for financial advisers only

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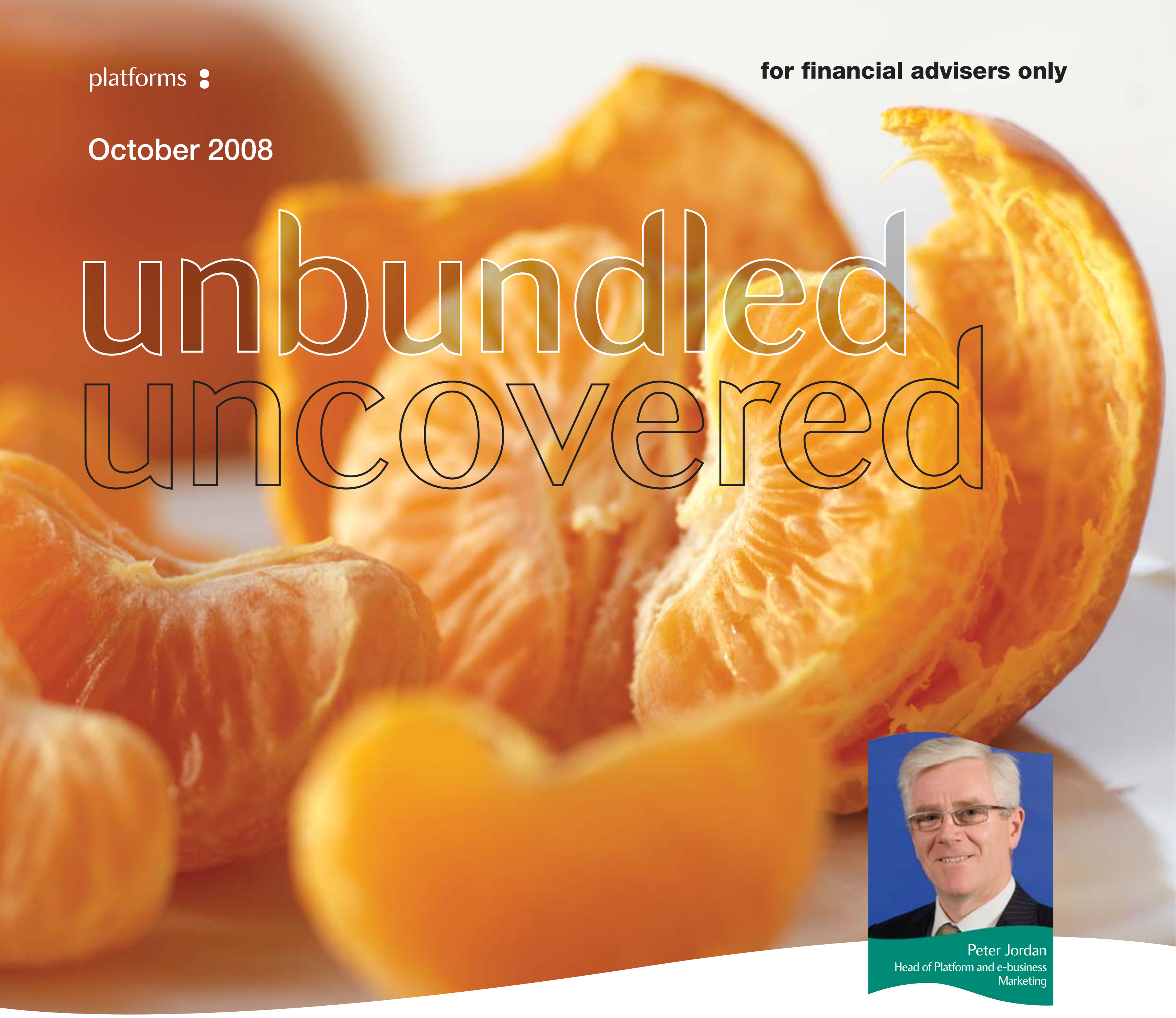
unbundled uncovered



Peter Jordan
Head of Platform and e-business Marketing

Peter Jordan explains why advisers need to be able to make true comparisons of platform pricing to ensure client suitability.

The key driver of the new Selestia Investment Solutions pricing structure was Skandia's desire to achieve the clearest price proposition in the fund platform market. Feedback so far has suggested that this objective has been accomplished. However, much of the discussion following the announcement of the new structure suggests there is a poor understanding of the other approaches to charging within the platform market and of how the overall charges compare.

This is hardly surprising given the number and nature of different approaches. Many new entrants have decided to adopt unbundled structures which typically have no inbuilt commission loadings and re-invest fund rebates. On the face of it this looks like a compelling, low-cost charging model, however don't forget that these providers then levy specific charges to cover advice and platform costs.
It is these additional costs that add an unnecessary layer of complexity, making it extremely difficult for advisers to understand the overall costs of investing via certain platforms.

Unbundling in its current form creates some clear marketing advantages for platforms that lack the scale to price their proposition competitively. Unfortunately for the end investor the benefits of unbundled charging structures are less clear, particularly in their current form. The FSA has recognised this and we believe the market is about to get a rude awakening.

transparent disclosure

Feedback on the FSA discussion paper ('0/72 Platforms: the role of wraps and

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fund supermarkets') issued in March this year reveals that no-one should be under the illusion that the FSA are unaware of the growing issue of charge misrepresentation in the platform and wrap market, and the following observation suggests that this will shortly be investigated.

FSA feedback on DP07/2

'The key requirement is for a firm to provide a customer with clear disclosure of the overall costs (of advice, of the platform services, and the underlying products and investment services). A customer should also be aware of the overall effects of the charges - especially any additional costs related to the platform service – so they can make an informed decision.

We have already discussed good and poor practice, both in the DP and in the publication on Key Features Documents and there are lessons for platform providers from these. Since platforms may add a layer of complexity, the provision of clear, transparent and comparable disclosure is essential. At its core, firms should clearly consider the needs of their customers in light of the particular product or service provided. We will engage with platform providers shortly in order to move this debate forward to achieve beneficial changes. In addition, we will be addressing this subject from the intermediary's point of view as well as part of our thematic view.'

Source: Feedback Statement 08/1 'Platforms and more principles based regulation'.

While specific issues have not been identified by the FSA, it is not difficult to foresee where the most significant problems are arising. Our experience this year suggests that the market has become good at creating a false impression of cheapness through the absence of inbuilt commission loadings and the re-investment of fund rebates. In truth, a like for like comparison will often reveal that investors face higher costs when investing through a platform with an 'unbundled' charging structure than they will through some of the less exotic fund platforms.

making true comparisons

So how have these relatively expensive unbundled structures gained acceptance in the marketplace? We believe a blinkered presentation of costs has allowed certain platforms to grab the moral high ground from a position of relative weakness. They have largely done this by creating the appearance of low cost through the adoption and promotion of a structure that reinvests rebates, apparently for the direct benefit of the end investor. In addition, they quote AMCs that are not pre-loaded with ongoing commission, further giving the impression of being low cost (sometimes termed 'factory gate pricing').

They do not, however, focus much attention on other charges such as switching costs, annual platform charges, adviser initial commission and adviser ongoing commissions, which also make up the final price to the investor.

When confronted with the realities of their pricing, they may claim that these additional charges are designed to cover the costs of wider investment choice. In practice, however, the customer may never fully utilise that wider choice – either because their adviser is not adequately authorised, their portfolio is not large enough to adequately diffuse the costs (or to achieve sufficient risk diversification) or simply because they do not have the appetite to invest beyond mainstream funds.

The issue of being able to compare platforms effectively is becoming increasingly important. Advisers are being encouraged to segment their client base in order to make informed decisions as to which providers best meet certain client needs. An adviser cannot base their choice on the needs of the exceptional customer, but on the need to serve everyone with an individually appropriate solution and in order to make an informed choice, due diligence will need to be carried out. Complex charging structures do not help this process and a simpler, more transparent approach must be the way forward. This issue of segmentation is clearly in the spotlight:

FSA feedback on DP07/2

'Although segmentation of customers can lead to better targeting of services, we remain concerned that firms may recommend platforms to customers by default without due consideration of the suitability for the individual customers. This may be particularly problematic when any conflicts of interest have not been adequately managed. Firms must manage this risk effectively and this will be one area we will be considering when we undertake our forthcoming thematic work.

We would also be very concerned if firms did not consider the suitability of the platform beyond the segmentation of customers. This may lead to individual customers suffering detriment purely for the convenience of the firm and its other customers.'

Source: Feedback Statement 08/1 'Platforms and more principles based regulation'.

summary

Although this discussion has only considered a few areas of the FSA's feedback, the message is clear. Treating Customers Fairly lies at the heart of future developments and this means we must all be focused on consumer outcomes. This will require an assessment of a number of factors, and it is inevitable that advisers will always be required to carry out a detailed analysis of charges.

The structure of the platform market does not make assessing charges easy, but it is a fundamental starting point for the due diligence assessment all financial advisers are required to undertake. Skandia's aim for its new platform pricing structure was to make this assessment easy for financial advisers, and to provide a proposition which allows for platform interaction without fear of recommending an overpriced service.

Peter Jordan will be presenting at the Skandia Trailblazer roadshows throughout November 2008 to discuss what the latest developments in the platform market really mean for consumers. Visit **www.skandiatrailblazer.co.uk** for further