

FCA Investment Platforms Market Study Terms of Reference

Response from The Investment Association

8 September 2017

IA response to the FCA Investment Platforms Market Study Terms of Reference

Summary

1. In order to understand competition dynamics in the UK investment product and services market, the role and function of different players along the value chain needs to be analysed. The retail fund market in particular contains a rapidly evolving intermediary function, which significantly shapes consumer choices and outcomes. The Platform Market Study will therefore contribute to a more complete competition analysis.
2. The retail value chain has been subject to a structural change brought about by RDR which has also effectively led to the emergence of new players and services. The market has now moved beyond a more traditional 'investment-platform-advice' split to a state of ongoing change that is seeing new models develop which do not separate these three activities but rather combine these and other functions in a range of ways. This has added an element of significant complexity when examining competition dynamics, which may deepen further as a result both of commercial and policy developments, including the narrowing distinction between the retail investment and retirement income markets.
3. There are now multiple journeys through which a retail investor is able to access funds and these can involve a wider range of players: e.g. advisers, discretionary fund managers, platforms, model portfolio providers, ratings services. Each journey will be associated with a different range of services and a different level of total cost of ownership for the end investor.
4. The broad proposed Terms of Reference, which extend well beyond fund platforms in the conventional sense, implicitly recognise the complexity that relates to the changing role of platforms and the interaction between different intermediaries in the retail market. However, the breadth also raises the question of what will be explored in competition terms at different points through the chain. Specifically, it would be helpful to have more clarity on the specific functions that are under consideration and the expected outcome in a competitive market. Value for money will ultimately depend on the journey each investor has taken, the utility attached to it and the associated total cost of ownership.
5. With respect to Scope, the Terms of Reference make clear that FAMR and the RDR review are considering the role of financial advisers. While recognising the practical difficulty in extending the scope further, we believe it is an omission to exclude advisers from the Platform Study given the existing breadth of the Terms of Reference. Advisers remain an extremely important link in the fund value chain, connecting most of the other players in different ways. It also appears inconsistent to be including vertically integrated retail services, but excluding those against which they compete.
6. Finally, we remain concerned about the sequencing challenge that arises from the more fragmented approach of multiple studies. Reaching conclusions on manufacturing before fully exploring distribution raises the risk of inconsistent, and potentially premature, application of

remedies. We urge the FCA to ensure as far as possible that a holistic overview emerges through the process, which would include considering the potential implications of the Platform Study for remedies now in development from the Asset Management Market Study. A particular case in point is the consumer testing of MiFID II disclosure, which by definition, concerns the distribution chain and will need to be delivered by intermediaries that are only now being examined by this study.

The changing nature of the UK retail market

7. A combination of technological advance and regulatory policy have driven significant changes in the way in which the UK retail funds market operates over the past decade, the most important of which was the rise of platforms as the main distribution channel.
8. Traditional platforms have become a key route to the market for the fund management industry, designed to facilitate a more efficient connection between end investor and the investment process. Platforms alone account for approximately 50% of gross retail sales and are over six times the size of direct sales.¹
9. Platforms offer an important service, giving investors and their advisers a way to access funds from more than one investment product provider. In its pure form, a platform is a piece of technology that facilitates the administrative connection between retail investors, advisers and fund managers. As a fund supermarket, a platform can offer hundreds of funds that an investor (advised or otherwise) can access to build their overall portfolio, together with the requisite record-keeping service.
10. This can provide efficiency gains for fund manufacturers, advisers and end clients:
 - Fund manufacturers are able to reduce the volume of fund administration, while gaining potentially new routes to market and routes to new customers.
 - Advisers are able to access a platform to administer and consolidate client assets (and post-RDR to facilitate adviser payments).
 - Client can easily access a wide range of funds without having to seek a more direct or indeed a more advised route to unit purchase.
11. Clearly, platforms vary in scale and degree of openness, but the basic principle is the same. Importantly, although some platforms do negotiate discounts with fund managers, the purpose of the fund platform is not to broker or guarantee flow (which is not possible), but to provide access points for thousands of end investors and/or their advisers. However, it is still important

¹ This is based on IA data and captures retail sales through UK fund platforms as reported by IA members. UK fund platforms covers fund companies' transactions (reported by fund companies) with the following: Ascentric; Avalon, Aviva Wrap; Cofunds; Fidelity; FNZ; Hargreaves Lansdown; James Hay Wrap; Novia; Nucleus; Old Mutual Wealth (including Selestia, Skandia Multifunds and Skandia Life); Parmenion; Standard Life Savings; Transact; Wealthtime.

to note that by volume of sales, the UK retail market has been – and remains – highly intermediated by advisers.

12. RDR introduced a significant structural change into this market, whereby previously bundled fund charging (fund product, distribution, advice) was unbundled with the intention of changing the incentive structures and increase transparency along the value chain. As we argued in our submission to the FCA Asset Management Market Study, we believe that transparency of fund charges has indeed increased as has price competition on an investment management fee level.
13. However, when the RDR was first conceived, this structure – and the role of different players within it – was also arguably much simpler than that seen today. In combination with evolving technology and distribution market innovation, RDR has also played a role in driving the emergence of new fund selection and asset allocation services which changed market dynamics in two key ways:
 - *Widespread outsourcing by IFAs of key fund portfolio construction decisions to external professionals.* Increasingly, IFAs are focusing on broader para-planning services and moving away from individual fund selection, asset allocation and portfolio management. This is seeing much greater use of multi-asset products operated by fund managers, but also model portfolios provided by discretionary fund managers (DFM) and third party research houses and platforms. Similarly, model portfolios are also frequently provided by direct to consumer platforms.
 - *Greater investor demand for a retail investment process that does not require formal advice.* This may involve significant guidance towards specific investment solutions. For example, an online account where investors can access rated funds and/or ready built portfolios. In the context of a perceived ‘advice gap’ in parts of the retail market, it is widely expected that such services will expand in scale in the coming years.
14. An important additional structural development that the architects of RDR may not have intended, given the emphasis on unbundling advice and distribution from manufacturing, has been the emergence of vertical integration across various parts of the value chain. This has been a marked trend in recent years with a number of firms having combined financial advice and portfolio management services with a platform offer in order to provide clients with an offering via a single brand.
15. At the same time, the role of platforms is likely to evolve further in the context of a growing DC pensions market and the Pension Freedoms introduced in 2015. Currently, the mass retirement income market is mainly accessed through insurance platforms rather than the traditional retail fund platforms. However, with Pension Freedoms the line between the traditional fund retail market and the retirement income market is becoming increasingly blurred and this may translate into a new function for retail fund platforms.

Implications for Platform Market Study

16. These evolving market dynamics suggest that the FCA is correct in expanding the Terms of Reference beyond a narrow definition of platforms. Rather, this is rightly a distribution and gatekeeper study, looking to cover the decision-making process and the competition dynamics in the area of the market that sits between fund manufacturers and an investor or saver looking to select investment products.

Defining competition

17. However, it is not yet clear how competition in this environment is defined and will be analysed. In other words, competition between which actors/functions and for what purpose? Acknowledging that functional distinctions are important for competition analysis, we would urge the FCA to take into account the fundamental importance of the overall consumer journey and the associated decision-making processes, including costs and delivery.
18. The retail investment market is characterised by a range of customer journeys, which involve a combination of functions in the retail supply chain (advice vs. guidance vs. self-guided, fund selection, asset allocation, fund administration and unit custody).
19. The decision points and the competition between providers does not necessarily take place as a series of functional distinctions by consumers. A choice at an early stage – for example, to seek advice or not, to go to a vertically-integrated provider or elsewhere – will be of fundamental importance in determining their investment choice set, costs and experience. For example, some consumers will identify a specific fund and then choose between direct or platform investment; others will choose an adviser who uses a particular platform and identifies funds available from that one platform.
20. Looking at patterns of competition through the retail chain both by function (e.g. fund selection, asset allocation) and consumer journey would help to re-draw the analytical framework according to the path and service experienced by different kinds of consumer.

Functional distinctions

21. The functional approach in particular will be helpful for analysing adviser decisions in areas such as platform selection and use of model portfolios and outsourced fund selection.
22. At its simplest, the platform market could be analysed as a choice between different technology solutions offering many funds from many providers to investors and their advisers. Competition would be based on quality and price of different services as well as on the types of products offered.
23. However, the scope is described in a way² that sets out a study which is going to look both at competition between platforms and competition across different types of intermediary. By going

² In particular see ToR paragraphs 3.3 and 3.24.

well beyond 'platforms' in the strict sense, a number of considerations come into play. We highlight below two key areas that are illustrative rather than exhaustive.

Asset allocation and fund selection

24. The outsourcing of asset allocation and fund selection has major implications for competition along the value chain, including between fund managers who market multi-asset or solution-focused funds and others such as DFMs and platforms offering model portfolios. In other words, fund managers who allocate assets or build solutions at a fund level are not just competing against each other but also against other solutions and others in the distribution chain who provide individual components of a portfolio as well.
25. Here, the issues around competition relate not just to services offered and associated charges, but to the wider infrastructure of portfolio management delivery. The Asset Management Market Study highlighted a number of areas that the FCA is prioritising, including governance, value for money, charges and cost transparency and performance reporting. We do not believe there should be major differences between the level of rigour, oversight and consistency required in the authorised funds environment and other players offering comparable services.

Competition for different access points to advice

26. It is not apparent whether the study intends to analyse how similar channels compete for business (for example, vertically-integrated businesses) or how savers assess and access different channels. If the intention of the Platform Study is to assess how different channels operate, we note that it would be difficult to complete this without also taking into account how platforms interact with other parts of the value chain, notably advisers, and how they compete for business with vertically-integrated advised propositions across the market.
27. As noted in the Terms of Reference, the advice market is being considered under the FAMR but in a functionally different way. FAMR focusses on access to advice and the definitional boundaries between advice and guidance and so is not intended to address competition. If the intention of the FCA Platform Study is to capture the dynamics of competition through the distribution chain, it may be necessary to include the cost of advice and consider how advisers interact and compete with other actors in the value chain, particularly since some firms offer advice and platform services combined, with other firms also offering portfolio management services as well.
28. Such an observation should not be read in any way as a judgement on the role of advisers, or on the role of vertically-integrated services. Rather, it points to a discrepancy in a Market Study approach that includes advisers as part of vertically integrated business models whilst excluding other advisers, thus accounting for only one part of the adviser market.
29. There is also a further connection between platforms and advice that may be relevant to the competition study. Platforms may facilitate the agreement on compensation for advisory services between adviser and client. Given that one aspect of the policy intent behind RDR was to separate product and adviser charges, this area may need further examination, with respect

to transparency and the information necessary for clients to make an informed choice through the value chain.

30. We recognise the implications of including the advice market, both for the logistics of the Platform Study, which is already very broad, and the timing of the RDR Review. There may be different ways of sequencing the analysis. Ultimately, the retail funds market, and the supply and demand interaction that shapes competitive dynamics, can only be understood through the behaviour of all players in the retail delivery chain.

Sequencing of market studies

31. We remain concerned to ensure that the analysis of the UK retail funds market is undertaken holistically, with remedies considered in a way that is joined-up and appropriately sequenced. Given the FCA's correct emphasis on the importance of high standards of governance, communication and transparency through the value chain, there are implications for Asset Management Market Study remedies which are now being developed in advance of even the Interim Report from a Study that will examine the critical consumer access and decision-making points in the intermediary market.
32. This point is salient to the overall package of remedies being presented in the Asset Management Market Study Final Report, and particularly relevant in the context of consumer testing currently being developed in the context of MiFID II disclosure requirements related to presentation of charges and costs.
33. MiFID II is clearly not a product directive, but a directive looking at a wide range of behaviours in the context of investment intermediary services. For the purposes of the majority experience of the UK retail market (advised and platform intermediated), the aggregation required will be total cost of ownership, not simply total cost of investment. In other words, the 'all in fee' that investors will be presented with (ex ante and ex post; ad valorem and pounds and pence) will be one that includes both the fund management charges and transaction costs and any additional costs incurred through the distribution and advice chain, including any relevant platform charges. As MiFID II legislates, a breakdown of that aggregated figure will be available upon request.
34. Without having concluded the Platform Market Study, it is surprising that the FCA is preparing to test MiFID II (all-in) disclosures having only reached conclusions on fund management costs, which are just one part of the aggregation. We strongly urge the FCA to ensure that testing is based on how savers and investors understand the total cost of ownership as well as the individual components, including the cost of investment (OCF alongside transaction costs).
35. This is particularly pertinent given that platforms sit between an investor and the manager, receiving information from the fund manager and communicating directly with the end client. Consumer testing needs to take into account the direct contact between platform and end investor. This interaction will be examined in the Platform Market Study.

36. As we noted in our submission to the Asset Management Market Study Interim Report, this needs to involve a model of consumer testing that helps to inform consumers in order to make better decisions. There is a critical distinction between cost accountability (single numbers to explain cost) and effective decision-making. This distinction is not currently always clear in the recent regulatory direction of travel, particularly the decision to make a breakdown of costs optional in MiFID II with the emphasis on full aggregation. We stress that such aggregation does little to assist consumer assessment of relative value of different services. This is where FCA consumer testing could add value.
37. At the same time, careful consideration needs to be given to relevant work expected to conclude in Q1 2018 on disclosure of performance and use of benchmarks as well as the consistency across all communications with investors. We see the disclosure across the different intermediary channels as particularly relevant to this, given that the largest part of the retail market is intermediated and disclosure on this level influences investor decisions and behaviour.
38. We suggest that the FCA publishes a composite report at the moment of the Final Report of the Platform Market Study that brings together its conclusions from both the Asset Management Market Study and the Platform Market Study.