect two years from this date, so on 6 April

5 *Analysis of the introduction of rebate bans on the platforms market*, by Deloitte, February 2012 www.fsa.gov.uk/smallfirms/pdf/deloitte-platforms.pdf

2016. It should be noted we are giving firms this extended two-year period for legacy business to allow them to move existing consumers over to the new explicit charging model on a gradual basis, as we were told that moving all customers over on a single date would be operationally challenging. We do not expect firms to wait until 6 April 2016 to move all customers with legacy assets to the new charging structure. We would expect most customers to have been moved to an explicit charging model before then.

Non-platform distribution

2.20 A further aspect of the Deloitte research looked at whether the rules we were proposing to introduce on banning rebates in the platforms market would lead to competition issues in relation to similar offerings in the wider retail investment market.[6] The issues considered included whether there would still be a level playing field between platform and non-platform adjacent markets[7] if the proposals went ahead.

2.21 Overall, the Deloitte research concluded that the bans did not distort competition in favour of other similar markets, but facilitated overall competition in the marketplace. In the Consultation Paper we asked the industry and consumers whether we should, at a future point in time, consider reading across our proposals on payments for platform services to non-platform markets.

2.22 In the consultation we therefore asked:

> *Q4:* ***Do you have any comments on the possible read-across of platform rules on payments for services to non-platform markets?***

Responses to consultation

2.23 A large majority of respondents felt we should read these rules across, otherwise an unlevel playing field would be created. A number of firms commented that if we did not apply similar standards to other markets it would leave a loophole in the rules, which firms may seek to exploit by re-engineering their service to circumnavigate our rules. A small number of respondents, essentially made up of life companies and execution-only brokers, felt there was no need to read any rules across, as there were not the same market failures that we had identified in the platform market.

Our response

Given the overwhelming number of respondents who felt that we should read across similar standards to all markets, we believe this issue merits further

6 In PS11/9, as consulted in CP10/29, the ban on cash rebates to consumers would apply on the sale of all retail investment products sold through advised business.

7 In CP12/12 we defined non-platform adjacent markets as those offerings typically provided by Self-Invested Personal Pension (SIPP) Operators; life companies offering life wrappers; discretionary fund managers, and those execution-only brokers and ISA managers that were not caught by the platform service definition.

consideration. We will consider these markets as part of our ongoing work and will aim to consult on rules at a later date, where necessary.

For example, an execution-only broker that uses a platform gives a similar outcome to a consumer to an execution-only platform. We already consider that execution-only brokers who white-label a platform are captured by the platform service definition (as explained later in this PS) and therefore need to be paid by a fee agreed with the consumer. And a SIPP is essentially a product wrapper which gives access to a wide range of underlying investments, in the same way that a product wrapper on a platform does. We have already identified concerns around disclosure of SIPP charges in CP12/29.[8] There is a strong case to apply similar rules, which will mean consumers pay directly for a SIPP, in the same way they will pay directly for the service a platform provides.

While the arguments for life companies are more complex, there may nevertheless be a strong case to read similar rules across. The RDR has moved the industry away from being able to buy distribution. However, a significant number of respondents felt that distribution arrangements between life companies and fund managers could give rise to the potential of providers buying distribution. We would expect firms to design their investment solutions in a way that provides good consumer outcomes rather than simply use those underlying products that are willing to pay a rebate to the firm to secure distribution.

We will also consider other retail markets where rebates can still be paid from one party to another, for example discretionary fund managers, and consider whether we should read similar rules across to avoid the potential for bias.

We intend to consult on rules later. To be clear, as in the platform market, we feel it is important for firms sitting between a product provider and a consumer to be able to negotiate a competitive price from the product provider, but we expect the consumer to benefit from this negotiation and we will ensure that any rules we introduce in this area take this into account.

Comments on the draft rules

2.24 In CP12/12 we also sought views on our draft Handbook rules and guidance.

2.25 In the consultation we therefore asked:

> ***Q5:*** ***Do you have any comments on the draft rules in Appendix 1 of CP12/12?***

8 *'Personal pensions - feedback to CP12/5 and final rules on disclosures by SIPP operators, and consultation on inflation-adjusted illustrations'*, November 2012.

Responses to consultation

2.26 Aside from the issues around legacy payments and clarification of what future payments platforms can still receive, a number of other comments were received. Some respondents asked for clarification on what was meant by 'vary….inappropriately' in COBS 6.1.E.3(G), which provides that a platform should not vary its platform charges inappropriately according to provider, or substitutable and competing retail investment products or type of retail investment product. Comments were also asked about the detail required for disclosure of the platform fee. Some firms also asked whether the platform was still able to receive cash, rather than units, from the fund manager provided this was passed on in full to the consumer in additional units.

Our response

The intention of the guidance in COBS 6.1.E.3(G) is to make our expectation clear that product costs should not be used to cross-subsidise the platform charge. The platform charge should essentially be similar across all products on a platform when there is not an appropriate reason for it to vary. So if a platform service provider is also a fund manager, we would not expect the platform to be labelled as 'free' if the consumer invests in funds operated by that manager. In much the same way as our adviser charging rules do not allow cross-subsidisation of advice charges by product charges (in the case of providers offering advice on their own products) or by advice charges on non-investment products, we expect firms to follow similar standards when determining their platform charges. With regard to the disclosure of the platform fee, we have deliberately kept the requirements at a high level and are working with firms to ensure consumers will be clear about the cost of the platform service. We have seen some examples of good practice, where the cost of using the platform is set out clearly to the consumer before they invest through the platform. This is then followed up by quarterly or half-yearly statements, which set out in pounds and pence exactly how much the platform charge has been for that period.

Our rules do not prevent a platform from receiving a rebate from a fund manager in cash, provided this is passed on in full to the consumer in additional units.

Platform service definition

2.27 Since the rules in PS11/9 came into force on 31 December 2012, we have received a number of queries about the 'platform service' definition. Due to a typographical error, the definition does not reflect the policy intention. We included within the definition the activity of '*safeguarding and administering assets*'. However this should have read, '*safeguarding and administering investments*'. So the definition incorrectly excludes execution-only firms that also arrange for the safeguarding and administration of their customers' investments. This typically takes the form of an execution-only firm white-labelling what would traditionally be considered a platform. When the consumer logs onto their account, they see the logo of the execution-only firm, although the established platform would be providing the custody service (this is commonly known as a white-labelling arrangement).

2.28 The policy intention to include such firms within the scope of the definition is clearly reflected in PS11/9 and in the cost benefit analysis (CBA).

2.29 We recognise the late correction to the definition and are correcting it now, without further consultation, because we believe that any further delay would be prejudicial to the interests of consumers. To ensure that there are no unintended consequences as a result of this correction, we will be consulting shortly.

Fund prices

2.30 There have been a number of comments since the RDR has come into effect that clean share classes (where the adviser commission and platform fee is stripped out) could actually cost consumers more. Some platforms have suggested that the level of rebate they have been able to negotiate from fund managers previously is not reflected in the clean share price now on offer to them. There have also been comments that the Total Expense Ratio (TER) on clean share classes is higher than that for share classes with rebates built in.

2.31 We have already expressed concerns with regard to pricing and competition in the asset management industry.[9] If a platform was able to negotiate, for example, a rebate of 90bps from a fund manager for a 150bps fund, then we would be concerned if the same deal would not be on offer to that platform when looking to add a clean share class, given that consumers will directly benefit from this negotiation. We do not expect these policy changes to be used as a reason by the industry to increase the fees they are able to receive.

2.32 With regard to the TER on funds, if we see the average TER across the industry increase as a result of these changes and the movement to clean share classes, this will add weight to the concerns we have around pricing and competition in this market.

9 www.fsa.gov.uk/library/communication/speeches/2012/0925-mw.shtml

3. Cost benefit analysis

3.1 The chapter outlines the views of the respondents to CP12/12 on our cost benefit analysis (CBA). We also set out our response to these views and how we have taken them into account.

Feedback on the CBA in CP12/12

3.2 We received 77 responses on the CBA published in CP12/12. The vast majority of respondents agreed with the main issues we identified in the CBA and provided no further comment on it. Several respondents were generally supportive of the CBA, suggesting that a fully disclosed platform model would provide more choice, cost-effective solutions for consumers and an improved sense of integrity in the industry.[10] However, a minority felt the CBA was incomplete for a number of reasons, summarised as follows:

- **Compliance costs –** A number of respondents disagreed with our estimate of compliance costs. In particular, some stated that they were either too low in the case of execution-only stockbrokers, or too high in the case of execution-only platforms. Others felt that the CBA understated the costs of creating and maintaining a unit rebating system. Many of these respondents also suggested that increases in compliance costs through higher-expected transaction costs of unbundling would lead to higher prices for consumers. Several respondents felt that our proposals were inadequately explained, in particular in relation to legacy business and payments for services, which added uncertainty in estimating robust compliance costs.

- **Complexity –** Several respondents said that banning cash rebates and moving to unit rebates would potentially discourage consumers from participating in this market, because of the perceived complexity of our proposals. It was argued that the possible rise in the number of share classes offered post-RDR could also add to complexity and be an additional administration burden on consumers or their advisers in keeping track of any capital gains liabilities.

- **Competition –** Some respondents also raised concerns about whether there would still be a level playing field if our proposals go ahead without corresponding changes made in adjacent non-platform markets. A couple of respondents went further, suggesting that non-UK platforms and what they referred to as 'institutional platforms', such as corporate wrap platforms, would in their opinion not have to comply with our proposals, and questioned whether this was taken into consideration. One respondent also believed that there were high barriers to entry and a perceived low profitability of many existing platforms that would discourage new entry and innovation in funds or providers.

10 Subject to transfers between platforms being straightforward and at minimal cost.

Our response

In response to concerns that we incorrectly estimated the compliance costs, we went back to a selection of firms and a trade body that expressed strong views on whether costs had been under or overestimated. We asked 12 firms, comprising execution-only brokers and a platform, to provide us with additional information on what they thought compliance costs ought to be for their circumstances and market segment, based on the most recent information we could provide, i.e. CP12/12.

We did not receive further information from the firms we approached that contradicted the initial estimates. However, in the process of reviewing the costs to platforms, we noted that in our original CBA we had not included the costs of compliance for two platform service operators that should have been included in our original industry estimates in CP12/12. Taking these firms into account revises our estimates of costs to platform services providers as follows:

Table 1: Incremental compliance costs for implementing the proposed rebate bans (£m)

	One-off costs	Ongoing cost
Platform operators	27.6-61.8	7.2-13.8
ISA managers	0.7	0
Ex-only brokers	1.0	0
Fund managers	3.7	1.1
Total*	33.0-67.2	8.3-14.9

Our estimates of total costs to industry have risen by £16m one-off costs and £4m ongoing costs from our CP12/12 estimates. The range of industry costs for compliance we have now estimated as between £33m and £67m one-off and £8m to £15m ongoing. We consider that these revised costs are likely to be on the high side of estimates. Indeed one of the largest existing non-advised platforms has informed us that the compliance costs estimated for the typical non-advised platform[11] were significantly higher than they anticipated for their circumstances.

To address concerns about the competition impacts on the wider market, we intend to consult on the read across of our platform rules to adjacent markets where relevant. Although Deloitte's platform business model report concluded that our bans would not distort competition in favour of related markets, responses to CP12/12 suggest that we should do more work in this area and consult more widely on this issue.

However, we do not accept some respondents' views that our platforms policy will affect platform competition and innovation adversely. Deloitte concluded in their report that the banning of rebates was unlikely to change the platform market structure, but would affect market behaviour through

11 See page 109 of Deloitte's 'Analysis of the introduction of rebate bans on the platform market' report, February 2012, which stated that the costs for the typical non-advised platform complying with our rebate proposals equated to £8m one-off and £2m ongoing costs.

improved transparency, which in turn would enhance competition in the market. Furthermore, Deloitte's report confirms that platforms are increasingly becoming more sustainable, and further market entry since the publication of CP12/12 contradicts views that barriers to entry are prohibitively high.

Finally, we do not accept that some platforms by way of their business model will somehow automatically circumvent our platform policy. Since publishing PS11/9 we have been clear that if a firm fulfils the definition then it would have to comply with our platform rules.

Changes made to the draft rules in CP12/12

3.3 In response to feedback we are making some changes to the draft rules. This section provides our view on the costs and benefits of these changes.

3.4 As we explained in Chapter 2, we are making the following changes to our rules:

a. We have clarified what a platform can charge fund managers directly for. This would be limited to a number of non-recurring events such as dealing with pricing errors, corporate actions and providing management information (MI). We also will allow platforms to continue to receive payments for advertising from product providers where this does not bias outcomes offered to end consumers.

b. We have amended the timetable for when a platform charge should become payable.

c. We are allowing rebates to platforms to continue for all legacy business for a period of two years following the implementation of this Policy Statement.

d. When a rebate due to the customer does not exceed a value of £1 per fund, we will allow this to be paid back to the customer as cash.

Update of the CBA in CP12/12 following changes made in the draft rules

3.5 The minor policy changes made in this Policy Statement do not significantly alter our assessment of costs, benefits and competition in CP12/12. If anything, allowing some non-recurring payments, setting a minimal level of cash rebate, having a transitional period and changing the timing of when platform charges should be charged should help towards reducing the compliance costs facing firms without materially changing the benefits of our policy.

Compatibility statement

3.6 We are not making any significant changes to the rules we consulted on in CP12/12, and the changes do not materially change the conclusions of our CBA. However the Compatibility Statement in CP12/12 did not explicitly take into account the FCA's objectives and duties and certain aspects were therefore not consulted on. In particular, the FCA's duty to consider the impact of its rules on authorised mutual societies. We do not expect the impact of the rules on authorised mutual societies to be significantly different from the impact of the rules on other authorised firms. However, we will consult on this and an updated FCA compatibility statement shortly.

3.7 We are making the rules now, having fully taken the FCA's objectives and duties into account, because the compatibility statement in CP12/12 is, in any event, adequate and a delay in making these rules would be prejudicial to the interests of consumers. If as a result of our consultation on an updated FCA compatibility statement we consider we need to change anything, we will of course do so.

Annex 1
List of non-confidential respondents to CP12/12

Association of British Insurers

Aegon

Association of Investment Companies

Association of Independent Discount and Non Advisory Brokers

Association of Independent Financial Advisers (now Association of Professional Financial Advisers)

A J Bell

All Funds Bank

Altus

Association of Member-Directed Pension Schemes

Artemis

Aviva

AWD Chase de Vere

AXA Wealth

Baille Gifford & Co

Blackrock

BNY Mellon (International) Ltd

Capita Life & Pensions Regulated Services

Chelsea Financial Services

Cofounds

F&C Fund Management Ltd

Fabian J.A. Finlay

Financial Services Consumer Panel

Friends Life Group

Fund Platform Group

Fundamental Tracker Investment Management Ltd

Future Capital Partners

Institute of Chartered Accountants in England and Wales

Investment Funds Direct Limited (Ascentric)

Investment Management Association

Intelligent Financial Advice

Interactive Investor Trading Limited

International Financial Data Services

Jupiter

Legal and General

Liontrust

LWM Consultants Ltd

M&G Investments

Martin Currie

Nationwide

Navigant Consulting

Novia Financial Plc

Nucleus

Page Russell Ltd

Pearson Jones Plc

Platform One

Prudential

Rathbones

Raymond James Investment Services Ltd

Schroder Investments Limited

Scottish Life

Seymour Sinclair Investments Limited

SVG Investment Managers Limited

Tata Consultancy Services Ltd

Tenet Group Ltd

Tax Incentivised Savings Association (TISA)

Torquil Clark Limited

Transact (Integrated Financial Arrangements Plc)

UBS Wealth Management

UK Platform Group

Vale Asset Management

Wealthtime Limited

Zurich Financial Services Ltd

Rod Price

Richard Gray

David Williams

Gareth Green

Arnold J Harper

Douglas Robertson

Appendix 1

Made rules (legal instrument)

CONDUCT OF BUSINESS SOURCEBOOK (PLATFORMS) (AMENDMENT) INSTRUMENT 2013

Powers exercised

A. The Financial Conduct Authority makes this instrument in the exercise of:

(1) the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(a) section 137A (The FCA's general rules);
(b) section 137T (General supplementary powers); and
(c) section 139A (Power of the FCA to give guidance); and

(2) the other powers and related provisions listed in Schedule 4 (Powers exercised) to the General Provisions of the Handbook.

B. The rule-making powers referred to above are specified for the purpose of section 138G (Rule-making instruments) of the Act.

Commencement

C. Annex B to this instrument comes into force on 1 May 2013.

D. Annex A and Annex C to this instrument come into force on 6 April 2014.

Amendments to the Handbook

E. The Glossary of definitions is amended in accordance with Annex A and Annex B to this instrument.

F. The Conduct of Business sourcebook (COBS) is amended in accordance with Annex C to this instrument.

Notes

G. In Annex B to this instrument, the "note" (indicates by "**Note**:" is included for the convenience of readers but does not form part of the legislative text.

Citation

H. This instrument may be cited as the Conduct of Business Sourcebook (Platforms) (Amendment) Instrument 2013.

By order of the Board
25 April 2013

Annex A

Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

Insert the following new definition in the appropriate alphabetical position. The text is not underlined.

platform charge	any form of charge payable by or on behalf of a *retail client* to a *firm* in relation to the provision of a *platform service* and which is agreed between the *platform service provider* and the *retail client*.

Annex B

Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

platform service	a service which: (a) involves *arranging* and *safeguarding and administering* ~~*assets*~~ <u>*investments*</u>; and (b) distributes *retail investment products* which are offered to *retail clients* by more than one product provider; but is neither: (c) solely paid for by *adviser charges*; nor (d) ancillary to the activity of *managing investments* for the *retail client*. <u>[**Note**: This definition applies only within the *FCA Handbook*.]</u>

Annex C

Amendments to the Conduct of Business sourcebook (COBS)

In this Annex, underlining indicates new text and striking through indicates deleted text.

6.1A Adviser charging and remuneration

…

6.1A.14A R A *firm* must not make a *personal recommendation* to a *retail client* in relation to a *retail investment product* if it knows, or ought to know, that:

(1) the product's charges or the *platform service provider's* charges are presented in a way that offsets or may appear to offset any *adviser charges* or *platform charges* that are payable by that *retail client*; or

(2) the product's charges or other payments are maintained by the *retail investment product* provider at a level such that a cash rebate, other than a cash rebate permitted by *COBS* 6.1E.10R(2), is payable to the *retail client.*

…

6.1B Retail investment product provider and platform service provider requirements relating to adviser charging and remuneration

...

Requirement not to offer commissions

…

6.1B.6 G ~~The requirement not to offer or pay commission does not prevent a *firm* from making a payment to a third party in respect of administration or other charges incurred, for example a payment to a *platform service provider* or third party administrator.~~ [deleted]

Distinguishing product charges from adviser charges

6.1B.7 R A *firm* must:

(1) take reasonable steps to ensure that its *retail investment product* charges are not structured so that they could mislead or conceal from a *retail client* the distinction between those charges and any *adviser charges* payable in respect of its *retail investment products*; ~~and~~

(2) not include in any marketing materials in respect of its *retail investment products* or facilities for collecting *adviser charges* any statements about the appropriateness of levels of *adviser charges* that a

firm could charge in making *personal recommendations* or providing related services in relation to its *retail investment products*; and

(3) not defer, discount or rebate *retail investment product* charges in a way that offsets or may appear to offset any *adviser charges* or *platform charges* that are payable, including by maintaining *retail investment product* charges at a level such that a cash rebate, other than a cash rebate permitted by *COBS* 6.1E.10R(2), is payable to the *retail client*.

6.1B.8 G *COBS* 6.1B.7R does not prevent a *firm* from offering a promotional discount to a *retail client* in the form of extra *units* or additional investment, but a ~~A~~ *firm* should not offer to invest more than 100% of the *retail client's* investment.

…

6.1E Platform ~~service~~ services ~~providers~~: platform charges and using a platform service for advising

Platform service providers: ~~fees and commission~~ platform charges

6.1E.-1 R This section does not apply if the *retail client* is outside the *United Kingdom*.

6.1E.1 R (1) ~~If, in relation to a *retail investment product*, a~~ A *platform service provider* ~~arranges to accept a fee or commission paid by a third party or a *person* acting on behalf of a third party, it~~ must clearly disclose the ~~amount of that~~ ~~fee or commission~~ total *platform charge* to the ~~*professional client*~~ ~~or~~ ~~*retail client*~~ *customer* in a *durable medium* in good time before the provision of *designated investment business*.

(2) In the event that it is not possible to make the disclosure in (1) in good time before the provision of *designated investment business*, the disclosure must be made as soon as practicable thereafter.

6.1E.2 G ~~If a~~ A *platform service provider* ~~accepts a fee or commission referred to in *COBS* 6.1E.1R, it~~ should pay due regard to its obligations under *Principle* 6 (Customers' interests), *Principle* 7 (Communications with clients) and the *client's best interests rule*, and ensure that it presents *retail investment products* to ~~*professional clients*~~ ~~and~~ ~~*retail clients*~~ *customers* without bias.

6.1E.3 G A *platform service provider* should pay due regard to its obligations under *Principle* 6 (Customers' interests) and the *client's best interests rule* and not vary its *platform charges* inappropriately according to provider or, for substitutable and competing *retail investment products*, the type of *retail investment product*.

Requirement to be paid through platform charges

6.1E.4 R Except as specified in *COBS* 6.1E.6R and *COBS* 6.1E.7R, a *platform service* *provider* must:

(1) only be remunerated for its *platform service* (and any other related services it provides), by *platform charges*; and

(2) ensure that none of its *associates* accepts any remuneration in respect of those services.

6.1E.5 G Examples of remuneration that should not be accepted by a *platform service provider* or its *associates* include (but are not limited to):

(1) a share of an annual management charge; and

(2) any payment (other than a product charge or a *platform charge*) made to a *platform service provider* in its capacity as a *retail investment product* provider where the relevant *retail investment product* is distributed to *retail clients* by its *platform service*.

Exceptions

6.1E.6 R A *platform service provider* or its *associates* may solicit and accept payments from:

(1) a *firm*, other than a *retail investment product* provider, which is in the business of making *personal recommendations* to *retail clients* in relation to *retail investment products*; and/or

(2) a *firm*, other than a *retail investment product* provider, which is in the business of *arranging* or *dealing retail investment products* for *retail clients.*

6.1E.7 R A *platform service provider* or its *associates* may solicit and accept payments from a *firm*, which are only for:

(1) pricing error corrections;

(2) administering corporate actions;

(3) research carried out by the *platform service provider* and management information; and

(4) advertising;

provided that:

(5) the services are available to *firms* at a price which does not vary inappropriately according to *firm*;

(6) the payments are reasonable and proportionate for the service; and

(7) the payments or service could not reasonably be expected to result in a channelling of business to the *firm* other than through the normal effect

of general advertising.

Distinguishing platform charges from product charges and adviser charges

6.1E.8 R A *platform service provider* must not *arrange* for a *retail client* to buy a *retail investment product* if:

(1) the product's charges are presented in a way that offsets or may appear to offset any *adviser charges* or *platform charges* that are payable by that *retail client*; or

(2) the *platform service provider's* charges are presented in a way that offsets or may appear to offset any product charges or *adviser charges* that are payable by the *retail client*; or

(3) the product's charges or other payments are maintained by the *retail investment product* provider at a level such that a cash rebate, other than a cash rebate permitted by *COBS* 6.1E.10R(2), is payable to the *retail client*.

Using a platform service when advising

6.1E.9 R A *firm* must not use a *platform service* as part of a *personal recommendation* to a *retail client* in relation to a *retail investment product* unless it has satisfied itself that the *platform service provider*, and its *associates*, only receive remuneration for business carried on in the *UK* which is permitted by the *rules* in this section.

Providing additional units or payment in cash to a retail client

6.1E.10 R *COBS* 6.1E.4R does not prevent a *platform service provider* receiving a share of an annual management charge from an *authorised fund manager* if the *platform service provider* passes that share on to the *retail client* in the form of:

(1) additional *units*; or

(2) cash, provided that it does not offset or appear to offset any *adviser charges* or *platform charges.*

6.1E.11 G Examples of a cash share of an annual management charge that would not offset or appear to offset any *adviser charges* or *platform charges* are:

(1) where the *retail client* has redeemed his *retail investment product*; or

(2) where the value of the payment made to the *retail client* in each month does not exceed £1 for each fund.

6.1E.12 G If a *platform service provider* passes a share of an annual management charge on to a *retail client* by way of additional *units* or cash, it should pay due regard to its obligations under *Principle* 7 (Communications with clients).

6.1F Using a platform service for arranging and advising

Client's best interests rule and using a platform service

6.1F.-1 R This section does not apply if the *retail client* is outside the *United Kingdom*.

6.1F.1 R A *firm* ~~(other than a *platform service provider*)~~ which:

(1) *arranges* for ~~a~~ *retail* ~~*client*~~ *clients* to buy ~~a~~ *retail investment* ~~*product*~~ *products* or makes ~~a~~ *personal* ~~*recommendation*~~ *recommendations* to ~~a~~ *retail* ~~*client*~~ *clients* in relation to ~~a~~ *retail investment* ~~*product*~~ *products*; and

(2) uses a *platform service* for that purpose;

must take reasonable steps to ensure that it uses a *platform service* which presents its *retail investment products* without bias.

…

TP 2 Other Transitional Provisions

(1)	**(2)**	**(3)**	**(4)**		**(5)**	**(6)**
	Material to which the transitional provision applies		**Transitional provision**		**Transitional provision: dates in force**	**Handbook provisions: coming into force**
...						
2.2A	*COBS* 6.1E	R	A *platform service provider* may continue to accept remuneration in relation to a *retail investment product* transaction which was executed on or before 5 April 2014:		From 6 April 2014 to 5 April 2016	6 April 2014
			(1)	if, after 5 April		

				2014, no change is made to that product or the investment held in that product; or		
			(2)	where there is such a change on or after 6 April 2014, only in relation to the unchanged part of that product.		
2.2AA	*COBS* 6.1E	G	The *platform service provider* may be remunerated by way of a *platform charge* for the changed part of that product.		From 6 April 2014 to 5 April 2016	From 6 April 2014 to 5 April 2016
2.2AB	*COBS* 6.1E	G	The following examples do not entail changes to the *retail investment product*:		From 6 April 2014 to 5 April 2016	From 6 April 2014 to 5 April 2016
			(1)	regular contributions to or a reinvestment of dividends from a *retail investment product* following instructions given on or before 5 April 2014;		
			(2)	a rebalancing of the *retail investment product* following instructions given on or before 5April 2014.		
2.2AC	*COBS* 6.1E	G	Examples of changes to the *retail investment*		From 6 April 2014 to 5 April 2016	From 6 April 2014 to 5 April 2016

			product are:			
			(1)	the *retail client's* investment in, or regular contribution to the relevant *retail investment product* is increased following instructions given on or after 6 April 2014. The *platform service provider* can continue to receive remuneration in relation to the amounts invested by the *retail client* following instructions given on or before 5 April 2014 but not in relation to any additional amounts invested by the *retail client* following instructions given on or after 6 April 2014.		
			(2)	the *retail client's* investment is switched between *retail investment products* held by the *platform service provider* following instructions given on or after 6 April 2014. This includes switching between funds within a *retail investment product*		

				such as a *SIPP* or a *retail investment product* wrapper such as an *ISA*.		
			(3)	the re-registration of the *retail client's retail investment product* to another *platform service provider* following instructions given on or after 6 April 2014.		
…						

Appendix 2

Notification to the European Commission

Notification and justification for banning platforms from receiving certain payments (or 'rebates') and banning certain payments to retail clients buying retail investment products from platforms

This notification relates to FCA Handbook text that will come into force on 6 April 2014, as explained in the Financial Conduct Authority's Policy Statement "PS13/1: Payments to platform service providers and cash rebates from providers to consumers" as well as related rules and any subsequent changes made to those rules which are within the scope of this notification.

1. In March 2010, we amended our previous notification under Article 4 of Directive 2006/73/EC, in relation to packaged products, as part of our "Retail Distribution Review"[1] (or "RDR"). We explained our revised approach to dealing with the risk of recommendations being biased as a result of the receipt of commission. This included a requirement banning retail investment product providers from offering predetermined amounts of commission to UK adviser firms, in relation to the recommendation of their products.

2. Since then, we have conducted further research and analysis of the UK platform market and are applying requirements in this specific area. 'Platforms' are internet-based services used by retail intermediaries and retail clients to view and administer investments. In the UK, as well as acting as distributors of collective investment schemes and other financial instruments[2] (receiving and transmitting orders as well as executing orders on behalf of clients), platforms are also involved in the provision of services for the safekeeping and administration of financial instruments for the account of clients.

3. This notification relates to the introduction of rules restricting platforms from receiving payments (commonly described as 'rebates') from product providers as well as payments from platforms to retail clients. This notification focuses on our application of such requirements to platforms in the UK regardless of whether or not advice is provided and is being submitted on a precautionary basis.

4. In the UK, many platforms – including those that are used through intermediaries as well as those that offer their services directly to retail clients (commonly referred to as direct-to-consumer (D2C[3]) platforms) – have been funded by payments from product providers, allowing them to market their services at no explicit cost to the retail client. This has led to some platforms hosting only those products that pay them a rebate, ignoring investments such as low cost, passively managed tracker funds. Our new rules are designed to ensure that all platforms are remunerated through explicit charges payable by

[1] The amendment to our 'Notification and justification for amending certain requirements relating to the market for packaged products' under Article 4 of Directive 2006/73/EC ("Level 2 Directive") implementing Directive 2004/39/EC ("Level 1 Directive")' is available on the European Commission's website at http://ec.europa.eu/internal_market/securities/docs/isd/implementation/uk_art_4_4_en.pdf

[2] These include various types of collective investment schemes (such as unit trusts, open-ended investment companies, investment trusts and exchange traded funds) as well as equities.

[3] D2C (direct to consumer) platforms enable retail clients to invest directly in a variety of retail investment products on a non-advised basis.

the retail client so that product providers are less able to influence the distribution of retail investment products through platforms. The introduction of rules to cover both circumstances where retail clients invest through an intermediary (on an advised basis) or directly using a D2C platform (on a non-advised basis) is needed to ensure the MiFID client's best interests and inducements rules are implemented fully and appropriately, taking account of the unique role of platforms in the UK market and to support the regulatory changes being introduced in the UK through the RDR.

Links with the UK's requirements on adviser charging[4] – application to platforms of rules already notified

5. Our existing notification covers our rules to ban payments from product providers to retail clients that could appear to offset adviser charges[5] and we will be following its rationale to apply the same approach to platforms. This requirement is designed to ban platforms and product providers from paying 'rebates' of product charges in cash to retail clients where this could offset the adviser or platform charges. Without it, firms could continue, in effect, to include commissions for intermediaries or platforms in their charges – paying the money to the retail client rather than to the intermediary or platform directly.

6. Similarly, we have extended the requirement for product providers relating to facilitation[6] of adviser charging (explained in our existing notification) to platforms. Platforms will therefore be required to meet the same standards as product providers when they facilitate adviser charging.

New restrictions on platforms receiving payments or rebates from product providers where advice is provided

7. We believe it is clear that the arguments made in our earlier notification[7] under Article 4 can be extended to platforms that are used on an advised basis. Our earlier notification explains our requirement for adviser firms to determine their own adviser charges, along with an equivalent requirement on product providers, which bans retail investment product providers from offering predetermined amounts of commission to UK adviser firms in relation

[4] Our rules require that all adviser firms should only be paid through 'Adviser Charging' for the advice and related services they provide. This means that adviser firms should be paid by charges that they have set out upfront and agreed with their clients, rather than commissions set by product providers.
[5] Paragraph 36 of the amendment to our existing notification (see footnote 1) explained that in order to make sure that particular practices do not undermine our new approach to adviser charging, we would also introduce a number of supplementary rules ("requirements relating to the practical application of adviser charging") – in particular, the final bullet point under paragraph 36 makes clear that product providers must not "defer, discount or rebate their product charges in a way that may appear to offset any adviser charges that are payable".
[6] The second bullet of paragraph 36 of the amendment to our existing notification (see footnote 1) sets out that where a product provider firm is collecting adviser charges from investments to pass on to an adviser firm, it must validate the instructions it receives to pay the adviser charge and offer sufficient flexibility in terms of the adviser charges it facilitates. Also, the product provider firm must not pay out the adviser charges over a materially different time period or basis to that in which it recovers the adviser charge from the retail client.
[7] See footnote 1.

to recommending their products. Following the logic of our existing notification, we feel it necessary to apply an equivalent restriction on platforms receiving payments from product providers.

8. From April 2014, equivalent requirements will apply to UK platforms used via an advice process as to product providers and advisers, following the same rationale as set out in our earlier notification. Just as payments made between product providers and intermediaries may bias advice, payments between platforms and other parties can have the same effect. We believe that these payments operate in the same way as commission payments from product providers to intermediaries and so are incompatible with our implementation of the client's best interests and inducements rules under MiFID, for the reasons already stated in our existing notification.

9. In order to clarify and give full meaning to the policy intent outlined in our earlier notification, we are introducing a rule such that platforms must be remunerated through an explicit platform charge payable by the retail client and platforms providing services to these retail clients are restricted from receiving payments from product providers in situations where advice is provided. In this regard, we are submitting a new notification under Article 4, on a precautionary basis, for this limited additional requirement.

New restrictions on platforms receiving payments or rebates from product providers and cash payments to retail clients where no advice is provided

10. Since our previous notification focused on advised situations, we have not previously notified equivalent requirements for non-advised transactions through platforms (D2C platforms), where D2C platforms receive rebates from product providers and where product charges could be similarly maintained at inflated levels in order to ensure that a commission for the platform can be paid out of a cash rebate offered to the retail client.

11. Our rules banning the receipt of payments by platforms from product providers as well as rebates of product charges in cash to retail clients where this could offset any adviser or platform charges, will apply to all types of platform services in the UK market, regardless of whether or not advice is provided. We are making clear that in both the advised and non-advised platform market this ban on rebates of product charges in cash to retail clients would not prevent retail clients from being able to receive cash rebates which, for example, have a minimal value as this would be unlikely to offset any adviser or platform charges. Similarly, our rule banning rebates of product charges in cash to retail clients where this could offset charges, would not prevent a platform from receiving a rebate of the product charge from a fund manager in cash, provided this is passed on in full to the consumer in additional units.

12. We are therefore including in our new notification under Article 4, on a precautionary basis, these additional requirements to apply to situations where no advice is provided.

13. In order to ensure a level playing field between platforms used via an advice process and D2C platforms, we consider it necessary to ensure that these rules equally apply to D2C platforms. If we excluded D2C platforms from the scope of our rules, product providers looking for ways to circumvent our earlier reforms may seek to 'buy' distribution from platforms in lieu of being able to secure distribution from advisers by offering commissions. This reflects the fact that, under the UK RDR rules, product providers will not be able to offer amounts of commission to adviser firms for selling their products.

1. Background description of the relevant UK market and risks

Key characteristics of platforms

14. Platforms are internet-based services used by advisers and retail clients to manage and administer investments online, offering a single view of the retail client's invested portfolio. They are normally investment firms and comprise a web based portal which can be accessed by either retail clients or advisers to execute investment transactions. Platforms are seen as a convenient channel through which investments can be arranged and then held in one place (for example to provide a single valuation for an entire portfolio).

15. The general characteristics usually associated with platforms that exist in the UK include the following:

- As well as receiving and transmitting orders and executing orders on behalf of clients, platforms also provide safekeeping and administration of clients' assets for retail clients.
- Platforms host and allow clients to purchase a wide variety of retail investment products[8], including both products that are subject to MiFID and others such as insurance-based investment wrappers.
- Platforms can also provide investment planning tools and other services for adviser firms.
- For product providers, platforms provide a means of distributing their products and some administrative services.

16. In the UK, platforms have in the past generally been funded by payments from product providers. These payments, commonly referred to as 'rebates' in the UK, are a proportion of the fund manager's annual management charge (AMC) paid by the retail client. As a result, many platforms (including those used via an advice process as well as D2C platforms) have been able to market their services at no explicit cost to the retail client. In contrast, some other

[8] Typically, MiFID products include: collective investment schemes such as unit trusts, OEICs, investment trusts and exchange traded funds (ETFs). Non-MiFID products typically include personal pensions, individual savings accounts (ISAs) and insurance bonds.

types of platforms charge retail clients a separate fee for their services and any cash rebate is generally paid into the retail client's cash account[9].

17. In recent years, there has been a significant increase in business transacted through platforms in the UK and this is expected to continue. The UK platforms market is the largest in Europe in terms of assets under administration (AuA)[10]. According to recent research[11] conducted on the UK platforms market, £229 billion of assets representing about 16% of total assets in the UK are currently held on platforms. The rate of growth of AuA on platforms in recent years has been significant, showing a compound annual growth rate of 16% between 2003 and 2011[11]. It is our understanding that in the UK, retail clients are more willing to make use of online or internet channels provided by platforms as a means of investing, whereas other markets with platforms appear to have a greater institutional focus.

18. The predicted growth in assets under management in the UK platforms industry together with the increasing usage of platforms by retail and professional clients in the UK underscores the importance of these services to the UK market.

19. Platforms are a key channel with respect to new business sales[12] in the UK retail investment market. Platforms are centrally positioned within the retail investment supply chain and, even where an adviser firm is also involved in a sale, provide services to and interface with retail clients, as well as advisers and product providers. There is significant potential for future growth in the UK platforms industry as a growing proportion of both new and legacy assets are migrated on to platforms. In this regard, the increasing need to ensure that both advised (where retail clients invest on a platform via an adviser) and direct channels (where retail clients invest without advice using D2C platforms) are brought in line with the client's best interests and inducements rules under MiFID, is demonstrated by their growing usage in the retail market in the UK. Consequently, we are concerned that the absence of equivalent rules restricting rebates in the platforms market could have the potential to pose significant risks to investor protection in relation to retail clients in the UK.

2. Requirements covered by this notification

A – Requirement on platforms (both in advised and non-advised situations) to charge retail clients for their services (rather than accepting payments from third parties)

20. Our new rules are designed to ensure that the platform is only remunerated through an explicit platform charge payable by the retail client for its platform service or any other related services. This will mean that the platform (and

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[9] Wrap platforms operate an account for the receipt of investments/premiums and investment income and to take fund discounts and platform charges and in future adviser charges.

[10] '*The European Platform Guide*', The Platforum, March 2012.

[11] '*Analysis of the introduction of rebate bans on the platforms market'*, by Deloitte, February 2012.

[12] Represented 41% of the total gross retail sales in Q3 2011, *Analysis of the introduction of rebate bans on the platforms market*, by Deloitte, February 2012.

any of its associates) will be prevented from accepting as remuneration a share of the AMC from the product provider. In this way, product providers will be less able to influence the distribution of retail investment products through platforms. A platform will be banned from receiving any remuneration other than platform charges payable by the retail client for its platform service[13].

21. The need for this requirement is supported by our experience in the UK of platforms, which have been funded by rebates from product providers, tending to host only those retail investment products that pay a rebate. Other types of platforms tend to provide access to a wider range of investments (such as low cost, passively managed tracker funds) since they rely on explicit charges from the customer as their main source of revenue.

Additional supporting requirements

22. In order to achieve effective delivery of our policy, we are also introducing a number of supplementary rules on adviser firms and platforms. These are included in the notification for completeness but relate to the requirements discussed above.

23. We are introducing rules to ensure that an adviser firm cannot make a personal recommendation to a retail client in relation to a retail investment product if it knows or ought to know that the product charges offset its adviser charges (covered in our existing notification[14] to the Commission) and we are extending this to also cover the platform's charges. This would mean that an adviser firm in the UK is prohibited from making a personal recommendation in relation to a retail investment product if:

- it knows or ought to know that the platform charges are presented in a way which offsets its adviser charges; and/or

- the retail investment product charges are presented in a way that would offset the platform charges.

24. Also, in order to prevent firms circumventing our policy approach, we will ensure that an adviser firm cannot use a platform service provider in relation to a personal recommendation to a retail client unless it has satisfied itself that the relationship with the platform allows it to comply with requirements applicable to the adviser firm in the UK (i.e. the platform and its associates only receive remuneration for business carried on in the UK in line with these rules). This further strengthens the rules[15] we have introduced for adviser firms whereby adviser firms using platforms must take steps to ensure that this does not bias their selection of products for retail clients.

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[13] Our proposed rules will still allow platforms to charge product providers for a limited range of services that do not form part of the platform service to the retail client. These include rectifying pricing errors made by the fund managers, communications on corporate actions and the provision of management information to product providers.

[14] See footnote 1.

[15] According to this requirement, if an adviser firm uses a platform to arrange or make a personal recommendation to a retail client, it must take reasonable steps to ensure that it uses a platform service which presents its retail investment products without bias, in line with the client's best interest rule.

25. To reinforce the additional measures we are introducing for advisers in this area (mentioned above), we will also ensure that platforms are prevented from presenting their platform charges in a way that offsets any adviser charges which are payable by the retail client.

26. Given the increasing demand for explicit pricing models in the UK market, together with the availability of the 'clean'[16] or institutional share class by fund managers, we expect that UK adviser firms will be able to acquire this share class with relative ease from platforms, regardless of their geographical location, in order to comply with rules imposed on them in the UK.

B – Prohibition on transactions where product charges are maintained at a level that could offset platform charges (in situations where no advice is provided), allowing a cash rebate to be paid

27. Our new rules are designed to ensure that the platform's charges are not hidden or obscured by the rebates that platforms receive from product providers or other payments being made to retail clients. To deliver this, we are introducing an equivalent rule to prevent D2C platforms (where retail clients invest directly via a platform without using an adviser) from arranging for a retail client to buy a retail investment product where the product charges may appear to offset any platform charges that are payable. This means that we will stop D2C platforms from selling products where product charges or other payments are maintained at a level such that a cash rebate is payable to the retail client. Our rules will not prevent platforms from passing on discounts from product providers to retail clients in the form of additional units.

28. The way that retail clients generally pay for platforms indirectly through the product charge causes confusion over costs and hinders competition in the market. Since the retail client is unaware of the amount of money being paid or rebated to the platform by the product provider on their behalf, retail clients are unable to make a reasoned judgement about whether the platform is providing good value for money. Disclosure of rebates would not fully address these issues as it would not tackle the further problem of product bias whereby platforms are incentivised to offer, or promote in particular, those products that pay a rebate. This outcome is not in the best interests of retail clients as they face difficulty obtaining access to those products that do not pay rebates to platforms.

In what way would the amended requirements be additional to those in the Level 2 Directive?

29. The bans on platforms receiving payments from product providers (used on both an advised and non-advised basis) and rebates of product charges in cash to retail clients of D2C platforms are intended to amplify the MiFID requirements on client's best interests and inducements as set out in Article 19

[16] The clean share price refers to those shares with no commission or rebate factored in, typically priced at 75bp in contrast to the retail share price of 150bp (which has adviser commission and the platform rebate built in).

of the Level 1 Directive and Article 26 of the Level 2 Directive respectively. These payments in their current form are not consistent with the intention of the inducement rules in the MiFID Level 2 Directive and can impair the ability of the platform to act in the best interests of its clients as provided in the MiFID Level 1 Directive.

30. Commission-type payments received by platforms have the potential to create product bias in the retail investment market. We are concerned that this potential for product bias will be amplified as both the intermediated and direct platform channels, which currently constitute an important route to market, continue to grow in significance for retail investors. It is important that we stop inappropriate inducements in this market.

31. Our policy of banning the receipt of rebates from product providers in the platform sector and rebates of product charges in cash to retail clients where these could be used to disguise the platform charge is needed to help secure the appropriate degree of protection for retail clients by helping to ensure that the client's best interest rule and the inducements rules under MiFID are met. This will help in ensuring that product providers are less able to influence distribution through platforms on both an advised and non-advised basis. To be clear, our rules would not prevent platforms from receiving a share of the product charge from a fund manager so long as the platform passes it on to the retail client in the form of additional units in the fund or in cash, provided that this does not appear to offset the adviser or platform charges.

Specific risks to investor protection not adequately addressed by the Level 2 Directive

32. Rebates in the platform market have the potential to obscure charges and maintain the potential for bias, restricting access and competition in the UK retail investment market. As a result, the way in which platforms are currently remunerated through rebates from product providers has the potential to restrict choice and influence the prominence of different products on a platform.

33. By allowing the industry practice of rebates to continue, product bias is likely to persist in the UK market, due to the continued ability of product providers to influence distribution by offering payments to platforms and rebate of product charges in cash to retail clients which can ultimately be used to pay for the charges of platforms. As a consequence, risks to investor protection are likely to arise.

34. The receipt of rebates by platforms from product providers and rebates of product charges in cash to retail clients can severely restrict market access to low cost investments that do not pay a rebate to the platform. Retail clients using platforms funded through payments from product providers have limited access to sometimes cheaper products that do not involve a rebate to the platform (such as passive low cost tracker funds and some investment trusts). Discussions we have conducted with UK fund managers confirm that those offering low cost funds without a rebate have difficulty or are unable to get access to platforms that are funded by rebates, in the case of both intermediated and D2C platforms. These payments therefore create barriers to

the distribution of low cost funds that do not pay rebates to the platform. Also, rebates in the platform market make it difficult for retail clients and their advisers to identify what services are being paid for and restrict the ability to compare different platforms.

35. Recent research[11] conducted into the platform market indicates that the typical customer AuA for intermediated platforms (where advice is provided) and D2C platforms (where no advice is provided) is approximately £38,000 and £32,000 respectively, which suggests that smaller investors (who might be expected to require access to low cost funds as part of their investment portfolio) use platforms as a route to market.

36. Given the predicted level of growth both in the advised and D2C platform market, together with the increasing reliance of UK retail clients on platforms, our rules in this area seek to address these specific risks relating to investor protection and market integrity as explained above.

In what way are the risks of particular importance in the circumstances of the market structure in the UK?

37. The increasing reliance of retail clients on platforms used via an advice process and D2C platforms in managing their investments is an important feature of the UK market structure. In this regard, the research on the UK platforms market suggests that rapid growth of AuA on platforms is likely to continue in the short to medium term. In the coming years, platforms are expected to be seen as an attractive channel through which retail clients can buy and manage retail investments both on an advised and non-advised basis. In the UK, the volumes of retail clients' AuA are concentrated on those platforms that are funded through payments from providers. Most assets are currently placed on platforms through adviser-led distribution. In Q2 2012, £190bn[17] of assets were held on advised platforms. Research reveals that platform penetration has grown, with approximately 80% to 85% of advisers now regularly using platforms. In Q3 2011 the AuA on D2C platforms was estimated to be approximately £73.2bn[18].

38. In terms of the predicted industry growth, research[11] indicates that the AuA on advised platforms is expected to grow at a compound annual growth rate (CAGR) of 21% from 2011 to 2014. For the D2C platform sector, research indicates that the AuA is expected to grow at a CAGR of 71% from 2011 to 2014, over three times the rate of growth assumed for platforms used on an advised basis.

39. It is possible that the reforms introduced under the RDR have had some impact in encouraging the growth of the platforms market in the UK, as consumers become more aware of the cost of advice and the options that they face in either paying for advisory services or accessing investment products and services directly. The introduction of adviser charging is also expected to encourage retail investment business to be conducted through platforms

[17] *The Adviser Platform Guide*, the Platforum, August 2012.
[18] *The Direct Platform Guide*, the Platforum, February 2012

because platforms can facilitate the collection and payment of adviser charges for clients. Consequently, we expect to see a strong trend towards both platforms used via an advice process and D2C platforms, as indicated by the research[11] into the platform market.

40. Platform services are a relatively new type of service that have recently emerged[19] on the UK retail investment landscape. Platforms used via an advice process which are funded through rebates continue to dominate the market and generally administer few non-commission generating products. As a consequence, there is no incentive for the platform to hold funds or other investments which do not, or cannot, pay them a fee.

41. The research[20] conducted into the interaction of retail clients with platforms indicates that retail clients are generally not aware of the costs or charges in relation to platform use. It found that few retail clients had a good understanding of how platforms are financed and the relationships between fund managers, platforms and advisers. It found that consumer understanding of charges was poor and few knew what the platform charge was. The research also found that retail clients using platforms on an advised basis are particularly lacking in awareness of the system of rebates from product providers to platforms and cash rebates to clients, with some expressing concerns about complexity and hidden charges. The research also found that some D2C platform clients believed that it was a free service.

42. These payments or rebates consequently result in a marketplace where retail clients cannot easily make price comparisons on charges levied between different platforms or between those products that are available on those platforms. This lack of comparability in turn hinders effective competition in the UK platform market. As a result, there appear to be limits on the extent to which retail clients are currently able to exercise informed choice, due to the industry practice of rebates.

43. In relation to the payment of cash rebates to retail clients using D2C platforms, the research suggests that the way in which retail clients habitually pay for D2C platforms (i.e. indirectly through the product charge rather than an explicit platform fee), hinders effective competition in the D2C platform market. Research[11] on platforms' business models indicates that D2C platforms have the highest effective charges per customer and that the implied costs associated with D2C platforms are substantially higher than platforms in the advised market. The research suggests that if retail clients pay an explicit fee, it is likely to lead to better engagement between the platform and the retail client, and as a result exert greater competitive pricing pressure on platforms (both in the advised and D2C market) to the benefit of the retail client.

44. D2C platforms provide a route for retail clients to directly access the retail investment market on a non-advised basis. Although retail clients are not

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[19] The first platform was introduced in the UK in 2000. Since then assets under administration (AuA) have grown substantially.

[20] *The platforms market: consumer interaction: Qualitative research to investigate consumer use and knowledge of platforms'* by NMG, January 2012.

technically receiving advice when investing through a D2C platform, their decisions do tend to be influenced by the investment information provided by the platform. The consumer research conducted on retail clients' interaction with platforms indicates that retail clients make use of (and in some cases rely on) the fund and investment information, tools, research, hints and tips provided by the D2C platform for its clients. The consumer research also revealed that some D2C platform customers perceive that an additional layer of investment management is carried out by the platform, such as identifying best funds and providing investment expertise. So, whilst retail clients decide for themselves what funds to invest in, they can still be influenced by the manner in which the D2C platform presents and markets the funds available on the platform.

45. Within this context, the potential impact of product providers influencing distribution through platforms through the rebates received by platforms and retail clients is significant. Given the increasing role that both platforms used via an advice process and D2C platforms will continue to play in the retail distribution chain, it is essential that the client's best interest rule and inducements rules under MiFID are applied effectively in this market.

Why is this approach proportionate?

46. This approach recognises the concern that rebates received by platforms from product providers and rebates of the product charges in cash to retail clients using D2C platforms have the potential to obscure charges and distort retail clients' outcomes.

47. Disclosure would not adequately address the failures identified in relation to the platform market in the UK. This is because disclosure of rebates would not sufficiently tackle the problem of product bias in this market, as it does not solve the problem of access to products that do not pay a rebate to the platform. Disclosure alone is likely to be ineffective in bringing about the necessary changes in behaviour in the platform market.

48. We feel that our new rules are proportionate, as we have taken into consideration the nature of the UK platform market. Based on the findings of the research carried out into the platform market, we intend to give platforms sufficient time (approximately one year) to implement the changes to their business models for banning the receipt of rebates. In the case of D2C platforms, the research indicates that they appear to be able to bear the costs associated with the bans and currently have strong profitability, with some operating margins in excess of 50%.

49. Furthermore, the platform industry, including both intermediated and D2C platforms, already appears to be moving in the direction of our proposals, in preparation of our policy approach on rebates. Some platforms are introducing an explicit charging structure and are now featuring some low-cost tracker funds that do not pay rebates. The research[11] indicates that platforms are already making many of the changes that would be required by these proposals and any additional changes are manageable for firms. Our requirements in this area would therefore have the effect of catalysing the market in this direction.

This is supported by research findings which found that platforms were already making many of the changes required by this policy.

Do the requirements restrict or otherwise affect the rights of investment firms under Articles 31 and 32 of Directive 2004/39/EC?

50. As with our current notification under Article 4, these requirements would not restrict or otherwise affect the rights of investment firms under Articles 31 and 32 of the Level 1 Directive. This is because the FCA will not apply them to firms exercising rights under Article 31 and will only apply them to firms exercising rights under Article 32 in the circumstances contemplated in Article 32(7).

Financial Conduct Authority

PUB REF: 004704

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