

07/2

Financial Services Authority

The responsibilities of providers, distributors and platform providers for the fair treatment of customers where a platform is used in the supply of a product

September 2007



This document, which is an additional chapter to Discussion Paper 07/2 – Platforms: the role of wraps and fund supermarkets, should be read in conjunction with, and as a supplement to, our Guidance on the responsibilities of providers and distributors for the fair treatment of customers (see FSA 2007/41 and Policy Statement 07/11) (The Guide). The Guide, issued under section 157 of the Financial Services and Markets Act 2000, sets out our view on what the Principles for Businesses (Principles) and detailed rules expect of providers and distributors to treat customers fairly. In Policy Statement 07/11 we acknowledged that there may be additional complexities in interpreting the Guide where there is a platform, and we indicated that we would publish additional materials on this topic. Accordingly, we are now publishing this additional chapter to Discussion Paper 07/2 which considers how the Guide applies where there is a platform.

At the outset, we note the following:

- This is not a free-standing document. It needs to be read alongside the Guide. Where appropriate, we have included cross-references to the Guide.
- This document is primarily relevant to platform providers and providers of investment products who distribute products through platforms.
- This document is less relevant to distributors, although it does have some relevance to them. In particular, distributors should look at the discussion of paragraph 1.24(1) of the Guide (p7 below). However, in the main, this document is targeted at product providers and platform providers, as it is the product provider responsibilities in the Guide that are most impacted by the presence of a platform. The implications of platforms for distributors are discussed in detail in chapters 4-6 of Discussion Paper 07/2.
- This document does not constitute guidance and is not part of the Guide. Rather, it is part of a Discussion Paper, and readers should bear that in mind when reading it. Once we receive responses, we will consider what further material, if any, to publish, and what form this should take.

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The Financial Services Authority invites comments on this Discussion Paper. Please send us your comments to reach us by 31 December 2007.

Comments may be sent by electronic submission using the form on the FSA's website at (www.fsa.gov.uk/Pages/Library/Policy/DP/2007/dp07_02_response.shtml).

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1 Introduction

In September 2006 we published Discussion Paper 06/4: The responsibilities of providers and distributors for the fair treatment of customers. In it, we set out our view of the respective regulatory responsibilities of providers and distributors to treat customers fairly, and proposed an overarching Statement of Responsibilities for providers and distributors. Several respondents to DP06/4 asked for more clarity on the respective responsibilities where a sale or service involves a platform.

In June 2007 we published our Discussion Paper on platforms (DP07/2: Platforms: the role of wraps and fund supermarkets). In that, we discussed implications of the widespread adoption of platforms by intermediaries.

In July 2007 we published a Regulatory Guide on the responsibilities of providers and distributors for the fair treatment of customers (the Guide), taking account of the feedback received on DP06/4 (see FSA 2007/41 and Policy Statement 07/11). We explained that a customer's experience should not be affected by whether a product or service was provided and distributed by a single institution or by two or more institutions. The Guide sets out our view of the responsibilities of firms to the customer throughout the life-cycle of a product or service. The Guide applies to all sectors of the financial services industry.

We have taken a principles-based approach with the Guide. This means that we have drafted it at a high level of generality in the expectation that firms will interpret it in a way that makes sense for their particular market and circumstances. We believe that the Guide should be sufficient for firms to interpret what is expected of them without the need for further elaboration by the FSA.

That said, we recognise that there may be some difficult or complex areas where additional clarification of what we expect of firms may be helpful. The responses to DP06/4, and the rapid growth of the platform segment, prompts us to consider the specific issue of how the responsibilities of providers and distributors of investment products are affected by platforms.

This paper is in three parts:

- First, we discuss the responsibilities of providers and distributors where there is a platform in the distribution chain. In this paper, ‘provider’ and ‘distributor’ are defined in the same way as in the Guide.¹ As we point out in the Guide, although we use the terms provider and distributor, ‘responsibilities flow from the actual roles or functions undertaken in a transaction’ rather than how the firm is labelled (paragraph 1.15). When we refer to the responsibilities of ‘providers’ and ‘distributors’ we are not referring to the responsibilities of the ‘platform provider.’
- Second, we discuss the responsibilities of the ‘platform provider’ under the Principles. As stated in the Guide, the Guide is ‘relevant to all regulated firms involved in the supply of products or services to retail customers’ (paragraph 1.7). A platform provider is therefore covered by the Guide. However, ‘what a firm has to do to meet the requirements of a Principle will depend on the circumstances’ (paragraph 1.7). Because the role of a platform provider differs to the role of a typical ‘provider’ or ‘distributor’, what a platform provider should do to meet its responsibilities will also differ.
- Third, we discuss whether it may be appropriate, in certain circumstances, for the platform provider to request treatment for itself from the product provider as a retail customer so as to bring the product provider within the ambit of Principle 6.

We invite comments on the material below and in particular on the questions set out at the end.

Responsibilities of providers and distributors, as set out in the Guide, where there is a platform

In the first instance, firms should refer to the Guide to understand what we expect from them in terms of meeting their responsibilities to customers. As explained in the Guide, depending on the precise nature of a firm’s business, this could mean addressing the fair treatment of customers at the following stages:

- design and governance;
- identifying target markets;
- marketing and promotion;
- sales and advice processes;
- after-sales information and service; and
- complaints handling.

1 The Guide defines ‘provider’ to ‘include persons who offer services such as portfolio management (through distributors or otherwise) as well as those who develop, manage or package products such as life insurance, general insurance or investment products or who develop or enter into home finance transactions (i.e. mortgages, home reversion plans and home purchase plans)’ (paragraph 1.12). It defines ‘distributor’ as ‘those persons who then make up the rest of the supply chain taking the product or service to the customer. This could include, for example, financial advisers, third party administrators, appointed representatives, banks, building societies, and those who sell insurance as a secondary part of their business’ (paragraph 1.13).

We believe that providers and distributors should be able to comply with their responsibilities at all of these stages whether or not there is a platform. We have considered for each stage the implications of a platform being used. Our view is that, for most of the stages, the presence of a platform does not make a difference to how firms should meet their obligations.

However, there are certain responsibilities set out in the Guide where the presence of a platform may merit further discussion as to how firms should meet their responsibilities. These are discussed below:

- *Paragraph 1.19(1) of the Guide. The provider's responsibility, when providing information to customers, to pay regard to its target market.*

Where there is a platform, the provider may not have direct interaction with the customer (e.g. because products are held through nominee accounts). This means that the provider may only deal with the platform and supply it (rather than the customer or a distributor) with information. The application of the Principles in such circumstances will depend on the precise relationships involved, but a provider should consider how it can ensure that information intended for the customer is provided to the platform in a timely manner and appropriate format so that it can be properly disseminated by the platform provider.

- *Paragraph 1.20(2) of the Guide. The provider's responsibility, when selecting distribution channels, to review how what is occurring in practice corresponds to (or deviates from) what was originally planned or envisaged for the distribution of the product or service given the target market. This involves collecting and analysing appropriate Management Information (MI) such that the firm can detect patterns in distribution as compared with the planned target market, and can assess the performance of the distribution channels through which its products or services are being distributed.*

This responsibility is relevant to all product providers, including providers of investment products through platforms. The presence of a platform does not in any way reduce the extent to which a product provider should meet this responsibility.

To understand paragraph 1.20(2) of the Guide it is important to refer to paragraph 1.17(1). Paragraph 1.17(1) envisages that providers will identify a target market for the products which they design; paragraph 1.20(2) envisages that providers will collect MI to ascertain whether the actual distribution of their products is occurring in a way that is consistent with the target market that was identified.

Thus, before a firm can determine what MI to collect, it first must be clear about how it has identified the target market. We state in the Guide that firms should "identify the target market, namely which types of customer the product or service is likely to be suitable (or not suitable) for" (Paragraph 1.17(1) of the Guide). With regard to this responsibility, we recognise that investment products that are sold to UK consumers, whether through platforms or not, present a broad spectrum of possible investment outcomes. The likely consequence of this is that, although some investment products are manufactured to be distributed to the broad consumer market, others will be developed for a target market of consumers with specific needs

or particular investment viewpoints. In characterising such a product, product providers should highlight the particular section or sections of the consumer market for which it is targeted.

The MI that should be collected will depend on the particular product and in particular on how the target market was defined for that product. For example, if a product is designed for customers in a particular income bracket or age range, then it may be appropriate for MI to be collected to analyse whether the product is ending up with these types of customers. Similarly, if a product was designed to be held for a particular duration (e.g. medium term rather than short term), firms may wish to collect MI to assess whether the product is generally being held for that duration. In some circumstances we expect that it will be appropriate for providers to proactively take steps to obtain information that they would not otherwise be collecting. In other situations, we anticipate that it will be sufficient for providers to analyse information that is ordinarily collected in the course of business. As we explained in Policy Statement 07/11, it is for firms to determine for themselves what MI is appropriate in the circumstances.

We also recognise that, in collecting and analysing MI, for some products, or for some types of information, it may be sufficient to analyse a sample of distributors or customers. We would expect that any sampling will be sufficiently robust.

Depending on the type of MI that a product provider decides to collect, it may be more challenging for a product provider to meet this responsibility when there is a platform. This is because, where there is a platform and an associated nominee account², a product provider is likely to have less information about where its products have ended up. However, we expect firms to meet the responsibility set out in Paragraph 1.20(2) whether or not there is a platform. As explained above, the presence of a platform should not be a factor in determining the level of analysis a product provider will undertake. Rather, the key question for a provider is whether the product is ending up with the types of customer it planned for in designing the product – and we do not believe that the presence of a platform should change the analysis of what information is helpful to address this question.

Where appropriate to do so, we expect that product providers will work with platform providers to ensure that the appropriate MI reaches the product provider. It may also be appropriate for product providers to speak with distributors.

We take this opportunity to reiterate that providers of investment products should consider all of the responsibilities set out in the Guide. We have only included in this supplement those that may require additional thought because of the existence of a platform. However, the other responsibilities in the Guide are equally (and in some cases, arguably even more) important to providers of investment products. In particular, product providers should focus on product design (paragraph 1.17 of the Guide), provision of information to distributors (paragraph 1.18 of the Guide); and on-going post sale review where performance may vary (paragraph 1.21 of the

2 This is also true for other situations in which products are held in a nominee account (eg discretionary investment management).

Guide). These responsibilities are relevant to the investment product provider on an ongoing basis, in particular to ensure that those firms that have a relationship with the beneficial owners of their products are fully aware of any changes in expected performance or differences in the risk characteristics of the product that are significantly different from those outlined in the initial disclosure material.

- *Paragraph 1.24(2) of the Guide. The distributor's responsibility, when advising on selection of a provider, to consider the impact the selection of a given provider could have on the customer.*

In meeting this responsibility, we believe there are at least two additional factors for a distributor to bear in mind where a platform is involved. First, it should assess whether a particular platform is suitable for individual customers. This is discussed in detail in Chapter 5 of DP07/2.

Second, where a distributor is considering moving future servicing and administration of existing customers to a platform, it should consider whether this is suitable for each individual customer. We would also remind firms that the bulk transfer of customers would be likely to require the express consent of all customers, as it would have the effect of transferring their rights to a nominee account.

Responsibilities of platform providers

Certain responsibilities belong to a platform provider. In providing custody, associated administration and possibly other services to customers, a platform provider creates its own responsibilities to an end customer, even where that customer also uses the services of a distributor.

Certain responsibilities for servicing ongoing customers may fall to platform providers where they hold customers' assets in nominee accounts. For example, the platform provider may have to take responsibility for ensuring that customers receive full and timely information on any changes to a product held in a nominee account - including on unit-holder voting or changes to an investment strategy – because the individual customers are unknown to the product providers. We have considered the associated responsibilities of product providers in respect of the timely provision of information above.

In general, we would not expect that a platform provider would be in a position to be able to assess the particular properties of an investment product; make a recommendation as to an individual fund's level of risk; or suggest a target market. While these tasks usually fall to the product originator, we are aware that certain platforms facilitate some analysis of individual funds, and some generic characterisation of products.

We are also open minded to the possibility that in the future some platform providers may choose to take on roles usually undertaken by product providers. Any such platform provider should bear in mind that regulatory responsibilities stem from the role that a firm undertakes, rather than whether a firm is labelled a provider, distributor or platform. Thus, if a platform provider expands its operations to take on a role that is traditionally one that has been undertaken by product providers, then, with respect to that role, we would expect that the platform provider would undertake the relevant 'provider' responsibilities as set out in the Guide.

Platform provider requesting treatment for itself from the product provider as a retail customer

The applicability of the Guide to providers where there is a platform depends on the client relationships between provider, platform, distributor and end-customer, which in turn depend on individual circumstances. There are certain combinations of client relationship and client categorisation (e.g. where the end-customer is not a client of the product provider and the platform provider is an eligible counterparty) where a product provider may not be bound by several of the Principles, including Principle 6, or some other rules.

We believe that in this context, platform providers should take into account COBS 3.7.2G, under which “it is the responsibility of a professional client or eligible counterparty to ask for a higher level of protection when it deems it is unable to properly assess or manage the risks involved”. A platform provider should consider the implications of this in light of its duty, as an entity that has a relationship with a retail customer, to have proper regard to the fair treatment of its customers. Where appropriate, we would expect that a platform provider would request treatment for itself as a retail client under COBS 3.7.1R or (when dealing as an agent) agree that the product provider will treat the underlying consumer as its client under COBS 2.4.3R(2)(a).

Questions

- Q1: Do you believe that the presence of a platform affects how any of the responsibilities in the Guide other than the three described above (i.e. those at paragraphs 1.19(1), 1.20(2) and 1.24(2) of the Guide) should be applied by a firm? Put another way: are there areas in the Guide that are not discussed in this paper but where, in your view, a platform makes a difference to how a provider or distributor should meet its responsibilities?
- Q2: For the three responsibilities described above (i.e. those at paragraphs 1.19(1), 1.20(2) and 1.24(2) of the Guide), do you agree with the approach we suggest? If not, what alternative do you suggest?
- Q3: Are there analogous situations which the Guide (or this Discussion Paper) does not sufficiently illuminate?
- Q4: Do you agree that a platform provider should, where appropriate, request treatment for itself as a retail client under COBS 3.7.1R or (when dealing as an agent) agree that the product provider will treat the underlying consumer as its client under COBS 2.4.3R(2)(a)?

The deadline for responses is **31 December 2007**.

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