Consultation Paper 10/29

Platforms: Delivering the RDR and other issues for platforms and nominee-related services

Response from the Tax Incentivised Savings Association

February 2011

TISA is pleased to have the opportunity to respond to the CP 10/29 Consultation Paper. We are aware that a number of our member companies will submit detailed responses on the questions raised in this Consultation Paper and we will therefore prefer to keep our comments specific to two wider industry issues.

TISA welcomes the thinking as set out in the Consultation Paper, feeling this demonstrates an increasingly detailed and nuanced understanding of the developing wrap and platform market in the UK and a continuity of regulatory approach from that set out in the preceding Discussion Paper 10/2.

In particular we welcome and are supportive of the clarification of what constitutes a platform service; the use of platforms by advisers as set out in Annex 5; the ability of 'fund supermarkets' to continue to be remunerated by fund managers as service providers; the intention to make platform reregistration mandatory; the adjustment of Pillar 2 ICAAP calculations to include wind-down costs and the majority of the proposals to extend full unit / shareholder rights to platform investors.

Having now had the opportunity of discussing the proposals as set out in this Consultation Paper with a considerable number of fund managers and platforms, we are concerned over two particular proposals.

- **Rebates from product providers to platforms (3.18 – 3.25)**

  We are concerned that the proposal to end the rebating of an element of a fund manager's annual management charge (AMC) in cash and from end-2012 restrict these to units or shares is disproportionate, creates considerable operational difficulties and may have the unintended consequence of derailing or nullifying the platform reregistration programme.

  The concern identified in the Consultation Paper that advisers may now or in the future seek to misrepresent such rebates as a deferment of an agreed adviser charge simply doesn't stand up to scrutiny:

  - All wrap platforms operating client cash accounts already post all credits and debits including fund rebates, fund distributions, platform charges and advisor payments quite separately to the client's platform bank account and report accordingly such that no confusion or conflation of the two could reasonably occur. Many such platforms then summarise this information on-line or in writing in a way that allows the separation and analysis of each type of posting over a variety of time periods, further mitigating against any such misunderstanding on the part of clients;

  - In any case, with most fund managers seeking to drop their fund annual management charges from 1.5% to 1.0% in the run up to end-2012, the likely level of such rebates, whether in cash or units, will fall to 0.25% - hardly sufficient to disguise any likely level of advisor payment more in the order of 0.5% to 1.0% per annum;

  - However illogical or misguided, an adviser so motivated to mislead a client that there was some kind of link between a fund manager rebate and the agreed level of adviser payment could just as readily maintain this for a unit rebate as for a cash rebate.

  At a practical level, unit / share rebates create a number of operational issues which, while not individually insurmountable, do add complexity and additional cost for fund managers and platforms alike:

  - A logical principle has grown up between platforms and fund manager's main registers that because platforms hold the granular level client records, any changes to unit holdings are only triggered from the platform end. Hence any fund distribution is paid in

cash and if the platform client wishes reinvestment, this is done so at the platform level as part of the following day's aggregation and dealing process. The same principle lies behind the current fund management rebate model where the due amount is calculated by the platform by aggregating the amounts due from each client's holding upwards. This is then invoiced by the platform to the fund manager who then settles against this in cash so as to allow ready and accurate disaggregation by the platform back to the clients' cash account;

- The considerable benefit of this approach is that it facilitates a ready means of reconciling units / shares in issue between the platform sub-register and the main fund manager register as changes can only be triggered from the platform end. Most platforms therefore conduct a units in issue reconciliation after each trade, on a monthly basis and a specific G1:G2 reconciliation on the XD date of the fund concerned.

- In addition, restricting rebates to units only will in itself lead to an increase in redemption trade volumes from platforms to provide liquidity in the client cash account, both to meet platform and advisor fees and for those clients opting to draw income.

Restricting rebates to units / shares necessitates the creation of a whole new transaction type and one that for the first time is calculated by the fund manager (or his transfer agent) based on the aggregated holding on the main register. Units would then be credited to each platform's nominee accounts and each platform would then be asked to disaggregate and credit these to individual clients. This gives rise to a number of issues:

- To the creation and liquidation trades being placed by platforms must now be added rebated units being pushed back down the pipe by fund managers effecting unit rebates. This will have significant issues for the reconciliation process as no one party will have control and responsibility for all in-flight trades. Many ancillary platform processes start from accurately keeping the nominee position on the main register in tight alignment with the total units credited to each client's account. Any subsequent rectification to the nominee unit holding creates a cascade of rectifications to fee calculations, dividend processing, adviser payments etc.;

- While most major transfer agency systems already have an annual management charge rebate capabilities, they all do so according to different protocols and frequencies (monthly snapshot, monthly average balance, weekly accrual with monthly credit etc.). These calculations will almost certainly not align with the platform rebate calculation methodologies currently employed (most of which use daily accruals), which will make the disaggregation process back to individual client accounts difficult and subject to rounding errors;

- It is not entirely clear whether such credited units should be considered Group 1 or Group 2. From the fund manager's perspective the units are newly created and therefore Group 2, but this would have the inadvertent outcome of diluting the equalisation pool for true new investors. A more accurate methodology would perhaps be to credit Group 1 units on the existing Group 1 nominee holding and only credit Group 2 units on the current Group 2 holding, but this would effectively double the complexity of the above processes.

As acknowledged in 3.23, an alternative to all the above would be for a platform to insist on having a share class of the fund in question where the annual management charge was set at such a level as to remove the need for unit rebates. Having now had input from all the current wrap platforms and those fund supermarkets developing wrap capabilities, it is our understanding that all but one platform will favour this route rather than suffer the operational compromise that unit-only rebates would entail. It therefore seems likely that a ban on cash

rebates would lead to the market bifurcating, with fund supermarkets listing 1.0% AMC share classes of funds from which they will be in receipt of 0.25% as at present and wrap platforms opting instead for a clean 0.75% or lower AMC share class of the same fund, thereby obviating the need for a unit rebate process.

As acknowledged in the Consultation Paper, such an outcome would increase fund manager costs through the need to support additional share classes for different platforms. Of much greater concern for TISA however are the implications such a move would have for the Platform Reregistration Programme in which we, the FSA and a number of industry participants have been engaged for almost 18 months. Having different platforms holding different share classes of the same fund (and particularly fund supermarkets holding one share class and wrap platforms another) will largely nullify this whole platform reregistration initiative and leave clients no choice but to opt for cash transfers between platforms with all the impediments of initial charges, out-of market exposure and for non-tax wrapped assets, incurring a capital gains event for CGT purposes.

TISA see this as a much more immediate and material consumer detriment than that which banning cash rebates was intended to address in the first place. We would therefore contend that a better all round solution would be to reverse the current policy position, allow cash rebates to continue and allow both fund supermarkets and wrap platforms to hold the same 1.0% share class and to allow clients to migrate freely between platforms.

Such risks that advisers or platforms might misrepresent client rebates could then be addressed through an absolute requirement on platforms to ensure transparency of their cash account postings and reporting and in ensuring all literature and websites emphasise that such rebates were entirely unconnected with their platform fees and any agreed adviser charges.

- **Investing in authorised funds through nominees**

As stated earlier, TISA welcomes the majority of the proposals to offer fair and equal treatment of intermediate unitholders as they would were they invested in the main register. In particular, we view the requirement to allow intermediate unitholders the same voting rights as main register holders as being long overdue.

We do however have concerns that the means of delivering some of the more regular unitholder documents should not become overly burdensome to the platform or the client. One of the benefits of an open-architecture platform is that it encourages clients to diversify their holdings more widely, such that while 10 years ago a client would typically have held their ISA allowance in a single fund, it is now not untypical for the same client to spread such assets over a dozen or more holdings. While this may well have portfolio diversification benefits, this is not to say that the client has any interest or desire in having twelve semi-annual and annual reports cluttering up either their letterbox or indeed their inbox.

Many platforms have embraced and made web-based servicing central to their proposition. For a number of reasons however, few if any have opted to use email as a core delivery mechanism within their client service model:

- lack of security and concerns over data protection issues;

- client reluctance to receive personal information by email where their main email address is linked to their employment;

- where clients will normally inform platforms of a change of physical address, they are much less inclined to do so over a virtual email address change;

- rapid change and turnover of client email addresses makes it a very unreliable mechanism of delivering any kind of assured service notification; and

- attempts to revalidate email addresses by platforms meets with low response rates, either because the current email address held by the platform is no longer valid or because of clients' concerns over spam / phishing.

Having spoken with a number of our platform members, for those that do collect and hold client email address details at all, they estimate they only have up to date and valid email addresses for 20 – 40% of clients at any given time. Consequently, where platforms do need to communicate with clients with a degree of certainty, they continue to do so in writing to the client's registered postal address. Given this, we would suggest a more tiered hierarchy of client communication mechanism that would be less costly and wasteful and more in line with UK and European environmental policy:

Activity	**Requirement**	**Likely mechanism**
Notification of unitholder meetings including proxy voting mechanisms (COLL 4.4)	Positive and timely delivery to all affected investors	In writing or by email
Change notifications from AFM including elective corporate actions (COLL 4.3)	Positive and timely delivery to all affected investors	In writing or by email
Notification of suspension of dealing, redemption deferment or winding down of scheme	Positive and timely delivery to all affected investors	In writing or by email
Interim and annual short form report and accounts	Make available in writing or email to investors only where specifically requested at no additional charge. Otherwise passive delivery to investors through hosting on platform website with periodic notification of their availability as part of broader communications	Where requested, delivered either in writing or as an attachment in an email. Otherwise hosted and made available on website

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