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The FCA's Investment Platforms Market Study: Interim Report

Kya Fear | 26 October 2018

1. Introduction

1.1 In July 2018, the Financial Conduct Authority (the "FCA"), published its Investment Platforms Market Study Interim Report (the "report"), with the final report due in the first quarter of 2019.

1.2 This follows from the Final Report of the FCA's Asset Management Market Study which announced the FCA's commitment to undertake a market study in respect of investment platforms, having considered several potential competition issues in the sector.

1.3 The purpose of the Investment Platforms Market Study is to look at whether the market is working for customers and advisers. Specifically, whether these groups are able to make informed decisions about their choice of platform, products on the platform, and the total cost of investing.

2. Overview of investment platforms and investment platforms' markets

2.1 Platforms are a significant and growing distribution channel. Since 2013, the market has almost doubled, and many advisers and retail customers use platforms to access retail investments and manage investments online. Further, platforms play an important role in the value chain by encouraging asset managers to compete for business.

2.2 The two main types of investor platforms are: (i) direct to consumer ("D2C"), which are used directly by retail clients, and (ii) adviser platforms, which are chosen by advisers but paid for by retail clients.

2.3 In its report, the FCA seemed concerned by the concentration of the D2C market, noting that one platform has a market share of just over 40%.

3. The report's findings

3.1 The report found that the market is working well in many respects, and customer satisfaction is high. Those customers who did pay more to a platform generally considered they had more functionality in return, and there were no widespread instances of customers paying more for no good reason. Further, the FCA did not find sustained profitability on aggregate in the market, noting that many platforms were in fact loss-making.

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3.2 While the overall picture was positive, the FCA pinpointed the following areas of concern:

3.2.1 **Switching between platforms can be difficult:** the FCA found the switching process for investors is complex and time consuming. The report mentions that some clients had tried switching at some point but due to the time, complexity and exit fees, failed to do so.

3.2.2 **Shopping around to find a lower-cost platform can be difficult:** the FCA found that retail clients' awareness of charges is low, with some retail clients believing they pay no charges, when in fact they do. The FCA's view is that it is not easy to select a D2C platform based on price since pricing information is not easy to find on platform websites, and when such information can be found, they are presented in a complex way, with platforms having a variety of pricing structures in place.

3.2.3 **The risks and expected returns of model portfolios with similar risk labels are unclear:** the FCA highlighted the steady growth in model portfolios offered by platforms. The FCA found that retail clients who are younger and less affluent seem to prefer ready-made portfolios. The FCA's view is that information provided to such clients for comparative purposes does not clearly indicate the different risks involved across portfolios.

3.2.4 **Clients may be missing out by holding too much cash:** the FCA found that retail clients using D2C platforms hold larger cash balances when compared with those on adviser platforms and these clients are not necessarily aware that they are charged on their cash balances, potentially losing out on investment returns as a result.

3.2.5 **Clients who were previously advised but no longer have a relationship with a financial adviser ("orphan clients") face higher charges and lower levels of service:** the FCA found that some orphan clients have limited access to alter investments on an adviser platform and so pay for functionality they cannot use. Further, it was found that some orphan clients pay extra fees despite the loss of functionality.

3.2.6 **Smaller platforms may find it harder to compete:** the FCA found that larger platforms can negotiate with asset managers to obtain lower investment charges for their consumers, and that asset managers offer such discounts to larger platforms that can attract larger flows into their funds. The FCA noted that arrangements in place between asset managers and larger platforms to offer the cheapest price in the market or prices no worse than on other platforms, could make it harder for smaller platforms to compete.

3.2.7 **Fund charges are not obvious:** the FCA noted investment platforms could improve the presentation of fund charges at relevant points in the customer journey, which would strengthen competition between asset managers.

3.2.8 **Non-compliance with FCA Rules:** the FCA showed concern that D2C platforms did not have robust best execution monitoring, making it difficult for clients to know when their trade would be placed. Further, the FCA found that some services offered by advisers are likely to be non-monetary benefits subject to the FCA's Conduct of Business Rules. Such services include education and training courses, white labelling and bulk rebalancing and model portfolio management tools that benefit the adviser but not the client.

4. Interim proposals on remedies

The FCA is keen for platforms to innovate solutions, allaying the need for enhanced regulation. It suggested the following interim proposals:

4.1 Innovative practices to help clients shop around and choose platforms based on price: the FCA wants to see more innovative practices in the way platforms present their platform costs and charges to enable investors to make more informed decisions when choosing between platforms.

4.2 Measures to strengthen competition between asset managers: the FCA wants platforms to play a role in increasing competition between asset managers. Platforms should be presenting fund charges in a clear, understandable and prominent way to clients. Further, the FCA is seeking views on arrangements larger platforms have in place to secure best or no worse price from asset managers.

4.3 Measures to help clients with large cash balances: before its final report, the FCA will assess whether current rules on disclosure go far enough or whether further rules or guidance are required to ensure that clients with large cash balances are aware of the interest, charges and loss of potential investment returns, and thus are able to make informed decisions.

4.4 Measures to make it easier for investors and advisers to switch platforms: the industry has established a Transfers and Re-registration Industry Group which is taking forward an initiative to improve the switching process and reduce transfer times. If improvements are not made before the final report, the FCA will consider taking further action.

4.5 Measures to help orphan clients: the FCA is considering measures tackling price discrimination between orphan and existing clients, requiring platforms to have a process to get customers to switch to a more appropriate proposition, requiring adviser platforms to check that their customers are receiving an advice service if there is no activity after a year, and inform the FCA of orphan clients who are paying an adviser for advice they no longer receive.

4.6 Measures to help clients who may be exposed to unexpected risk levels: the FCA is undertaking further work to assess the scope of the issues. In particular, the FCA suggested: (i) expanding the disclosure requirements that apply to funds so that they also apply to model portfolios, or (ii) requiring firms to use standard terminology to describe their strategy and asset allocation.

5. Next steps

5.1 The consulting stage of the report closed on 21 September 2018, and we await the final report which is anticipated in the first quarter of 2019.

5.2 The FCA highlighted that the following actions should be taken prior to the publication of the final report:

5.2.1 **Switching:** investor platforms must progress existing industry initiatives to assist customers switch between platforms, including introducing standardised times for transfers, improving communication to customers, and publishing transfer time data.

5.2.2 **Costs and charges:** while the MiFID II cost disclosure provisions should help customers compare the total cost of investing, the FCA wants to see investor platforms and other intermediaries innovate to present costs and charges to customers in a clear, understandable and prominent way, increasing the attention that customers pay to charges in order that they may make more informed choices between platforms as well as between the products available on platforms. The FCA has conducted behavioural testing in respect of drawing attention to charges in the asset management industry and it encourages industry players to take note of its findings published in an occasional paper.

5.2.3 **Inducements:** investor platforms and financial advisers should consider whether the non-monetary benefits that they receive or offer comply with the FCA's inducement rules which are set out in the FCA Handbook, COBS 2.3 (for non-MiFID business) and COBS 2.3A (for MiFID business).

5.2.4 **Best execution:** investor platforms that are providing stockbroking services to retail clients should ensure they are providing those clients with information on best execution. The FCA noted that such platforms could do more to achieve and demonstrate the best execution results for their clients consistently.

6. Further information

Please find links to notes on the FCA's Asset Management Market Study below:

6.1 Note on the Interim Report.

6.2 Note on the Final Report.

6.3 Note on the new remedies set out in the Policy Statement.