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CHARTERED INSTITUTE FOR SECURITIES & INVESTMENT

Investment Operations Certificate

Platforms, Wealth Management and Service Providers

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Welcome to the Chartered Institute for Securities & Investment's Platforms, Wealth Management and Service Providers study material. This manual has been written to prepare you for the Chartered Institute for Securities & Investment's Platforms, Wealth Management and Service Providers examination.

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A learning map, which contains the full syllabus, appears at the end of this workbook. The syllabus can also be viewed on cisi.org and is also available by contacting the Customer Support Centre on +44 20 7645 0777. Please note that the examination is based upon the syllabus. Candidates are reminded to check the Candidate Update area details (cisi.org/candidateupdate) on a regular basis for updates as a result of industry change(s) that could affect their examination.

The questions contained in this workbook are designed as an aid to revision of different areas of the syllabus and to help you consolidate your learning, chapter by chapter.

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Changes in industry practice, economic conditions, legislation/regulations, technology and various other factors mean that practitioners must ensure that their knowledge is up to date.

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It is estimated that this manual will require approximately 80 hours of study time.

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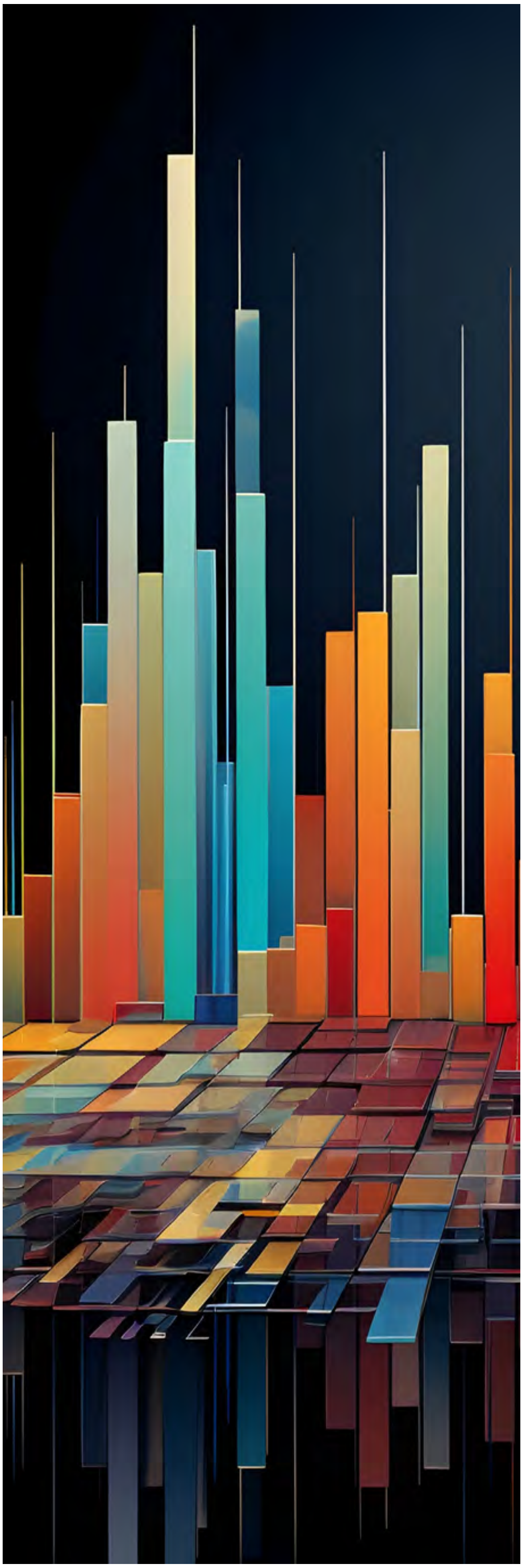
Chapter One

Platform Assets

This syllabus area will provide approximately 4 of the 50 examination questions



1. Overview

Learning Objective

1.1.1 Know how a platform is structured: wrappers; assets

Platforms are services designed to enable retail investors (and any financial advisers assisting those investors) to manage their investment portfolios. They enable investors to communicate via different media – usually online services, although telephone and postal facilities may also be available. Each **platform operator** (the term used in this workbook to describe the regulated financial services firm responsible for the functionality and performance of the platform) must decide upon the range of assets to be supported. Platforms commonly enable investors to choose from a wide range of authorised **collective investment schemes (CISs)** (such as **open-ended investment companies (OEICs)** and **authorised unit trusts (AUTs)**), together with many types of assets that trade on a range of **Regulated Markets** (sometimes referred to as 'exchanges').

Each platform will also enable investors to make use of various tax allowances and tax-efficient methods of investing, such as **individual savings accounts (ISAs)** and pensions. Such products are designed and operated by a product provider, which may be the platform operator itself or some other regulated firm specialising in those products. The **product provider** is responsible for ensuring that their product has been designed in line with the relevant tax laws and guidance so that investments made using the product are not subject to certain taxes. As these product rules are wrapped around the investment assets, they are commonly referred to as tax-efficient wrappers, or just **wrappers** for short.

Alongside these wrappers (which are subject to **HM Revenue & Customs (HMRC)** limits on how much money can be invested and the types of assets that can be held), each platform will also generally offer a product that is not tax-efficient and which can be used for general investment purposes aside from any regulatory limits. Different terms are used for such products; within this workbook, we will use the term **general investment account (GIA)**. We will look at wrappers in more detail in chapter 2.

2. Assets

The assets available on most platforms will be a combination of:

- cash
- exchange-traded assets (such as **equities**)
- units/shares in a collective investment scheme (CIS), and
- structured products.

The aim of the platform operator is to enable the investor to perform all their investment activity via the platform's services. The investor will hope that their investments generate a combination of capital growth and income. Cash will not, therefore, simply be a means of paying for transactions that have already been performed; the platform will expect the investor to retain some cash available in readiness for future transactions (and to pay platform charges when they become due). As such, the platform operator must consider whether it will only handle sterling or will enable the investor to hold balances in other currencies. This will depend, in part, upon the geographical range of assets it supports for trading purposes.

The platform operator will also need to consider whether it will pass on to the investors any interest that is earned on these uninvested cash balances.

2.1 Exchange-Traded Assets

Exchange-traded assets represent a diverse range of investments that are listed and traded on a stock exchange, and include shares and government **bonds** (eg, **gilts**) through to **exchange-traded funds (ETFs)**. We will look at various types in more detail, though a common factor of these asset types is that, at any given time, the asset will be available to purchase if another investor is willing to sell. The number of shares/bonds available is fixed, and the regulated market is the market mechanism for willing sellers to be paired off with willing buyers.

2.1.1 Equities

Holding shares in a company is the same as having an ownership stake in that company, and so shareholders generally have a right to vote in key decisions relating to the structure of the company. Being an owner of the company creates the opportunity for growth but also for the risk of losses (either through a reduction in the market value of the company or through reduced levels of dividend payment).

2.1.2 Corporate and Government Bonds

A bond is a debt instrument; essentially, it is an 'I owe you' (IOU), usually written for a fixed period. The issuer of the bond receives money from the initial buyer of the bond and undertakes to repay that money (the capital) at a specified future date. Over the intervening period, the issuer will make interest payments to the bond-holder. The regular interest rate that is paid by the issuer is known as the coupon rate, and the date on which the interest is paid is known as the coupon date.

Bonds are issued by governments, supranational institutions and companies. Government bonds are issued by national governments, with UK government bonds being known as gilts. Supranational bonds are issued by agencies, such as the European Investment Bank (EIB) and the World Bank. Corporate bonds are issued by companies (eg, Unilever, BP, and Shell).

While the capital value of the bond at maturity is fixed, the market value can change over time (eg, the prevailing interest rates can make the interest offered by the bond either more or less attractive to investors, changing what is known as the yield of the bond). Bonds are generally considered less risky than shares, providing that the issuer remains solvent. Government bonds are regarded as being of particularly low risk, as it is unlikely that a government will default (ie, fail to pay the interest or repay the capital on the bond) – although unlikely, governments have been known to default especially when a country undergoes a turbulent regime change or encounters serious economic problems (eg, the restructuring of Greek government bonds in 2009 during the fallout of the global financial crisis).

2.1.3 Closed-Ended Funds

Investment trusts, **real estate investment trusts (REITs)** and **venture capital trusts (VCTs)** are listed assets like shares, but the nature of the issuing company is different. Where standard equities are issued by, for example, shops, manufacturers, utility providers, oil/gas companies and airlines (ie, companies that seek to sell specific goods and services in the wider economy), **closed-ended funds** are issued by companies whose business is investment.

The fund issues a fixed number of shares, and uses the capital it receives to build an investment portfolio. That investment portfolio may generate income (which is passed on to the shareholders of the fund in the form of dividends), and may also generate capital growth. This portfolio is managed by an investment manager and therefore, the investment trust pays for their services.

The success of the investment manager running the fund's portfolio will affect the level of demand to buy shares in the fund. As the number of shares available is fixed at any time, such increase in demand will increase the market price of the fund.

Real Estate Investment Trusts (REITs)

A real estate investment trust (REIT) is a company that owns and (in most cases) operates income-producing real estate. REITs own many types of commercial real estate, ranging from office and apartment buildings to warehouses, hospitals, shopping centres, hotels and even agricultural land. Some REITs also engage in financing real estate. The REIT structure was designed to provide a real estate investment structure similar to the structure that mutual funds provide for investment in stocks.

In order to be a UK REIT, the company must be a closed-ended investment trust, reside in the UK, be publicly listed on a stock exchange recognised by the **Financial Conduct Authority (FCA)**, and distribute 90% of its income to its shareholders.

Venture Capital Trusts (VCTs)

A venture capital trust (VCT) is a highly tax-efficient UK closed-ended CIS designed to provide private equity capital for small expanding companies and capital gains for investors. VCTs are companies that are listed on the London Stock Exchange (LSE) and that invest in other companies which are not themselves listed on any regulated market. Investors can claim income tax relief to the value of 30% of their initial investment (as long as the VCT is held for five years), and will recieve any capital gains or dividends tax free.

2.1.4 Exchange-Traded Funds (ETFs)

An ETF combines aspects of these closed-ended funds with the open-ended CISs discussed in section 2.2. For practical purposes, the assets behave as closed-ended assets, which can be traded by matching up a willing buyer with a willing seller. However, unlike these pure closed-ended assets, the number of shares in an ETF can change each day.

Assets owned by the ETF are managed to generate an investment return, often designed to replicate the performance of a market index (such as the FTSE 100). The listing of the ETF shares should mean that the shares are liquid (ie, a shareholder can sell their shares to another person when they choose so). However, it is possible, instead, for that holder to redeem their portion of the fund's assets (ie, in return for their ETF shares, they receive a proportionate amount of the fund's portfolio, rather than simply receiving cash). A similar process enables the fund to grow if an investor can offer suitable assets in return for new units.

2.2 Open-Ended Collective Investment Schemes (OECISs)

Collective investment schemes (CISs) are the most common investment type offered by platforms. Many types of fund might be available via a given platform, such as the following:

- UK-domiciled funds that have been authorised by the FCA. This includes authorised unit trusts (AUTs) or OEICs which are operated according to the FCA's **Collective Investment Scheme Sourcebook (COLL)** rules.
- UK-domiciled unauthorised unit trusts, such as 'insured funds'.
- Funds domiciled within the EU, operated according to European Directives such as UCITS or the Alternative Investment Fund Manager's Directive (AIFMD).
- Funds domiciled in other parts of the world, but recognised by the FCA.

There are many authorised UK CISs available, each one run by a regulated financial services firm (referred to in the FCA rules as the **authorised fund manager (AFM)**). The AFM aims to deliver investment growth or income through its work as an investment manager running a portfolio of assets in line with the scheme's stated **investment objective**.

While authorised CISs are available to all retail investors, unauthorised CISs are available for some more limited purposes (eg, insured funds for specific use within insurance bonds or insured pension wrappers). These will operate in a broadly similar way, though they are not available to the general retail investors so are subject to fewer regulatory restrictions.

The key aspects of an authorised CIS are as follows:

- Any investor can buy CIS units/shares from the AFM. There is no formal secondary market for investors to trade with each other.
- Authorised CISs are open-ended assets; if the AFM has more requests to buy units/shares than requests from investors wishing to sell their units/shares back to the AFM, additional units/shares are issued to satisfy these requests.
- The price of the units/shares is directly related to the **net asset value (NAV)** of the underlying investments in the fund calculated by the AFM at the **valuation point** stated in the fund's **prospectus**. Most retail CISs have a daily valuation point, and investor deals are executed at the next price calculated (known as 'forward pricing'), which means that the investor will not know the transaction price when placing their order with the AFM.
- The AFM applies an **annual management charge (AMC)** against the scheme to cover their services in running the fund. This is generally a percentage of the fund accrued in the NAV each day.
- Income units periodically pay a cash distribution (representing income earned on the asset portfolio), or offer a chance to buy extra units with this money. Accumulation units retain the earned income within the fund without issuing additional units – although the investor is still considered to have received the corresponding taxable income.
- A given fund might be available in multiple share classes to suit different investor groups. For example, one class might have a larger minimum investment level (better suited to institutional investors), and will generally have a lower AMC than the equivalent retail class.
- An independent organisation (the trustee or depositary) is appointed to protect the interests of unitholders and keep safe the property of the CIS. While the AFM operates the fund, the trustee/depository should ensure that the structure and operations of the scheme do not unfairly prejudice any group of unitholders/shareholders in favour of another group.

Aside from the AFM's decision about which share classes to create, each platform must make a decision as to which classes of a given fund it will support. One particular operational difficulty that arises from multiple share classes is that an investor wishing to move their portfolio from one platform to another might find that a particular class held by the current platform is not accepted/supported by the receiving platform. The FCA has been concerned that platforms have had to sell and buy assets rather than simply re-registering those assets (and that the additional trades impose costs on the investor). The FCA, therefore, expects the industry to identify a *'common share class'* for each fund so that re-registration between platforms will not require fund assets to be sold and bought again.

2.2.1 Property Authorised Investment Funds (PAIFs)

A **property authorised investment fund (PAIF)** is a form of open-ended CIS whose investment portfolio comprises predominantly real estate property or shares in UK REITs and similar entities. In order to avoid distortion in the tax paid by investors, a PAIF will pay a distribution that contains three distinct streams of income. It is important that the accounting records of any platform supporting PAIF investment will correctly differentiate each income sum received between these three income streams:

1. **Property income** – including that from UK-REITs and foreign equivalents.
2. **UK dividend income** – aside from property income.
3. **Other taxable income** – primarily interest and non-UK dividends.

2.3 Implications for Pricing and Dealing

The price of open-ended funds is entirely dependent on the NAV of the underlying assets of the fund at the time of the valuation point. For closed-ended exchange-traded assets, the balance between the supply and demand of the asset will impact its market price, causing the price to vary throughout the day.

This has implications for how a platform will need to administer and price the transactions it performs for its clients:

- For **open-ended funds**, it is essential that all orders that are received prior to the valuation point are aggregated and executed on a timely basis. The platform will generally set a cut-off point to ensure it has time to aggregate orders received by this point and instruct the trade to the AFM prior to the valuation point.
- For **exchange-traded products**, the platform operator must be clear whether it will aggregate such orders (which can reduce the transactional costs for investors) or deal upon receipt of the investor's instructions (which will reduce any potential shift of the asset price from that expected by the investor, though it may increase the transactional costs).

2.4 Structured Products

Structured products differ from shares, bonds, and CISs because they are effectively engineered promises from a financial services firm to anyone wishing to buy into that promise. Often, that promise will be based upon the performance of some publicly available financial measure, such as the value of a stock market index. For example, a structured product might offer the investor a five-year period after which they would receive their money back, plus or minus an adjustment reflecting the performance of that stock market index during the five-year period.

For example, a structured product related to stock market performance might offer the following sort of return:

- if the stock market index rises, 75% of the increase, and
- if the stock market has fallen over the period, only 30% of the decrease.

Note that, in such a case, the investor has no right to the underlying investment assets; they have purchased a promise that the issuer of the structured product will pay a certain value according to market conditions. If the issuer becomes insolvent before that promise is fulfilled, the investor may lose out. The potential benefit to the investor is that they gain exposure to market gains while not being fully liable to the potential loss if the market falls. The issuer of the structured product gains from having use of the investor's money over the period – though they must of course secure the necessary financial return to keep their promise (which will be invisible to the investor, who must simply trust that the issuer will deliver on their promise upon the maturity of the structured product).

When considering whether to allow investors to buy structured products on their platform, a platform operator will need to consider the different implications that such an asset raises. In particular, it may be necessary to pay money to the issuer ahead of the structured product being created. Also, there may be no secondary market available to sell such an asset once purchased. It may be necessary for the investor to hold the asset until maturity – which could pose administrative difficulties for the platform, especially if the investor at some point decides to move their affairs to a different platform.

2.5 Extra Considerations with Regard to CIS Dealing

Learning Objective

1.2.1 Know: the difference between hard and soft closure; the difference between deferred and queued redemptions; the implications for the platform and the client of fund dealing being restricted or suspended

2.5.1 Frequency of Redemptions

Generally, the Collective Investment Schemes Sourcebook (COLL) requires investor redemption instructions in a UK-authorised CIS to be executed at the next dealing valuation point. This will usually be daily, though some funds are established with less frequent dealing days.

There is a risk, however, that a large proportion of investors in a fund might happen to redeem their units on a single dealing date, which may cause difficulty for the investment manager trying to sell a substantial proportion of the fund's assets at a reasonable price. For this reason, COLL permits a daily dealing fund to implement a mechanism called deferred redemption.

Deferred redemption allows the AFM to move forward all redemption instructions received for a given dealing day, so that they will instead be actioned on the following dealing day. Importantly, any instructions from investors wanting to purchase units will be processed as normal.

The AFM may choose to bounce the full transaction forward, or it can choose to deal a portion of each investor's redemption instruction (eg, 10% of every redemption instruction on the original dealing day, with the remaining 90% processed the following day). The approach must be stated in the scheme documentation that defines the CIS.

While deferred redemptions do give the AFM a small amount of additional flexibility in managing fund liquidity, they have not been widely used in the industry. Platform operators should consider the implications of allowing investors to buy units in a fund that may employ deferred redemptions, as the platform would need to amend its own transaction records based on any deferral taking effect.

There is a separate approach not available to COLL funds, but which might be encountered for other types of funds. Some funds allow the fund manager to queue redemption instructions, processing them over time in the order they were received. Note that the funds utilise this approach can be more costly for platforms to administer as the trade date and settlement dates will be unknown at the time the order is submitted.

2.5.2 Fund Closure and Suspension

A number of different scenarios can result in a fund being effectively closed to trading activity. A true fund closure sees all trading activity cease, so that the assets of the fund can be sold off and the relevant cash value returned to the registered unitholders. Such events are rare and are sometimes referred to as 'hard closure' or 'winding up the fund'.

Soft closure is used to describe the scenario where the fund manager is not winding up the fund, but in order to avoid any expansion of the open-ended fund, the fund manager applies some punitive measure so that investors will not wish to invest. Suppose the fund manager considers that the investment portfolio had reached an optimum level for the fund's investment objective – to the point that adding further assets would have a negative effect – in such a case, the fund manager might choose to apply a substantial minimum investment level, or raise the fund's **initial charge** in order to deter investors from applying for units.

Another scenario is that the fund manager may encounter a problem that they expect will prevent them from fulfilling their function for a relatively short period of time (perhaps, a few days). The cause may be a system failure, market disturbance, issues in the national banking system, or even the result of political elections. In such a situation, the fund manager may choose to suspend dealing in the fund. Changes in market sentiment may lead to increased levels of unit redemptions and would exhaust the more liquid assets in the fund portfolio. Where the fund manager considers that further repurchases are likely and that settling such deals would require it to sell off less-liquid property holdings at an effective discount, the funds may instead be suspended (preventing further repurchase activity, and giving additional time for the manager to reposition the portfolio).

When a fund is suspended, no buy or sell orders will be actioned (though the fund manager might choose to accept orders and hold them in a queue until the fund reopens). The fund manager should of course keep all unitholders and potential unitholders informed of the situation if a suspension becomes necessary.

All of these considerations are relevant to a platform operator when determining the balance between the asset range to be offered and the administrative functionality required to service those assets. For example, the platform might need to communicate with investors who submitted orders that become subject to delay or rejection. The platform should also consider its enhanced functionality (such as **portfolio rebalancing**, discussed in chapter 3) to ensure it can function in scenarios where certain assets cannot be bought or sold.

2.6 Selection of an Asset Range

As shown throughout section 2, each type of investment asset raises a set of processing requirements for any firm transacting or holding that asset. In addition, the rules defining tax-efficient wrappers will often restrict the type/value of certain asset types that can be held.

Each platform operator must decide what range of asset types, and individual assets of each type, it will support, based on its own decision of the balance between:

- investor desire for a given asset (which could provide the platform with valuable competitive differentiation in the market)
- the cost to the platform of building the necessary system functionality and communication mechanisms to transact and service that asset
- the need for robust controls to ensure that an investor using a tax-efficient wrapper cannot purchase an asset that breaches the rules of that wrapper, and
- the ongoing cost of servicing a potentially small proportion of the assets to be held (and whether the relevant investors would be willing to pay a higher fee as a result).

The platform operator must also consider its obligations under the Consumer Duty (discussed in chapter 6, section 4). As noted above, each platform operator will determine the asset range to be supported. However, many platforms will also provide functionality so that investors can record other assets held but not supported by the platform. Examples of such assets include shares in privately owned (ie, non-listed) companies, commercial/residential property, art, and antiques. Such information is for reference only; the platform will provide no trading or valuation functionality in respect of these off-platform holdings.

End of Chapter Questions

Think of an answer for each question and refer to the appropriate section for confirmation.

1. **What is a general investment account (GIA)?**
   Answer Reference: Section 1

2. **What is the difference between an equity and a corporate bond?**
   Answer Reference: Section 2.1

3. **What type of closed-ended fund must distribute at least 90% of its income to shareholders?**
   Answer Reference: Section 2.1.3

4. **What aspects would a platform provider consider when deciding the range of assets that will be available on their platform?**
   Answer Reference: Section 2.6

5. **In respect of a collective investment scheme (CIS), what is the trustee and what is its purpose?**
   Answer Reference: Section 2.2

6. **What is the main difference between a property authorised investment fund (PAIF) and a real estate investment trust (REIT)?**
   Answer Reference: Section 2.1.3 and 2.2.1

7. **On what is the market price of units in an open-ended collective investment scheme (CIS) dependent?**
   Answer Reference: Section 2.3

8. **The price of what type of assets will fluctuate according to supply and demand?**
   Answer Reference: Section 2.3

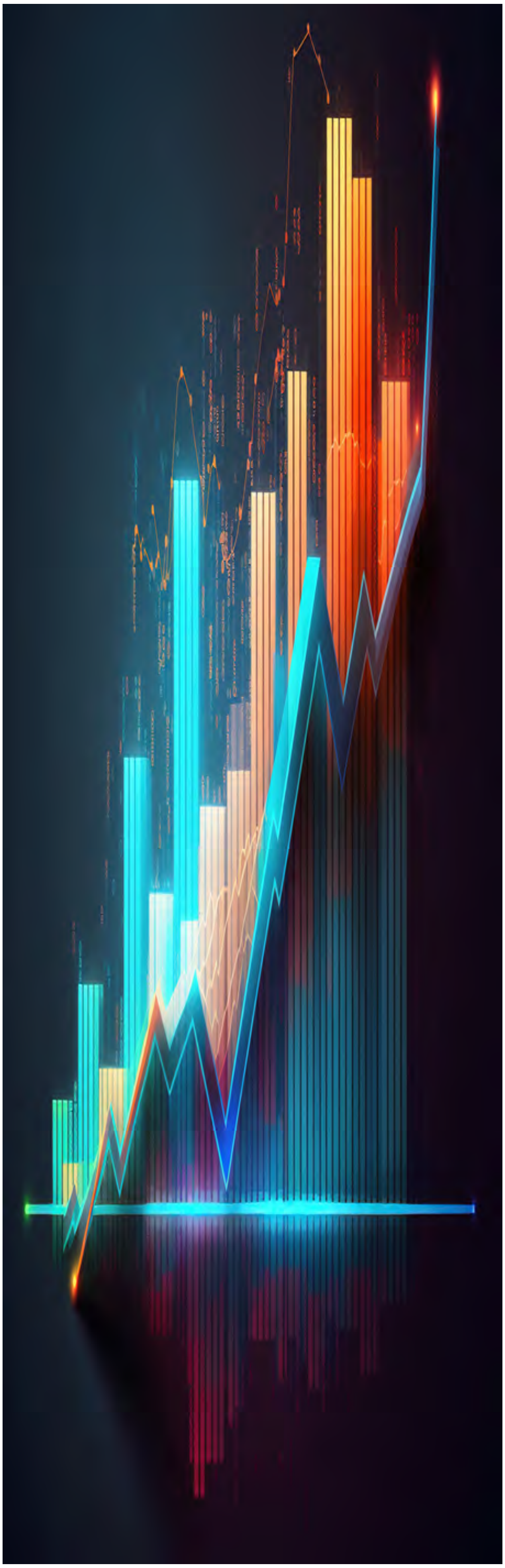
9. **What type of asset might feature a fixed maturity date and an investment return related to the performance of a specific index over the period?**
   Answer Reference: Section 2.4

10. **In respect of a collective investment scheme (CIS), what is meant by soft closure?**
    Answer Reference: Section 2.5.2

Chapter Two

Platform Wrappers

This syllabus area will provide approximately 5 of the 50 examination questions



1. Overview of Wrappers

Learning Objective

2.1.1 Know the range of typical wrappers available: general investment accounts; protection policies; investment bonds – onshore, offshore; ISAs; pensions

In addition to offering flexibility of asset type, a platform will also provide a range of tax-efficient wrappers (such as individual savings accounts (ISAs), investment bonds, and pensions), to enable investors to maximise their tax-free allowances. While various terms can be used, the most popular for such products is 'wrappers' – conveying the sense that the investor wraps money or assets within a product in order to benefit from any associated tax exemption.

These tax-efficient wrappers are subject to regulations which usually limit the types of assets that can be used – and so, even though the platform provider has selected the range of assets it will support (as noted in section 2.6 of chapter 1), the assets available within any given wrapper may be only a subset of this list. Similarly, the regulations creating tax-efficient products will usually restrict the types of investor who can open such a product, and so some wrappers will only be available to certain types of investors.

Most platforms will also include one product wrapper that carries no tax advantage but enables all investors to make any other investments they wish from the asset range supported by that platform. Again, different providers use different names, but 'general investment account' (GIA) is a common term.

The following list of wrapper types is typical:

- general investment account (GIA)
- **stocks & shares ISA**
- **cash ISA**
- **Junior ISA (JISA)**

- **Lifetime ISA (LISA)**
- **onshore bond**
- **offshore bond**
- **self-Invested personal pension (SIPP)**
- **insured personal pension**, or
- **S32 buyout bond**.

Of these product types, only onshore bonds, offshore bonds and GIA wrappers can be held in joint names. All the other wrappers listed may only be opened in the name of a single individual. Broadly speaking, most tax-efficient wrappers require that the client is a UK resident who meets certain age-related criteria.

2. Wrappers

Learning Objective

2.1.2 Know the regulatory limitations and restrictions associated with these wrappers: contribution limits; restrictions around withdrawals; restrictions around investment eligibility; restrictions around client eligibility; ISA guidance notes – applications & transfers, subscriptions, Investment activity, reporting, void & repair; pension regulations – HMRC Pension Tax Manual (allowances, tax reclaim, investor documentation, member benefits, death benefits, benefit crystallisation events), and FCA requirements (default investment option, investment pathways, cash warnings)

2.1 Individual Savings Accounts (ISAs)

2.1.1 General Information

ISAs were introduced by the UK government in 1999 to provide a tax-efficient mechanism for citizens to save and invest. Any investment growth and income generated within an ISA are exempt from income tax and **capital gains tax (CGT)**, though the government sets an annual subscription limit which determines the maximum amount of money that each person can subscribe to ISA products each tax year.

2.1.2 Evolution of the ISA

Originally, there were just two types of ISA: a cash ISA and a stocks & shares ISA.

The rules allow a stocks & shares ISA to hold uninvested cash and a broad range of investments, with no restriction on when or how much money can be withdrawn. However, each ISA manager will define the behaviour of their ISA products according to their business model and asset universe.

Any private individual who is a UK resident and aged 18 or over may apply for a cash ISA or stocks & shares ISA.

In recent years, governments have sought to leverage the success of the ISA brand for a wider range of product types, each having a slightly different purpose or focus:

- **Innovative Finance ISA** – based on peer-to-peer lending propositions.
- **Help-to-Buy ISA** – offered by banks/building societies with a government bonus available for savers who use the product to help purchase a home.
- **Lifetime ISA (LISA)** – launched in 2017: to support those saving to purchase their first residential property and/or to provide savings for their retirement. As an incentive to such savings goals, the government pays a bonus of 25% of all monies subscribed into a LISA – though additional restrictions are applied to both investor eligibility and withdrawals (including a LISA withdrawal charge in certain cases). An investor can only open a LISA up until their 40th birthday, and then can only make subscriptions until they are 50 years old.

In a single tax year, an individual can subscribe to any number of Cash ISA, stocks & shares ISA, and Innovative Finance ISA products and up to one Lifetime ISA, but must not in total exceed the subscription limit of £20,000. Note, however, that there is also a separate limit of £4,000 for the amount that can be subscribed into a LISA. These two limits operate separately: if an individual subscribes £4,000 directly into a LISA, it would count against both the overall ISA subscription limit (being new money subscribed into the ISA family of products) and the LISA limit (being a new subscription into a LISA). If, however, an individual transferred money from an existing stocks & shares ISA into a Lifetime ISA, this would count as a subscription against the LISA limit (being a new LISA subscription), but would not be counted against the overall ISA subscription limit (as the money is already within a type of ISA product and is simply moving between ISA types).

A platform operator will need to understand the rules governing ISA products to ensure the wrappers they administer are compliant. This means understanding the ISA Regulations and also the 'Guidance Notes for ISA Managers' issued by HM Revenues & Customs (HMRC). It is commonly understood that an ISA manager cannot prevent all types of abuse (eg, an ISA manager would not be able to identify that an investor had opened up multiple stocks & shares ISAs in the same year, or exceeded their annual subscription limit when subscriptions made with different ISA managers are aggregated). However, as a platform's ambition is to maintain the investor's full investment portfolio, it is important that the platform operator ensures that any breaches visible in their records are identified and appropriate controls are put in place.

Investors can transfer an account to a different provider (retaining the tax benefits of the wrapper), and can also transfer value between the various types of ISA product (though a transfer from a LISA to a different type of ISA might trigger a LISA withdrawal charge). Such flexibility can be useful if the investor wants to change their investment relationships, or change their investment exposure.

The ISA subscription limit was originally created as a fixed sum of money that could be subscribed during the tax year, regardless of any withdrawals made during the year.

The introduction of the personal savings allowance (which enables bank interest to be paid gross) required this to be relaxed, and so, under the 'flexible ISA' rules introduced in 2016, the manager of a stocks & shares ISA can allow its customers to replenish any amounts withdrawn in cash from that stocks & shares ISA during the same tax year. Note that ISA managers were not obliged to adopt this flexible feature, though more have been enhancing their technology to do so.

One final piece of ISA evolution reflects the fact that many people are using ISAs as part of their long-term investment strategy and building up substantial sums that are protected from CGT as well as income tax. It was deemed unfair that the death of an ISA holder stripped the ISA benefits from the assets when being distributed by the executor, and so the ISA rules have been amended to allow the surviving spouse an 'additional permitted subscription' (APS) equal to the value of the deceased spouse's ISA. Such APS subscriptions are allowable only for three years after the date of death (or 180 days after the administration of the estate is complete, if later). Some providers enable the surviving spouse to instruct that the assets held in the deceased person's account are simply transferred into an ISA in their own name, removing the need to sell the assets and buy them again after subscribing the cash proceeds of the sale.

The Junior ISA was introduced in 2011, and is only available to UK residents under the age of 18. It is available as either a cash account or a stocks & shares account, though (unlike an adult ISA) a child can only hold a total of one JISA of each type. The rules also prohibit withdrawals from the JISA until the child is 18 years old (though an exception is permitted in the case of terminal illness or the death of the child). Any JISA transfer must, therefore, include all money invested in prior years. The annual subscription limit for JISA is lower than for ISA; for 2024–25, the JISA subscription limit is £9,000 (which can be used for any combination of cash and stocks & shares JISA subscriptions).

A child can open their own JISA account from age 16 otherwise, a person with parental responsibility can open the JISA for the child. At age 18, the JISA matures into an adult ISA.

2.1.3 ISA Applications

HMRC's guidance to ISA managers states that investors must apply for an ISA. In the application, they must provide the following information:

- The first tax year during which they are applying for the ISA.
- The investor's full name, permanent residential address including postcode, National Insurance (NI) number and date of birth.
- The type of ISA they wish to open (eg, a cash ISA or a stocks & shares ISA).
- A declaration that the information given in the application is correct (HMRC Guidance provides the declaration wording for different types of ISA product).

Applications in writing include any signed application forms – including faxed or scanned copies, or an emailed form containing an electronic signature.

Where the application is not made in writing (eg, by telephone or online), the ISA manager must still ensure that the declaration is made and evidenced. The declaration should be read back on a telephone application, or replayed on-screen for internet applications. Further, the ISA manager should then email, fax or post a copy of the declaration to the applicant. The investor's signature is not required.

Applications may be made through third parties, such as financial advisers. Such applications must be authorised by the investor, but they can be passed to the ISA manager by the third party.

Where bulk applications are passed on by a third party, ISA managers must ensure that each investor's personal details are complete, and that the type of ISA each investor is applying for is clear.

2.1.4 Qualifying Investments for Stocks & Shares ISAs/JISAs/LISAs

The monies subscribed to a stocks & shares ISA (or JISA or LISA) can be held as uninvested cash, and can earn tax-free interest. Once subscribed, the money can be used to purchase assets – providing those assets satisfy the HMRC requirements of qualifying investments for a stocks & shares ISA (and providing the ISA manager and/or platform operator concerned supports the asset).

The following table lists the types of asset recognised by the ISA rules as qualifying investments for stocks & shares ISAs, LISAs, and JISAs.

Asset Type	Comments
Shares	Issued by a company (aside from investment trust companies – see below), and either: • officially listed on a recognised investment exchange, or • admitted to trading on a recognised investment exchange in the European Economic Area (EEA).
Securities issued by companies	Issued by a company and satisfying at least one of the following conditions: • the securities are officially listed on a recognised stock exchange (or traded on a recognised stock exchange in the EEA) • shares in the issuing company are officially listed on a recognised stock exchange (or traded on a recognised stock exchange in the EEA), or • the issuer is at least 75% owned by a company whose shares are so listed/traded.
Shares and securities in qualifying investment trust companies (ITCs)	Securities in ITCs are qualifying if they satisfy the same listing requirements above.
Government securities	• UK gilts and gilt strips, or • securities or strips issued by or on behalf of any EEA state government.
Core capital deferred shares	Issued by a UK building society.
Securities issued by certain multilateral organisations	The security must be on the official list of a recognised stock exchange.

Asset Type	Comments
Shares in a UK UCITS, qualifying non-UCITS schemes, and recognised UCITS	• UK-authorised unit trusts (AUTs) and open-ended investment companies (OEICs) defined under the Collective Investment Schemes sourcebook (COLL) as UCITS schemes. • Non-UCITS retail schemes (NURS) (as defined under COLL) providing the scheme permits redemption at least fortnightly. • Recognised UCITS are UCITS schemes constituted in a non-UK EEA state, recognised in the UK under the Financial Services and Markets Act (FSMA).
Units in a CIS specified as a stakeholder product	Specific details of these asset types will not be discussed in this workbook. Any platform/wealth manager considering such asset types should review HMRC's ISA Guidance Notes in detail.
Depositary interests	
Shares emerging from a Save As You Earn (SAYE) option scheme or **Share Incentive Plan**	
Certain life insurance policies	
Other assets that were previously held in a personal equity plan (PEP)	

ISAs cannot be used as security for a loan. They are not a pension product, but can be a useful complement or replacement to a pension for retirement income.

Managers must buy/sell ISA investments at the open market price, and must not buy them from the investor or their spouse. Purchases should be settled using cash held in the ISA, so that the ISA does not go into deficit. However, where instructions are given at the same time to match a purchase with a sale, HMRC accepts that if the purchase settles a few days before the sale, making the account overdrawn for a short period, the ISA rules are not breached.

2.1.5 ISA Transfers

Adult investors are allowed to move an ISA account to a different ISA manager. Such a move is called an 'ISA transfer' and can include either the full ISA account or part of it. Importantly, when an ISA is transferred between managers, the assets remain sheltered from tax. The ISA transfer process simply means that the investor's account will end up being managed by a different ISA manager and under a new set of terms and conditions. It is therefore, common for new investors joining a platform to transfer the value of their existing ISAs into the ISA product(s) supported by the new platform.

When transferring an ISA to a new ISA manager, the investor must make a transfer application to the new ISA manager. This can be achieved by the investor completing a transfer authority form (as the ISA manager must hold a valid application from each ISA holder).

As mentioned earlier, it is also possible to transfer from one type of ISA product into another; for example, a stocks & shares ISA might be used to transfer into a Lifetime ISA (in which case, the amount transferred would be counted against the LISA annual limit, though would not be counted against the overall annual ISA subscription limit).

2.1.6 Withdrawals

Adult investors have the right to withdraw money (or, where the manager offers partial withdrawal, part of their money) by request to the manager. Money (including the income received and the proceeds from selling assets held in an ISA) can be paid to the investor without any deduction for tax. Note that a withdrawal from a LISA might give rise to a withdrawal charge of 25% of the amount withdrawn (effectively cancelling out the government bonus previously received). No such withdrawal charge is applied where the money is used to buy an applicable residential property, or if the investor is aged 60 years or older, or if the investor has a terminal illness.

If an investor wants to withdraw an asset (rather than asking the ISA manager to sell the asset and withdraw the sale proceeds), the manager must provide the investor with written details of the market value of the investment at the date of withdrawal. Note that 'flexible subscriptions' arise only where cash is withdrawn from the stocks & shares ISA, and so withdrawing an asset instead might be less advantageous to the investor.

Life insurance policies cannot be withdrawn from the ISA by the investor. The proceeds from termination of the policy – or the partial surrender of the rights in the policy – may be withdrawn.

2.1.7 Reporting to HMRC

Each ISA manager is obliged to provide certain reports to HMRC. The key reports are:

- **ISA10 and ISA14** – which enable the ISA manager to claim back from HMRC any tax suffered on income/interest received for ISA holders during the tax year (ISA14 is an annual claim, while ISA10 is an optional interim claim).
- **ISAComm100** – known as the 'Annual Return of Information'. This report provides HMRC with a full list of the ISA wrappers held for each ISA holder (information that HMRC can use to ensure that any abuse of the ISA limits is identified).
- **ISA14a(Stats)** – which gives overall data (rather than investor-level data) of ISA activity to enable HMRC to perform statistical analysis of the ISA market. ISA14a(Stats) includes information on both subscriptions and investment market values. A firm can use separate forms for these two purposes: ISA14(Stats) for market value; and ISA25(Stats) for subscriptions.

The following table summarises the relevant dates and submission deadlines for each report. Similar reporting is made for JISA products, while LISA managers complete separate electronic reporting to HMRC (which is outside the scope of this workbook).

Report/Claim	Period/Purpose	Start Date	End Date	Submission Deadline
ISA10 (Optional report/ claim)	Usually one tax month, but can be up to six tax months within a tax year	Sixth day of the relevant month	Fifth day of the month chosen by the ISA manager	Last working day of the month in which the period ends
ISA14	Annual claim for tax suffered during a complete tax year	6 April	5 April of the following calendar year	5 October following the claim period
ISAComm100	Annual return of information	6 April	5 April (or an earlier date on which the ISA manager ceased being an ISA manager)	60 days after the end date
ISA14a(Stats)	Annual return of statistical information – combining subscriptions and market value	6 April	5 April (or an earlier date on which the ISA manager ceased being an ISA manager)	60 days after the end date (ie, 4 June at the latest)
ISA14(Stats) (unless ISA14a(Stats) is submitted)	Annual return of market value data	N/A	Market value as at 5 April (or an earlier date on which the ISA manager ceased being an ISA manager)	4 June following the end of the relevant tax year
ISA25(Stats) (unless ISA14a(Stats) is submitted)	Annual return of subscription data	6 April	5 April (or an earlier date on which the ISA manager ceased being an ISA manager)	4 June following the end of the relevant tax year

Where an ISA has been transferred in full, the new ISA manager must include current-year subscriptions made to the old ISA manager in the period of return.

2.1.8 Void and Repair

An ISA may be found to be invalid (for example, because the investments held in the account are non-qualifying, or the investor is not a qualifying individual, or the subscription to the account is invalid). The rules allow certain types of invalid ISAs to be made good and continue as valid ISAs (this is known as the repair of the ISA). The repair process ensures that the investor does not gain unfairly as a result of any failure to apply the ISA rules to the invalid account. Invalid accounts that cannot be repaired must be voided, which removes all tax benefits from that account.

In some cases, the account may be invalid because the ISA manager failed to perform some of the necessary checks when opening it (eg, if the investor's ISA application was missing some necessary information, such as the NI number, date of birth, or a signature). In other cases, it is the investor who has acted contrary to the ISA rules (whether consciously or not) – such as by exceeding the total annual subscription limit for the tax year.

In most cases, investors who have subscribed to a disallowed combination of ISAs, or who have exceeded the overall subscription limit, are not aware that they have made an error until it is found during the HMRC compliance programme, which examines the annual returns submitted by ISA managers.

As there may be several different ISA managers dealing with the same investor, the repair action will be advised to the manager(s) by HMRC, who will issue a notice of discovery to each stating which ISAs can be repaired, and to what extent. They will also inform the investor of the action to be taken by the manager(s). The Guidance Notes provide a number of case studies that may be helpful to students who need more detail on this topic.

Managers should not repair an investor error without a notice of discovery. The date of the notice is the date of repair of the invalid ISA. All investments in a repairable ISA lose their tax exemption from the date of the first invalid subscription up to the date of repair.

Invalid Accounts that Cannot Be Repaired

An ISA is not eligible for repair if it is invalid because the investor:

- did not satisfy the residence condition at the time the subscriptions were made, or
- was underage at the time the subscriptions were made.

If an ISA manager finds out that the investor has subscribed to an ISA while not satisfying the residence condition, or when underage, they must void the invalid subscriptions and return them to the investor.

Recovery of Tax

The HMRC notice will specify whether the manager must adjust the ISA in order to return any income tax avoided when investments purchased with the invalid subscriptions generated income. If, after using any cash balance and the sales proceeds from investments, there are insufficient funds, the manager must write to HMRC providing details of the amount of tax that has not been recovered.

2.2 Investment Bonds (Offshore and Onshore)

An **investment bond** is generally a single premium life insurance policy that has a small element of life insurance that is paid out after the insured person's death. However, it is an investment wrapper rather than insurance in the general sense.

An insurance company will take the premium and invest it for income or capital gains which accrue until a policyholder withdraws money from the policy. As a policyholder does not receive income from the policy, personal income tax is deferred until certain events occur and the insurance company calculates any gain on the bond. As a result, an investment bond is a potentially tax-efficient way of an investor holding a range of investment funds in one place.

Each bond is usually designed to provide benefits for different types of investor, but a common element is that they aim to produce long-term capital growth and/or generate a long-term return.

There are often minimum investment levels which may range from £1,000 upwards and can typically be set at £10,000. A bond investor will be allocated a certain number of units in their choice of funds (from those available within the bond). Each fund will invest in a range of assets and the price of the units will normally rise and fall in line with the value of these assets. The value of an investment bond can fluctuate and the investor may not get back the full amount of the original investment.

The main benefit to an investor of using insurance bonds is that up to 5% of the investment can be withdrawn each year as income without being subject to UK income tax. If this allowance is not used in a particular year, it can be carried forward to the following year. They are useful, therefore, to investors who have used up all their subscriptions to other tax wrappers. However, early cash-in charges may apply on some investment bonds.

There are two types of insurance bonds: onshore bonds, where the product is created and domiciled in the UK, and offshore bonds, where the product is created and domiciled in locations outside the UK, and companies can offer customers growth on their funds that is largely free from tax. This includes 'true offshore' locations such as the Channel Islands and the Isle of Man, and other locations such as Dublin. Tax treatment can vary from one type of investment to another, and from one domicile to another.

The main tax benefit of investing in an offshore bond is gross roll-up. Gross roll-up means that any underlying investment gains are not subject to tax at source – apart from an element of withholding tax.

With an onshore bond, corporation tax is payable by the fund itself on some of the income or gains made by the underlying investments before it allocates income to investors. This means that the offshore investment has the potential to grow faster than one in a taxed fund.

2.3 Pensions

2.3.1 General Information

We have seen that an ISA allows an individual to use money, on which they have already paid any applicable tax, for investment purposes without any further tax being paid.

By contrast, a pension enables people to save and invest without suffering any income tax on the sum contributed to their pension, though the investor will pay income tax when they eventually take money from the pension product (as such sums are considered to be taxable earnings).

To be eligible to invest in a personal pension, the investor must be aged under 75 and be a UK resident at the time that the contract was first entered into. If the investor leaves the country, then they can continue to contribute to that pension for another five years in addition to the remainder of the tax year in which the pension was started.

The investor is able to withdraw value from their pension (known as 'taking benefits'), though is generally only allowed to do this once they are 55 years of age, and there are specific rules about the income a person receives from their pension.

Over time, the pension rules have increased the range of assets that can be held within a personal pension. However, as with other types of wrapper, there are still many products available that only offer a small proportion of the possible options. A scheme that is labelled a self-invested personal pension (SIPP) will usually provide a wider range of asset options than is available in other **personal pension schemes** – so SIPPs are a popular choice of pension product within a platform.

SIPPs allow individuals to make their own investment decisions from a broad range of investment types. However, many platforms will only support a subset of the asset types allowed by the pension rules, with the SIPP terms and conditions confirming what asset types can be held within the product. It should be noted that asset types allowable in a SIPP may be subject to income or CGT charges.

The assets that are not subject to a tax charge are:

- stocks & shares listed on a recognised exchange
- futures and options traded on a recognised exchange and contracts for difference (CFDs)
- carbon credits
- authorised UK unit trusts, OEICs and other UCITS funds
- unauthorised unit trusts that do not invest in residential property
- unlisted shares
- investment trusts subject to Financial Conduct Authority (FCA) regulation
- deposits and deposit interests
- commercial property
- ground rents (as long as they do not contain any element of residential property)
- traded endowment policies, and
- gold bullion.

However, SIPP rules specifically exclude residential property and 'exotic' assets, eg, vintage cars, wine, coins, stamps and works of art.

2.3.2 HMRC Pension Tax Manual

Pension products have a long duration, and some aspects of the pension rules tend to be changed each year – either replacing past rules or creating new product paths alongside previous arrangements.

HMRC collates the current rules in the Pension Tax Manual. We will consider the main points of relevance to platform operators.

Annual Allowance

The annual allowance is the total amount that can be contributed to an individual's pension scheme in a tax year while benefiting from tax relief. Since 2023–24, the annual allowance has been £60,000 contributed from any sources (including contributions from the investor's employer). As the ability of a person to save for their pension can vary from year to year – and because some employers' **defined benefit (DB) schemes** might make substantial contributions to staff members who receive a promotion in the closing years of their career – the pension rules permit an individual to carry forward any unused annual allowance from the previous three tax years. This can be useful to the investor, although it gives rise to administrative complexity for the pension scheme.

There are also circumstances in which a lower limit may apply. For example, some individuals earning more than £260,000 are subject to a tapering adjustment. The specific calculation is complex and outside the scope of this workbook, as it requires the calculation of four separate values of income and savings. Where those calculations result in an individual being subject to a tapering adjustment, their £60,000 annual allowance is reduced by £1 for every £2 of 'adjusted income' earned above the £260,000 threshold. However, this tapering is capped so that the minimum value of annual allowance is £10,000.

If the investor is aged 55 or over, and has already started to take benefits from their pension savings, their annual allowance is reduced to £10,000 (to prevent the investor from taking the pension savings and recontributing the same money in order to increase the tax benefit).

While pension schemes continue to refer to a 'pension input period' against which pension contributions are assessed for tax purposes, the pension input period for all schemes has been aligned with the tax year. The sum contributed during a given pension input period is known as the **pension input amount**. When an investor wants to check if they have exceeded their annual allowance they must sum the pension input amounts for that tax year across all pension schemes of which they are a member.

Tax Reclaim

Investors will usually make pension contributions from income that has already been taxed (ie, their earnings), and so any income tax already suffered by the investor on that pension contribution can be recovered (subject to the annual allowance described above). However, the pension rules allow any person to reclaim 20% tax on the first £2,880 paid into their pension each year, even if they are low-income individuals who do not pay income tax.

The scheme administrator would affect the tax reclaim at basic tax rate, with the investor using their own self-assessment tax return to resolve any higher rate tax suffered on the pension contribution. However, many employers will make contributions on behalf of their staff on which no additional tax reclaim should be made.

The scheme administrator (and therefore, the platform operator) will need to ensure that the correct tax treatment is applied to any contributions processed.

Example

Georgina Green, who earns £100,000 pa, decides to make a pension contribution of £10,000. As the standard rate of income tax is 20%, and her marginal rate is 40%, the system works like this:

- Georgina would pay £8,000 into her pension scheme, calculated as £10,000 less income tax at the standard rate (£2,000). The scheme would reclaim from HMRC £2,000 of tax already suffered on the income Georgina is contributing to her pension.
- As Georgina pays income tax at 40%, she is entitled to additional relief of £2,000, which will be addressed within her self-assessment (and this does not go into her pension).
- If Georgina was in a position to pay contributions of £65,000, then HMRC would only grant Georgina tax relief on £60,000, unless she had at least £5,000 of unused annual allowance carried forward from any of the previous three years.

Benefit Crystallisation Events (BCEs)

Following a simplification from the 2024–25 tax year, pensions tax law does not impose a lifetime allowance on a person's pension savings. However, a person is not permitted to receive more than £268,275 in tax-free payments (known as the 'lump sum allowance') – though in cases of serious illness a person may instead have a 'lump sum and death benefit' allowance of £1,073,100. The individual's position against this allowance will be tested whenever that person receives one of the following types of lump sum from a pension scheme:

- A pension commencement lump sum.
- A serious ill-health lump sum.
- An uncrystallised funds pension lump sum.
- A stand-alone lump sum.

These events are known as relevant benefit crystallisation events, and track the portion of the allowance which that person has used to date. If the total received exceeds the allowance, the person will pay income tax on the amount that exceeds the allowance.

Investor Documentation

Investor documentation in this context includes the following:

Pension Input Amount Statements

As the member may be entitled to some unused annual allowance, the scheme administrator may need to confirm the total pension input amount processed in respect of the previous three tax years. Such a report should be automatically triggered if at any point the individual's pension input amount in the registered pension scheme exceeds the current annual allowance and should be given to the member by 6 October following the end of the tax year.

Member Benefits

For a **defined contribution (DC) scheme**, the value of benefits that will eventually be available is determined by the value of assets accumulated within the scheme by/for that member. This is sometimes referred to as 'the member's pot'. Scheme administrators are, therefore, responsible for keeping each member informed of the value of their 'pot' – and, in due course, the various options available for taking their benefits (such as flexible drawdown, or purchasing an **annuity** in order to provide pension income until death).

Benefits may be paid in the following ways:

- Scheme pension.
- Lifetime annuity contract.
- Unsecured pensions.
- Income withdrawal.
- A short-term annuity contract.
- A pension commencement lump sum.
- Serious ill health lump sum.
- A refund of excess contributions lump sum.
- Trivial commutation lump sum.
- A lifetime allowance excess lump sum.
- Short service refund lump sum.
- Winding-up lump sum.
- Stand-alone lump sums.

However, not all of these methods of drawing benefits will be available to all investors, and close attention must be given to the HMRC rules and the terms and conditions of the scheme.

Death Benefits

Generally speaking, pension schemes can provide benefits to a member's estate on the event of death. These benefits can take the form of lump sum payments and widow/widower's pensions or a combination of both. There are limits to the amounts that can be paid without the beneficiaries incurring a tax charge. Inheritance tax is discussed in chapter 7, section 1.4.

2.3.3 Pension Drawdown

The traditional approach to pensions has previously been to purchase an annuity (a form of life policy) with the accumulated pension pot. However, for a number of reasons, the annuity option has become less popular in recent years and the government has provided greater flexibility to pension savers to retain control over their pension pot and to make a series of withdrawals from it rather than using the full value to purchase an annuity.

Pension drawdown, therefore, introduces the need for the saver to be responsible with their withdrawals; if there is no annuity to provide an annual income until death, the saver must be careful not to spend all of their pension savings too quickly.

To mitigate this risk, there was originally a limit on what amount could be withdrawn each year. From April 2015, these rules were relaxed and any member is now permitted to withdraw any amount of their pension pot as income at any time.

Up to 25% of the pension pot can be taken as a tax-free lump sum, with the rest treated as taxable income at the member's marginal rate of tax.

2.3.4 Section 32 Buyout Policies

Section 32 of the Finance Act 1981 was an attempt to help give flexibility over pension arrangements while employers were closing or changing aspects of their defined benefit pension schemes. It allowed the accrued rights in the scheme to be traded in for an insurance policy that would pay the holder a particular level of benefit.

While these are less likely to be written in the current climate (with greater consumer interest in flexible pension arrangements and fewer DB schemes being amended), platform operators will be aware that their core client base may well hold such policies. Given that the ambition of the platform is to enable the investor to see all their assets and wrappers in one place, this is a sort of pension policy that platforms will need to consider.

2.4 FCA Requirements for Pension Providers

Most personal pension schemes available via platforms are operated by investment firms which are authorised and regulated by the FCA. As such, the pension operator is subject to many regulations which will be discussed in chapter 6 of this workbook.

However, this is a good time to discuss three specific topics in which the FCA recently created rules that are particularly focused on pension schemes sold to investors who are not receiving financial advice or an investment management service to help them select the assets in their pension scheme. As such, the features discussed in these rules will be of particular interest to platforms – especially if they accept non-advised clients.

2.4.1 Default Investment Option

With non-workplace pension schemes – particularly SIPPs – often offering their members a vast range of investment options (some of which might have differing costs and charges or risk appetite), the FCA became concerned that a non-advised investor might inadvertently make a poor decision from the options available. As such the FCA introduced rules so that where a non-advised investor first becomes a member of a non-workplace scheme, and when they first contribute to that scheme, the scheme should provide a side-by-side comparison between:

- the investment options that the investor is considering, and
- a 'default option' that the scheme operator has identified from the assets available as being generally satisfactory for the target market of the pension scheme.

Note that the investor is not being put into this 'default option' or asked to accept it (the position is therefore very different from the sort of 'default fund' required in an auto-enrolment workplace pension scheme, which is outside the scope of this workbook). The obligation on the scheme operator is to determine the default option and to ensure it is presented to the Member at the relevant times as a comparison to demonstrate the features of this potential choice. The default option must be given equal prominence, must be clearly labelled, and the firm should explain the needs, objectives, and characteristics that it believes the default option is well-suited to satisfy.

The scheme operator must include information about the default option in the regulatory reports submitted to FCA.

2.4.2 Investment Pathways

While the requirements for 'investment pathways' also relate to non-advised members of a pension scheme, it is important to note that this topic is separate from the 'default option' discussed above. Where the 'default option' related to a member when joining a scheme (and making their first contribution), investment pathways are relevant when a member wishes to crystalise some or all of their pension value into a drawdown fund (so that it can be invested for further investment growth, but can be withdrawn as taxable income at any time) without having an adviser help select the assets in which that drawdown fund will be invested.

The FCA has defined four investment pathways – each essentially reflecting a different expectation of how and when the member will use the value they are placing into drawdown:

1. I have no plans to touch my money in the next five years.
2. I plan to use my money to set up a guaranteed income (annuity) within the next five years.
3. I plan to start taking my money as a long-term income within the next five years.
4. I plan to take out all my money within the next five years.

In readiness for this feature, the pension operator must decide for each of these pathways whether it will:

- identify and offer a particular investment approach (known as a 'pathway investment') that should be appropriate for a member of its target market who identifies that pathway as being applicable for them, or
- identify a different pension provider firm to whom it will refer a member who identifies that pathway as being applicable for them.

The same pathway investment might be used for more than one investment pathway, but cannot be used for all four investment pathways. The firm must itself offer a pathway investment for at least two of the 'investment pathways'.

The non-advised member entering drawdown should select the investment pathway they consider applicable to them, and then the firm must communicate the single pathway investment route it has decided will be used for that investment pathway (whether offered by the firm or as a referral to another pension provider).

Given the complexity of this process, a firm that believes it will have fewer than 500 non-advised clients enter drawdown in the following 12 months can elect not to provide any pathway investments but will instead need to refer the member to the MoneyHelper comparison tool (or to another firm that does offer 'pathway investments').

Note that referral to another firm would effectively result in the member's drawdown pot being transferred to that pension provider in order to take up that firm's pathway investment.

2.4.3 Cash Warnings

If a client that has been through investment pathways does not invest at least 50% of the relevant money in the corresponding pathway investment the firm must engage with the client to warn them of the consequences of adopting their own investment strategy,

If the member's investment instruction would result in more than 50% of their drawdown fund being invested in cash-like assets the firm must issue a cash warning and ensure that the member has made an active decision.

In such cases, the firm should give a further annual cash warning for as long as the drawdown fund remains more than 50% invested in cash-like assets (and the member continues to be non-advised).

2.5 Summary of Tax Wrappers

Learning Objective

2.1.3 Know the advantages these wrappers provide: tax treatment of contributions/withdrawals; tax treatment of investments held/income applied within these wrappers; pension drawdown

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While a pension product allows untaxed contributions to grow until they are withdrawn as taxable income, an ISA allows taxed earnings to grow without any additional tax becoming due. A higher rate taxpayer can therefore use a pension to defer money that would otherwise be taxable earnings – with the potential to draw that money upon retirement within a lower tax band. It should also be noted that, as the pension contribution (being gross of the 20% reclaim achieved by the scheme administrator) is higher than the equivalent amount subscribed to an ISA (being net of tax), the overall value built up within a pension should be higher than within an ISA wrapper holding the same investments.

This demonstrates the importance of considering the taxation implications when both contributing using a wrapper and when taking benefits from that wrapper. While a personal pension contribution benefits from the tax reclaim, income tax is payable on the benefits later taken. By contrast, an ISA offers no tax reclaim when subscribing, and no income tax is payable when withdrawing.

The following table summarises key aspects of the taxation arrangements for these wrappers.

Product	Sub-Product	Annual Allowance 2024–25	Tax Treatment of Investments	Tax Treatment of Withdrawals
ISA	• Cash ISA • Stocks & Shares ISA • Innovative Finance ISA	£20,000 across all forms of ISA product.	No liability to income tax on income earned, or to CGT on investments sold.	No tax applied to withdrawals. Withdrawals from a stocks & shares ISA can be replenished if the ISA manager has chosen to operate as a flexible ISA (otherwise putting the money back in counts as a fresh subscription).
	Lifetime ISA	In addition to counting towards the overall ISA subscription limit, contributions into a LISA are capped at £4,000.	No liability to income tax on income earned or to CGT on investments sold. A government bonus is received on all LISA subscriptions.	No tax applied to withdrawals. However, a withdrawal charge is applied to some types of allowable withdrawal (eg, the investor is less than 60 years old and not making an eligible house purchase), to effectively cancel out the government bonuses received.
Junior ISA	• Cash JISA • Stocks & Shares JISA	£9,000	No liability to income tax on income earned or to interest received on CGT on investments sold.	No withdrawals permitted until child reaches the age of 18.

Product	Sub-Product	Annual Allowance 2024–25	Tax Treatment of Investments	Tax Treatment of Withdrawals
Investment Bond	Onshore	No limit	The fund manager pays tax on any interest, dividend or capital profits the bond earns.	5% of the initial investment sum may be withdrawn each year without crystallising any income tax liability, and this allowance can be carried forward if unused. Higher-rate taxpayers may be able to mitigate any remaining liability through 'top-slicing relief' (effectively sharing the realised gain over a number of tax years).
	Offshore	No limit	The fund manager pays tax on any interest, dividend or capital profits the bond earns (though the offshore domicile should minimise such tax amounts).	
Personal Pensions		£60,000 Can be contributed and receive the tax benefit.	No liability to income tax or CGT on activity within the scheme.	Withdrawals from the age of 55 only. 25% tax-free lump sum when taking a benefit (capped at £268,275). Remaining withdrawals are taxable income.

End of Chapter Questions

Think of an answer for each question and refer to the appropriate section for confirmation.

1. **Which types of wrapper are available to investors who hold assets in joint names?**
   Answer Reference: Section 1

2. **How many Lifetime ISAs (LISAs) and stocks & shares ISAs can an investor subscribe to in the same tax year?**
   Answer Reference: Section 2.1.2

3. **Which types of individual savings account (ISA) wrapper exist, and which are most commonly offered by a platform?**
   Answer Reference: Section 2.1.2

4. **Who can open a junior individual savings account (JISA) for a child under the age of 16?**
   Answer Reference: Section 2.1.2

5. **What information should be included on an individual savings account (ISA) application?**
   Answer Reference: Section 2.1.3

6. **To qualify as an investment for a stocks & shares individual savings account (ISA), a company that is not itself listed or traded on a recognised stock exchange must be partially owned by a company that is listed on a recognised exchange. What percentage shareholding is required?**
   Answer Reference: Section 2.1.4

7. **What limitation affects the transfer of a stocks & shares ISA into a Lifetime ISA?**
   Answer Reference: Section 2.1.5

8. **What is the purpose of an ISA14 return, and how often is it submitted?**
   Answer Reference: Section 2.1.7

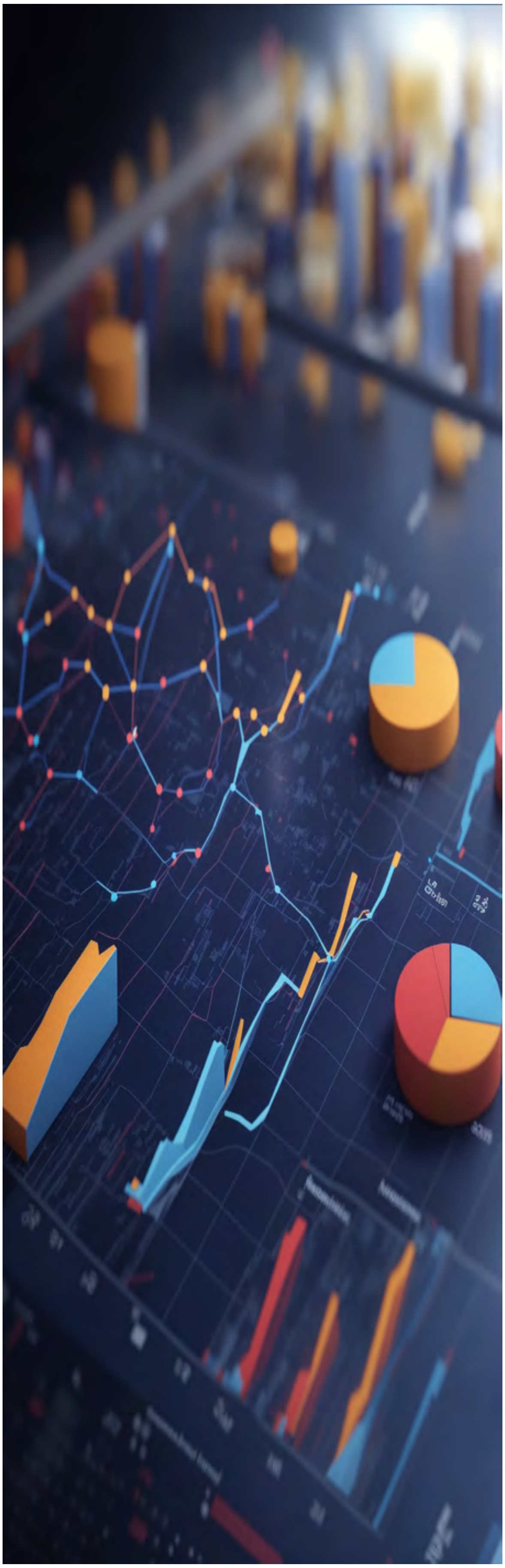
9. **What type of investment wrapper advertises itself as offering ‘gross roll-up’?**
   Answer Reference: Section 2.2

10. **What type of personal pension scheme is allowed to invest in futures and options without incurring a tax charge?**
    Answer Reference: Section 2.3.1

Chapter Three

The Market and the Platform Service Provider

This syllabus area will provide approximately 9 of the 50 examination questions



1. The Market

Before we consider the platform model in more detail, we should first consider that investors have different wants and needs, and so there are a range of regulated firms that offer a variety of different services to the investor population. Not all investors will make use of all these services, yet the platform will often become the heart of the operational structure by which all of these services are delivered.

In general, we can think about three broad types of investor. First, there will be those who want to make their own decisions and look after their own investment accounts. Such a client might approach a platform provider directly and request an account to access the range of assets and products available from that platform. These investors are sometimes referred to as 'self-service' clients, though from the platform's perspective, the preferred term is 'execution-only' clients (as the platform will simply execute the transactions as instructed by the investor). The execution-only client will only have to pay the platform charges, as there is no financial adviser involved in their accounts.

At the other end of the scale are high net worth individuals (HNWIs) who will be happy to pay for professional investment management services, including for example, asset allocation, stock selection and tax management. In such cases, the client will enter into an agreement with a **discretionary investment manager** who will be given authority to enter into transactions on behalf of the client.

This authority (sometimes known as a discretionary mandate) will be tailored to specific requirements of the client, which may include certain industry sectors the person wishes to avoid (eg, arms or tobacco), and may reflect certain sectors or individual stocks in which the client wants to maintain a particular interest. Where the investor's account is held on a platform, it is necessary that the discretionary investment manager is able to access the client's account and give instructions.

We will see that such firms may use additional features offered by the platform to help provide a coordinated and efficient service across their various clients and do so without breaching the personalised requirements of each discretionary mandate.

Between these extremes of the self-service client and the HNWI receiving a personalised service are a range of alternatives. Some investors might not yet have the confidence to make their own investment decisions, so will make use of services designed to help with that process. In the past, an **independent financial adviser (IFA)** would have assisted with asset selection (usually being paid for by the commission received from the fund manager of the selected funds). While IFA services remain available (paid for by a specific advice fee) it is also common for a platform's web portal to include a guided sales process which enables the investor to filter the available asset range according to their views on risk and exposure.

Slightly more advanced is the so-called robo-adviser model, which generally reflects a risk rating performed electronically within a portal which then leads to a portfolio being suggested to the client. Each provider of a robo-advice service will need to carefully consider whether their particular service satisfies the regulatory definition of investment advice (being the provision of personal recommendations to a client in respect of transactions in designated investments), or whether the service is simply offering information to help the investor make their own decisions. This is important because the firm must ensure that it has been authorised by the FCA for any regulated activities it is performing for clients.

There continues to be a market for personally advised services, particularly for those who do not require the full services of a discretionary investment manager but who want to be able to talk over their financial affairs with a professional. Such advice businesses need to be able to give efficient services to their clients, and so the advice service will not be as tailored as the discretionary mandates supported by a discretionary investment manager, though a **platform service** will often support the adviser's need to act across a range of clients.

1.1 Benefits of the Platform Model

Learning Objective

3.1.1 Understand how platforms support distribution for product providers and investment providers

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The platform business model enables the investor (and their adviser) to view their entire portfolio on a single screen; place buy and sell orders via the platform's technology, and see details of executed transactions, income payments and corporate actions. They can also use the tools provided by the platform to help make investment decisions.

The platform aggregates these investor-level transactions, resulting in a smaller number of market trades – each being of higher value – producing greater operational efficiency.

- Benefits to the investor:
  - a wide range of assets are available
  - centralised paperwork – a single statement gives information on all assets and wrappers on request
  - a single ISA or pension plan within the platform can hold funds from various providers, and
  - increased flexibility to switch assets.
- Benefits to the adviser/discretionary investment manager:
  - simplified administration
  - efficient buying and selling of investments on behalf of clients
  - increased time to spend on advising clients and achieving sales
  - reduced time spent on building a portfolio from the schemes of various providers
  - simplified switching between schemes and different providers – using a platform reduces the time when the client is out of the market and reduces the adviser's costs, and
  - integration into existing back-office systems.
- Benefits to a fund provider (AFM):
  - Administration costs can be reduced significantly as only one account is maintained on the **register** in the name of the platform's **nominee company**:
    - reduced volume trade instructions (only receiving the aggregated deals from each platform, rather than every separate investor trade)
    - fewer unitholders to communicate with (including contract notes and other documentation, and queries into the firm's contact centre), and
    - one distribution payment to the platform provider satisfies all the units held by the platform's clients.
  - A further benefit for any product provider (including a fund manager), is that the platform can be a reliable source of securing new investment into the firm's products (increasing the distribution and marketing of the products to the retail market at minimal cost to the product provider).

Therefore, if a product provider or asset manufacturer is able to reach agreement with a platform provider for its products to be sold on that platform, the provider gains access to a large potential market without the costs of directly contacting those potential investors.

2. Tools and Services

Learning Objective

3.1.2 Know the range of tools and services that may be provided by a platform

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A platform may be considered as having the following four components:

- a **web portal** (or other user interface)
- a transaction processing and settlement service
- a custody service, and
- ancillary and value-added services.

2.1 The Web Portal

The web portal enables the users to see the current state of their holdings, instruct activity, and access other services. The web portal may support a different range of functionality for different types of user. For example, an advisor might need extra functionality not applicable to the retail investor.

The web page that summarises the current holdings is sometimes known as the dashboard. The dashboard view makes the investor's portfolio visible to the platform user (note the platform user could be the investor or an adviser working on their behalf). Normally the dashboard lists each asset that an investor owns in each wrapper, showing the number of shares/units held, the original cost, and the current market price and value. The user is then able to drill down into individual assets and perform other functions or make more detailed enquiries.

A platform investor might wish to review:

- one or more wrappers individually
- the combined picture of all the wrappers
- all the family's holdings in a particular fund, across all wrappers
- all the family's holdings in assets specialising in a particular sector, and
- how the portfolio(s) have performed in comparison to the **benchmark** portfolio(s).

In addition, the financial adviser might need to see the combined picture of all its customers who:

- have similar investment objectives (ie, across different families)
- have portfolios of a similar size, and
- are invested in a particular fund, product provider, geographical sector or industry sector, etc.

2.2 Transaction and Settlement Services

A platform would not be successful if it simply remembered the assets already held by an investor. It is important that the platform accepts transaction orders from the investor and then performs the market activities necessary to turn that order into an executed trade and achieve settlement of that trade.

While the trade order will usually be input via the web portal, we are here concerned with the platform's work to aggregate the orders it receives in respect of each asset, submit that aggregated order to either the fund manager (for deals in a collective investment scheme) or a broker (for deals in a listed asset), and ensure that the trade is subsequently confirmed/matched and settled on time.

Buy and sell orders may be simple one-off transactions to make an individual purchase or sale, or part of more complex instructions (such as making regular purchases each time pension contributions are received, or regular sales of assets followed by withdrawals to provide pension income). Platforms might also enable an investor to instruct an asset sale together with a corresponding asset purchase to reinvest those proceeds. Such instructions are commonly referred to as a switch because the investor's investment exposure is switched from one asset to another. In most cases a platform will perform the 'buy-side' of a switch on the day after the 'sell-side', because it needs to have processed the broker confirmation of the sale transaction in order to know the value to be invested into the new asset.

2.3 Custody Services

The custody service ensures that any assets taken into the platform's care are held securely for the investor – whether as investments or cash. Each asset transaction will involve the exchange of money for investments, and the custody service ensures that these exchanges take place correctly while also ensuring that the client's assets are separate from any assets of the platform itself.

In addition to such pure custody activity, the platform will also require some banking services (usually obtained from a selection of retail/high street banks) so that investors can easily pay money to the platform. For example, the platform's bank will process direct debit instructions for investors who wish to save a certain value each month, and the transaction service of the platform will stand ready to place deals once that money has been received.

2.4 Ancillary Services

Ancillary services include value-added services such as capital gains tax (CGT) calculators, portfolio modelling and risk management tools, as well as administrative tools such as the ability to access fund literature and other investor information documents.

Again, note that while some value-added functions may be of relevance to the investor, some of these services are primarily included for the benefit of the adviser. For example, the platform might provide access to regulatory forms that the adviser might use when running their business.

2.5 Example – Transferring a New Client's Assets onto a Platform

You will note that the above services will all work together to achieve the right outcomes for the investor. Let us consider the scenario of transferring a new client's existing portfolio onto the platform. For most asset transfers, the following data will be entered for each holding:

- identification of the asset (its name, market symbol and/or ID numbers)
- quantity held
- original cost of the asset (note that this is useful for checking investment performance, and is also important if the platform record will be used to determine CGT due)

- who is currently holding the asset in custody
- the product/wrapper in which the asset is held, and
- current value of the asset.

Once this data is entered, the platform will:

- update the dashboard with details of the holding (though a restriction might have been added to prevent the investor selling such a holding until it has been delivered to the platform's **custodian**)
- regularly obtain details of the current market price of the asset and display the current market value of the asset on the dashboard
- initiate a transfer request from the current custodian/fund manager – depending on the type of asset this may be an automated process or a manual process involving forms to be signed by the client and/or adviser
- ensure that the requested stock transfer actually takes place, flagging if the delivery is late, and recording when the asset has been received, and
- provide ongoing asset reconciliations that will track any stocks not yet received by the platform's custodian.

3. Charging Structures and Revenue Streams

Learning Objective

3.2.1 Know: the difference between the different charging structures that platforms can apply; the revenue streams that platforms can generate for their owners

Advisers are no longer paid commission by authorised fund managers (AFMs). Instead, they charge investors a fee for their services, which can (but does not have to) include the supply of the platform service. This means that, in some cases, the platform operator may invoice the adviser for the supply of the service, in which case the platform fee is said to be bundled with the adviser's fees. In other cases, the adviser will introduce the client to the platform and the platform operator will invoice the investor directly. In this case, the platform charge is said to be unbundled. Obviously, the investor would expect an adviser to charge a lower rate if the platform charge was unbundled.

Each platform will determine whether there are any operational tasks for which an investor should pay a discrete fee (sometimes known as a 'click charge'), or whether the administrative costs of all tasks will be covered through the standard annual fees applied to each account.

Activities that may be subject to a specific charge may include:

- asset buys/sells (though each investor might be allowed to perform a certain number of 'free' transactions each year before any additional charge is applied)
- electing to vote at the company meeting of an asset held in the portfolio, and
- property investments within SIPPs wrappers.

Activity-based charges are usually set as a fixed cash amount. However, different platforms take differing approaches in respect of their regular account charges. Some may apply a fixed cash sum, while others might charge a percentage of the value of the investor's account. This has implications as the investor's account value increases; a fixed charge model will continue to charge the investor the same amount each year, while a percentage charging model will see the platform collect higher amounts of charges as the investor's account value increases.

The FCA rules require platform operators, product providers, fund managers, and other types of regulated firm to consider the financial value of their offering to retail investors.

Part of the overall 'Consumer Duty', these rules continue to give firms flexibility in how they define their charges – but firms must, in particular ensure:

- that any customers (or customer groups) receiving a similar service should pay a similar charge, and
- the charge should be proportionate to the firm's services for the customer (which can recognise all obligations on the firm – such as regulatory capital and corporate governance activity).

4. Support for Financial Advisers

The matters we have considered so far enable a platform to offer services to satisfy a wide range of investor needs. However, if a platform aspires to service the adviser community, it will need to support some more specialist requirements.

4.1 Determining an Investment Strategy for a Client

Before we examine the tools that platforms need to provide to advisers and investors, let us look at how the adviser services the client. The adviser first of all needs to ascertain the client's investment objectives (eg, capital growth or income generation).

Once that has been established, additional factors need to be considered, such as the length of time the client wishes to invest for, and the level of risk they are prepared to take in order to achieve these objectives. The adviser can then start constructing an investment strategy which they feel is most likely to deliver the investor's desired return.

The following is some of the essential information that all investment advisers must obtain to ensure that they recommend the most appropriate financial planning for their clients.

1. **Growth or income** – the client's requirements for capital growth or income need to be established to ensure the correct combination of assets are selected. As a rule, those clients looking for income are usually not candidates for strategies that involve a large number of high-risk assets, unless they are investing a significant amount or their required income is in the middle- or long-term future.
2. **Timescale** – if the client only requires an income, then the time period may be open-ended. A client who requires capital growth may need to access some or all of their capital at a point in the future, such as their retirement date, or the date when their mortgage needs to be repaid. When dealing with shorter timescales, the liquidity and volatility of the underlying assets must be considered. For example, if the client says that they need access to some of their capital in the next six months, then

investments that are very liquid and of relatively low volatility should be high on the list to ensure that the capital value is both preserved and easily accessible.

3. **Attitude to risk** – understanding the client's attitude to risk is an extremely important part of the investment selection process. A number of different methods may be used to assess how a client feels about investment risk, including: questionnaires, software applications, and training/ investment information. Question-based assessments generally categorise clients into one of a number of risk classifications. Very often the result of such a questionnaire categorises the client on a scale between risk averse and adventurous. All UK-authorised CIS funds also score their investment policy on the same scale, which helps to recommend suitable funds. The combination of the client's objectives, timescale and attitude to risk helps as a guide in choosing a suitable choice of investments.
   As the client's risk tolerance increases, the adviser will be able to incorporate higher-risk assets into the portfolio they recommend to the client, or they might increase the proportion of the portfolio invested in assets that offer potentially higher returns (at a higher investment risk).
4. **Investment knowledge** – when advising clients on investment, it is extremely important to ensure that the client fully understands how different assets work and their corresponding risks. Part of the adviser's due diligence obligation is to ensure that 'adventurous' investors are also knowledgeable investors.
5. **Existing investments and debts** – as part of any introductory process, most investment advisers ask clients to complete an application and information form. One of the key reasons for this, in addition to establishing their investment objectives, is to obtain information about their current financial position. The adviser needs to know about all existing debts and of any other current investments to ensure that their financial advice truly meets the client's goals and risk exposure.

Only when an adviser is aware of their client's current position, financial objectives and risk tolerance, can they analyse the information and suggest an investment strategy. The core of any investment strategy is to create a portfolio that provides cash as and when liabilities fall due. This is known as objective-based financial planning.

4.2 Suitability and Appropriateness

Learning Objective

3.3.1 Understand: the appropriateness and suitability requirements; the circumstances in which a platform would block a client from trading in a particular asset

The Markets in Financial Instruments Directive (MiFID) introduced two distinct types of test that a firm may need to perform when transacting with/for a client:

- suitability assessment, and
- appropriateness test.

4.2.1 Overview of Suitability

Where a firm is giving financial advice to its client, or performing portfolio management on behalf of the client, the firm must undertake a suitability assessment for any personal recommendations and trading decisions it makes.

A suitability assessment requires the firm to obtain sufficient information about the client's financial affairs and knowledge to enable the firm to assess whether the service or asset or transaction being proposed is suitable for that particular client. Such assessment should in particular consider the client's risk tolerance and ability to bear losses.

It should be noted in passing that, on occasion, a firm will provide advice to a client only for that client to instruct a different course of action. Such scenarios can place the adviser in a difficult position – particularly where the investor wants that firm to arrange the preferred transactions on their behalf. The FCA has created some specific material to guide firms in how to handle such 'insistent clients'. For the purpose of this workbook, the focus is on the suitability test that the adviser would perform.

The regulatory requirements for a MiFID firm are now contained within COBS 9A (there is separate material in COBS 9, which sets out a similar suitability regime for non-MiFID business). It is, therefore, important that each firm determines whether it is providing a portfolio management service or giving personal recommendations about investment business – and also whether it is providing MiFID services. As most platform and wealth management services are expected to be MiFID firms the comments in this section will reflect the COBS 9A rules applicable to MiFID business.

Some firms do not provide portfolio management services or financial advice to their clients. Various platform providers simply enable their clients (and the agents of those clients) to instruct their own decisions, with the platform simply executing the orders it receives. Such 'execution–only' business models are not required to perform suitability assessments – but the firm must instead ensure that the asset concerned is 'appropriate' for the client.

We will now consider these two types of assessment in more detail, and highlight the key differences between these two MiFID obligations.

4.2.2 Assessing Suitability

The important point about suitability assessments is that they relate to a specific investor, so the firm must collect the personal information necessary to enable it to make this assessment. The firm needs to understand the client's level of knowledge and experience of the types of asset and risks being considered.

The firm should also understand the client's risk tolerance and ability to incur losses as a result of the investments being proposed.

Such assessments should be performed for any personal recommendation made – whether that is a recommendation to buy or sell an investment, or to use a particular wrapper or platform. Further, the rules recognise that the firm will also inevitably make recommendations to *not* buy or sell (including recommendations to continue to hold a given asset) – and also oblige the firm to perform a suitability assessment in respect of those recommendations. This is important because it gives balance to the regulatory regime; where a firm is providing investment recommendations the firm needs to pay equal attention to all recommendations – whether the recommendation is one that proposes taking action or one that proposes no actual transactions be performed at that time. All such scenarios are recommendations which the firm should determine in the light of suitability for the client concerned. Suitability tests, therefore, also arise when advising the client to switch from one asset to another.

Where the firm provides a portfolio management service, the obligation is slightly different. Suitability assessments are required when the firm establishes a mandate with the client and at any subsequent point at which the firm suggests that the client should amend that mandate to give the firm greater scope to act for the client.

Where the firm is obliged to complete a suitability assessment, and has not yet done so, it may be necessary to prevent relevant transactions from progressing.

4.2.3 Receiving Information

The firm will need to request various items of information about the client in order to perform a suitability test, such as:

- the **amount of experience** the client has with various types of investment asset
- the **types and frequency of transactions** previously performed by the client
- any **relevant professional qualifications** held by the client
- the **client's regular income, financial commitments, and assets** (including information on the liquidity of those assets), and
- **the client's investment objectives** – including the purpose of the investment and level of risk the client is willing to accept.

The firm is not required to independently validate the accuracy of all information it receives – though it is obliged to design its processes to ensure that the requests it makes will be correctly understood by the client (thus reducing the potential of the wrong information being inadvertently provided). The firm is also obliged to consider whether any obvious inaccuracies arise in the information received. If the firm is maintaining an ongoing relationship with the client, this information should be kept up to date. If the client fails to give the firm sufficient relevant information to complete its suitability assessment, the firm is not permitted to progress with that recommendation (though other forms of service to the client might continue). A firm is not permitted to discourage a client from providing any of the information requested.

4.2.4 Suitability Reports

A firm that provides investment advice must provide the client with a 'suitability report' confirming that the advice is suitable for that individual based on the information received/held by the firm. This report must be given in a 'durable medium', eg, paper, or some electronic communication that the recipient can store and which cannot be amended.

While the suitability report should be provided before the investor's transaction is executed, the rules accept that, in some cases (such as telephone communications), the client might instruct the firm to proceed before the suitability report can be received. In such cases, the client can consent to receiving the report after the transaction has been executed – provided the client was given the option of delaying execution until they have received the suitability report.

The adviser must also decide whether it will provide an additional service: a periodic assessment of the suitability of the financial instruments recommended. Prior to providing any advice, the firm must inform the client whether such a service will be provided and explain to the client how such a service will be provided. In such cases, the periodic report required under COBS 16A should also include confirmation of how the investments held for the client align with the preferences, objectives and other characteristics of that client.

If the firm is providing a portfolio management service, there is no requirement to provide a suitability report at the point of an individual transaction. However, the firm would still be required to include the confirmation described above within the periodic reports it issues to the client.

Further, the firm does not need to issue a suitability report to the client if the:

- firm acts as investment manager and makes a recommendation relating to a regulated CIS
- client is not resident in the UK and is not within the UK when the advice was given
- recommendation is to increase the premium of an existing contract, and
- recommendation is to make additional single premiums/contributions into a product into which the investor has already paid single premiums/contributions.

4.2.5 Appropriateness Tests

A MiFID firm providing non-advised (ie, execution-only) services is required to satisfy the appropriateness testing rules in COBS 10A. The appropriateness test is in some ways similar to the suitability assessment described above (for example, the firm will seek information regarding the client's knowledge and experience). However, as the firm here is not performing any advisory or management service there is no need to consider the client's personal investment objectives or personal status.

Importantly, if the firm's appropriateness test concludes that the product or service is not appropriate for the client, the firm must formally warn the client of this fact. Where the client does not provide the firm with the information requested, the firm will be unable to complete the appropriateness test and so must warn the client that it has been unable to determine whether the product or service is appropriate for the client.

Note that as these are only warnings; the client might request that the firm executes their instructions despite the appropriateness test not being favourably completed. However, COBS confirms that:

> *'…it is for the firm to consider whether to do so having regard to the circumstances.'*

This raises a practical point for a platform's business model and automated dealing service. If, as a matter of policy, the firm concludes that it will only execute orders for a client once the relevant appropriateness test has been favourably concluded, it will be necessary for the platform service to queue instructions pending completion of the test, and to prevent transactions from progressing where the appropriateness test for a given investor has not been favourably completed.

There are, however, some circumstances in which the appropriateness test need not be completed. These include:

- where the same firm has performed a suitability assessment in respect of the same order
- where the firm relies upon a recommendation made by an investment firm, or
- where a service relating to specific types of financial instruments (discussed in section 4.2.6) is provided at the initiative of the client and relates only to execution or the reception and transmission of orders (with or without any MiFID ancillary services).

In such cases, the firm can simply inform the client that no appropriateness test will be performed.

4.2.6 Financial Instruments Outside the Appropriateness Tests

The third of the exemption cases noted in section 4.2.5 arises only where the financial instrument concerned has certain characteristics by which regulation considers them to be effectively appropriate to any form of investor.

A number of types of assets are specifically identified as falling into this category, such as:

- **company shares trading on a regulated market** – provided such shares do not include an embedded **derivative** (note also that this exclusion does not apply if the company has the characteristics of a collective investment scheme, though this point will be discussed further below)
- **bonds and other forms of securitised debt trading on a regulated market** – again provided there is no embedded derivative, or any complex structure that would obscure the risk faced by the investor
- **money market instruments** – excluding those that embed a derivative or have a complex structure
- **shares in an undertakings for the collective investment in transferable securities (UCITS) scheme** – other than a structured UCITS, and
- **structured deposits** – provided the structure does not obscure the inherent risks, or disguise a cost of exiting the product before it reaches maturity.

The above list provides a substantial asset universe to which appropriateness tests need not be applied (provided the service being offered does not extend beyond the execution, receipt and transmission of orders, and is provided at the initiative of the client concerned). However, the regulations also recognise that a number of financial instruments might not fully fit within these categories yet would be inherently 'non-complex'.

The rules, therefore, enable the firm to assess any individual asset against a set of criteria to determine whether the specific asset can be considered a **non-complex financial instrument** – in which case, the appropriateness test can similarly be set aside.

The following list summarises the criteria for a non-complex financial instrument:

- It does not give a right to acquire or sell another asset (which excludes asset types such as traded options or warrants).
- It is not a derivative (including variants such as options, futures, swaps and contracts for differences).

- There are frequent opportunities to dispose of the asset at publicly available market prices.
- The asset does not create a potential liability that exceeds the cost of purchase.
- The asset does not contain a provision that could fundamentally alter the nature of the investment or the payments to be expected.
- The asset does not include explicit or implicit exit charges that have the effect of making the asset effectively illiquid for the investor (even though there may still be frequent opportunities for disposal).
- Comprehensive information on the characteristics of the asset must be publicly available, and sufficiently clear so that an 'average retail client' would be expected to be able to make an 'informed judgement' on whether to invest.

In the previous section, we noted that no appropriateness test need be performed in respect of a listed share, provided it was not a CIS. Note that investment trust company (ITC) shares are a common example of such an asset type. While ITC shares, as a whole, are not automatically outside of the appropriateness test, the firm can perform an assessment of each specific ITC share in order to determine whether that particular ITC issue satisfies the criteria to be a non-complex financial instrument.

Note that the assessment of non-complex financial instruments is performed based on the characteristics of the instrument and not the characteristics of the investor, and so the results of the assessment are likely to be stored within the firm's security master file enabling the firm's dealing processes to instigate appropriateness testing only in those cases where the test is required.

4.3 Model Portfolios

Learning Objective

3.3.2 Understand the principles and application of: model portfolios; advisers; wealth managers; discretionary investment managers

3.3.3 Understand the benefits and risks of using model portfolios preloaded to the platform

It is likely that an adviser firm or investment manager will have many clients with similar investment objectives and attitudes to risk. To avoid the expense of creating individual portfolios for each of them, and also to avoid the situation when two clients (both with the same objectives and same risk appetite) have portfolios that produce widely different returns, adviser firms and investment managers may employ the concept of **model portfolios**.

A model portfolio is a pre-selected portfolio of assets with a specific set of targets, objectives and level of risk, which can be used for any investor who has the same desired outcomes. The person designing the model portfolio will apportion a weighting to each asset (ie, the percentage of the total fund that will be invested in this asset) and then individual investor portfolios will be set to invest according to the weighting of that model portfolio. A number of specialist firms offer model portfolios to advisers, and each will have its own view as to how many different funds should form part of a diversified model portfolio. Platform operators are, therefore, keen to offer those funds that are the constituents of widely used model portfolios. The platform operator may also be able to negotiate with the respective AFMs to offer units/shares at a reduced rate of annual management charge (AMC).

Some platform operators go further by including a range of model portfolios within their services. Once the model has been assigned to a given account, investment transactions can be generated according to the allocation in the model. Where the model portfolio is pre-loaded into the platform, the platform's technology can automatically calculate the investor-level transactions required – either at the start of the account or subsequently (ie, to ensure that investment levels remain aligned with the chosen model – a process known as rebalancing the portfolio). Such a platform must however ensure it has correctly understood its contractual position and the regulated services it is providing.

Provided the adviser/manager has a reliable process for evaluating the customer's **risk profile**, and a sufficient range of model portfolios to cover the outcomes of that risk analysis, the use of model portfolios helps the adviser/manager to be consistent in its treatment of similar clients.

Selecting model portfolios that are pre-loaded in the platform also reduces the risk of the adviser making incorrect calculations when deciding on transactions for an individual account. In this way, the platform makes it easier for the adviser to provide an accurate and consistent service to its clients.

However, there are corresponding risks. The platform must ensure that its model portfolio functionality is calculating the correct transactions, as otherwise it risks being liable for investment losses if the investor's portfolio allocation becomes incorrect. The risks for the adviser/manager centre upon:

- whether the pre-loaded model portfolio has been correctly risk-assessed, and
- ensuring that the correct model portfolio has been assigned to each account.

4.4 Portfolio Planning Tools

Learning Objective

3.3.4 Know the range of research, portfolio planning and performance measurement tools that platforms can offer

The common range of planning tools that platforms provide includes the following:

1. **'What-if' scenario analysis** – one of the most used tools of this kind in objective-based financial planning sets out to provide the answer to questions such as:
    - What do I have to do if I want to retire sooner or later?
    - What do I have to do if I want a higher retirement income?
    - What will happen if I save more/less from now on?
    - What will happen if I invest more cautiously/more adventurously?
    - When will I run out of funds?

    The investor and their adviser can input various assumptions into the tool, such as the level of savings the investor is able to make, the expected age of retirement, and the growth projections of the portfolio. The application will then estimate the income the fund will produce. It is also possible to work backwards; if the application is told the amount of income required and the year when it is required, it will calculate the amount that needs to be invested. Another major use of 'what-if' scenario analysis is in portfolio rebalancing.
2. **Analysis of the portfolio** – by wrapper type (such as a SIPP, an ISA or a GIA) and by asset type (such as funds, shares, bonds or property), as well as by business sector, country and geographic region.

3. **Investment opportunities reports** – simple reports that advise the adviser of opportunities to generate business. Examples include:
   - a list of all clients who have not yet used their ISA allowance for this year
   - a list of all clients who might have a liability to capital gains tax (CGT) this year.
4. **Benchmark comparisons** – these tools show how the portfolio's performance compares to one or more user-specified indices over user-specified periods. One of the problems involved in benchmark comparison is that the benchmark rate of return is usually calculated using the assumption that at the start of the period, a fixed sum was invested, and there were no further new investments and no withdrawals. Not all client portfolios behave in this simple fashion – in practice, investors might invest into new funds, and/or make withdrawals. There are two methods of taking further investments and withdrawals into account: money-weighted rate of return (MWRR) and time-weighted rate of return (TWRR).

4.4.1 Money-Weighted Rate of Return (MWRR)

MWRR is one method of measuring the internal rate of return of an asset (ie, understanding the extent to which performance of the asset, rather than transactions undertaken, has generated a return for the investor).

It is based upon finding a value of 'r' that satisfies the following complicated integration formula, where each cash flow event is designated as a series counted from i=1 to i='n':

$$V_1 = \sum_{i=1}^{n}\left[CF_i \times (1+r)^{w_i}\right] + V_0(1+r)$$

where:

V_1 = the full fair value of the portfolio, including accrued income at the end of the period
V_0 = the full fair value of the portfolio, including accrued income at the beginning of the period

$$w_i = \frac{(CD - D_i)}{CD}$$

CD = the total number of calendar days in the measurement period
D_i = the total number of calendar days from the beginning of the measurement period that cash flow CF_i occurs
CF_i = the i^{th} cash flow.

The key difficulty with this formula is that it enables you to calculate the portfolio value at the end of a period providing you know the internal rate of return. Unfortunately, if the rate of return is the unknown variable, it is necessary to use trial and error to determine the value of 'r' to satisfy the equation.

An alternative method is TWRR.

4.4.2 Time-Weighted Rate of Return (TWRR)

TWRR is established by breaking the investment period into a series of sub-periods. A sub-period is created whenever there is a movement of capital into or out of the fund. Immediately prior to this point, a portfolio valuation must be obtained to ensure that the rate of return is not distorted by the size and timing of the cash flow.

TWRR is calculated by compounding the rate of return for each of these individual sub-periods and applying an equal weight to each sub-period in the process:

$$r_{TWRR} = \left[\left(1 + r_{t,1}\right) \times \left(1 + r_{t,2}\right) \times \cdots \times \left(1 + r_{t,n}\right)\right] - 1$$

where:

$$r_{t,n} = \frac{V_1 - V_0}{V_0} = \text{the total return for sub-period t,n}$$

V_1 = the full fair value of the portfolio, including cash and accrued income at the end of the period
V_0 = the full fair value of the portfolio, including cash and accrued income at the beginning of the period.

For each period of time between cash flow events, a calculation determines how the fund/asset/portfolio has performed. The next time period is then assessed, starting with the opening balance after the cash flow event took place. Providing all of the necessary data is captured, the formula allows the overall rate to be calculated. Each of the sub-calculations on the right-hand side of the equation represents the period of time between a cash flow event. In this way, TWRR enables the investor to determine the value added by the investment manager aside from any cash flow activity impacting overall performance.

4.5 Dealing Controls

Learning Objective

3.3.5 Know the control processes that firms may implement around platform dealing

While performing incorrect or inaccurate deals on an investor's account may upset them, it also imposes a financial liability on the firm to correct the client's account. Given the different firms that may each be involved in any given trade (from advice to execution), accuracy of the order is vital.

Straight-through processing (STP) is an important part of minimising this risk. If the adviser accurately inputs the trade order to the platform, then STP should ensure that the order is executed without the risk of manual errors being introduced. It is common for a firm to have some form of quality control over the input of trades, so that a second person reviews the instructions entered manually into a trading solution, but there are other risks to be managed within the dealing process.

In general, platform providers do not want their customers to become overdrawn, or to sell assets that are not held in that account. The platform's control processes will, therefore, include limits on how much available cash must remain on the account (for example, to cover future commitments, such as fees due), and controls to ensure that an asset sale quantity does not exceed the quantity held in that account.

Each adviser must only be able to instruct trades for the relevant clients, and in some cases the platform may place a restriction on an account to prevent trading for a period (eg, if the investor no longer satisfies the qualification requirement for a given wrapper).

Other dealing controls may prevent transactions from being executed until the relevant suitability or appropriateness checks have been completed, or until a payment of cash received from the customer has been successfully cleared through the banking system and all applicable anti-money laundering checks have been completed.

4.6 Portfolio Rebalancing

Learning Objective

3.3.6 Understand the purpose of portfolio rebalancing

An adviser will initially allocate an investor's money between different assets and asset types according to the proportionate exposure desired. Over time, the movement in price of the underlying assets means that the balance of investment will diverge from the original starting point. Portfolio rebalancing is the process of realigning the weightings of a portfolio of assets, and is achieved by periodically buying or selling assets in the portfolio, either to return to the original asset allocation or to implement a new specific allocation for the coming investment period.

For example, suppose that the original target asset allocation was 50% equities and 50% bonds. If the stocks performed well during the period, it could have increased the stock weighting of the portfolio to 70%. There are two ways to rebalance the portfolio to return to the original 50/50 allocation. Any new money invested could be used to purchase only bonds. This would restore the balance, providing sufficient new money was available, but it may take time. Alternatively, a portion of the equities could be sold and the proceeds used to buy bonds.

To take another example, the investor's circumstances may have changed and 50/50 is now no longer appropriate. If the investor has become more risk averse, then 30/70 may be recommended, and some equities sold to purchase bonds.

If the target asset allocation is achieved by using a 'model portfolio', portfolio rebalancing would be used to re-align the assets.

While portfolio rebalancing can, therefore, be useful in returning the asset allocation to the intended ratio, each transaction has the potential to affect the investor's CGT position (unless the assets are held within a wrapper that is exempt from the effects of CGT). The adviser should be mindful of any tax implications before undertaking portfolio rebalancing.

4.7 Fund Switch Tools

Learning Objective

3.3.7 Understand the differences between and implications of simultaneous and sequential fund switch tools

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At times, investors will want to sell one asset in order to purchase another with the proceeds. Such activity is often referred to as a switch. However, as different assets may have different settlement periods, the platform operator needs to consider how the cash flow implications of switch activity will be handled.

Consider, for example, an investor who wants to switch out of a T+4 fund into a T+2 equity. The platform operator must consider whether it is happy to allow the buy side of the switch to be settled before the corresponding sale proceeds have been received. If the investor does not already have sufficient available cash in the wrapper to settle the T+2 purchase, such an approach would create an overdrawn account balance and require the platform operator to use its own money to cover that exposure until the T+4 sale proceeds are received and the overdrawn balance resolved (such matters relating to the control and treatment of client money are discussed further in chapter 6 of this workbook).

The platform might choose to support simultaneous switches (where both the buy and 'sell' side are instructed at the same time, or as soon as the purchase value is known), or may require that switches are instructed sequentially. Simultaneous switching provides an advantage to the investor because they remain exposed to market price movements throughout the switch activity. This is generally seen as a virtue, as the investor would not miss out on any increase in asset prices that took place while the switch was in progress (though delaying the buy side would benefit the investor if market prices were falling). The disadvantage of simultaneous switching is the need for the platform operator to manage the cash flow implications of either a failed trade settlement or differing settlement periods.

Sequential switching effectively reverses this position. In this case, the investor is out of the market for a period of time (between the time the price of the sell deal is determined and the time the buy side deal is later instructed and priced). However, the use of sequential switching can mitigate or even remove the risk that the buy deal will require settlement ahead of any corresponding sell proceeds being received.

The key decision for a sequential model is defining the point in time at which the buy trade can be instructed. The firm might only wait until it has received confirmation of the sell price (which confirms the exact cash value that can be reinvested but does not in itself protect against cash flow implications of differing settlement periods or failed settlement). A more extreme approach to sequential switching would arise if the platform operator only instructed the buy trade once it had received the settlement proceeds of the sell deal. Such an approach would, of course, extend the period in which the investor is not exposed to market price movements, which could have performance consequences if market prices were to rise or fall significantly during that time. The platform operator will, therefore, select their approach in the light of factors such as client expectations and its own risk appetite.

4.8 Liabilities

Learning Objective

3.3.8 Know how the liabilities that arise from the provision of portfolio and dealing tools is managed by: platforms; user firms

Essentially, the ways in which platforms and other firms manage such liabilities are to:

- Take out professional indemnity insurance which protects them against legal claims based on negligence.
- Write well-worded terms and conditions with the retail investors, which clearly set out the service that the platform will provide (eg, the period of time within which a given instruction will be performed) and which also state any obligations/expectations placed on the customer (eg, money to be paid to a specific bank account and quoting a specific reference).
- Have robust legal agreements with the other parties involved in the proposition (eg, between platform provider, adviser, and investment manager).

In addition, all firms will maintain detailed records of their own service provision, in particular to satisfy regulatory requirements and to demonstrate, if challenged, that the services were performed in a compliant manner.

Despite all the controls and mitigants implemented by a firm, errors and servicing problems will arise on occasion. At such times, it is important for a firm managing its liabilities to take prompt action to rectify the problem. Where some error or issue results in a customer having the wrong assets, or where there is a mismatch between the assets held by a platform and those it should be holding for its clients, the firm concerned is exposed to the risk of market price movements until the problem has been corrected. Strong processes for risk management, compliance monitoring, complaint handling, and breach investigation/resolution are, therefore, also important parts of how a firm manages its liabilities.

5. Relationships

Learning Objective

3.4.1 Understand the structure and importance of a platform's relationship with associated risks, and appropriate governance structures for dealing with: retail investors; financial advisers; discretionary investment managers

5.1 Investors, Advisers and Discretionary Investment Managers

Platforms provide a service to retail investors who are the individuals who benefit from and pay for the service. Some of these investors will have chosen the particular platform on the recommendation of their financial adviser.

Advisers are companies and/or individuals who advise investors about investment choices, whether as independent advisers or restricted advisers (the latter includes tied agents). Because advisers often choose which platform their clients will use, a successful platform operator must market itself to financial advisers and provide them with tools to help manage their clients' business.

Investors who choose to use a discretionary investment manager (DIM) hand over complete control of their portfolio, including key asset allocation decisions. The granting of such a mandate differs from the relationship between an investor and an adviser, because an adviser must consult the investor about proposed allocation changes and asset switches. Discretionary investment management services are offered by stockbrokers, **wealth managers** and private banks, and are generally only offered to HNWIs who have a significant level of investable assets.

Advisers operating at the top end of the market have long-standing relationships with discretionary managers. If the portfolio is large enough, or is diversified into asset classes such as derivatives (where the adviser may not have the expertise) the adviser may recommend that the client should use a discretionary manager to manage the portfolio. The adviser would then focus on monitoring performance, maintaining client relationships, and dealing with non-investment issues (such as effective tax planning).

The discretionary manager will either create a bespoke portfolio for each client, or base the portfolio on a model portfolio. Like the adviser, the discretionary manager will need the platform to provide it with a wide range of services in order to manage the investors' portfolios.

5.1.1 Risks and Governance Considerations

The key risks faced by the platform when supporting such relationships are:

- ensuring that information about each investor is only made available to the right parties (ie, to that investor, or entities that are acting on behalf of that investor), and
- ensuring that it only accepts trade instructions from parties authorised to instruct transactions for that investor.

Robust operational and system-based controls are therefore vital to the mitigation of such risks, though platform operators will also wish to establish contracts with each party to make clear what service is being supported and any limitations/dependencies that are applicable before the platform will act on an instruction received.

Given that each of the regulated firms will share a common desire for the investor service to be prompt and correct, the platform operator might have periodic meetings with the discretionary managers and/or advisers, and will provide updates outlining changes to the platform service being provided.

5.2 Other Industry Participants

Learning Objective

3.4.2 Know how the platform operators manage the risks of their various relationships: custodians; fund managers; wrapper providers; outsourced service providers

5.2.1 Custodians

FCA **Client Assets Sourcebook (CASS)** rules require that client assets are segregated from any assets of the company itself. A platform must, therefore, ensure that the assets held for its clients are clearly held on behalf of those clients, even though they will usually be held in an aggregated account.

The platform will usually set up a nominee company to act as holder of the assets. A nominee company is a type of non-trading company that should not, therefore, fall into insolvency (as it would not have corporate debts). CIS units/shares can be registered directly into the name of the platform's nominee company, in which case the platform will itself perform any administrative functions in respect of those assets (eg, managing distribution collections and other types of corporate action that may arise).

However, to hold listed assets the platform may need to retain the services of an external custodian as such organisations have direct access to the major share exchanges around the world. The platform would become a client of the custodian, and the custodian would open an account in the name of the platform (or the platform's nominee company).

The custodian would then ensure that all asset positions are correctly maintained in the market, though the platform would need to establish the necessary reconciliation controls to ensure that its custodian reflects the correct holdings and that no discrepancies have arisen against the assets that the platform believes should be held for its clients.

The platform will enter into a contract with the custodian which will confirm the service being provided by that custodian and set out the custodian's liability in the event of any problems arising. Such an appointment is not 'outsourcing'; the platform is instead receiving a regulated service as client of the custodian. The platform's ongoing custody reconciliations are a key part of managing the risk of retaining such a third party service.

5.2.2 Fund Managers

Contracts with fund managers need to include details of which funds will be carried by the platform. Whether a particular class of a given fund is available on a particular platform will depend on the results of negotiations between the fund manager and the platform operator. From a platform perspective, the decision as to which investments to offer can be complicated. Offering as wide a range of investments as possible may broaden the platform's appeal, but creating and maintaining a large investment range has implications in terms of IT infrastructure and staff resources.

Equally, the fund manager must be satisfied that the platform has the necessary skills and resources to service the assets concerned, as poor service by a platform may reflect badly on the fund manager. The platform may also have regulatory concerns, such as the alignment of the platform's target market with the target market of a given fund. For example, the regulator might question whether a platform that generally offers simple, low-risk funds to non-advised consumers is an appropriate distribution channel for a highly complex, high-risk fund suitable only for advised investors who have an adventurous appetite for risk.

Fund managers will often perform due diligence on the platform operator's financial state. The platform operator, on the other hand, will seek assurance that the fund manager can support its STP model and service levels by looking at, for example:

- What message standards will be used to place orders, confirm orders and effect settlement?
- How will the platform be advised about current market prices, income distributions (in the case of funds), coupon payments (in the case of bonds), and corporate actions?
- Will the AFM impose unusual dealing frequencies and minimum deal sizes that make STP transactions difficult for the platform to perform?

5.2.3 Wrapper Providers

In many cases, the platform will obtain the necessary regulatory authorisations to set up its own wrappers for use by its clients. However, in some cases, the platform may want to offer its clients a wrapper that it does not feel it should create itself.

The platform might, therefore, identify a firm that is able to provide those wrappers, and enter into a commercial arrangement so that the platform can sell that firm's wrappers to its clients.

The wrapper provider benefits because the platform is effectively introducing its products to a larger group of prospective clients. However, the platform must be able to support the requirements of the wrapper, so the platform operator needs to understand all the features of the wrapper, and ensure that its operational processes will obtain and deliver all the information needed by the wrapper provider to create a wrapper for a client.

The platform operator and wrapper provider will also need to agree which firm will provide what types of communications and disclosures to the client to ensure that the necessary information is provided without the client receiving duplicated communications.

It is, therefore, important that the platform operator and wrapper provider can enter into such an arrangement by viewing each other as partners; the relationship does not mirror an outsourcing relationship in which one party is providing a service on behalf of the other.

5.3 Contracts with Other Parties

Message carriers (eg, EMX or Calastone) have the role of carrying messages such as orders, order execution reports and market prices between the platform and the product provider, and settlement instructions and reports between the platform and its banks and custodians. Such contracts would normally include clauses about message security and resilience (eg, how does the carrier guarantee that a message is actually received by the intended party under both normal circumstances and also in times of stress that may be caused by systems failure or events such as fire and flood?).

There are two types of contracts with technology providers. There may be a contract for development of new software, such as enhancements to the platform functionality, and a second contract that deals with the availability of the service. Like the contract with the message carrier, this contract needs to cover security and resilience.

Any part of the technology, transaction processing, and ancillary services may be outsourced to a third party (either in part or as a whole). The external organisation to which services are outsourced may be able to offer the platform operator economies of scale, and also specialist expertise that the platform operator may not retain in-house. However, a decision to outsource any component must take into account the cost of implementing the necessary oversights and controls and any insurance required to ensure that the client assets are fully protected. Although an operator may outsource the performance of a function, it remains responsible for that function under the regulations. It is, therefore, critical that the platform operator is contractually protected against any errors or negligence on the part of the service provider.

When any service is outsourced, the service provider has the responsibility to uphold the other company's brand, so extreme care must be employed in selecting the right vendor. Regardless of how robust the selection process has been, and how exceptional the vendor chosen, a rigorous supervision process is essential.

5.4 Service Level Agreements (SLAs)

Learning Objective

3.4.3 Know the key elements of a Service Level Agreement

The contract with an outsourced service provider must be of sufficient detail and scope in relation to the nature and scale of service being offered, and will include the following elements:

- introduction (confirming the parties)
- service provider's duties and responsibilities
- customer's duties and responsibilities
- performance standards
- key performance indicator (KPI) reporting (content, frequency)
- dispute resolution (procedures, escalation)
- remuneration
- data protection and security obligations
- intellectual property rights
- termination clauses, and
- signatures.

A **service level agreement (SLA)** is the part of a service contract in which the parties define in greater detail the level of service that must be provided for activities to operate correctly. 'Level of service' in this context refers to both the quality of each activity and the time deadlines for performing it. Any dependencies that must be met before a particular service element can be provided should also be noted in the SLA as part of protecting one party from liability if the other party has not yet completed some required step within the overall process. The documentation may also specify penalties to be paid by either party if the level of service achieved falls below the minimum standards as stated in the agreement.

The SLA is a fundamental tool from the perspective of both the supplier and the recipient in managing the service. The quality of the SLA is critical as it defines the relationship between all concerned parties.

The contract will set out the approach that the parties will take to escalate any unresolved items of concern. It should also identify which performance metrics need to be provided, how they should be reviewed, and the consequences or escalation required when certain limits are met or breached. These metrics or KPIs may be categorised into areas such as supportability, recoverability, durability, performance, reliability, functionality, scalability and flexibility.

KPIs might be presented in a dashboard to give a health evaluation of the service. If an area is below what is expected, it will be given a low mark or highlighted by an alert. Examples of measured values for a technology service that might be included in a dashboard include:

- availability of the application over a period of time (downtime measurement)
- transaction speeds
- response times
- functional errors reported by the system, or
- the average number of users or transactions.

The recipient of the service could use this KPI data as part of its oversight of the services. While not usually part of the SLA or KPIs, the contract will usually set out the platform provider's obligations regarding the resilience of the service and the arrangements for business continuity/disaster recovery. In this way the advisers using the platform should have confidence not only regarding 'business as usual' service levels, but also in the potential implications if a service disruption was to occur.

6. Investors and Their Advisers – Choice of Platform

6.1 Features of Platforms

Learning Objective

3.5.1 Understand the features of platforms that inform the selection process

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When an adviser is selecting a platform to use with/for its clients, there are various key considerations:

- **Wrapper choice** – can the platform support all the tax-beneficial products the adviser requires?
- **Asset range** – are sufficient assets available on the platform to support the adviser's business?
- **Cost** – how much would the investor (or adviser, for a bundled offering) pay for the service?

In addition, the adviser will be attracted by value-added tools and the usability/appearance of the web portal, but such aspects will not outweigh the need to support the necessary product and asset range at an acceptable cost.

The adviser will consider the total cost of investing, which includes three elements:

1. **Cost of advice services**.
2. **Cost of platform services** – which may be bundled.
3. **Costs built into the assets** – eg, the initial charge and AMC of a collective fund (which may differ between the classes available on differing platforms).

These cost elements may be combined to determine the **reduction in yield**.

Reduction in yield reflects the amount of investment growth lost due to the effect of charges. For example, a fund that is projected to grow at a notional rate of 7% per annum may actually grow at a rate of 5.5% pa once the effect of charges implicit in the fund has been taken into account. Therefore, the reduction in yield is 1.5% (ie, 7% minus 5.5%). When an adviser and platform are also involved, their charges must also be considered.

Example

Charges applied as percentages, which are typical for both platform and advice costs, will increase in cash terms as the investments grow in value. If, for example, a client invests £100,000 in a portfolio with a 7% growth rate and a 1.5% annual charge, the actual charge applied in year one may be close to £1,500 (ie, £100,000 x 1.50%), depending on the timing of the charge, but by the start of year two, the portfolio value should have grown to approximately £105,000 so the 1.5% charge will now be 1.5% of the new (increased) portfolio value, therefore something like £1,600. As time passes, and the portfolio continues to grow (and the growth is reinvested), the 1.5% charge could amount to as much as £2,500 by year ten and over £4,000 by year 20.

The key point to remember, in terms of reduction in yield (or loss of growth), is that the growth itself is also compounded, not just the charges. Consider also that growth in a fund held by an investor is delivered by the fund manager (in managing the fund's portfolio) and the adviser (in selecting the fund). The question for a client is whether the charges for these services represent good value – good value in terms of improved performance, perhaps, but also in terms of the investor's other considerations, such as investment volatility, risk, tax implications and convenience.

Note that MiFID II introduced specific disclosure obligations for the total charges arising to the investor and an illustration of the 'cumulative effect of costs and charges'. These obligations are discussed in chapter 6, section 2.2.3.

6.2 Adviser Obligations

Learning Objective

3.5.2 Understand advisers' obligations in relation to platform selection, including ongoing due diligence

The regulator expects advisers to use due diligence in selecting and recommending platforms for their clients. Such analysis needs the adviser to have understood the requirements, and then to assess the ability of the platform to deliver the necessary services.

In addition, the adviser should consider whether the platform is robust or could add financial risk in respect of their clients.

Such analysis is subjective, though there are various criteria and data items that a firm should consider when performing due diligence on a platform, such as:

- About the business:
    - the overall business model and the type of services you want to offer – which might differ depending on the type of client
    - the typical target market and approach to client segmentation
    - the remuneration model – eg, fees, commission or a combination, and
    - the existing systems and procedures.
- About the platform(s):
    - the platform provider (for example, their reputation and financial standing)
    - terms and conditions of using the platform
    - charges – including actual cost, charging structure and transparency of charges
    - range of assets/asset classes, tax wrappers and other products available
    - functionality (eg, the ability to switch or reregister off-platform or record legacy assets)
    - accessibility
    - additional tools (for example, risk profiling and asset allocation tools), and
    - support services (for example, help facilities and training).
- Developments in the market could mean that the chosen platform provider(s) may not remain the most appropriate option for your business or clients. Periodic reviews may be required.
- Segmenting customers: if the platforms the firm is considering are not appropriate for all the customers, they may need to divide them into separate groups that they monitor differently.

Note that it was stated above that periodic reviews may be required. As with the other forms of relationship entered into between financial services firms, continued oversight of any firm working on a firms behalf should be recognised as a necessary task. If the success and stability of one firm rests on the stability of another firm, it is prudent to exercise ongoing due diligence of that firm, as it will give you confidence and provide proof to demonstrate to the regulator (should the need arise) that regulatory obligations were not neglected.

Use of a platform comparison service may be a cost-effective part of achieving such ongoing due diligence. These services are sometimes available free of charge to advisers, as the platforms themselves bear the cost and supply the data needed to achieve comparisons.

The adviser considers the type of business they intend to perform (eg, asset types, wrapper types, duration), and enters these parameters into the comparison tool. The tool then indicates the costs of achieving the necessary service blend using different platforms, which the adviser can then use when discussing their proposition with an investor.

7. Customer Agreements

Learning Objective

3.6.1 Know: the purpose and the main content of the platform's customer agreements; the appropriate circumstances for changing a customer agreement

All of the servicing elements we have discussed need to be accurately reflected in the contract that documents the relationship between a firm and its clients. The contract is central to everything that a regulated firm does – including transactions, compliance with CASS rules, anti-money laundering (AML) protections, and the availability of portal services.

The firm must know the identity of its clients to ensure that it protects against money laundering. The relationship must clearly be created between a specific regulated firm and the client (whether an individual or some corporate entity that has contractual capacity). 'Know your customer' (KYC) requirements are important in ensuring that the firm can demonstrate it is managing the risks of financial crime. At the same time, it is important that the client knows which legal entity is working on its behalf – particularly if there is a contractual dispute or if the client wishes to escalate a complaint against the firm.

Rules in the **Conduct of Business Sourcebook (COBS)** require certain disclosures be made to a prospective client when a firm is to perform regulatory business for that client, and CASS 9 includes a signpost reminding firms of the particular obligations relating to safe custody assets and client money.

The formal client agreement – essentially a legal contract, often described as 'terms and conditions' – sets out the contractual obligations on each party to provide information or execute certain tasks within certain time periods in order that the client's instructions can be correctly carried out.

Terms and conditions will also enable the firm to document various factors such as:

- How will the client's assets be held?
- How will clients be categorised, and what consents might the client give to the firm in respect of the business to be undertaken? Other consents might be written into the firm's terms and conditions as standard elements – though the firm's lawyers should always review such decisions to ensure that the clauses will be robust against legal or regulatory scrutiny.

- Whether the firm has unilateral power to amend the agreement (such as by advising the client of changes, to become effective after a certain number of days) or whether any change to the contract requires specific negotiation between the firm and each client. While the first approach enables the firm to maintain a standardised service across all clients, for some types of business such an approach might be too limiting, in which case the firm will take conscious and specific steps to ensure that it will support bespoke services, as this will affect the design and implementation of transaction processing and CASS controls within the firm.
- The treatment of interest earned on client money balances should also be stated.

End of Chapter Questions

Think of an answer for each question and refer to the appropriate section for confirmation.

1. **In what ways does the use of a platform benefit an adviser or an investor?**
   Answer Reference: Section 1.1

2. **What are the four components of a platform service?**
   Answer Reference: Section 2

3. **What is the difference between a bundled and an unbundled platform charge?**
   Answer Reference: Section 3

4. **What is the aim of objective-based financial planning?**
   Answer Reference: Section 4.1

5. **What risks might arise for a platform or an adviser from the use of model portfolios?**
   Answer Reference: Section 4.3

6. **What types of controls mitigate the risk in a platform's dealing process?**
   Answer Reference: Section 4.5

7. **What types of requirements for dealing in a CIS might make it difficult for a platform to achieve STP?**
   Answer Reference: Section 5.2.2

8. **What are the typical sections of an SLA?**
   Answer Reference: Section 5.4

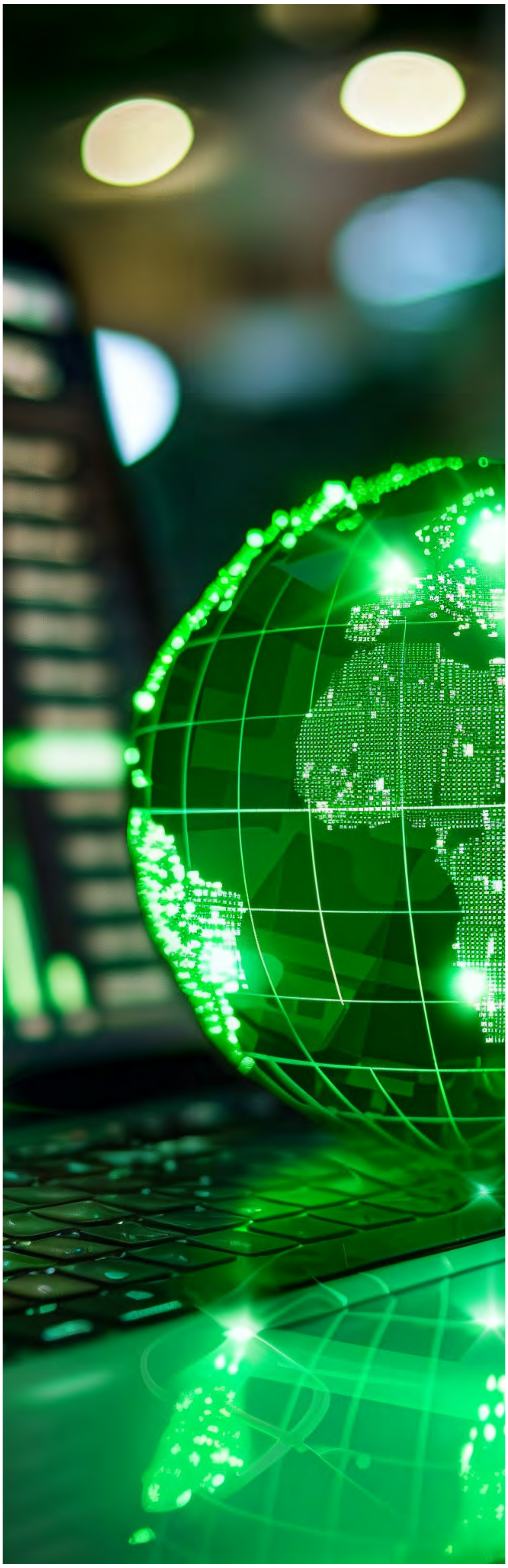
9. **When an adviser recommends the use of a platform as part of servicing its clients, what types of cost elements need to be recognised within the overall service?**
   Answer Reference: Section 6.1

10. **What is the role of the platform comparison service?**
    Answer Reference: Section 6.2

Chapter Four

Transactions and Ownership

This syllabus area will provide approximately 12 of the 50 examination questions



When using a platform service, the investor (in conjunction with any agent they have retained) is responsible for making choices regarding the assets to be bought and sold within each of the wrappers held.

Those trade orders are instructed to the platform, which will perform the trades with the relevant counterparties and update its investor-level records of cash and assets to reflect the executed trade.

In this chapter, we consider how such instructions are processed and the methods used to ensure that legal ownership of the assets remains clear and demonstrable.

1. Processing Investor Transactions

1.1 The Context of Investment Transactions

Learning Objective

4.1.1 Understand the issues that exist for platform providers in relation to online dealing (cut-off points, volume spikes, timely execution requirements)

4.1.2 Know the range of dealing that: may be available for listed securities (live dealing, limit orders, aggregated deals) on different platforms; platforms may provide including portfolio construction and asset allocation

Platforms enable a wide range of deals to be undertaken. Often simple investment and disinvestment deals are executed (buying or selling assets – whether accompanied by payments from/to the investor, or simply using/retaining money held on the platform as uninvested cash).

Sometimes, the investor might choose to sell one or more holdings, using the proceeds to purchase one or more different assets (a process sometimes referred to as a switch).

However, advisers may require more complex functionality to help service their clients. They may wish to construct a target asset allocation within the platform and then be able to automatically instigate trades to align each client's account against that target asset allocation. The platform seeks to support all such types of activity – usually aggregating the investor-level orders to place larger, more cost-effective, trades in the stock market. This chapter will explore the implications of all these types of trade activity – regardless of whether the trade is an 'execution–only' instruction, a model portfolio rebalancing, or a wealth manager/investment manager instruction.

Where exchange-traded securities are concerned, one advantage of **aggregation** (ie, consolidating all buy orders received during the day into a single market order) is that brokerage charges are reduced for each individual investor. However, it does mean that there is a delay while orders are being aggregated. This does not matter in the case of an open-ended fund with a daily valuation point (providing aggregation takes place in time to send the order before the valuation point), but in the case of an exchange-traded security, there is potential for the asset price to move adversely while the platform waits for additional orders before placing the single market order. The platform's **best execution** policy needs to state how it will manage the balance between various considerations, such as price, costs, speed of execution, likelihood of execution, and settlement (which may vary according to the dealing counterparty and type of asset being traded) when executing trades. The platform's terms and conditions and service levels should make clear to investors when any submitted order will be dealt with.

As far as collective investment schemes (CISs) are concerned, the majority now use 'forward pricing', and the platform may experience a spike in order volume in the run-up to the valuation point. Platforms must ensure that their technology can ensure that all orders received will be processed, aggregated, and delivered to the authorised fund manager (AFM) in time for the next valuation point even in the busiest trading days.

Platforms will therefore stipulate a cut-off point by which a CIS order must be received for it to be included in the platform's aggregated order with the AFM for the next valuation point. For example, if the fund has a noon valuation point the platform might set its cut-off point for 11:30am (allowing 30 minutes to complete processing).

1.2 Types of Order

The first stage of fulfilling a deal is for the investor, or the adviser acting on the investor's behalf, to place an order. An order is an instruction to the receiving party to buy or sell either a specific quantity, or a specific cash value, of a financial instrument.

A simple order will take the form of:

- buy (or sell) 10,000 units/shares of X, or
- buy (or sell) sufficient units/shares of X for a value of approximately £10,000.

Platforms need to support a number of more complex forms of order due to the different types of user being serviced:

- **Orders that affect multiple clients** – discretionary managers may decide to switch multiple clients out of one investment and into another. Hence, this type of platform user needs the facility to enter an order that might need to be expressed in terms of:
  - Sell all holdings of X where client type = (enter a value that identifies the range of clients affected).
- **Regular purchases** – retail investors in particular may wish to make regular monthly subscriptions into their investment wrappers, such as self-invested personal pensions (SIPPs) or individual savings accounts (ISAs), in order to use up the relevant contribution limits over the course of the tax year. Advisers and platforms supporting such clients need to be able to establish and manage standing orders, such as:
  - For client A, on the first working day of each month (until further notice OR until a defined date) buy sufficient units/shares of X that will result in transaction proceeds of £Y.
- **Regular sales** – this facility is mainly, but not exclusively, used for clients who are in pension access/drawdown:
  - For client A, on the first working day of the month (until further notice OR until a defined date) sell sufficient units/shares of X that will result in transaction proceeds of £Y and pay proceeds to the client.
- **In the case of pension access payments** – this transaction is, of course, further complicated by the fact that before paying the proceeds to the client, the platform (or other organisation making the payment) needs to calculate and deduct income tax from the payment to the client, and pay the tax deducted to HM Revenues & Customs (HMRC).
- **Conversion instructions** – platform software applications need to accommodate specialist CIS transactions to convert **accumulation units/shares** to income units/shares and vice versa, or to convert legacy holdings of one share/unit class to another class that has a more favourable charging structure. The new class may not have been available when the holding was first purchased.
- **Bed & ISA transactions** – while HMRC rules do not allow shares to be transferred directly to an ISA from outside an ISA, many investors with existing shareholdings outside an ISA may want to move those assets within an ISA (eg, to avoid tax on future capital gains). A technique known as 'Bed & ISA' enables this to be done. The existing shares are sold, the cash transferred into the ISA and then the shares repurchased with the subscribed money. The sale and repurchase are made at the same time to limit potential price movements.

1.3 Additional Considerations for Listed Securities

As the prices of exchange-traded securities change throughout the day, further considerations apply to orders for listed securities.

Platform operators must therefore consider the range of order types that will be accepted:

- Price-related conditions:
  - **at best or at market** – meaning buy or sell at the best available price the firm can obtain at the time
  - **limit** – meaning that execution should only occur once a threshold price condition has been satisfied
    - if selling, do not sell for a price lower than the limit price
    - if buying, do not pay more than the limit price

- **stop-loss** – instructions, requiring the platform to sell if and when the market price falls to this level; as its name implies, the purpose of this condition is to limit the potential loss to an investor of holding this asset.
- Time-related conditions:
  - **good til cancelled or open order** – there is no time limit on this order
  - **expiry date** – if the order cannot be filled by this date then it should be treated as cancelled
  - **fill or kill** – if the order is to buy a stated quantity of shares of ABC plc, then it must be completed in full or rejected if the firm can only obtain part of the requested quantity.

1.4 Transaction Handling Methods and Straight-Through Processing (STP)

Learning Objective

4.2.1 Know: the methods by which investor transactions are executed: the role of market makers; brokers; retail service providers in the trading process

Straight-through processing (STP) consists of a set of working practices and systems that enable transactions to move seamlessly through the processing cycle without manual intervention or physical handling. Adoption of STP by platforms makes the model efficient, though some transactions are still instructed in paper form or by telephone. Fax messaging is also relevant, either as a primary transmission channel for some firms, or a back-up mechanism in case their STP system experiences difficulties.

In order to gain the maximum efficiencies, the platform will ensure that each transaction (such as an order or income payment) is entered into the firm's systems only once. Where the information also needs to be held in other systems operated by the platform (eg, its client money ledgers), the platform will usually build automated processes to connect its internal systems.

Having built these automated connections, manual intervention should be minimised. Administrative staff may occasionally need to intervene (eg, if a stage of the automated process fails), and will need the necessary skills to resolve the difficulty and resume the automated processes. A common approach is for the platform to establish a 'repair queue', to which instructions are routed if, for some reason, the automated processes stall. Given the need for platforms to ensure that trade orders are processed by the next dealing point, the repair queue will be closely monitored, and any items remaining there for too long will be escalated to management.

1.5 Message Carriers and CIS Dealing

Common message standards have been developed for use by platforms, AFMs, and settlement agents (such as the platform's custodian). A number of companies (such as EMX and Calastone) exist to provide services to carry these messages between firms.

For STP message carriers, the high-level process runs as follows:

- The platform creates the deal instruction they wish to send (eg, if the deal relates to units in an authorised CIS, they need to send the instruction to the AFM of the fund concerned).
- The platform operator submits the completed deal instruction to the message carrier, addressed to the relevant AFM.
- The message carrier sends the data to the relevant recipient.
- The recipient (here, the AFM) actions the instruction received.

There are generally three methods by which platforms can send and receive messages:

1. **Direct data entry** – the first method is through a web portal. The platform simply keys in the data they wish to send into the message carrier's website, and uses other website facilities to view the incoming messages. This method is best suited to low-volume users as there is no integration with the platform's own internal systems and, as such, it does not achieve the principles of STP.
2. **File transfer** – at various points in the day, the platform's internal systems generate trade order files in agreed specified format (normally either comma-separated values (CSV) or tab-separated values (TSV)). The files are then sent electronically to the message carrier for onward processing. At various points during the day, the message carrier sends information files to the platform (containing, for example, price or holdings information), which are uploaded into its internal systems. File transfer is suitable for medium-volume users, and this method broadly complies with most of the STP principles.
3. **Application Programming Interface (APIs)** – a computerised facility by which the platform's internal systems generate outgoing messages and receive/process incoming messages without manual intervention. APIs give the customer great flexibility as to how and when messages are generated and how they are processed on receipt. This method fully complies with the STP principles, and is used by high-volume customers. Messages created by APIs are usually sent over a dedicated connection between the user firm and the carrier.

Most message carriers operate on the 'store and forward' principle. Providing that the final destination (such as an AFM, when purchasing units in an authorised CIS) is reachable, the message is forwarded in only a fraction of a second. However, should the final destination be unreachable (eg, it is affected by problems such as a power cut or software outage), the message carrier will retain the information (store) and continue to retry delivery (forward) until such time as the destination is back online.

The message carrier verifies the integrity of each message it receives, so the sender can be confident that the message will be received in full at the correct destination. Similarly, the recipient can be confident that the message did in fact originate from the sender and is not a fraudulent communication.

The messages will be encrypted by the message carrier from the point it leaves the sender, ensuring a high level of security. The information remains encrypted until it has been delivered to the recipient, at which point the message carrier's technology decrypts the message.

The range of messages that can be sent includes:

- buy/sell orders
- reregistration
- settlement and trade matching confirmations
- price reporting, and
- holdings and/or valuation information.

The order is sent by the platform to the AFM, and the AFM confirms the order. Once the fund has been valued and the price of the deal is determined, the AFM sends the platform an electronic contract note (sometimes called an electronic confirmation). This message is the starting point for the platform's disaggregation process, by which the bulk transaction is broken down into its constituent transactions for each platform investor.

Each day, the AFM sends the platform the market prices of the assets that are held by the platform, and a list of the holdings that the platform uses to reconcile its client assets. The message carrier can also supply a complete transaction history for a given period if there is a discrepancy between the AFM's holdings lists and the platform's records.

The platform sends its settlement instructions to the carrier, which passes the instructions to the custodian. When settlement of other cash or stock movements actually occurs, the custodian sends reports to the carrier who then forwards them to the platform.

1.6 Brokers and Market Makers

Trading in a CIS is relatively straight forward; the platform aggregates its request and submits it to the fund manager (by whatever method is chosen). As the fund manager can create any shares necessary, and will cancel surplus shares, there is no need to find a willing seller when the platform wishes to buy.

By contrast, for assets such as shares and bonds the number of shares in issue is essentially fixed at any given time. Trading in such assets does not involve the issuer but instead takes place on a secondary market. Brokers and market makers (institutions that have assumed the market risk of holding transferable securities in given assets in order to release those assets where required to enable liquidity) are needed in order to maintain the liquidity of the assets and to enable buyers and sellers to reach agreement on a trade.

In essence, the broker collects orders from people seeking to trade. It will often be possible for brokers to match different people's requirements against each other and so match the orders and broker a deal.

If, however, there are insufficient investors wishing to trade at a given time, the broker might approach a market maker, ie, the market maker makes it possible (on occasion) for the brokers to match orders.

1.7 Settlement

Learning Objective

4.2.2 Know: the regulatory requirements for settlement; the different methods of settling investor transactions

1.7.1 Traditional Methods of Settlement

Once a person has entered into a contract to buy or sell a financial asset, the next stage is for the contract to be settled. This requires the amount of money due under the contract to be paid and the legal title to the asset to be transferred to the new owner. For the platform, this involves the receipt or payment of client money.

For a CIS, the fund prospectus will detail the arrangements for the dealing and settlement of units. This will normally include the terms on which the settlement of transactions takes place.

The Collective Investment Schemes sourcebook (COLL) regulations require CIS redemptions to be settled on the fourth business day following the trade (known as T+4) or once the AFM has received all the duly executed instruments and authorisations to effect the transfer of title back to the AFM, eg, a form of renunciation signed by the unitholders/shareholders. (Note a given fund might adopt a shorter settlement period – maybe T+3 or even T+1. The relevant period will be stated in the scheme documentation published by the AFM.)

For redemptions, the AFM must ensure that it remits the proceeds to the investor (who is no longer shown as owner of the units/shares that have been sold), as failure to make payment would be a breach.

For new investment transactions (ie, units/shares purchased by the investor), the settlement period will be the same as for redemption deals (ie, T+4, or some shorter period as specified). When dealing with an institution, such as a wealth manager or platform operator, an AFM will generally accept the order ahead of payment being received. The AFM will normally chase the investor for payment if the funds are not received by the settlement date. If payment remains outstanding, the AFM is entitled to cancel the transaction as the investor has failed to satisfy their obligations under the contract. In this situation, the AFM is of course exposed to financial risk if unit prices have moved during the period.

The normal settlement cycle for secondary equity market transactions is T+2, though some exchanges have already adopted a one-day settlement cycle. Different settlement periods can, however, be agreed between the parties concerned. Settlement of UK Government bonds occurs on the business day following the trade.

In some cases, the platform operator will need the investor to deposit additional money in order that it can pay the relevant counterparty (and the platform operator's systems will need to manage the associated cash movements). However, many investors hold substantial uninvested cash balances on the platform and no additional deposit may be required for the trade. In such cases, the platform operator simply debits the relevant wrapper when a purchase is settled, and credits the relevant wrapper when settling an asset sale.

1.7.2 Transfers between Bank Accounts

The investor might prefer to instruct their bank to transfer money directly to the platform operator's bank account, and so methods such as BACS and CHAPS are well-established ways for firms to receive money from their clients.

The Association for Payment Clearing Services (APACS) is the UK payments association. In 2008, it introduced a new system for institutions to deliver payment services to customers. This is known as the Faster Payments Service (FPS) and was the first new payment service to be introduced in the UK for more than 20 years. The system enables payments to be made during any bank working day and cleared within a couple of hours. Some banks will even action FPS items over the weekend.

The maximum value accepted by the FPS has been increased as the system becomes more established, and is currently £1 million. However, each bank imposes its own transaction limit (which can vary by instruction method or client type).

2. Ownership of Assets

2.1 Recording of Asset Ownership

Learning Objective

4.3.1 Know: the requirements for the establishment, maintenance and contents of the platform's records of asset ownership; who can be recorded as a holder of an investment

The platform has a responsibility to maintain accurate records of the activity it performs for its clients. This is important because the platform's market trades are usually performed in aggregate, rather than in the name of its underlying clients, and so the platform's internal records are the only evidence of which assets are held on behalf of which of the platform's clients. Each firm through which the assets are purchased or held (such as fund managers, brokers and subcustodians) have no knowledge of the individual clients on whose behalf the trades have been placed.

Before focusing on the platform's records, we should first consider how direct ownership of investments is usually achieved. Authorised CISs (such as unit trusts and open-ended investment companies) provide a useful example as the regulations require a register to be maintained. When an investor applies to the fund manager and buys units, the investor's name and personal details are added to the register. Similarly, companies operate a register recording their various shareholders – though for a listed company, that register is essentially maintained within the stock exchange's records.

When any other type of entity is inserted between the actual investor and the asset's register, it is like adding a link in a chain; each entity will only have information about its own links in the chain and does not have visibility of the full chain of information. A platform is such a link in the overall chain of asset ownership.

Therefore, the platform must recognise the importance of its client records and maintain those records in a clear, current and accurate manner. The platform will define, in its terms and conditions, any eligibility requirements for a client to be accepted and serviced and, having accepted a client, the platform's records must reflect the holdings being maintained for that client.

In many cases, the client will be acting in isolation, opening an account with the platform that will be operated by that client (or potentially with their agent/adviser's support). However, in some cases, a joint account might be set up – such as if an account is being run by a married couple or an investment club.

Underlying regulations and/or securities laws tend to limit a register to recognising up to four people as joint holders of a given asset, and so platforms will tend to operate within that same limitation (though the platform could write its terms and conditions so that only two holders would be recognised as joint holders of an account).

The platform's records will need to distinguish between assets that can only be traded in whole shares, and other types of assets which can be purchased in quantities of less than one share. For example, it is usual for authorised collective investment schemes to be traded to four decimal places. We will consider, in chapter 6, the obligations on the firm in respect of asset and cash reconciliations, and, while such processes are important controls, they can only be effective if the platform has first ensured that it is maintaining adequate records of its client-level activity.

2.2 Third-Party Interest

Learning Objective

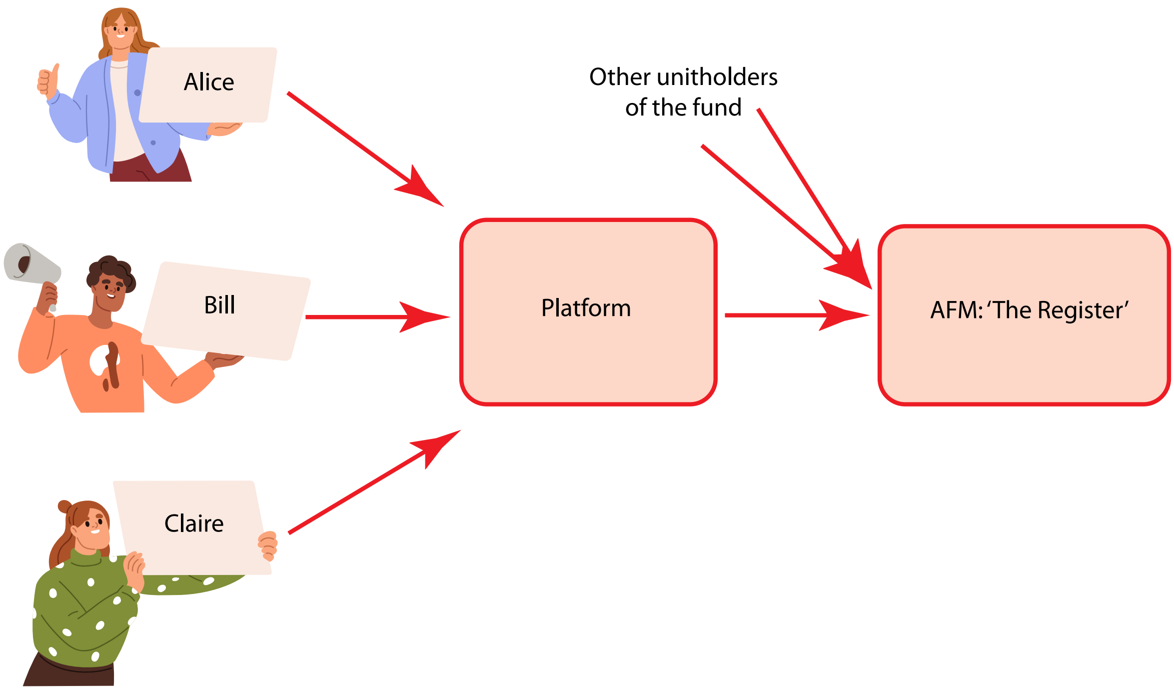
4.3.2 Know: the requirements for the collection of beneficial holder details; how third-party interests are recorded

We have already seen that the platform operator places an aggregated deal with the underlying CIS representing the underlying transactions of multiple investors. The scheme's register does not, therefore, record units/shares as being held by the various individual investors – it shows a single position for the platform. The platform must keep its own records to evidence how many of its units/shares are actually held on behalf of each investor. If the platform's records were to become corrupted, it would be difficult for the investors to prove to the AFM that certain of the units registered to the platform had in fact been purchased by them through the platform.

This is an example of a third-party interest, ie, a person who is not the legal/**registered owner** of an asset, and who was neither of the parties to the contract that purchased the asset, but who has a claim to some or all of the benefits that the asset provides. As they have a claim on the benefits, such a person is often referred to as a **beneficial owner**.

It has become important in recent years for some beneficial ownership details to be captured by financial services firms as part of increased detail in anti-money laundering controls. It is not, however, necessary for a regulated firm to obtain the details of underlying beneficial owners if its client is a regulated firm or its nominee.

The following image reflects the position reached so far (we will add further detail as the chapter progresses):



The AFM will show the platform as holding units (in the name of the platform's nominee company). The fund's register will not feature Alice, Bill or Claire – although they are all beneficial owners of the units registered to the platform. The register will only show the aggregated holding of the platform, while the interest of Alice, Bill and Claire will only be shown from the platform's internal records.

This is a simple illustration of a 'custody chain', where each party is known by the entities one step on either side of them, but may be invisible to parties further away in the chain.

2.3 Custody Services

Learning Objective

4.4.1 Understand the different types of custody model and how they are used: pooled; segregated; multiple nominees; investor's own name

2.3.1 Nominee Companies

Nominee companies exist to be the registered owner (or legal owner) of assets on behalf of investment firms (including platform operators). As the nominee company has no business activities, it is unlikely to become insolvent even if the investment firm using its services runs into financial difficulty; this helps reduce the risk for beneficial owners of their interest not being reflected on the ultimate asset register.

A platform operator may own a nominee company, or may retain an external service. Three forms of nominee accounts are possible:

- **One single, pooled nominee account** – the platform uses one large nominee account to hold all assets relating to all its client holdings across all the wrappers it offers. This approach offers maximum aggregation of transactions and minimises the number of asset positions maintained. It is generally the most cost-efficient model to operate.
- **Multiple pooled nominee accounts** – on occasion, a platform operator might wish to separate assets held within one wrapper from those held in another. For example, prior to the personal savings allowance being introduced, it was common for ISA holdings to be registered in a different nominee account from holdings in a general investment account (GIA). Such separation was beneficial because the ISA manager could receive gross interest payments from assets held for ISA accounts, providing the payer knew that the assets related to ISA accounts. As a result, the use of multiple nominee accounts enabled gross payments to be received where appropriate, while other holdings would receive income net of tax.
- **Segregated nominee accounts** – also known as designated nominee or sole nominee accounts. The stocks are still registered in the name of the nominee company, but no aggregation takes place. Instead, a designation (like an account code) is used to differentiate the assets held for each different investor using the platform. This is a more expensive model, as it generates no economies of scale; every new client gained increases the number of asset positions held and the number of nominee accounts to reconcile. However, where events such as corporate actions allow each investor to choose from certain alternative options for their future asset ownership, a segregated nominee structure enables the platform to readily process the different instructions that each client may provide.

In respect of platforms, two of the servicing aspects affected by the choice of nominee structure adopted are as follows:

- **Elective corporate actions** – at times, the issuer of an asset may offer holders some choice (eg, a vote regarding a potential corporate takeover). Where a segregated nominee structure is in place, each platform client's holding is distinct, so their choice/decision can readily be provided. However, where a pooled nominee model is in place, the platform will need a mechanism to receive and aggregate the elections made by the relevant underlying clients.
- **Asset transfers between spouses** – it can be common for spouses to transfer assets between them as a means of tax management. If the platform has adopted a segregated nominee model, every such spousal transfer would need to be instructed externally so that the records of the next link in the custody chain can also be updated. Where the platform uses a pooled nominee structure some or all of these spousal transfers can be completed purely by updating the platform's internal records.

FCA rules would also allow a platform to register assets in the client's own name. However, this would be an unusual model for a platform to implement:

- the asset register would not recognise the platform as owning the asset
- the investor would receive direct communications about each asset held, rather than such information flowing through the platform, and
- the investor might therefore transact without the platform being aware.

2.3.2 The Role of a Custodian

The duties of a custodian are to:

- hold assets/securities (such as stocks, bonds or commodities such as precious metals) and cash (in both domestic and foreign currencies) for its client
- arrange settlement of any purchases, sales and deliveries in/out of such securities and currency
- collect information on and income from such assets (dividends in the case of stocks/equities and interest payments (sometimes known as coupons) in the case of bonds) and administer related tax withholding documents and foreign tax reclaims
- administer voluntary and involuntary corporate actions on securities held, such as stock dividends and stock splits
- provide information on the securities and their issuers, such as annual general meetings and related proxies
- maintain currency/cash bank accounts, effect deposits and withdrawals and manage other cash transactions, and
- perform foreign exchange transactions as required/instructed.

Custodians often perform additional services for particular clients, such as investment fund services (eg, fund accounting, administration, legal, compliance and tax support services).

Custodians are often referred to as global custodians if they service assets for their clients in multiple jurisdictions around the world. A global custodian might either use its own local branches or, if it does not have a branch in a particular jurisdiction, other local custodian banks in each market to hold accounts for its respective clients. The custodian may refer to the individual local banks in such a model as its subcustodians, and the overall structure is referred to as a global custody network. Subcustodians are often, but do not have to be, member firms of the same organisation as the global custodian.

When a global custodian selects a subcustodian, it should perform a due diligence review to ensure that the subcustodian:

- has the necessary regulatory approval, as well as the skills and resources to administer assets in the jurisdictions in which it is operating, and
- has sufficient financial resources to perform these activities.

2.4 Transfer Requirements

Learning Objective

4.5.1 Know the internal/external transfers that may take place

We have seen how moving an asset between wrappers on a platform may require the platform to reregister the asset (ie, when different nominee accounts are used for the different wrappers). However, reregistration may also be necessary if an investor chooses to move their affairs from one platform to another.

This could be for a number of reasons, including the following:

- An investor has changed their financial adviser and the new adviser uses a different platform.
- An adviser has decided that all or some of its clients would be better served by a different platform.
- An investor who does not use an adviser has decided to use a platform that is less expensive, or more suited to their needs as the portfolio grows in size and/or complexity.

If multiple substantial portfolios are involved, reregistration of this kind can become difficult to coordinate between the two platforms concerned.

The Investing and Saving Alliance (TISA) established the TISA Exchange (TeX) to facilitate the electronic transfer of wrappers and fund units/shares. Fund managers, platforms, wealth managers, and any firm which holds assets on behalf of investors can use TeX to improve the reregistration process.

TeX's purpose is to make these transfers accurately, within five working days, using standardised agreements and contracts that are based on STP principles. It mandates common standards to cover liability issues, service level agreements (SLAs) and a dispute resolution process, and has achieved cross-industry support and agreement to use standard messages to transfer assets and wrappers between platforms of all types.

2.5 The Chain of Custody

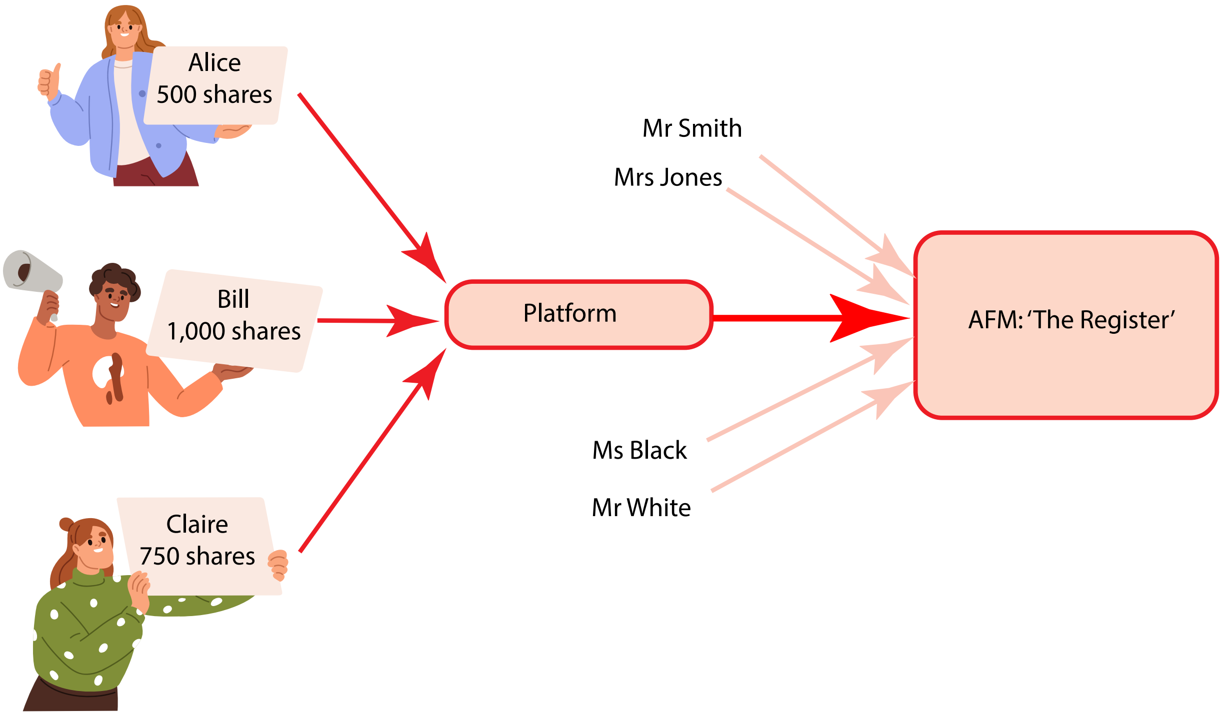
Learning Objective

4.6.1 Know the chain of custody

We can now expand our earlier simplified model of the custody chain to include the involvement of custodians and nominee companies. We will first update the AFM example before looking at the longer custody chain experienced where a custodian and its subcustody network are involved.

2.5.1 The Chain of Custody with Regard to a CIS

Assuming that the platform has adopted a single pooled nominee model (using its company 'Platform Nominee ltd'), the following diagram gives a fuller picture of the custody chain noted earlier:



Investor	Holding	Nominee
Alice	500	2,250
Bill	1,000	
Claire	750	

Registered Unitholders	Holding	Units in Existence
Mr Smith	1,000	5,450
Mrs Jones	1,500	
Platform Nominee ltd	2,250	
Ms Black	250	
Mr White	450	

The AFM sees only 'Platform Nominee ltd' among its list of registered unitholders. However, Alice, Bill, and Claire are all beneficial owners of the units registered to the nominee.

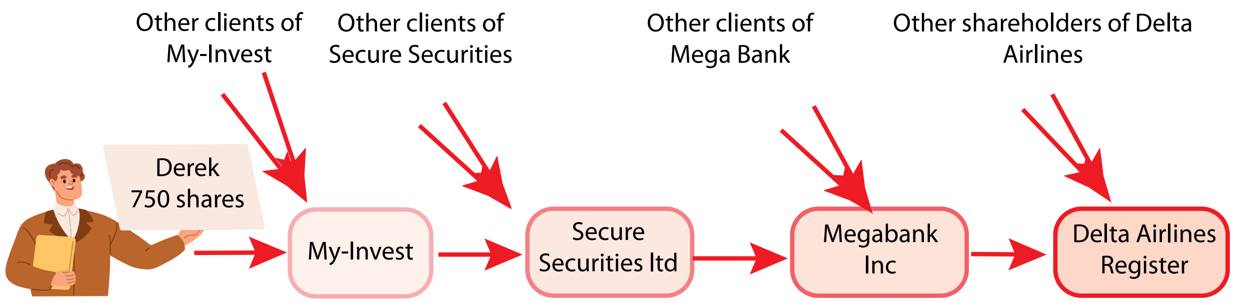
While Alice, Bill, and Claire know their own holding at the platform, they rightly have no knowledge of the total aggregate number of units held by the nominee at the AFM. Each party knows only the activity in their own links of the chain.

Even if the platform had chosen to use a segregated nominee structure, the registered owner on the AFM's register would be the nominee, though there would be three holdings rather than one, each being designated in some way (such as by the use of a code number, or the initial letters of the investor's name).

2.5.2 Custody Chain with Regard to Listed Assets

Unlike CIS units, equity positions must effectively be held with a custodian, resulting in a longer chain of custody.

Suppose that Derek wants to buy some Delta Airlines shares through his UK platform. Assuming the platform uses a UK custodian then these US shares will be held by the US subcustodian which would appear on the asset register. If we call the platform ‘My-Invest’, the UK custodian ‘Secure Securities ltd’, the US subcustodian a part of ‘Megabank Inc’, and assume each of them uses a similarly-named nominee company, then the chain of custody would be as shown in the following diagram.



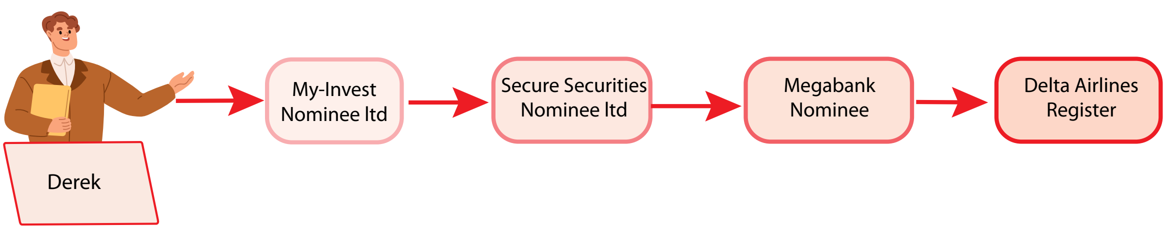
Investor	Holding
Derek	750
Erin	500
Fran	1,250
Total:	2,500

Custody Client	Holding
—	3,000
—	2,250
My-Invest Nominee ltd	2,500
—	1,750
—	1,000
Total:	10,500

Custody Client	Holding
—	15,000
—	10,000
—	14,500
—	8,000
Secure Securities Nominee ltd	10,500
Total:	58,000

Registered Holder	Holding
—	55,000
—	22,000
—	18,750
—	43,250
Megabank Nominee	58,000

The list of registered owners along the custody chain is:



In reality, there would often be an additional link near the end of the chain as, in many countries, the registered shares are held within a **central securities depository (CSD)** – which in the UK is called **CREST**. The local subcustodian would have the direct relationship with the CSD of its jurisdiction.

End of Chapter Questions

Think of an answer for each question and refer to the appropriate section for confirmation.

1. **What is aggregation?**
   Answer Reference: Section 1.1

2. **What components of best execution should a firm consider?**
   Answer Reference: Section 1.1

3. **Why might a discretionary manager enter an order with the following parameters? Sell all holdings of X where client type = (enter a value that identifies the range of clients affected).**
   Answer Reference: Section 1.2

4. **What is the difference between a limit order and a stop-loss order?**
   Answer Reference: Section 1.3

5. **What is the store and forward principle and why is it required?**
   Answer Reference: Section 1.5

6. **When does Collective Investment Scheme Sourcebook (COLL) require the authorised fund manager (AFM) to settle a redemption?**
   Answer Reference: Section 1.7.1

7. **What is the maximum value of a payment that can be made by the Faster Payments Service?**
   Answer Reference: Section 1.7.2

8. **Why is it important that a platform maintains accurate records of which assets are held for which of its clients?**
   Answer Reference: Section 2.1

9. **Which of the following members of the custody chain would be the beneficial owner of an asset: the investor, the platform, or the nominee company?**
   Answer Reference: Section 2.2

10. **What is the advantage of using a pooled nominee account if an investor wishes to transfer assets to the account of her husband?**
    Answer Reference: Section 2.3.1

Chapter Five

Asset Servicing

This syllabus area will provide approximately 7 of the 50 examination questions

1. Introduction

The Financial Conduct Authority (FCA) permission relating to custody is described as the 'safeguarding and administration' of assets. We have seen how the platform model enables the transactions necessary to acquire a portfolio of assets, within the intended wrappers, and achieves the safeguarding of those assets by the platform's nominee. We now turn to the administration of assets – which includes the various behaviours that the different types of asset might exhibit.

These behaviours are referred to as corporate actions (as they occur at the corporate level of the issuer, and involve action in the form of change or movement relating to the asset). Corporate actions fit into three broad categories:

1. **Income** – actions that result in each registered investor receiving a proportionate amount of the income generated by the asset during the relevant accounting period.
2. **Structural changes to the asset held** – at times, the issuer might change the corporate structure of the funds they manage, or the listed assets representing the company's capital (examples of such changes would include conversions, mergers, closure of a fund or company, stock splits and rights issues).
3. **Matters on which each registered investor is asked to give their opinion** – whether as a decision or as part of a vote across the ownership of the company/fund. Often a structural change proposed by the company/authorised fund manager (AFM) will require approval, via such a vote, before it takes effect.

Platform operators need to be aware of these types of corporate actions and establish the processes necessary to engage in these events, including obtaining input from the relevant clients (subject to the terms and conditions in place).

2. Income Events

Learning Objective

5.1.1 Know: the sources of income; the different treatment of income for income and accumulation shares/units; equalisation and the purpose of Group 2 units

2.1 Income Payments by Listed Securities

Equities usually pay dividends to shareholders out of the profits made by the company. However, if a company chooses to reinvest its profits back into the business, the company might not pay a dividend for a given accounting period. In the UK, dividends are usually paid twice a year; in the US they are usually paid quarterly.

When a dividend is announced, the company will specify an 'ex-dividend date'. Share purchases made on or after this date will not be entitled to receive the dividend. Such share deals after this date are described as ex-dividend (meaning that the purchaser will not be entitled to the dividend payment once paid out) – though it can be possible for a trade to be performed 'cum-dividend' (meaning that the new investor will benefit from the dividend payment). Buying/selling the dividend entitlement in this way can be part of an investor's taxation management, and so it is important to check the terms of any equity transaction contract after a dividend is announced whether the price used for the trade reflects the value of any pending dividend.

Government and corporate bonds pay interest, known as coupons, at regular intervals. The coupon rate (interest rate) is a percentage of the bond's face value. Coupons may be paid annually, semi-annually, or (less commonly) quarterly or monthly according to the rules laid down in the bond's prospectus. While equity holders do not know in advance the value of income payments (or indeed whether any payment will be made), bond payments are generally known in advance, which allows the market price to reflect the income coupon being accrued.

This affects the transactions of many bonds, as the purchaser on any day will buy the amount of income already accrued in that coupon period (this is not possible for equities or funds, as such income does not accrue in a linear way). The contract note for a bond purchase/sale will, therefore, distinguish between the capital value of the bond itself and the value of the interest already accrued during the current coupon period. A platform operator that enables investors to trade in such accrued interest securities must have the administrative capability to handle these transactional and income implications.

2.2 Income Payments for Authorised Collective Investment Schemes (CISs)

2.2.1 Overview of Income Distributions

Authorised CISs (such as OEICs and unit trusts) earn income from the assets held within the scheme property – primarily equities and bonds such as those described in section 2.1. Under the Collective Investment Schemes sourcebook (COLL) regulations, income accrued during the accounting period is included within the valuation process. At the end of each annual accounting period this sum of accrued income is removed from the valuation (causing the fund's price to drop slightly), and, at a specified point during the following months, that income will be paid to the investors who were registered unitholders as at the end of the period. For a COLL fund, such income payments to registered unitholders are known as a distribution.

Most funds will also have at least one interim accounting reference date, enabling a portion of the income to be distributed more frequently than annually (eg, semi-annually, quarterly, monthly), and the AFM's decision about distribution frequency will be made with reference to the investment objective and purpose of the fund. For example, a fund that is being designed to generate high levels of income (potentially at the expense of capital growth) may be positioned as a monthly income fund and have an interim accounting reference date each month.

COLL allows up to four months between the accounting reference date and the actual payment date to enable validation and processing (and the production of the fund's report to unitholders). The scheme documentation should state the specific timing of distributions for the fund.

As noted above, the accrued income which is to be distributed ceases to be included in the scheme valuation from the first valuation point following the accounting reference date concerned. The term 'ex-distribution' is used to note that the unit price excludes the income payment that will be paid out in the following months. Remember that, if an investor sells their units after the accounting reference date, they will still correctly receive the distribution when paid, because they were the registered unitholder as at the accounting reference date.

2.2.2 Income, Reinvestment and Accumulation

AFMs can enable investors to receive the value of this distribution in three ways. Firstly, the income can simply be paid to the investor as a distribution payment in line with the timeline specified in the scheme documentation. Share classes that deliver this outcome are known as 'income classes' (or 'income units' for a unit trust scheme).

The second option is known as accumulation, which retains the value of the income within the fund. An 'accumulation class' never pays income sums as cash. The entire income allocation is instead moved to the capital account of the scheme, where it becomes available for investment purposes. As a result, the unit price of an accumulation class does not fall at the accounting reference date, because the capital value of the units already held now reflects the income they have earned. The value of the accumulation to each investor remains subject to income tax though there is no other implication for the investor; they continue to hold the same number of units with the income retained within that investment.

As a result, if a fund operates both types of unit, over time a difference opens up between the prices of the income units and accumulation units. This difference reflects the income amounts that have been retained within the value of accumulation units. Each unitholder receives the same relative financial benefit at any distribution point, but either receives that benefit as cash (income units) or a higher relative unit price (accumulation units). A platform must ensure it deals in the correct class, and uses the correct price when valuing the units.

Many fund managers support a third approach to fund distributions, though it is less common for platforms to accommodate it. This option is known as the 'reinvestment' of the income distribution, and results in additional units being bought with the distribution payment made on income units. Where accumulation units provide the benefit of the income through an increased unit price, reinvestment of income results in the unitholder having an increased number of income units.

2.2.3 Equalisation and Group 2 Units

As accrued income is only stripped out of the unit price when the fund 'goes ex-distribution' (ie, the valuation point following an accounting reference date), most investors purchase units/shares at a price that includes an element of income. Assuming the fund's income receipts exceed its expenses, those units/shares purchased early in the accounting period will have less income included in the price than those purchased towards the end of the period. Equalisation is the concept designed to recognise that investors will have effectively bought a portion of the income received – which has tax implications.

The equalisation amount is deemed by HM Revenues & Customs (HMRC) to be a return of capital, rather than earned income. As such, it is not liable to income tax and is deducted by investors from the purchase cost of those units for capital gains tax (CGT) purposes. The portion of a given distribution considered to be equalisation is only determined after the accounting period ends so, for most funds, it is an average figure applied to all holders who bought units at any time during the accounting period. The equalisation rate is calculated by the fund accountant according to the aggregate amounts of fund income included in the price of the units 'bought' by investors during the period.

Units/shares purchased during the accounting period are referred to as **Group 2 units/shares**, whereas units/shares already held at the beginning of the period are referred to as **Group 1 units/shares**.

Holders of Group 1 and Group 2 units/shares will receive the same cash value of distribution – but, for Group 2 units/shares, a portion of the cash amount represents equalisation, and so they receive a smaller amount of taxable income. Any distribution statement/voucher shows the breakdown between Group 1 and 2 units held and the amount of equalisation applicable to Group 2 units/shares.

2.3 Obligations of a Platform in Respect of Income Events

As the platform holds assets on behalf of its underlying clients, it will need to ensure that all income sums arising on the portfolio are correctly received. The platform will need to decide whether it will process income payments or restrict the CIS share classes available to those that accumulate income rather than effecting a cash distribution. Similarly, if the platform does allow its clients to buy income units, the platform will need to decide whether automatic reinvestment of such income will be supported.

The platform should also determine whether it will pass income to its clients on a receipts basis or a contractual basis – a decision that has consequences for both its cash flow and its client money processes. The terms and conditions should specify whether income arising on an investment will be made available to the investor only once the platform provider has received the income amount and disaggregated it (a receipts basis), or whether the platform will guarantee to provide the income amount to the client as of the official pay date of the dividend (regardless of whether the income sum has actually been received). The posting of the income items through the platform's client money ledgers will need to align with the contractual position taken in the platform terms and conditions.

Finally, the platform will need to report to its clients the income earned, plus any tax already suffered by the client, so that they can complete their own tax affairs.

3. Events Including Structural Changes

Learning Objective

5.2.1 Know the obligations of a platform in relation to each type of corporate action

Some corporate actions give each investor something extra, such as a right to purchase (on preferential terms) additional ownership in the company. Others result in the asset the investor already holds being changed into something different. Funds can also implement events relating to their structure – though these are less frequent and less complicated than the range of corporate actions affecting equities. Many of these corporate actions require the formal agreement/approval of the shareholders of the asset, usually obtained from a vote among the shareholders.

The main types of such corporate actions are summarised in this section. The procedures for gaining shareholder approval for the actions are discussed later.

3.1 Termination/Wind Up/Liquidation

At times, a company may cease trading and wind up its affairs. Similarly, a fund manager might conclude that one of its funds should cease operation. In either case, the assets of the company/fund belong to the registered investors. A formal process is undertaken to sell off the corporate assets and determine the value due to each unit/share. Once each investor receives a payment representing their portion of the company's assets, the liquidation of the company is completed, and the units/shares previously held have no continuing value (effectively ceasing to exist).

As liquidation of the assets can take time, there may be a period during which trading of the assets is suspended, or any market listing might be withdrawn. The units/shares, however, remain in place until the company/AFM pays the relevant sum to the investor. The platform operator must, therefore, have functionality to manage any such trading restrictions that arise on the assets they support.

Once the decision has been taken to terminate/wind up/liquidate a fund or company, then the event will take place and all investors will be impacted in the same way.

3.2 Fund Mergers

Rather than winding up a fund, a fund manager may instead choose to merge multiple funds into one larger fund. This may arise for a number of reasons, such as:

- the existing funds might be too small to operate efficiently, or
- changes in investor sentiment might mean that the investment objectives of the separate funds no longer match to a target market.

Once the decision to merge the funds has been taken, all investors in the funds will be affected in the same way. As with a liquidation event, it is not possible for an investor to continue with their existing holding as that asset will simply cease to exist when the corporate action takes effect.

3.3 Conversions

Where two companies are combined (either as a result of a merger or takeover), the corporate structure is affected. Generally, one (or more) of the old shares will effectively cease to exist, and so all underlying ownership rights need to be reflected by the shares existing under the new corporate structure.

Investors holding any shares that will not continue under the new corporate structure must receive a proportionate number of the new shares in exchange (ie, their existing unitholding is converted into something new).

Conversions are not limited to corporate merger or takeover activity, and can arise any time the company wants to change its corporate structure.

3.4 Bonus Issues and Stock Splits

These arise where a company is changing its capital structure. The original shares continue to exist, ie, the investor gains some new holding in addition to the shares already held (the new holding is a bonus given to the investor). This new holding might be a different type of asset (eg, a bond or warrant), and so a platform operator will need to be alert to the potential that an equity currently supported might, at some point, give rise to an asset of a type that the platform does not functionally support (such as accrued interest securities or warrants).

Similar processes arise in the case of demergers (where one company splits off a section of its corporate structure to become a new independent company, resulting in extra shares in the new company).

A stock split occurs if the company wants to change the number of shares in issue – possibly because the company wants to reduce the current price of each share. It will specify a ratio setting out how many shares will be held for each share that was held (eg, 7 shares for every 2 shares currently held). The price of each share will generally move proportionately so that the total value held by each investor is not directly affected by the stock split.

The ongoing value of the assets held will be determined by market sentiment and the supply/demand for those assets.

3.5 Scrip Dividends

As an alternative to paying a cash dividend, a company might choose to release additional shares which are 'paid' to its shareholders. The income event, therefore, becomes a corporate action similar to a bonus issue, and each shareholder receives a scrip dividend.

3.6 Obligations of a Platform in Respect of Structural Events

When a structural event affects an asset that is held by, or available on, a platform, the platform needs to make a number of changes. First, it must make any relevant updates to its asset master file to ensure that subsequent transaction instructions will reflect the new/continuing asset and that no instructions will be issued in respect of an asset that no longer exists.

Second, the platform must also make any relevant updates to the actual holdings of investors that own the affected assets. For example, if two equities have merged, the investors holding either of those shares should now see the shares held after the merger (this is particularly important if the structural event meant that the investor holds a different number of the new shares compared with the number of old shares previously held).

The platform should ensure that their custodian position reflects the new holdings, and the CASS 6 asset reconciliations performed by the firm should identify any discrepancies arising as a result of the structural event.

4. Events Where Investors Have a Choice

Learning Objective

5.2.2 Know: the processes used to communicate, respond to and implement corporate actions; the range of additional services that platforms can offer advisers/investors

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Some of the above types of corporate action can only be performed once the shareholders overall have voted in favour of the action being undertaken. For example, an AFM is only permitted to merge two funds once the respective unitholders have voted in favour of the merger. The AFM will issue a notice to registered unitholders (such as the nominee of the platform operator) stating the date of the unitholder meeting to approve the proposal and setting out information on the proposed merger:

- the rationale for performing the merger
- the date that the merger will take place, and
- the first day of dealing in the new fund.

Each platform must allow its clients to exercise the rights those clients would have held as direct shareholders so will collect votes and submit these to the company (via its custodian/subcustodian where appropriate). When a platform operator receives notice of a meeting, it needs to pass on the details to investors and their advisers and ask for their instructions. Remember that, depending on the chain of custody for that asset, the platform may also not be the registered shareholder. Following this, any voting instructions would need to be passed up the chain so that the wishes of each beneficial owner are represented at the relevant company meeting.

Much of the business that is discussed at AGMs is routine, such as adopting the annual report and accounts, and reappointing the auditors; however, sometimes at AGMs and extraordinary general meetings (EGMs), more radical business needs the approval of the owners. Examples include approval of a merger or takeover, the restructure of a bond issue, the conversion of a unit trust into an open-ended investment company (OEIC), or the closure of a CIS to new investors.

Therefore, the result of a vote might lead to a corporate action that changes a client's holding regardless of how that client happened to vote. Note that, while each investor can vote, once the proposal is agreed it is not possible for any individual investor to dissent from any structural actions taking effect. There are, however, some types of corporate actions for which each investor can make their own decision (often known as an election) as to how their own holding will be impacted.

In such cases, the platform must communicate the position to each affected client and request their chosen outcome. The platform will then aggregate the decisions taken by its clients and advise its custodian/subcustodian of the number of shares taking up each of the offered outcomes. These elections must be passed along the chain of custody so that the relevant changes are made on the company's main register. It is common for the company offering such an elective option to identify a default selection that will be applied to any investors who do not submit their choice. Again, the platform's terms and conditions need to ensure there is clarity as to how the platform service will enable its clients to give instructions for an elective action.

We will now consider some of these types of elective action.

4.1 DRIP Dividends

We noted that a scrip dividend affects all shareholders equally. DRIP dividends are more like the CIS income reinvestment process mentioned in section 2.2.2. A dividend re-investment programme is an option that some companies offer to their shareholders, and each investor can choose whether or not to participate. Where an investor shareholder joins such a programme, the company will no longer pay cash dividends to the shareholder, but will instead use that money to purchase additional shares which it registers to that shareholder. The potential benefit for investors is that broking charges are reduced by being part of the company's bulk transaction.

Where a platform supports an equity for which a DRIP scheme exists, the platform operator would need to decide whether to offer membership of that company's DRIP to its clients (rather than simply fulfilling any reinvestment requests using normal aggregated trade orders according to its own terms and conditions); note that this is only possible where each link of the custody chain will support the DRIP.

4.2 Rights Issues

So far, we have considered corporate actions where each shareholder receives equivalent treatment. Rights issues differ in this respect, because each investor can choose their own response from a number of options available.

A rights issue is so named because it relates to the investor's right that their proportion of company ownership should not be eroded without their ability to act first. For example, suppose a company was going to raise a substantial amount of additional share capital in return for new shares. An investor that holds 1% of the shares currently in issue would see that proportion reduce if new shares are issued but sold to other investors.

The company will often give each existing shareholder the right to purchase the number of new shares corresponding to their existing holding to avoid any such erosion of their ownership. However, while the investor has the right to purchase these shares, there is no obligation to do so, and the company may also make other options available, so the investor can choose how they wish to proceed.

Rights issues are generally known by the ratio between shares offered for shares held. For example, a '3 for 2' rights issue allows an investor to purchase three of the new shares for every two of the existing shares held. The right itself can, however, have value. An investor who does not wish to buy the new shares themselves might choose to sell this right to buy new shares to some other market participant.

It is, therefore, important that the company registrar receives confirmation of each shareholder's instructions by the stated date – and so each link in the custody chain must obtain instructions from its respective clients to pass its aggregate decision up to the party holding their aggregate position. In the event that a given shareholder does not give an instruction to the registrar by this stated date, it is normal for the rights of that shareholder to lapse, ie, the shareholder gains no value. After these rights have been taken up, any of the shares not taken up by existing holders can be offered to the wider market.

Some investors will use a technique known as **tail swallowing**, which involves selling the portion of rights necessary to pay for the rights taken up. In this way, the net effect for the investor is that they gain some new shares without having to pay any of their own money – though, of course, as a result, their proportionate ownership in the company will reduce.

The following is an example of a rights issue.

Example

A company announces a '5 for 12' rights issue, with each new share costing £7.

An investor holding 100 existing shares has a right to purchase 41 new shares (ie, 5 for every 12 of the 100 shares owned – note that this calculation results in 41.667, but any fractions are ignored).

The investor could take up the 41 rights at a total cost of £287. Alternatively, they could sell the rights (at a price relating to the difference between the market price of the existing shares and the rights price of the new shares).

Suppose that each right could be sold for £3. The investor could try to sell their full rights (which would earn them £123). If they chose to tail swallow, they could take up 12 rights (at a cost of £84) and sell the remaining 29 rights (receiving £87) – with the net result that the investor will receive an additional 12 shares and receive £3. Alternatively, the investor could take up 13 rights (at a cost of £91), selling the remainder for £84 – with a net result of obtaining 13 additional shares for a cost of £7.

A platform operator must have an approach in place to manage rights issues. It must decide whether it will offer its clients the chance to choose from the various options under rights issues, or apply a default position on all its clients. It must also ensure that it responds promptly to any information received from its custodian to ensure that its clients do not miss out on the potential to benefit from a rights issue.

Where the platform enables each client to make their own decision in respect of such 'elective' corporate actions, it is important to ensure that the platform clearly communicates to investors the operational deadline by which they must confirm their chosen course of action. The platform will require time to reconcile the responses and notify its custodian (who will similarly be aggregating responses across its own client base).

4.3 Warrants and Convertible Bonds

Note that the types of corporate action mentioned within this section are rights or implications that arise for the shareholder because of a particular decision taken by the issuer at the time. It is, therefore, worth noting that asset types such as warrants or convertible bonds are structurally different, as such assets carry a built-in ability for the holder to convert or exchange the warrant/bond for another asset (often equity in the company).

If a platform operator permits its clients to hold warrants or convertible bonds in their account, the platform operator would need to establish similar processes to remind the relevant clients about any time periods in which those rights could be executed, and work with its custodians/subcustodians to ensure the investors, instructions are implemented.

5. Valuation of Assets

5.1 Accuracy of Pricing

Learning Objective

5.3.1 Know: how the value of platform assets is updated; the control processes that platforms may apply in relation to investment pricing

It is important that the platform can provide users with an accurate current valuation for the assets held within the various wrappers supported. The price available for a CIS will generally be the price published by the fund manager at the most recent valuation point (which will be a daily price for most funds available on a platform).

For exchange-traded securities, the price changes frequently during the dealing day, and so the market closing price is generally used by a platform when valuing the assets held.

Platform operators will purchase the services of a market price feed vendor/supplier (such as Reuters or Bloomberg) to provide them with a data file of prices for the relevant asset universe, which will be stored within the platform's technology for reference when providing portfolio valuations.

It is necessary for the platform operator to ensure that it shows accurate prices, as otherwise investors may make bad decisions based on the inaccurate information, and processes such as fee calculations will generally be based upon the value of the portfolio. Accurate information is therefore necessary to ensure that the correct fees are collected. A range of controls may be implemented to ensure the accuracy of the price data received from the vendor. Many of these controls are based upon the platform comparing the newly received price to the previous price used.

For example, the platform might identify any cases where the following scenarios arise in order that a manual check can be performed to confirm that the price file received was correct:

- **Static/stale prices** – ie, cases where today's price is the same as the price from the prior day.
- **Large movements** – where the percentage movement in the price since the previous day exceeds a particular tolerance defined by the platform.
- **Volatility monitoring** – where the price moves erratically during a prescribed period.

In some cases, a platform might obtain price files from multiple vendors and then perform additional checks to compare the two sources. It is, of course, also important for the platform operator to ensure that, when a new asset is added to the security master file (containing core information such as the name of an asset, or the applicable market identification codes), the data is correctly populated.

5.2 Pricing Errors

Learning Objective

5.3.2 Understand the impact of pricing errors on client investments

Despite the efforts of the platform operator to ensure that it applies accurate prices to its systems and client accounts, the overall complexity of these industry mechanisms means that errors will still occur.

The term 'pricing error' is generally used to refer to the situation where the AFM of a CIS fund has incorrectly valued a fund at a given valuation point. The valuation of an authorised CIS is covered by the COLL rules and is outside the remit of the platform operator. However, the published price of the CIS is received by the platform operator, either when dealing with the AFM concerned or as part of the daily market price feeds.

Where the AFM discovers an error in the CIS prices it has calculated, it is obliged to assess the materiality of the error. FCA considers that an error exceeding 0.5% of the price is material and any trades performed by the AFM at a materially incorrect price must be corrected in favour of the client concerned. In cases where the AFM's pricing error was below this 0.5% materiality threshold the trustee of the CIS may or may not require the AFM to correct impacted trades. It should be noted that depending on the underlying cause of the AFM's pricing error, the unit prices might have been incorrect for an extended period, requiring much resource of the AFM to rectify the impacted transactions.

If the platform operator was one of the unitholders that had dealt with the AFM at the incorrect CIS price, the platform operator might therefore receive compensation (additional money or additional units) which it should forward to the underlying clients who had suffered from the incorrect price originally provided by the AFM. It is possible for the platform operator to claim redress from the AFM to cover the administrative effort involved in performing such corrections (as the platform operator becomes obliged to manage the implications of the AFM's error), though this is usually only applied in complicated or long-running errors.

In cases where the AFM has made a pricing error that moves the price by less than the 0.5% materiality threshold (and with the agreement of the CIS's trustee), the AFM will not inform any unitholders of the error and will not publish corrected prices. Therefore, a platform operator or its clients would be unaware of any minor pricing errors that may have occurred within the valuation of a CIS – even if the platform operator had happened to trade in that CIS at a price later found to be inaccurate.

5.3 Off-Platform Assets

Learning Objective

5.3.3 Understand how platforms value 'legacy' or off-platform assets

Almost all platforms include functionality enabling the investor to record assets that cannot (for any reason) be transferred into the custody of the platform operator. The platform must, therefore, consider how prices for such assets might be obtained, as it will not wish to be subject to increased risk if a reliable price source cannot be identified.

Two broad approaches are adopted:

1. **A notepad option** – where the asset details are entered as free text and the adviser/investor is able to manually enter a price/value for the asset.
2. **A live version** – where the platform will apply price data received from a vendor.

The notepad version is typically used for illiquid, rarely traded assets (such as property or holdings in private companies), whereas the live version is more likely to be used to value instruments traded on overseas stock exchanges, where the platform operator does not have the capacity to execute transactions (probably because of very little client demand), but does have the capacity to capture price information.

End of Chapter Questions

Think of an answer for each question and refer to the appropriate section for confirmation.

1. **What are the three broad categories of corporate actions?**
   Answer Reference: Section 1

2. **What are the key differences between a share dividend and a bond coupon payment?**
   Answer Reference: Section 2.1

3. **How often will a collective investment scheme (CIS) authorised under the collective investment scheme sourcebook (COLL) issue a distribution?**
   Answer Reference: Section 2.2.1

4. **What is the difference between an accumulation unit and an income unit?**
   Answer Reference: Section 2.2.2

5. **What is equalisation?**
   Answer Reference: Section 2.2.3

6. **Why might a fund manager decide to merge two funds?**
   Answer Reference: Section 3.2

7. **What is a bonus issue?**
   Answer Reference: Section 3.4

8. **Give two examples of corporate actions where the investor will be able to choose what happens in respect of their own holding.**
   Answer Reference: Section 4

9. **What is meant by tail swallowing?**
   Answer Reference: Section 4.2

10. **What are the implications for a platform if a pricing error is identified in one of the funds held for investors?**
    Answer Reference: Section 5.2

Chapter Six

Regulatory Framework

This syllabus area will provide approximately 9 of the 50 examination questions

All businesses and citizens are subject to laws and regulations that govern their actions. We have already considered the HM Revenue & Customs (HMRC)/HM Treasury (HMT) rules that govern the tax-efficient wrappers offered by platforms. In this chapter, we will focus on the Financial Conduct Authority (FCA) rules that govern a platform operator's provision of retail financial services, and the data protection/information security considerations that are so important to a business that is dependent upon technology and personal data.

1. Financial Conduct Authority (FCA) Regulations

Learning Objective

6.1.1 Know the key rules and regulations that apply to services provided by platforms: COBS – 2.2 and 2.2A information disclosure before providing services, 6.1 compensation arrangements, 16 and 16A reporting information to clients, 11 and 11A best execution; CASS – 6 custody, 7 client money (including statutory trust and fiduciary responsibilities); SYSC – systems and controls, record-keeping, treatment of shortfall, business continuity planning, disaster recovery, risk assessment

6.1.2 Know the regulatory risks associated with the above

6.1.3 Know a firm's obligations in relation to the recording of breaches

6.1.4 Understand client categorisation (retail vs professional) and the implications of those designations

6.1.5 Know the reporting obligations of platforms in relation to their clients, particularly those set out in COBS 16 & 16A: durable medium; content and timeliness for occasional reporting; content and timeliness of periodic statements

Each platform operator must be authorised by the FCA for the activity it performs (eg, dealing in investments; safeguarding and administration of assets) and bears a number of obligations under the FCA Handbook (which contains all FCA rules and guidance – handbook.fca.org.uk).

The Handbook is made up of various sourcebooks, each addressing a different aspect of the regulatory environment. In this workbook, we will focus on three of these sourcebooks:

COBS	**Conduct of Business Rules Sourcebook**	Sets out obligations on a firm when providing services to its clients. These include how the firm advertises for business, defines and explains its services, performs transactions, and reports activity to its customers.
CASS	**Client Assets Sourcebook**	Sets out methods and controls to minimise the risk that investors' money or assets could be lost – particularly in the event that the firm became insolvent.
SYSC	**Senior Management Arrangements, Systems and Controls**	Sets high-level standards for senior management running the business on matters such as risk management, governance, and compliance.

Failing to comply with the FCA rules exposes a firm to risk of regulatory sanction. It may be fined by the regulator, which of course has a financial impact, but also affects the firm's reputation. Additionally, the directors and other senior managers responsible for the firm's activities could be fined or banned from performing such roles in the industry. Even if the firm is not fined, defending itself against an FCA investigation is itself a costly exercise.

All firms must maintain a record of regulatory breaches that have arisen in order to demonstrate that any detriment to investors has been correctly resolved and also to show that they have taken action to address any deficiencies in their processes or controls.

It is standard for firms to conduct 'root cause analysis' to determine whether individual breaches are isolated cases (eg, breaches resulting from simple human processing errors) or have arisen because of a broader weakness within the control mechanisms in place within the firm.

The FCA Handbook identifies certain events or breach types as requiring immediate notification to the regulator should they occur. These items tend to be suggestive of systemic failings within a firm's structure or operations, which the FCA is concerned could expose investors to significant risk.

We will now consider aspects of these sourcebooks in greater detail.

1.1 Conduct of Business (COBS) Rules

The most relevant rules for a platform are as follows:

1.1.1 COBS 2.2 and 2.2A – Information Disclosure before Providing Services

The FCA rules require that each client should receive certain information before any investment activity is performed to enable the client to understand the risks concerned and so make informed investment decisions. Following the updating of the MiFID rules, COBS now holds two versions of the disclosure requirements. COBS 2.2A reflects the obligations relating to MiFID business, while COBS 2.2 sets out the requirements for non-MiFID services, though, in this instance, both versions are broadly the same.

Appropriate information on the following should be provided to the investor:

- The firm and its services.
- Designated investments and proposed investment strategies, including appropriate guidance on, and warnings of the risks associated with, investments in those designated investments or in respect of particular investment strategies.
- Execution venues.
- Costs and associated charges.

1.1.2 COBS 3 – Client Categorisation

Financial regulation is designed to protect consumers, yet recognises that those active in the industry might appropriately be given greater flexibility to obtain services. Therefore, the rules distinguish between retail clients (who are most protected by the rules) and those who are professional participants in the financial services markets (who are classified as either professional clients or eligible counterparties). The professional and eligible counterparty categorisations have less protection under some rules, which provides them with greater flexibility as they are considered to be knowledgeable about the risks they may take.

The rules define that some types of firm will automatically be defined as either professional clients or eligible counterparties in respect of any business performed on their behalf by other firms. The list includes:

- credit institutions
- investment firms
- insurance companies
- collective investment schemes (CISs) and their managers
- pension funds and their managers, and
- commodity derivative dealers.

The rules enable some other clients to be placed in the professional client category, providing they can satisfy a quantitative test (relating to matters such as the size of their investment portfolio and the number of transactions performed), and a qualitative test (confirming that the client has the necessary expertise, experience and knowledge of the intended business).

1.1.3 COBS 6.1 – Information About the Firm and Compensation Arrangements

Like COBS 2.2, COBS 6.1 specifies certain disclosures that must be made '*in good time before the provision of designated investment business*' to the client (with COBS 6.1ZA providing equivalent obligations for MiFID businesses). The general obligation requires a firm to provide the following information to all retail clients:

- The name and address of the firm and the contact details necessary to enable a client to communicate effectively with it.
- The languages in which the client may communicate with the firm and receive documents and other information from it.
- The methods of communication to be used between the firm and the client including, when relevant, those for the sending and receipt of orders.
- A statement that the firm is authorised and the name of the competent authority that has authorised it (in the case of a UK-based platform operator, this would be the FCA itself, but if the operator was based in another country, this would be the FCA equivalent in that country).
- The nature, frequency, and timing of reports to the client on the performance of the service.
- A summary of the firm's conflicts of interest policy.

Further obligations are then recorded, according to the type of investment services that the firm provides.

This section of COBS also requires the firm to provide details of any compensation scheme relevant to the business being undertaken. In the UK, that would be the **Financial Services Compensation Scheme (FSCS)**.

In addition to the disclosure points summarised above, COBS 6 includes specific requirements for many types of regulated firm. This includes specific requirements for platform operators, which prohibit platform operators from accepting rebates from product providers. Similarly, firms that select platform operators for their clients must comply with the client's best interests rule and take reasonable steps to select a platform that presents investment products without bias.

1.1.4 COBS 11.2 and 11.2A – Best Execution

It is important that an investor can trust that the firm will strive to obtain the best possible outcome for the investor when executing market trades on their behalf. If the firm did not try to gain the best available price, the investor would needlessly pay more money for their investment. If the firm does not consider how promptly a counterparty will settle a transaction, the investor may be needlessly inconvenienced (such as if the investment sale is needed in order to cover some urgent expense).

Chapter 11 of COBS includes a number of controls relevant to a firm's market activity, though we focus here on the 'best execution' obligations. Again, rules relating to MiFID firms are separate from those covering other types of activity (COBS 11.2 covers most Non-MiFID business, while COBS 11.2A sets out the rules relating to MiFID firms, and COBS 11.2B gives a set of requirements that apply to UCITS fund managers). For the purposes of this workbook, we will focus upon the MiFID rules in COBS 11.2A.

The overarching obligation is that the firm should take sufficient steps to gain '…*the best possible results for its clients*…' in the context of the instructions being performed. A number of execution factors are highlighted – ie, matters that the firm should consider in determining what counts as the best possible result. These factors include price, costs, speed, likelihood of successful settlement, and the size of the order. However, the rules make clear that the total consideration for completing the trade (ie, the settlement value once all associated transaction costs have been included) is more important than the price alone. The firm must be able to consider the balance between these different factors and also recognise whether the client's specification of the order itself should have a bearing on how the best possible outcome should be defined for a given trade.

In some cases, the firm will allow the client the ability to make some specific instructions as to how, where or when a given order will be executed. The rules give the firm protection in such cases where the firm cannot be criticised for failing to obtain the best possible outcome if it executed an instruction in line with some requirement specified by the client concerned (though of course the firm must recognise its obligations under the FCA Principles to treat all customers fairly and to act with integrity).

The MiFID firm should, therefore, establish an order execution policy to guide its employees on how it considers different types of client orders would best be executed. This policy should be shared with the client to clearly explain how their orders will be executed. The firm should obtain prior consent that the client accepts the execution policy, and, of course, should perform internal monitoring to ensure that its order execution arrangements and execution policy are (a) operating as intended; and (b) achieving the desired outcomes for the firm and its clients.

1.1.5 COBS 16 and 16A – Reporting Information to Clients

This is another section of COBS where the rules differ between MiFID business (COBS 16A) and non-MiFID business (COBS 16). While both sets of rules cover similar types of information, we will focus on the specific obligations of COBS 16A as most platform activity is subject to the MiFID rules.

The rules require that the firm provides its client with adequate reports on the services provided by the firm. The rules also contain requirements for reporting following certain events/actions.

Of particular relevance to a platform operator or wealth management service are three types of reporting requirement, summarised in the following table:

COBS Title	General Description	Additional Comments
Occasional reporting	Sending a contract note or a similar document following a transaction, including 'essential information concerning the execution of that order' (see below).	This material must be provided no later than the first business day after the transaction is priced. This requirement does not apply to a firm that is managing investments.
Periodic reporting	A firm that is managing a client's investments must provide that client with a three-monthly summary of all transactions undertaken. Such a report should include most of the 'essential information' fields that would have appeared on any occasional reporting (if the firm had not been managing investments for the client).	If the firm is able to provide this information via an online portal that qualifies as a 'durable medium', and can provide evidence that the client has accessed an online valuation at least once during the relevant three months, then the firm need not issue a periodic statement. Alternatively, if the client elects to receive execution information following each trade (in the same manner as 'occasional reporting'), the periodic statement need only be issued once every 12 months.
Statement of client financial instruments or client money	Quarterly report confirming the balance of client money and custody assets that the firm holds for that client. This is a report of balances and need not include details of transactions performed. The data can reflect either a traded or settled position, providing the approach is consistently applied.	If the firm has undertaken securities financing transactions or collateralised business, then this statement of holdings will also need to include information about which assets are subject to those transactions. If the firm can provide evidence that the client has accessed an online statement during the last quarter (via a web portal that qualifies as a durable medium), then the firm need not issue this report.

A MiFID firm that is transacting for a client will either confirm each separate transaction as it happens (where the client is instructing individual deals) or produce a three-monthly summary of the deals instigated by the firm, under the terms of the investment management mandate operated by the firm on behalf of the client.

Where issued, each of these reports must be provided in what the regulations define as a ‘durable medium’. Essentially, this is either a paper or electronic communication that is personally addressed and capable of being evidenced in the future in an unchanged form. Platforms will often look to their online portal as the means of delivering regulatory information to their clients, which is acceptable providing the website satisfies the above requirements. Additionally, for a firm to rely upon internet communication methods to achieve compliance with COBS 16A, there must be evidence that the client has regular access to the internet and the communication channel must be appropriate to the context of the business being undertaken for that client.

Essential Information

COBS 16A requires a MiFID firm to provide essential information about the transaction, while COBS 16 talks instead of ‘trade confirmation information’.

While the underlying data required by these sections is generally very similar, it is important to highlight the distinction in trade confirmation information where a platform operator buys or sells units in a UCITS fund on behalf of its client. While the authorised fund manager (AFM) will provide a contract note containing the trade confirmation information items (aligned with the UCITS Directive), this will not match the data fields that the platform operator will need to provide to its client as essential information (aligned with MiFID).

The elements required by COBS are summarised in the following table:

Trade Confirmation Information (UCITS)	Essential Information (MiFID)
The identification of the management company	The reporting firm identification
The name or other designation of the unitholder	The name or other designation of the client
The date and time of receipt of the order and method of payment	The trading day and the trading time
The date of execution	The type of the order (for example, a limit order or a market order)
The identification of the UCITS scheme	The instrument identification
The nature of the order (subscription or redemption)	The buy/sell indicator (or the nature of the order if other than buy/sell)

Trade Confirmation Information (UCITS)	Essential Information (MiFID)
The number of units involved	The quantity
The unit price at which the units were subscribed or redeemed	The unit price
The reference valuation date	
The gross value of the order including charges for subscription or net amount after charges for redemptions	The total consideration
The total sum of the commissions and expenses charged and where the investor so requests, an itemised breakdown	A total sum of the commissions and expenses charged (for a CIS operator, initial charges may be disclosed in cash or percentage terms) and, where the retail client so requests, an itemised breakdown, including, where relevant, the amount of any mark-up or mark-down imposed by the firm or its associate where the firm or associate acted as principal in executing the transaction and the firm owes a duty of best execution to the client
	The rate of exchange obtained where the transaction involves a conversion of currency
	The venue identification

1.2 Senior Management Arrangements, Systems and Controls (SYSC) Rules

The key sections of SYSC are as follows:

1.2.1 SYSC 4 – General Organisational Requirements

Most platform operators will fall within the FCA's definition of a common platform firm (as they provide services of the sort defined by the MiFID rules). SYSC 4 sets out a number of general requirements that the FCA expects any common platform firm to implement (with other types of firm viewing the material as regulatory guidance).

SYSC 4.1 highlights the need for the company's governance structures to be clearly defined, with sufficient accounting and operational controls in place. Data and information held by the firm must be protected.

SYSC 4.1.6 requires a common platform firm to take reasonable steps to ensure continuity of its regulated services and meet its regulatory obligations in the event of an unforeseen interruption. These arrangements should be regularly updated and tested to ensure their effectiveness.

Business continuity is closely related to disaster recovery – though different firms may use the two titles in different ways (due to the negative connotations of talking about disasters). However a firm chooses to label the potential events, the aim is the same: that the firm should understand what sorts of events could threaten its ability to remain operational (whether events relate to its internal environment or its external relationships) and should establish appropriate measures to enable the firm to either remain operational despite those events occurring or to swiftly recommence activity having implemented a controlled response to such events occurring.

1.2.2 SYSC 7 – Risk Control

This rule requires that various types of firms – such as banks and designated investment firms – establish, implement and maintain adequate risk management policies and procedures. Such procedures should include effective procedures for risk assessment, which identify the risks relating to a firm's activities, processes and systems, and, where appropriate, set the level of risk tolerated by the firm.

Firms will establish a range of governance controls to ensure the correct running of their business. Often, there will be a formal committee structure to set and review corporate policies, and provide direction where difficulties arise. In addition to the main board, there will often be a specific committee to address key areas of activity, such as an IT committee, a risk management committee, and a client assets committee. Such a structure can be beneficial in ensuring the firm has a cohesive direction.

The rules recommend that other types of firm (ie, those not directly required to implement such controls) should consider implementing similar mechanisms by treating the rules as guidance.

1.2.3 SYSC 9 – Record-Keeping

This rule obliges a firm to arrange for orderly records to be kept of its business and internal organisation, including all services and transactions undertaken by it. Such records must be sufficient to enable the regulator to monitor the firm's compliance with the requirements under the regulatory system and, in particular, to ascertain that the firm has complied with all obligations with respect to clients.

In general, a firm must retain records relating to its MiFID business for at least five years (and so other firms should consider this period as regulatory guidance) – though individual rules elsewhere in the Handbook may require specific items to be retained for longer periods.

1.3 Client Assets (CASS) Rules

The key purpose of the Client Assets (CASS) Rules is to ensure that any clients' safe custody assets and client money that the firm may hold on behalf of its clients are clearly distinct from any assets that the firm may hold for its own account, and that, when a firm says it holds a given asset (or sum of money) for a particular client, it does indeed hold that asset/money. This is important for overall market confidence, as it protects investors against loss if the firm were to become insolvent.

CASS is a complex set of regulations, with CASS 6 setting out the necessary controls for safe custody assets and CASS 7 providing the controls required for client money. In respect of both CASS 6 and CASS 7, the aspects most significant for a platform relate to:

- **segregation** (ensuring a clear separation between client assets and corporate assets – important in protecting client assets if the company becomes insolvent)
- reconciliation (ensuring that the firm does hold the assets it thinks it does), and
- maintaining clear and accurate records of which client owns which assets/money.

1.3.1 CASS 6 – Client Safe Custody Assets

CASS 6 restricts the ways in which a firm can register ownership of client assets. Use of a nominee company complies with CASS 6 and also satisfies a platform's function of holding the assets of its clients. The rules do acknowledge that, in some global markets, this might not be possible, in which case the firm may need to register the assets in the name of a third party.

CASS 6.2 obliges a firm to make adequate arrangements so as to safeguard clients' ownership rights, especially in the event of a firm's insolvency, and to prevent custody assets belonging to a client being used on the firm's own account except with the client's express consent. The practical application of this rule is that platform operators must have procedures in place to prevent the delivery of one client's holdings to settle a transaction entered into by another.

Firms must also introduce adequate organisational arrangements to minimise the risk of the loss or diminution of clients' safe custody assets, or the rights in connection with those safe custody assets, as a result of misuse of the assets, fraud, poor administration, inadequate record-keeping or negligence.

CASS 6.3 requires firms to exercise all due skill, care and diligence in the selection and appointment of a third-party custodian, both when making the initial appointment and also when reviewing the performance of the custodian. Such reviews should take into account:

- the expertise and market reputation of the third party, and
- any legal requirements or market practices related to the holding of those assets that could adversely affect clients' rights.

CASS 6.6 requires firms to keep records and accounts to promptly distinguish safe custody assets held for one client from those held for any other client and from the firm's own applicable assets. Regulatory records under CASS should be kept for five years from the latter of the record being created or subsequently modified. CASS 6.6 also sets out the requirements by which the firm should validate the accuracy of its internal records of client entitlement and reconcile those internal records against relevant external records.

The following table summarises these controls:

Type of Control	Required Frequency	Comments
Internal custody record check The firm can choose between two methods: • Internal custody reconciliation method (ICRM). • Internal system evaluation method (ISEM).	'As often as is necessary' – but at least once a month.	Performed using the firm's internal records only to validate the accuracy of the client-level positions shown. The ISEM can be used by any firm. If the firm maintains separate data for its aggregate position and its investor allocations, then the ICRM is a reconciliation between those records.
External custody reconciliation	'As often as is necessary' – but at least once a month.	Performed to check that the firm's internal records align with the assets held for the firm at an external third party.
Physical assets reconciliation The firm can choose between two methods: • Total count method. • Rolling stock method.	'As often as is necessary' – but at least once every six months.	Validates that the firm holds in physical form the correct number of assets reflected for each client. The 'total count' method requires all vault assets to be counted in a single process. Where that may be infeasible, the rolling stock method enables the firm to perform the reconciliation in phases.

Any differences identified in these reconciliations must be investigated, and the relevant action taken to resolve such differences. This first requires the firm to conclude whether its books and records remain current and correct. It must then consider whether the firm or some external party (such as its custodian) needs to act in order to rectify a reconciliation difference. A shortfall exists where the firm's holdings are not sufficient for its obligations to its clients, though, for asset positions, the firm might conclude there is no need for it to take action if the custodian is still working to achieve market settlement of a purchase trade. The firm should also consider whether its clients are exposed to some risk as a result of the asset shortfall, or whether the exposure is suitably mitigated in some way, such as by using cash or other assets of a similar value to protect the clients against the risk of the firm's insolvency.

Platforms rarely hold physical assets, though they might be temporary holders of physical share certificates if a customer has sent the certificates to the platform so that they can be reregistered and held on the platform. Therefore, platforms are mainly concerned with the internal custody record check and the external custody reconciliation.

Each firm must determine how often to carry out these checks, taking into account:

- the frequency, number and value of transactions that the firm undertakes in respect of clients' safe custody assets, and
- the risks to which clients' safe custody assets are exposed, such as the nature, volume and complexity of the firm's business and where and with whom safe custody assets are held.

The firm must keep a written record of the decision process used to choose a particular reconciliation frequency, and review such decisions regularly in the light of changing business activities, processes or volumes.

1.3.2 CASS 7 – Client Money

Client money is any money that the firm receives from (or holds for, or on behalf of) a client, if it is in respect of designated investment business and no exemption applies.

Segregation is again fundamental. Under the normal approach to segregation, a firm must ensure that any client money it receives is banked directly to a client bank account (which is protected by a trust 'acknowledgement letter' signed by the bank concerned). This provides legal and physical separation of client money, from the firm's corporate money (as client money is technically held under the terms of a statutory trust. Once a given amount of client money has been received by the firm (and so becomes part of the statutory trust), the firm remains responsible to the client for that money until a discharge of fiduciary duty occurs, such as paying the money to the investor's bank account, or using it to settle a trade for that investor. The firm should perform due diligence in its selection of a bank or other third-party holding client money on its behalf.

The firm must ensure it has established:

> *'adequate organisational arrangements to minimise the risk of loss or diminution of client money'.*

There is no limit to the value of client money that a firm can deposit with a single entity providing the third-party is not part of the firm's corporate group. Where client money is held with an associated company of the firm (known as a 'relevant group entity'), the total amount held by group entities must not at any point exceed 20% of the total client money held by the firm.

The firm must perform a daily internal client money reconciliation, which includes a check to ensure that the client money requirement (the aggregate amount of client money recorded as allocated to its clients) matches the client money resource available (the aggregate balance the firm's ledgers maintain as being held in its client money bank account). External client money reconciliations must be performed at least monthly, though it is common for firms to perform these daily where they trade frequently.

The client money rules are, however, highly technical, and the process of monitoring the firm's activities to ensure that the rules are being complied with can consume a lot of resources.

1.3.3 Reporting Problems to the Regulator

CASS 6 and CASS 7 each contain a list of breaches or failures that, if they arise, must be immediately notified to the FCA. Requiring the firm to formally notify the FCA that such a breach has arisen enables the regulator to become involved prior to any actual business failure taking place.

CASS contains two separate lists of notification requirements (one in CASS 6 and another in CASS 7). While both lists cover essentially the same types of risks and controls, we will list them separately for reference.

CASS 6 requires a firm to notify the FCA if:

- its internal records and accounts of safe custody assets are materially out of date, or materially inaccurate/invalid, to the extent that the firm cannot distinguish assets held for different clients
- it is unable to (or materially fails to) take necessary steps in respect of any shortfall identified
- it is unable to (or materially fails to) conduct an internal custody record check at the frequency determined as being required
- it is unable to (or materially fails to) conduct a physical asset reconciliation at the frequency decided in the firm's policy
- it is unable to (or materially fails to) conduct an external custody reconciliation at the frequency decided in the firm's policy, or
- it is unable to distinguish safe custody assets held for one client from another client and from the firm's own applicable assets when acting as trustee/depositary of an authorised investment fund (AIF).

CASS 7 requires a firm to notify the FCA if:

- its internal records/accounts are materially out of date/inaccurate/invalid to the extent that the firm cannot distinguish client money held for different clients
- it is unable to (or materially fails to) identify and resolve discrepancies having completed an external reconciliation
- it is unable to (or materially fails to) complete the daily internal client money reconciliation
- it is unable to (or materially fails to) resolve an identified shortfall or withdraw an identified excess having completed the internal client money reconciliation
- it is unable to (or materially fails to) perform its external client money reconciliation per the firm's internal policy, or
- it becomes aware that, during the past 12 months, the amount of client money actually segregated was materially different from the amount required to be segregated.

1.4 Target Market Information

Learning Objective

6.1.6 Understand the purpose of target market information

There is a regulatory expectation that financial services products should be designed in order to meet some form of identified market need, ie, firms should not simply invent a product because they think they can manage to sell it profitably; there should be a customer segment for whom the product is intended to be beneficial. This consideration of market need is also important to each firm's approach to the Consumer Duty, which was introduced by the FCA in 2023 (and discussed in section 4 of this chapter).

Therefore, each product manufacturer must understand the market need that each of its products is designed to satisfy. In some cases, a product might be generally designed to meet the needs of retail investors. As a product becomes more detailed in its operations or asset allocation, the nature of the target market will become more specific (and smaller).

The product manufacturer is required, therefore, to not only perform initial target market analysis to understand the intended consumers of the product, but to ensure that its product is being distributed in line with that market view. If the manufacturer is directly selling the product to its own clients, it has ready access to the client data needed to ensure the product has only been sold to that target market.

However, where a given product is distributed via a platform operated by a different firm, the product manufacturer is likely to require information or assurances from the platform concerned that the customers exposed to that product are aligned with its view of the target market. It follows, therefore, that manufacturers will also share their target market analysis with relevant platforms to reduce the risk that the platform considers a product to be applicable to a market segment that the manufacturer's own analysis did not consider was part of that identified market need.

2. Disclosure

2.1 Key Disclosure Documents

Learning Objective

6.2.1 Know the key disclosure information available to investors and their relevance to the type of wrappers and assets: PRIIPs key information document; key investor information document; pre-investment disclosure document

In addition to high-level requirements to communicate openly with clients in a way that is clear, fair, and not misleading, the FCA Handbook includes certain specific documents that different types of firm are obliged to produce. CIS funds will offer a comprehensive document, known as the prospectus, which enables a prospective investor to perform a detailed review of the fund's features.

However, it has long been recognised that such a document does not enable retail investors to readily compare different funds. Regulations have, therefore, created an obligation for firms to offer summary documents.

Due to the evolution of regulation, different types of documents are used to provide investors with the key information about a fund or packaged product they are buying. 'Packaged product' is a broad regulatory term and includes various types of assets and wrappers, such as units in a CIS, an interest in an investment trust, a life policy, and personal pension schemes.

A firm that creates such products should produce and publish a 'key information document' (KID) as defined by the 'Packaged Retail and Insurance-based Investment Product' rules (known as PRIIP). Any firm selling the PRIIP should provide this KID to the client concerned.

However, UCITS funds are currently outside the PRIIP rules, and so continue to publish a 'Key Investor Information Document' (KIID). FCA rules allow a NURS operator to adopt the KIID format across their full retail fund range – in which case the operator will publish a document known as a 'NURS-KII'.

Some products and services fall outside of these various documents. In such cases, the FCA rules expect the firm to produce a key features document (KFD) that will summarise for clients how the product or service will operate.

While these various documents differ, they will all include aspects such as:

- the investment objectives and policy
- risk and reward
- charges
- past performance, and
- other practical information.

The following table summarises which document will be produced for each type of packaged product. A platform operator selling any of these types of assets/wrappers is required by the COBS rules to provide the relevant document to its clients.

Type of asset/ packaged product	Document required	Comments
UCITS schemes	KIID	KIID is defined in the Collective Investment Schemes (COLL) Sourcebook rules
Non-UCITS retail scheme	The fund manager has a choice between the: • NURS-KII, or • PRIIP KID	

<table>
<tr><th>Type of asset/
packaged product</th><th>Document required</th><th>Comments</th></tr>
<tr><td>Life policy</td><td rowspan="4">• PRIIP KID (if the packaged product is a PRIIP), or
• KFD (if the packaged product is not a PRIIP)</td><td rowspan="4">The content of the KFD is defined in COBS</td></tr>
<tr><td>Interest in an investment trust savings scheme</td></tr>
<tr><td>Stakeholder pension scheme</td></tr>
<tr><td>Personal pension scheme</td></tr>
</table>

It should be noted that the FCA's FUND Sourcebook also includes a disclosure obligation requiring the manager of an Alternative Investment Fund (AIF) to make a disclosure for each AIF it manages. As the AIF definition is broad, some AIFs fall outside the rules discussed above, and this is particularly relevant for AIFs that have a corporate structure and are traded as market-listed shares (such as investment trust companies).

One name commonly adopted for this market-facing disclosure is the 'pre-investment disclosure document'. Due to the types of risk that can arise for AIF investors, the contents of this disclosure document are more detailed than for packaged products, including:

- the investment objective and strategy of the AIF
- a description of the assets that might be held
- the investment techniques to be used, and any associated risks
- whether the AIF can use leverage (and, if so, details of the limits on leverage, the methods to be used, and the resulting risks)
- a description of the contractual relationships entered into in the various jurisdictions relevant to the AIF (ie, where it is constituted and where it is listed)
- details of the AIF manager, depositary, and other key roles
- information on costs and charges, and
- a description of how the AIF ensures fair treatment of investors, including details of any preferential treatment that an investor might receive.

2.2 Illustrations

Learning Objective

6.2.2 Understand the purpose of illustrations, and: how growth rates are set; why growth rates vary by wrapper and by asset; ex ante costs and charges

6.2.3 Understand how the effect of charges is different from the level of charges

2.2.1 Background

The purpose of illustrations is to indicate the likely outcomes that a given asset or wrapper might deliver. They are designed to indicate the likely answer to questions such as the following:

- If I save £500 each month, how much will I have when I am 60?
- How much do I need to save if I want to retire at 55?
- If I close my cash individual savings account (ISA) and put the money into an investment fund, will I be better off?

Any such illustration needs to consider three fundamental variables:

- How much money will be invested over what timeline?
- By how much will the assets grow during the period?
- What charges will I have to pay over the period?

The first of these questions is defined by the investor's planned investment (though, as we will see, an illustration need not reflect actual/expected investor behaviour). The second question requires the fund manager/product provider to make an assumption as to the investment return expected. Rather than allowing each firm to market its products based on an overly optimistic view of asset growth (which could mislead consumers), the FCA has defined three standard rates of investment growth for use by firms calculating a 'standard deterministic projection':

	Lower Rate	Intermediate Rate	Higher Rate
Tax-exempt wrappers	2%	5%	8%
Other products	1.5%	4.5%	7.5%

The FCA rules generally expect an illustration to use all three rates, though two particular aspects of the rules are worth noting:

- If a firm considers that the intermediate rate is not appropriate for its products (eg, a packaged product offering a specific return), it is entitled to define its own intermediate rate – in which case, the lower rate and higher rate (if applicable) must remain 3% below or above that intermediate rate respectively.
- In some circumstances, the firm can simply publish the intermediate rate projection.

Similarly, the FCA has defined corresponding rates of price inflation and earnings inflation, which would be relevant if illustrating the potential future buying power of a pension annuity upon retirement.

The FCA has also specified how a projection should reflect the charges incurred over the expected investment period. All charges, expenses, and deductions expected should be taken into account, though the firm is not expected to include dealing costs incurred on an underlying portfolio.

It should be noted that the level of charges might remain fixed, but the amount paid in charges increases due to asset growth in the portfolio. For example, paying a 1% annual management charge on a CIS purchase of £100,000 would result in a charge of £1,000, assuming the fund remained at a constant value. Assuming the fund grows at 4.5% pa, after ten years the fund would be worth £150,000, meaning an annual charge of £1,500.

Of course, the charge is applied each year, and so pure asset growth of 4.5% would be effectively reduced by this 1% charge. It is, therefore, necessary for investors and advisers to consider, not only the level of charges, but also the effect of those charges (ie, the amount by which they reduce the expected returns generated).

It is important to realise that these illustrations are generally based on broad assumptions and, in some cases, the regulatory obligation to issue an illustration can be satisfied by providing a generic example built into a standard disclosure document. Such simple illustrations do not, therefore, reflect any aspect of the client's actual (or expected) investment transactions, and merely seek to describe the potential returns that an asset/product might deliver for a given value invested.

2.2.2 MiFID II Costs and Charges Disclosure (Ex ante/Ex post)

The MiFID II rules brought further detail to the disclosure of costs and charges. We have seen that a number of different regulated firms may each play a distinct part in achieving investment growth for a given client, and each had been required to disclose their own costs. MiFID II requires the adviser (or whichever other firm has the direct connection with the client and is responsible for coordinating other parts of the overall service) to summarise the overall costs and charges that will be incurred while achieving the investment approach decided upon. However, Parliament and FCA have subsequently amended the scope of this rule so that a firm servicing a professional client or eligible counterparty does not need to provide this costs and charges disclosure unless the firm is providing advice or investment management.

The 'costs and charges disclosure' is a far more detailed obligation than a mere illustration. The MiFID obligation requires calculations based on the exact costs to be incurred by each of the parties that will be involved in servicing that individual investor's intended activity, as recommended by the adviser.

Consider the scenario where an adviser has decided to service a retail client by purchasing a small portfolio of listed company shares and UCITS funds, and recommends that the client use a particular platform to ensure streamlined administration of the assets (and the availability of tax-efficient wrappers). Before any assets are traded, the adviser is obliged to provide details of all the expected costs affecting the client as a result of the overall advice being given.

This calculation (referred to as 'ex ante' costs) will include various elements, with some being fixed and others being estimations. Costs would include:

- the cost of the advice itself
- the cost of opening the platform account (combining any fixed-rate fee charged by the platform, plus an assumption for any annual charge based on the value of the holdings, including any additional costs for the products due to be opened)
- brokerage costs related to the expected number of equity transactions
- the annual management charge (and other costs) reflected within the pricing of the relevant UCITS funds, and
- any initial (or exit) charges applicable when trading the UCITS funds with the AFM concerned.

Note that if the adviser or platform has negotiated a discount from the AFM, the effect of that discount should be factored into the calculation. All of these costs must be determined in respect of the activity being recommended for that particular client, including the sums to be invested in each asset.

The adviser will only be able to perform this calculation if the other entities involved can provide the basic data needed to perform the calculation. The FCA rules require AFMs to make available information about their charges, and so the MiFID firm can use the KIID/KID and/or the fund's reports and accounts to understand the cost profile of investing in a given fund. This enables the MiFID firm to assemble the overall calculation relative to the client's intended investments. Remember, no other party is able to perform the actual calculation, as only the party with the direct relationship with the client (and recommending the overall approach) can be confident of all the relevant cost components applicable.

As the overall expenses of each CIS are disclosed in the annual report and accounts, the adviser might simply need to effect a calculation based on the prior year's data for each fund. However, the calculation is complex, as it would also consider the costs of portfolio transactions within the CIS fund itself, ie, the broker charges incurred within the fund when buying and selling portfolio assets. Many AFMs, therefore, publish the costs and charges information that they believe a MiFID firm would require in order to invest their client's money within those funds, giving a consistent picture to the wider market rather than having each adviser attempt their own calculation. This information is commonly published via the European MiFID Template (EMT).

While the ex ante costs and charges information will inevitably include an aspect of estimation (particularly in matters such as portfolio transaction costs within a CIS, and any percentage costs that will be impacted by changes in the portfolio value), the adviser is also required to provide annual 'ex post' reporting, confirming the actual charges incurred throughout the investor's holdings and transactions during the past year. This should allow the investor to see whether the ex ante disclosure had been a reliable indicator of the actual charges experienced during the year. Both the ex ante and ex post disclosures are to be provided in both cash terms and percentage terms, which should help investors to understand the data, but also aid comparison if the individual has asked multiple advisers to recommend a course of action.

The FCA has summarised that the following items must be disclosed:

- All one-off charges, ongoing charges, and transaction costs associated with the financial instrument.
- All one-off charges, ongoing charges, and transaction costs associated with the investment service.
- All third-party payments received.
- The total combined costs of these three categories.

Note that costs and charges relating to the financial instrument must be distinguished from costs and charges relating to the financial service(s) being provided.

2.2.3 Effect of Costs and Charges

Aside from the MiFID II obligation for ex ante and ex post disclosure of costs and charges, there is an extra requirement to provide the investor with an illustration of the cumulative effect of those costs and charges. The costs of assets and products can range from low to high. Those on the higher end of the scale may argue that such costs are justified because the techniques adopted and attention being paid generate better underlying investment returns for the client.

The intention of a 'cumulative effect' illustration is to help the client understand this relationship and to understand the difference between net performance and gross performance. Suppose a fund's price increased by 3% over the course of a year, and that the fund's reports and accounts showed that the total costs incurred by the fund were approximately 1.5% of the fund's net asset value (NAV). In simple terms, this would indicate that the fund price would have grown by 4.5% if the charges had not been applied. (Of course, this is purely a theoretical view because, without the charges, the fund manager would not operate the fund.)

The above is, however, a very simplified situation, and does not consider any of the mathematical complexities that would arise if trying to demonstrate to an individual investor exactly how their personal portfolio would have behaved over a period of actual investments had there been no costs or charges incurred. However, as a simple illustration, the above shows that the effect of costs and charges reduced a gross performance of 4.5% to a net performance of 3%.

Note that, while the ex ante and ex post disclosures must be based upon the actual activity undertaken by/for that particular client (as the aim is to enable the investor to understand the expected costs of the investment strategy being proposed and to see each year whether the actual costs have reflected that expectation), the cumulative effect information need only be provided as an illustration. The firm can, therefore, decide how best to explain the interaction between asset growth and the types of charges and costs being incurred, but this piece of MiFID II disclosure need not reflect the personal circumstances and transactions undertaken for that client's account.

3. Regulatory Reporting

Learning Objective

6.3.1 Know the types of regulatory reporting required: complaints; payments services regulations; client money and asset reporting; transaction reporting; FCA returns

3.1 Complaints

The FCA Handbook gives detailed instructions on how complaints about any part of the firm's service are to be handled. Firms must keep a record of each complaint received and the measures taken for its resolution, and retain that record for at least five years when the complaint relates to either MiFID business or collective portfolio management services for a UCITS scheme, and three years for all other complaints.

The FCA's DISP rules require that every six months each firm must provide the FCA with reporting on all complaints received from eligible complainants. (An eligible complainant means anyone with recourse to the **Financial Ombudsman Service (FOS)**, and includes consumers using the firm's regulated services.)

This reporting includes a breakdown of the complaints received according to the type of regulated activity being performed and the type of assets concerned. In this way, the FCA can observe trends arising in either an individual firm's work with its clients, or across the industry as a whole.

The FCA has designed two types of report, and the volume of complaints received by the firm determines the template to be used in any given reporting period. If the firm has received more than 500 complaints from eligible complainants, the firm must use a more detailed FCA template.

3.2 Payment Services Regulations (PSR)

The Payment Services Regulations (PSR) 2009 defines the law relating to banking and credit card matters, including how unauthorised banking and card transactions must be dealt with. Platform operators may find themselves subject to these regulations if they accept debit cards as a method of payment.

Each payment services provider must provide the FCA with statistical data about its experience with fraud (annually for smaller firms, but semi-annually for larger firms). Specific other data requirements may also be added to the firm's electronic FCA reporting returns. An 'authorised payment institution' will need to provide a capital adequacy return, while a 'small payment institution' is required to provide a report of payment services directive transactions. Both of these are annual returns.

3.3 Client Money and Asset Reporting

All CASS medium and large firms (defined as those that hold either client money with a total value of over £1 million or custody assets with a total value of over £10 million) must provide a monthly client money and asset return (CMAR) to the FCA. The CMAR must be completed and submitted within 15 business days from the end date of the reporting period. The report is sent to the regulator electronically using the FCA's online regulatory reporting system.

The CMAR is a formal periodic submission by the firm to the FCA as its regulator. The requirements of the report are, therefore, contained within the Supervision Sourcebook (SUP) rather than in the CASS Sourcebook. Note that a 'CASS small firm' is not required to submit a CMAR.

The data contained in a CMAR should be taken from the firm's internal records, effectively based on the close of business position at the end of the calendar month (though firms need only submit the return by the fifteenth business day of the month). Therefore, the firm's internal reconciliation material completed on the first business day of each month is the primary source material for populating CMAR.

The CMAR return includes information such as:

- the parties involved in the firm's CASS operational mode (ie, banks and subcustodians)
- the number of clients of the firm
- the highest and lowest balances of client money and safe custody assets held during the month, and
- the number of open reconciliation items, (split according to the age of the exception item: 6–29 days/30–59 days/60–90 days/over 90 days).

3.4 Transaction Reporting

Where a firm deals in a listed asset, it must report that trade to the FCA on the following day. This includes all transactions that buy or sell the asset (at either investor-level or the firm's aggregated position). The purpose is to enable the FCA to detect and investigate suspected cases of market abuse, and so all executed orders in a reportable asset must be reported, regardless of whether or not the transaction was performed on the listed market itself.

A 'reportable asset' is an asset that is available to trade subject to a relevant market listing, or is available for trading on a multilateral trading facility (MTF) or organised trading facility (OTF), but also includes financial instruments that are based on other assets having these characteristics. Therefore, an instrument that represents a financial market index would itself be a reportable asset, as would a financial instrument related to an underlying security that was itself listed on a relevant market. However, a fund that is not listed would not be included in such reporting.

The other key criterion for transaction reporting is the set of reportable fields that must be provided in respect of each executed order; MiFID II significantly expanded the number of data fields required, with some 65 pieces of information now included. Many of the fields align broadly with the 'essential information' we saw when discussing disclosure of transactions to clients (eg, identification of the asset; time/date/price of the trade, see section 1.1.5). However, transaction reporting also looks into the mechanisms within a firm that led to the decision to trade. The reportable fields also include details of the decision-maker within the firm who initiated the transaction, whether that was a named individual, an identified committee, or a trading algorithm operated by the firm (in which case, that algorithm should be identified in the report).

Each platform operator must, therefore, determine whether its asset universe contains reportable assets. If so, the firm will need to ensure that it implements the processes and procedures necessary to collate the various data fields required within transaction reporting so that the firm's reports can be submitted each day.

3.5 HMRC Reporting

HMRC requires reports about pension schemes and ISA investments. These requirements were covered in chapter 2, section 2.1.7.

3.6 FCA Returns

Regulated firms are required to send detailed financial returns to the FCA each month so that the regulator can monitor if the firm has adequate financial resources.

4. Conduct Risk and Consumer Duty

Learning Objective

6.4.1 Know the outcomes arising from the FCA's approach to managing conduct risk within firms

6.4.2 Understand the particular implications for platforms of FCA Consumer Outcomes 3, 5 and 6

6.4.3 Know: the key principles of consumer duty; what constitutes a vulnerable customer; firms' obligations towards customers

6.4.4 Know: what a value assessment is; a firm's obligation with respect to its value assessment

4.1 Consumer Outcomes

The FCA has repeatedly sought to increase the focus on the consumer outcomes delivered by financial services firms. All these various efforts have stemmed from FCA Principle 6:

> *'A firm must pay due regard to the interests of its customers and treat them fairly.'*

This need to treat its clients fairly remains central to the FCA's expectations of firms' conduct, ie, that firms put the wellbeing of customers at the heart of how they run their businesses.

The FCA identified six Consumer Outcomes that it expects regulated firms to achieve as part of satisfying Principle 6:

Outcome 1	Consumers can be confident that they are dealing with firms where the fair treatment of customers is central to the corporate culture.
Outcome 2	Products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly.
Outcome 3	Consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale. This rule obliges platform operators to make sure that general marketing literature, platform service contracts and also specific confirmations of executed trades and other investment actions meet this standard.
Outcome 4	Where consumers receive advice, the advice is suitable and takes account of their circumstances.
Outcome 5	Consumers are provided with products that perform as firms have led them to expect, and the associated service is of an acceptable standard and as they have been led to expect. The regulator is looking for evidence that the outcomes are being achieved; firms might consider carrying out regular customer satisfaction surveys.
Outcome 6	Consumers do not face unreasonable post-sale barriers imposed by firms to change product, switch provider, submit a claim or make a complaint. Firms should bear this outcome in mind when deciding pricing policies and fee levels. The FCA will not look favourably on a policy that has a low basic charge but very high charges for some actions, especially if it makes it difficult for consumers to change platform.

4.2 Conduct Risk

Building from this foundation, the FCA has encouraged the good management of conduct risk within firms. Conduct risk relates to actions or conduct of a firm that may:

- harm clients
- cause reputational damage to the firm, or
- risk undermining the integrity of financial markets.

The FCA notes three approaches to identifying conduct risk which a firm may use in conjunction:

1. Define a central list of key risks, which is mapped to each asset's track records, growth projections, investment policies and business processes.
2. Consider each business process in turn and determine what risks could arise and to aggregate that risk data.
3. Identify the threats within each of the firm's processes and review the design of relevant controls to ensure those underlying threats were properly mitigated.

4.3 Consumer Duty

Most recently, the FCA took the step of adding a new Consumer Duty in the shape of an additional Principle for Business by firms that service retail clients:

'A firm must act to deliver good outcomes for retail customers.'

This is the first time that the FCA has added a Principle since it was founded, and the wording puts significant additional pressure onto a firm when it considers its approach to its clients and how it can justify the approaches taken in the design and delivery of its services. Where the existing obligations focused on the need for a firm to not take action that would be detrimental to its clients (or a subset of its clients), the language of the new Principle obliges the firm to:

'…act to deliver good outcomes…'.

It will no longer be sufficient for a firm to claim that it took no harmful action; it must instead show that it took all reasonable actions to achieve good outcomes for its clients.

The FCA has published extensive non-Handbook Guidance on this new duty. The following bullets from FG 22–5 note that the expectations on a firm include:

- putting consumers at the heart of their business and focusing on delivering good outcomes for customers
- providing products and services that are designed to meet customers' needs, that they know provide fair value, that help customers achieve their financial objectives and which do not cause them harm
- communicating and engaging with customers so that they can make effective, timely and properly informed decisions about financial products and services and can take responsibility for their actions and decisions
- not seeking to exploit customers' behavioural biases, lack of knowledge or characteristics of vulnerability
- supporting their customers in realising the benefits of the products and services they buy and acting in their interests without unreasonable barriers
- continuously learning from their growing focus and awareness of real customer outcomes, and
- ensuring that their board or equivalent governing body takes full responsibility for ensuring that the Duty is properly embedded within the firm, and senior managers are accountable for the outcomes their customers are experiencing, in line with their accountability under the Senior Managers and Certification Regime (SM&CR).

While financial services firms are commercial enterprises and exist to generate profits for their owners and/or shareholders, the challenges presented in the above bullet points demonstrate that the FCA wishes to prevent (or at least be able to punish) cases where a firm is able to abuse its position by seeking to benefit itself rather than pursuing the needs of its clients. It might however be argued that this new wording effectively enables the FCA to find any firm to be in breach upon the discovery of any poor customer outcome arising from that firm's services. It will therefore be interesting to see what cases the FCA selects as the first enforcement actions it undertakes for breaches of the new Consumer Duty.

One strand of the work relates to value-for-money. While the FCA has emphasised for many years that it is not a price regulator, the Consumer Duty requires firms to ensure that their services are offered at a price that represents good value for the consumers using those services.

The directors of all regulated firms therefore need to consider some key questions:

- What clients are the firm seeking to serve?
- Are the products and services suited to that target market?
- Do those services represent good value for money?

This value-for-money question has particular importance for a platform provider which essentially exists to offer a dealing and custody service to its clients and will apply a combination of periodic charges and activity-based charges to obtain remuneration from its clients. The Consumer Duty obliges the firm to ensure that each element of such pricing is appropriate and overall results in a good outcome for each client.

The FCA's non-Handbook guidance highlights certain factors that a firm should consider when performing a 'value assessment' including:

- the costs incurred by the firm in providing its products/services
- whether the firm's price would be considered an outlier if compared with general rates and charges available in the market, and
- whether the charges applied for one of the firm's products differ from those of a similar product offered by the firm.

The 'value assessment' must be performed while the product/service is being designed, and so must be completed before any clients make use of the new product/service. The assessment should be reviewed regularly over the lifetime of the product to ensure that no cause of detriment has arisen in the interim.

The firm will struggle to justify charging one rate to one set of clients if other groups of clients receive a similar service for a lower cost. The value assessment should therefore result in firms taking a clear stance over what parts of their offering are intended to generate particular benefits for the clients being serviced as such benefits will help to justify the charges being applied.

Aside from the value assessment, a platform operator will remain mindful of consumer outcomes 3, 5, and 6 – and is likely to ask itself questions such as the following:

- Are the platform's processes and procedures shaped to ensure investors will receive the right forms of communication or documentation at the right time in respect of any particular service being provided?
- Do the terms and conditions of the platform, and the terms and conditions of the wrappers available via the platform, clearly explain to consumers how those services and wrappers will operate? Does the platform see complaint data as informing its view of this?
- Does the platform have reliable and successful processes to enable investors to transfer their business to an alternative platform operator if the investor so instructs, or is the platform slow to respond to such requests?

4.4 Vulnerable Customers

While seeking to prevent behaviour by a firm from affecting any of its clients, the FCA separately emphasises that certain types of consumer may be at greater risk of harm if a firm does not act with the appropriate levels of care. The FCA refers to this higher-risk population as 'vulnerable customers', and has identified four key drivers of vulnerability (ie, four types of consideration that may make a person at greater risk of harm):

- **Health conditions** – illnesses that affect the person's day-to-day activity.
- **Life events** – such as bereavement or redundancy.
- **Resilience** – where the person is less able to handle emotional or financial difficulties.
- **Capability** – such as having little knowledge of financial matters.

Firms should review their operational and administrative processes to identify any part of the customer engagement and interaction which might cause problems to a vulnerable client. For example, firms should consider how information is provided, and what types of instruction can be submitted by which medium.

5. Data Protection and Information Security

Learning Objective

6.5.1 Know the key principles of the Data Protection Act 2018 and information security

6.5.2 Know the key elements of an information security policy: physical; logical; encryption

6.5.3 Understand how the Data Protection Act 2018 and information security risks are managed by platforms

6.5.4 Know the context and principles of the Digital Operational Resilience Act

The General Data Protection Regulation (GDPR) came into force across the EU in May 2018, and prescribes how personal data should be dealt with to protect its integrity and the rights of the persons concerned. While the UK has since left the EU, the approach to data protection remains in UK statute via the Data Protection Act 2018 (DPA 2018).

5.1 Principles

Data protection is based on seven key principles, summarised in the table below.

Number	Principle	Comment
1	**Lawfulness, fairness, and transparency**	Processing of personal data must be lawful, fair and transparent in relation to individuals.
2	**Purpose limitation**	The purpose for which personal data is collected must be specified, explicit and legitimate, and the personal data should not then be used in a manner incompatible to that stated purpose. If the data controller wants to use the data for an additional purpose, they must receive fresh consent from the data subject.
3	**Data minimisation**	The personal data collected for that specified purpose must not be excessive to achieve that purpose. The data should be adequate, relevant, and limited to what is necessary for the stated purpose.
4	**Accuracy**	Personal data must be accurately processed and kept up to date. Firms should establish reasonable steps to ensure that any inaccurate personal data identified in its records will be erased or rectified without delay.
5	**Storage limitation**	This relates to the ability to identify the data subject due to the way in which the personal data is retained. The data controller should not retain data in such a form for longer than is necessary to achieve the processing objective.
6	**Integrity and confidentiality**	The personal data should be secure, ie, protected against unlawful or unauthorised processing. The data should also be protected against accidental loss, damage, or destruction.
7	**Accountability**	The data controller is accountable for complying with the other principles, and for providing evidence that this is the case.

5.2 Penalties for Non-Compliance

If a UK data controller identifies that a breach has occurred – whether due to an internal failing, or an external attack on their databases – it must notify the Information Commissioner's Officer (ICO) within 72 hours of the breach being identified. Failing to notify the ICO can result in a fine of whichever is the greater of £10 million or 2% of the data controller's global turnover from the previous financial year (note: turnover, not profit).

The same level of penalty can be applied if the data controller is considered guilty of various administrative breaches, including breaches relating to organisational obligations (including those relating to data security).

Any breaches relating to infringements of the data subject's individual privacy rights can result in a fine of up to the greater of £20 million or 4% of the data controller's annual global turnover.

5.3 Information Security

Information security is a technical subject, though an appreciation of the ways in which a firm can protect its data is relevant to this workbook.

One way of categorising information security protections is to consider controls as physical, logical, and encryption.

5.3.1 Physical

While this readily applies to any physical documentation received or held by a firm, including the safe storage or destruction of reports and printouts generated when providing services, there are some physical considerations relating to information security as well.

Security desks, CCTV cameras, and staff ID badges (both as visible identification and to access controlled parts of the office) are examples of physical controls. In recent years, it has also become common for network printers to store print jobs until the user is physically present at the printer (eg, by swiping their staff ID at the printer). Such an approach mitigates the risk that could arise if confidential information is printed by one member of staff but intercepted by a colleague.

5.3.2 Logical

Most computer systems are protected by a username and password; only those staff who have been authorised are given the credentials necessary to access a given system. By ensuring that staff do not share passwords and login details, the firm mitigates the risks of data being accessed and misused by members of staff who have no need to access that information.

It has also become common for staff to require a physical token as a supplement to their username and password when logging into the firm's network.

5.3.3 Encryption

While logical measures limit the user's ability to access data, encryption protects the data when it is either at rest within the company's servers or in transit between the data store and the user. Given the potential of data being intercepted in transit, encoding the information via encryption means that an unauthorised party intercepting the data would still be unable to read the contents.

5.3.4 Information Security Risk Management

Platforms hold volumes of detailed, valuable data about their investor clients, for example:

- investor names and addresses, dates of birth and National Insurance (NI) numbers
- family and business relationships
- bank account details
- details of actual investments held within the platform and outside the platform
- details of fact-finding information, and
- relationships with financial advisers.

Platform operators, therefore, need to consider a range of practical issues concerning protection of their own data, as well as their clients' and employees' data:

- **Security culture** – does the firm hold regular training courses on the subject of data security, and are these courses regularly updated to take account of new threats? In particular, do these courses tell staff members about the techniques that criminals use to carry out identity theft?
- **Physical security** – are data centres and physical record archives kept secure? Are there procedures to record who enters and leaves such parts of the office?
- **Encryption** – is data encrypted at rest or in transit?
- **Password protection** – how does the firm control staff access to its computer network? How often do staff passwords expire?
- **Data segregation** – firms must ensure that they consider how any personal data of the user will be segregated from corporate data, particularly in respect of a user's smartphone or laptop activity.
- **Portable devices** – are there controls over what data may be copied to external drives and memory sticks? Are there controls about what data may be held on laptops, smartphones, tablets and other devices that may be taken out of the office? How are these devices and the data held on them protected?
- **Outsourcing arrangements** – do the controls that apply to the firm's own employees also apply to any organisations to whom functions have been outsourced? What procedures are in place to ensure that these external organisations comply with these controls? Note that EU data protection rules have, for many years, stated that data may only be transferred to a country outside the EU if that country provides an adequate (ie, similar to EU-standard) level of protection. If the outsourcing is being made to a country that does not provide adequate overall protection, the receiving party should demonstrate that it has established adequate safeguards (above any local legal obligations).
- **Reconciliation** – does it carry out regular and accurate reconciliation of data with third-parties, such as banks and custodians?

5.3.5 Digital Operational Resilience Act (DORA)

We have already noted that regulated firms should have plans for business continuity and disaster recovery. However, the EU became particularly concerned at the levels of operational resilience built into the systems and processes of financial services firms – particularly as IT supply chains become more complex and digital interactions more important to the services that firms provide.

This led to the Digital Operational Resilience Act (DORA), a piece of EU legislation designed to harmonise the regulatory requirements relating to information and communication technology (ICT) and so reduce ICT risk.

DORA took effect in early 2025 and requires that each financial services firm establishes:

> *'…an internal governance and control framework that ensures an effective and prudent management of ICT risk… to achieve a high level of digital operational resilience'.*

The board of each firm must, therefore, ensure that strong mechanisms and policies to manage ICT risk are implemented and working as intended, though the Act recognises that each firm will respond to these requirements according to the size, risk profile, nature, scale, and complexity of its services, activities, and operations (known as the 'proportionality principle'). The reporting of major ICT incidents is included, with the European Supervisory Authorities (ESAs) devising standardised disclosure templates.

Five key topics within DORA are:

- ICT risk management
- ICT-related incident management, classification, and reporting
- digital operational resilience testing
- ICT third party risk management, and
- information sharing arrangements.

While this Act relates to financial services firms located in EU member states (estimated at approximately 22,000 firms), the complex international supply chains that exist mean that suppliers of ICT located outside of the EU will need to support the requirements of DORA in order to continue servicing clients located in the EU. As such, DORA will indirectly place obligations onto companies that provide cloud computing facilities, or situations where the EU-based members of a financial services group make use of centralised group ICT services located outside the EU.

The EU's hope is that these rules will make firms more conscious of:

- the magnitude of their reliance on ICT systems, protocols, and tools, and
- the reliability of those tools for the scale of the firm's business.

6. Key Controls – Three Lines of Defence

Learning Objective

6.6.1 Understand the principles of the 3 lines of defence model

6.1 The Principles of the Three Lines of Defence Model

Many firms use the 'three lines of defence model' when implementing risk management. This model recognises the differences between functions of the firm that own and manage risks, the functions that oversee risks and the functions that provide independent verification.

The three lines of defence model can provide an effective way of improving communications on risk management and control by defining key roles and responsibilities within the organisation. The techniques can be used in any size of firm and in firms with different complexities. The model ultimately comes together at board level within the firm, where executive management decisions can be informed by the risk management approach.

6.1.1 First Line of Defence: Business Operational Management

The first line of defence consists of various controls a firm implements to deal with day-to-day business operations and transactions. Individual business unit managers should be aware of the risks that they 'own' in their business unit. They are responsible for identifying, assessing and mitigating the risks faced. Such work should include the necessary controls and checks, and reporting to senior management regarding these risks and controls.

Risk controls should be designed to fit into the firm's systems and processes. There should be an adequate level of risk management controls in place to identify compliance and to highlight any breakdowns in control, any inadequacies of process and other eventualities. The first line of defence provides management of the firm with such information, and provides feedback to the audit committee by identifying risks and business improvements, implementing controls and reporting on progress.

Larger firms might have a risk management committee who will have overall responsibility and accountability for planning, implementing and monitoring their various departments' daily risk environment. This committee also advises on the treatment of identified risks, should they occur.

6.1.2 Second Line of Defence: Risk Management and Compliance Functions

The second line of defence monitors the implementation of effective risk management systems and controls by the firm's management. This line of defence relates more to the oversight of risk, the reviewing of the risk management procedures that have been implemented, and also challenging what has been implemented to ensure that the control mechanisms remain effective.

The compliance function ensures that the firm complies with the rules and regulations that apply to the firm and reports separately to senior management and/or the board of directors.

There are many functions in companies that are linked to risk management and compliance roles, including:

- enterprise risk management
- quality monitoring
- compliance
- IT security
- legal
- health and safety, and
- environmental.

These functions form part of the business unit's risk committees and will review risk reports, validate that the risk management framework requirements have been met, and so help ensure that the risks identified are being properly and actively managed.

6.1.3 Third Line of Defence: Internal and External Audit

The third line of defence is the independent assurance provided by the firm's audit committee and the internal audit function that reports to that committee. The independent assurance also includes any external audits undertaken by relevant third parties.

The internal audit function undertakes a programme of risk-based audits covering all aspects of both the firm's first and second lines of defence to ensure that the risk management arrangements are sufficient and effective. The internal audit function might well take some assurance from the work of the second-line functions and thereby amend the scope of operational activity being reviewed.

The internal audit function gives the board of directors and senior management assurances based on the highest level of objectivity within the firm. They will review and report on the effectiveness of internal risk controls, governance and risk management arrangements within the organisation. The assurances that the internal audit gives to the board of directors and/or senior management cover such areas as:

- the effectiveness of business operations and arrangements to safeguard assets of the clients and the firm
- the reliability and usefulness of reporting procedures, and
- how successfully the firm complies with the applicable rules and regulations.

7. Complaints

Learning Objective

6.7.1 Know the regulatory requirements in relation to complaint handling: timescales required; role of the Financial Ombudsman Service

The FCA defines a complaint as:

> *'any expression of dissatisfaction, whether oral or written, and whether justified or not, from or on behalf of an eligible complainant about the firm's provision of, or failure to provide, a financial service'.*

The rules that relate to complaint handling are found in the DISP (Disputes) section of the FCA Handbook. The first FCA rule is that complainants must be treated fairly; the regulator expects firms to:

> *'put the wellbeing of customers at the heart of how they run their businesses'.*

Every regulated firm needs to have a written internal complaints procedure, and all staff need to be aware of its contents. FCA rules require firms to respond to complaints, in writing, within eight weeks, informing the complainant whether the complaint has been successful or why they need more time to look into it. However, most complaints procedure documents would recommend a far more proactive approach than that.

For example:

Sample Complaints Procedure: Timescales

1. We will acknowledge your complaint within five working days of receipt of your complaint.
2. We will investigate your complaint and endeavour to send a final response to you within four weeks of receipt of your complaint. If we are unable to provide you with a final response within this time, we will send you an update.
3. We will endeavour to send a final response to you within eight weeks of receipt of your complaint. If we are unable to provide you with a final response within this timeframe, we will write to you explaining why and advise you when you can expect a final response.
4. If more than eight weeks from the date of your complaint have passed and you have not received a final response, or you are dissatisfied with the final response you have received (at any stage of the process), you can write to the FOS.

You must refer your complaint to the FOS within six months of the date on the final response.

As noted in the example above, an unsatisfied complainant may refer their complaint to the Financial Ombudsman Service (FOS), which was established to help settle disputes between consumers and UK-regulated firms.

The FOS deals with complaints from consumers about most financial matters including banking, insurance, mortgages, pensions, savings and investments, credit cards and store cards, loans and credit, hire purchase and pawnbroking, financial advice, and money transfer operators.

The FOS can only act once the consumer has given the firm an opportunity to look into the complaint itself. If the firm does not resolve the complaint within eight weeks, or if the consumer is not happy with the response, they can then refer the complaint to the FOS.

The FOS makes decisions on the basis of what it considers fair and reasonable in the particular circumstances of each case. In making decisions on individual complaints, the law requires the FOS to take into account relevant law and regulations, regulator's rules, guidance and standards, codes of practice, and (when appropriate) what it considers to have been good industry practice at the relevant time. If the consumer chooses not to accept a FOS decision, their legal rights remain unaffected and they can take the matter to court instead – subject to any requirements set by the courts.

The FOS is funded by the financial services sector through a combination of statutory levies and case fees. The service is free to consumers and can award up to £430,000 for a complaint referred after April 2024 relating to an act or omission of the firm occurring since 1 April 2019 (with other limits applying for earlier periods).

8. Investor Protection

Learning Objective

6.8.1 Know the scope of the Financial Services Compensation Scheme (FSCS): eligible investors, eligible investments, protection limits

The Financial Services Compensation Scheme (FSCS) is the UK's statutory compensation scheme for customers of authorised financial services firms. This means that it can pay compensation if a firm is unable, or likely to be unable, to pay claims against it. The FSCS is an independent body funded by a levy on 'authorised financial services firms'. The scheme covers deposits, insurance policies, insurance brokering, investments, mortgages and mortgage arrangement.

It should be noted that the FSCS protects investors against the firm being unable to deliver its promised service; however, it does not protect investors against market loss if a purchased asset proves to have been a poor investment.

8.1 Investors Eligible for Compensation

The FSCS protects UK-based retail customers of banks, building societies, credit unions, investment firms and insurance companies that are regulated by the FCA or the PRA in the UK.

The regulations define 'retail customers' as the following:

- Private individuals.
- Small charities and small businesses. To qualify, charities and businesses must satisfy at least two of the following:
  - Balance sheet assets do not exceed £5.1 million.
  - Not more than 50 employees.
  - Annual turnover does not exceed £10.2 million pa.
- The executors of estates of private individuals.

8.2 Investors Ineligible for Compensation

Those ineligible for compensation from the FSCS include:

- larger businesses and charities
- most pension funds
- overseas financial services institutions
- supranational institutions
- governments and central administrative authorities (whether provincial, regional, local or municipal)
- directors or partners of the firm that has failed, and
- persons who (in the opinion of the FSCS) are responsible for, or have contributed to, the firm's default.

8.3 Compensation Limits

Compensation limits apply to different classes of regulated activities.

The FSCS compensation limits are shown in the following table:

Business Activity	Level of Cover	Maximum Payment
Bank, building society and credit union deposits	100%	£85,000 per person per firm (or £170,000 in the case of a joint account with two names) The scheme will protect individuals for a temporary high balance up to £1 million. Note: this protection will only be provided for a period up to six months from the date the amount was first deposited
Insurance contracts	Either 90% or 100% depending on the type of contract (Note 1)	Unlimited
Authorised investment business	100%	£85,000 per person

Business Activity	Level of Cover	Maximum Payment
Pensions and annuities	100%	100% protection of annuities and general failures of a pension provider. However, if a SIPP Operator fails (the assets being held as investments) the limit is only £85,000 per person (as for other authorised investment business)

Note 1: The compensation level for compulsory insurance products (eg, third-party motor insurance policies) and long-term insurance is 100%; for all other policies, it is 90%.

The activities of a platform operator are categorised as authorised investment business. This means that, if the platform itself became insolvent, an individual customer would receive compensation of up to £85,000. However, if the platform operator remained solvent, but an insurance company that provided the same investor with a life insurance policy that was held on the platform became insolvent, the compensation due to the investor would be 100% of the loss to the investor, with no upper limit.

9. Other Regulatory Issues when Onboarding Investors

Learning Objective

6.9.1 Know the importance of the following to investor onboarding: anti-money laundering checks; know your customer; sanctions

As a provider of financial services, the platform operator must ensure that it is not being used for money laundering purposes, or being used as a means of bypassing economic sanctions. The fact that the platform will usually only interact with its clients via the internet (without any in-person interaction) makes it important that the firm establishes robust controls to minimise the risk of criminal activity taking place.

9.1 Know Your Customer (KYC)

The first challenge is to ensure that the firm is being given accurate personal data by the prospective client. The firm may ask a new client to provide documentation to support their identity, or the firm may retain an electronic checking service to ensure that the name and address details provided by the investor are a good match against the electoral roll (or other databases of personal data).

The firm should consider what information will be relevant to how its services are delivered to ensure that material facts are verified.

9.2 Anti-Money Laundering (AML) Checks

Know your customer (KYC) checks are an important part of protecting a firm against money laundering. The firm should comply with the guidance published by the Joint Money Laundering Steering Group (JMLSG). In addition to validating the customer, it may also be relevant to confirm the source of funds or the source of wealth. In simple terms: does it seem reasonable for the customer to have available the sums of money being invested, or is there a danger that the money has been gained from illegal activity?

Anti-money laundering (AML) checks will, of course, continue beyond the point of initial onboarding. AML checks (such as KYC) are not simply completed at the beginning of the firm's relationship with its client. JMLSG Guidance is clear that:

> *'firms must conduct ongoing monitoring of the business relationship with their customers…'*

The guidance explains that such ongoing monitoring includes scrutiny of the transactions performed by the client as the relationship continues. The obligation to identify and report suspicious activity requires firms to remain vigilant. Many firms have set up trend-analysis software that looks beyond individual account transactions to see whether an investor's behaviour over a period indicates any wider cause for concern.

For example, does an investor's transaction behaviour change in the period following a change of address (or other change of contact details)? Does a large withdrawal follow shortly after a new bank account has been recorded against the account? Such events may be perfectly innocent – a reflection of the investor making changes in their life and circumstances – or they may indicate that someone is attempting to take over the investor's account unlawfully.

9.3 Sanctions

Periodically, national governments and international agencies announce that the cash or assets of certain individuals are to be seized, such that financial services firms should not perform business with the relevant individuals. The reasons can range from criminal activity (such as embezzlement or terrorism) to transitions of power within countries affected by war or other instability (eg, situations in which there is concern that a given politician or their family could have removed wealth from the country before being removed from power).

Sanctions lists provide a firm with the current list of individuals that are subject to these economic sanctions. It is, therefore, prudent for the firm to check any new investor against the most recent sanctions list to ensure that it is not commencing a business relationship contrary to government or international sanctions.

As with AML checks, the task of protecting the firm against the risk of sanctioned individuals does not end at the onboarding stage; firms will include periodic checks to ensure that no existing client has subsequently become subject to economic sanctions so that any necessary reporting to authorities can be performed.

End of Chapter Questions

Think of an answer for each question and refer to the appropriate section for confirmation.

1. **What are the categories of client defined by COBS 3?**
   Answer Reference: Section 1.1.2

2. **What is segregation of assets and what is its purpose?**
   Answer Reference: Section 1.3

3. **What are the FCA rules around illustrations, specifically with regards to percentages and projected growth?**
   Answer Reference: Section 2.2

4. **Which regulated firms must submit CMAR reports to the FCA, and what sort of data is included in such reports?**
   Answer Reference: Section 3.3

5. **What are the six FCA Consumer outcomes?**
   Answer Reference: Section 4.1

6. **What are the seven principles of data protection regulation?**
   Answer Reference: Section 5.1

7. **The Digital Operational Resilience Act (DORA) requires financial services firms to establish what?**
   Answer Reference: Section 5.3.5

8. **The compliance department is part of which line of defence?**
   Answer Reference: Section 6.1.2

9. **What is the maximum level of compensation that the Financial Ombudsman Service (FOS) can award for an act or omission made by a firm since 1 April 2019?**
   Answer Reference: Section 7

10. **What retail investors are eligible to receive compensation from FSCS?**
    Answer Reference: Section 8.1

Chapter Seven

Taxation

This syllabus area will provide approximately 4 of the 50 examination questions

1. Key Taxation Aspects

Learning Objective

7.1.1 Know which taxes apply to specific investments: income; capital gains; inheritance; transaction

1.1 The UK Tax Year

In most countries, the government's financial year (also known as the tax year) is the same as the calendar year. The UK is an exception; for historical reasons the UK's financial year runs from 6 April until 5 April the following year. The tax rates and reliefs for the following tax year are decided by Parliament in the annual Finance Act, which follows the presentation of the Budget to Parliament each year. UK residents are required to pay the relevant taxes on their income and other gains realised during the tax year, subject to any applicable allowances and exemptions.

1.2 UK Income Tax

1.2.1 Scope

Income tax may arise on the following types of income:

- earnings from employment, including the value of any perks such as company cars
- earnings from self-employment, also including perks
- most pension income (state, company and personal)
- interest on most savings
- dividend income from shares and collective investment schemes (CISs)
- rental income, and
- income paid from trusts.

Each resident is given a personal allowance (a level of income on which no income tax is payable), and will pay income tax on additional income earned above that level.

The following types of income are not taxable:

- certain kinds of state benefits, such as disability benefits, housing benefit, maternity allowance and tax credits
- interest on National Savings certificates, and
- premium bond winnings.

1.2.2 Income Tax Rates and Allowances

The full personal tax calculation includes a number of different considerations beyond the remit of this workbook.

Income tax is applied at tiered rates; the more money a person earns, the greater the percentage of that additional income they will pay as income tax. Every person is given a personal allowance and then starts to pay income tax on the income earned above that allowance.

The tax bands and associated tax rates for the 2025–26 tax year are shown in the following table (note that some rates and thresholds are different for residents of Scotland):

Taxable Income (above the Personal Allowance)	Rate Applicable
First £37,700 (£0 to £37,700 of taxable income)	Basic rate (20%)
Next £87,440 (£37,701 to £125,140)	Higher rate (40%)
Over £125,141	Additional rate (45%)

While the personal allowance is £12,570 the value is reduced for those earning over £100,000. For every £2 earned over this £100,000 threshold, the personal allowance is reduced by £1. This means that once a person earns £125,140 their personal allowance is reduced to nil.

Income tax on employment income is normally deducted at source by the taxpayer's employer under the Pay As You Earn (PAYE) scheme and paid to HM Revenue & Customs (HMRC). All other forms of income need to be declared on an annual tax return which must be completed by the end of January following the tax year end. Tax must be paid no later than 31 January in the following year; interest is charged on late payments. Note that pension contributions made within the individual's annual allowance are excluded from the calculation of taxable income.

1.2.3 Savings Income

Any interest earned on savings is subject to income tax, but with some variations. Firstly, each person gains a separate personal savings allowance for savings income (the term used for interest earned from sources such as bank accounts, savings accounts or government bonds). For the 2024–25 tax year this allowance is the first £1,000 for basic rate taxpayers and £500 for higher rate taxpayers. Additional rate taxpayers do not receive a personal savings allowance.

Savings income up to this allowance is not subject to tax. However, any savings income earned above the individual's personal savings allowance is taxable at their prevailing rate of tax. As the saver might not, therefore, be liable for any tax on their savings income, the savings institution will pay the income to the saver without deducting any tax amount. If the saver owes any tax, they must pay the relevant sum through their HMRC self assessment.

1.2.4 Dividend Income Allowance

Each person must also pay tax due on any dividend income they earn (including any dividend distributions paid by collective investment schemes). Again, each person is entitled to receive a certain amount of dividend income before tax becomes payable. For the 2025–26 tax year this dividend allowance is £500.

The rate of tax paid on dividend income above the dividend allowance depends upon the rate of income tax paid by the individual. The tax bands for dividend income are set out in the following table:

Income tax band of the investor	Rate applicable to dividend income over the dividend allowance
Basic rate	8.75%
Higher rate	33.75%
Additional rate	39.35%

1.2.5 A Simplified Example

While a full tax computation involves components outside the remit of this workbook, let us consider a simplified example drawing together the above elements.

Suppose a person earns £110,000 from their employment, £7,500 of dividend income, and £400 of savings income.

As the person earns more than £100,000 from employment their personal allowance will be tapered. The £10,000 earned over this threshold will reduce their personal allowance by £5,000 (to a figure of £7,570). The person will be a higher-rate taxpayer, paying 20% on the first £37,700 of their taxable income, and 40% on the rest of their taxable income (a total of £33,432).

No tax is payable on the savings income (being below the £500 allowance applicable to a higher-rate taxpayer), but they will pay tax on £7,000 of dividend income (being £7,500 less the dividend allowance). As a higher-rate taxpayer the person will pay 33.75% on this dividend income, adding £2,362.50 to their tax bill.

1.3 Capital Gains Tax (CGT)

1.3.1 Introduction

Capital gains tax (CGT) is payable on profits generated on the sale of most assets, including equities and CISs. The investor pays tax on the net gain made during the tax year. Note that any capital losses made during the tax year can be used to reduce liability to CGT.

CGT does not apply to gains made within an individual savings account (ISA) or pension wrapper. Additionally, private investors in the UK are exempt from paying CGT on profits generated from the sale of gilts and qualifying corporate bonds. The capital gain generated on an equities transaction is calculated as the difference between the sale price and the purchase price of the quantity of shares concerned.

Example

An investor purchases 1,000 shares in a company at £1.70 per share, selling all 1,000 shares several months later for £2.00 each.

The capital gain generated on their investment would be:

(1,000 x 2.00) – (1,000 x 1.70)

= 2,000 – 1,700 = 300

The investor has made a capital gain of £300 on the transaction.

The investor would be permitted to offset any costs including brokerage charges and stamp duty against this profit for tax purposes. For example, if the investor had incurred a £25 cost in trading charges and other overheads, the gain potentially subject to CGT would be £275.

Candidates will be aware that individuals may suffer losses, as well as make gains, from their investment transactions. In the event of a net loss in a fiscal year, individuals may carry forward such losses to be offset against gains in future fiscal years. There is no limit on the number of years that such losses may be carried forward.

To calculate the amount of gain that may be subject to CGT, an individual will need to ascertain the purchase price of the shares that have been sold. If the shares have been bought in one tranche, that would be simple, but shares may have been accumulated over a period of time. HMRC has a set of rules that must be followed to identify which acquisitions should be allocated to a sale.

These are known as the matching rules, and are applied in the following order:

1. Acquisitions on the same day as the sale.
2. Acquisitions during the 30 days following the sale on a first-in, first-out basis.
3. Shares bought at any other time. All shares acquired prior to the day of the sale, of the same share class in the same company, are pooled together. This is called a **Section 104 holding**.

The cost of any given share in a Section 104 holding is calculated by dividing the total amount paid for shares in the Section 104 holding by the number of shares.

Example

An investor buys 5,000 shares in March 2017 for £4,000. In August 2020, the investor buys another 7,000 shares of the same type in the same company for £6,000.

This will create a Section 104 holding of 12,000 shares at a cost of £10,000 (ie, price per share = £0.83)

In May 2025, the investor chooses to sell 4,000 shares from this Section 104 holding. Thus, the proportion of the Section 104 holding that is being sold is 4,000 ÷ 12,000.

For CGT purposes, the cost of the assets being sold is this proportion of the total cost:

10,000 x (4,000 ÷ 12,000) = £3,333.33.

There is one exception to this. Shares held on 31 March 1982 are valued at the price on that day and not at the original cost.

1.3.2 CGT Rates and Reliefs

Every individual has an annual exempt amount before they start to pay CGT. For 2025–26 this is £3,000 for individuals, personal representatives and trustees for people with disabilities, and £1,500 for other trustees.

Investment gains above this amount are taxed as follows:

- 18% for basic rate taxpayers.
- 24% for higher and additional rate taxpayers.
- 24% for trustees and the personal representatives of someone who has died.
- 14% for gains qualifying for business asset disposal relief (BADR).

BADR allows individuals and some trustees to claim relief on qualifying gains made on the disposal of all or part of their business, provided the person was a sole trader or partner, and had owned the business for at least two years prior to the sale.

1.4 Inheritance Tax (IHT)

1.4.1 Introduction

Inheritance tax (IHT) is usually paid on an estate when somebody dies. It is also sometimes payable on trusts or gifts made during someone's lifetime. There is a minimum threshold of £325,000, so no inheritance tax is payable on an estate worth less than this value. In addition, if a family home is being passed on to children or grandchildren, this threshold can increase to £500,000. Where the value of the estate exceeds the threshold, IHT is payable at 40% on the excess.

Married couples and registered civil partners can effectively double the threshold on their estate when the second partner dies. If the estate was passed to the surviving spouse, the unused IHT threshold or 'nil rate band' can be applied upon the death of the second spouse or civil partner when they die.

1.4.2 Reliefs

Even when an estate is over the threshold, sometimes assets can be passed on without having to pay inheritance tax. Also, the government recognises the possibility that an individual might try to reduce the value of their estate upon death by making various gifts prior to their death. The inheritance tax rules include circumstances in which some gifts need to be added back into the value of the estate. Key considerations, therefore, include:

- **Spouse or civil partner exemption** – the estate usually does not owe inheritance tax on anything left to a spouse or civil partner who has their permanent home in the UK, nor on gifts made to them during the deceased's lifetime, even if the amount is over the threshold.
  This exemption is also important for income tax and CGT planning for unwrapped accounts. It means that an individual who is a higher rate taxpayer and/or has used up their annual CGT can transfer assets to their spouse (who may be a non-taxpayer or a basic rate taxpayer) without penalty.
- **Charity exemption** – any gifts made to a qualifying charity, during the lifetime or in the will, will be exempt from inheritance tax.
- **Potentially exempt transfers** – if the benefactor survives for seven years after making a gift to someone, it is generally exempt from inheritance tax, no matter what the value.
- **Annual exemption** – individuals can give up to £3,000 away each year, either as a single gift or as several gifts adding up to that amount; they can also use any unused allowance from the previous year, but they must use the current year's allowance first.
- **Small gift exemption** – individuals can make small gifts of up to £250 per person to as many individuals as they like tax-free. Note these small gifts are not included in the annual exemption allowance.
- **Wedding and civil partnership gifts** – gifts to someone getting married or registering a civil partnership are exempt up to £1,000 per person (or higher figures for your own children or grandchildren). Note that wedding and civil partnership gifts are separate from the annual exemption allowance.

1.5 Transaction Taxes

Transaction taxes are triggered by trading in specified assets, eg, trading shares, or the sale of a property. In the UK, **Stamp Duty Reserve Tax (SDRT)** is a tax applied to trading in securities. Separate taxes are applicable when purchasing or leasing land or property, and are sometimes payable on transfers of ownership of property or land when no money is exchanged.

1.5.1 Stamp Duty Reserve Tax (SDRT)

SDRT is payable on purchases of:

- shares in a UK company (though not on CIS units/shares bought from the fund manager)
- shares in a foreign company with a share register in the UK
- options to buy shares
- rights arising from shares already owned, and
- an interest in shares, like an interest in the money made from selling them.

The current SDRT rate in the UK is 0.5% (for purchases costing £1,000 or more).

Most trades in listed UK securities are settled through the CREST system, which automatically deducts SDRT from chargeable trades and pays over the tax to HMRC. If the transaction is performed off market, then the individual must account for their own SDRT.

1.5.2 Land and Building Taxes

Devolution within the UK means that three different types of land transaction tax now apply:

- **England/Northern Ireland** – Stamp Duty Land Tax (SDLT).
- **Scotland** – Land and Buildings Transaction Tax.
- **Wales** – Land Transaction Tax.

While these land taxes may be applicable to an investor, it is unlikely that a platform will be involved in calculating any tax amounts due.

Tax is generally payable on the purchase or transfer of property or land when the amount of a property transaction is above a certain threshold. Most UK land and property transactions must be notified to the government within a certain time limit, even if no tax is due.

2. Tax Implications for Wrapped Accounts

Learning Objective

7.1.2 Understand the tax advantages of the following wrapper types: ISAs; pensions; insurance bonds

The use of a tax wrapper will reduce the types of tax that may be payable. While no form of tax wrapper can mitigate the need to pay stamp duty, individual wrappers assist in mitigating income tax and CGT liabilities.

The following table summarises how individual wrappers assist in this:

Wrapper	Income tax on contributions	Income tax within the wrapper	CGT within the wrapper	Income tax on withdrawals
ISAs	No effect – contributions are paid from taxed income (A LISA government bonus is not related to tax)	No liability	No liability	No liability (Lifetime ISA (LISA) withdrawal charge is distinct from income tax)
Personal pension or self-invested personal pension (SIPP)	The investor suffers no income tax on pension contributions within their annual allowance	No liability	No liability	Up to 25% of fund value (to a maximum of £268,275) can be withdrawn as tax-free cash. Any withdrawals in excess of this are taxed at the investor's marginal rate
Insurance bonds	No effect – contributions are paid from taxed income	Paid by the insurer to the tax authority in the country of domicile. For offshore bonds the amount payable may be zero or minimal	Paid by the insurer to the tax authority in the country of domicile. For offshore bonds the amount payable may be zero or minimal	Higher-rate taxpayers may incur a liability upon withdrawal or surrender. However, 5% of the initial investment sum may be withdrawn each year without crystallising an income tax liability, and this allowance can be carried forward if unused. Higher-rate taxpayers may be able to mitigate any remaining liability through 'top-slicing relief' (effectively sharing the realised gain over a number of tax years)

2.1 Tax Planning

Learning Objective

7.1.3 Understand how investment bonds are used within tax planning

The taxation applicable to bonds is complex, because the treatment changes depending on how and when the bondholder chooses to receive gains from the investment.

One key aspect of using investment bonds is that up to 5% of the investment can be withdrawn each year as income without that amount being subject to UK income tax in the year it is received. Therefore, an investment bond can be used to provide an additional income stream that is non-taxed at the point of receipt.

If the 5% amount is not used up in any given year, any remainder is carried forward to the following year (up to 10% after two years; up to 15% after three years).

If, in any given year, the investor withdraws more from an investment bond than the tax-free amount available, then the 'excess' figure withdrawn is taxable as a gain in that tax year. Note that the taxable gain in this context is the value of the excess amount received (ie, the amount that exceeds the cumulative tax-free amount available), rather than the amount by which the bond has increased in value; as such, the tax liability arising on a partial surrender will often be substantial.

The above describes the position for partial surrenders from a bond. However, the taxation approach is different at full surrender (whether the holder's death or transfer of the policy for value). The taxable gain at full surrender is calculated as:

$$\text{Current value } + \text{Previous withdrawals} - \text{Initial investment} - \text{Previous excesses}$$

Note that this calculation includes any previous withdrawals made from the bond. Effectively, the tax due on the income previously taken as partial surrenders in previous tax years has simply been deferred to the maturity/full surrender of the bond.

You will note that the above treatment of an excess creates an artificially high tax liability, compared with the tax liability arising at full surrender, and so, many investment bond providers adopt a process of segmentation by which the investor actually buys a large number of small bonds (segments) rather than a single large bond. In this way, if the investor unexpectedly needs to make a large withdrawal, they can fully surrender a number of segments (paying a gain on the investment return only) rather than partially surrendering above the tax-free level available and being taxed on the value of the excess sum withdrawn.

The above can make bonds a flexible way of achieving ongoing income while deferring and minimising the associated tax liability.

There are additional tax considerations for investment bonds relating to the way the bonds are held. Bonds may be held in a trust, in which case there can be liability for the settlor, beneficiaries, or trustees. One approach used by some firms is the 'discounted gift trust' (sometimes used by elderly people seeking to leave assets for grandchildren). However, the tax implications for different parties in a trust setting are complex and are outside the scope of this workbook.

3. Tax Vouchers and Reporting Fund Status

3.1 Tax Vouchers

Learning Objective

7.1.4 Understand the content of tax vouchers

As we have seen, various types of tax liability can arise from transactions in investment assets. Some of these liabilities are managed by the firm during the course of business while carrying out its client's instructions (such as paying stamp duty on relevant equity trades).

For many years, it was usual that standard rate income tax would be automatically deducted from investment income being passed down the custody chain. A tax amount would be deducted at source with that information being passed on to each entity in the custody chain. In order that each recipient could correctly account for the income on both a net and gross basis – and accurately reflect the tax that had effectively already been suffered to avoid inadvertently paying the tax a second time – it was common for **tax vouchers** to be issued.

A tax voucher would record the income paid and confirm the amount of tax that had already been paid. The investor could then use that information to populate their own tax calculation and establish whether they had any further tax obligation (such as if a higher-rate taxpayer received income that had already been taxed at 20%).

In recent years, the creation of extra personal allowances for different types of investment income has resulted in far more types of income being paid gross (without any tax amount being withheld). While the investor receiving such income still needs to know the details of the income received in order to calculate any tax due, it is less common for such information to include details of tax already paid.

Many firms, however, continue to talk of tax vouchers as being the way to communicate this information on investment income received, regardless of whether any tax has already been paid on the investment. It is therefore important that a platform's administration function can correctly reflect on an investor's tax voucher the income that has been received.

The key information that an investor needs to receive is:

- the gross amount of income to which the holder is entitled (whether paid out or reinvested)
- any tax already suffered on the income (note: this was more common prior to the introduction of the personal savings allowance), and
- for income received on CIS units, whether any proportion of the income entitlement represents equalisation (as any such amount would be treated as a return of capital).

Note that distributions paid by property authorised investment funds (PAIFs) can include up to three different sources of income – property income, interest income and dividends – and the tax voucher must separate them (and any associated tax credits and tax deductions) to ensure accurate treatment.

If the investor holds an **offshore fund** with reporting fund status, they may need to include additional income information in their tax calculation.

3.2 Reporting Fund Status

Learning Objective

7.1.5 Understand the tax treatment of offshore funds with Reporting Fund status

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An offshore fund is defined in UK tax legislation. Broadly, such a fund is an investment scheme of which the trustees or operators are not resident in the UK (for example, unit trusts operated under Jersey laws, or SICAVs (société d'investissement à capital variable domiciled in many EU jurisdictions).

The tax treatment of UK-resident investors in an offshore fund will depend on whether the fund has been granted **reporting fund** status. UK resident investors can benefit by investing into a reporting fund, as the disposal of such investments is treated as a capital gain and subject to a maximum rate of tax of 20%. This compares favourably to a disposal of an investment in a non-reporting fund which is taxable as income (which would require an additional rate taxpayer to pay 45% tax on disposal). Reporting fund status is, therefore, a key consideration for all offshore funds hoping to attract UK investors.

Note that UK investors in a reporting fund must pay income tax on any income arising in the fund, regardless of whether the income is actually distributed or is merely a 'deemed distribution' of excess reported income (which the investor should include within their income tax calculation).

The regulations require a reporting fund to provide HMRC with a computation of its reportable income for each period of accounting and for each reporting share class. Reporting funds will also be required to make a report available to each investor who is resident in the UK within six months of the end of the reporting period. The report must state the amount actually distributed to investors, the excess of the amount of the reportable income over the amount actually distributed, the dates of distributions and a statement as to whether the fund remains a reporting fund.

This regime presents platform operators with a practical problem. The platform will have sent the investor a tax voucher for the actual income paid by the fund, but it may not learn about any excess reported income until several months after the event.

4. Value-Added Services

Learning Objective

7.1.6 Know the range of additional services that platforms can offer advisers/investors: tax reporting; tax planning; trust and estate administration services

4.1 Tax Reporting and Planning

While most platforms provide a 'consolidated tax voucher' detailing all the income that the investor has received during the year (across all sources), many platforms also offer 'what-if' tools to help manage capital gains arising. Platforms usually supply advisers with a CGT modelling tool that enables them to:

- simulate the sales and purchases that are required for portfolio rebalancing, and calculate the CGT due, and
- explore and model alternative actions.

4.2 Trust and Estate Administration Services

Many platforms offer services which include the following:

- Preparation of **probate valuations** for the estate of deceased clients. A probate valuation is a valuation for inheritance tax purposes as at the date of death.
- Administering trusts. Trusts take many forms, but a popular form of a trust is one whereby grandparents put some of their assets into trust for their grandchildren during the grandparents' lifetime. Assets that are gifted in this way may not become subject to inheritance tax upon the death of the donor. The trust deed would normally be drawn up by a law firm, and the trust might be domiciled in the UK, or in an offshore centre such as Guernsey. If the platform was involved in facilitating the trust, it would normally be viewed as a 'wrapper' within the platform's records.

End of Chapter Questions

Think of an answer for each question and refer to the appropriate section for confirmation.

1. **Which types of income are not taxable?**
   Answer Reference: Section 1.2.1

2. **What is the reduction in the personal allowance for an individual who earns £106,000 in the 2025–26 tax year?**
   Answer Reference: Section 1.2.2

3. **The matching rules form part of which type of tax, and how are they applied?**
   Answer Reference: Section 1.3.1

4. **Why is it necessary to calculate a person's income tax liability before you can calculate their CGT liability?**
   Answer Reference: Section 1.3.2

5. **What steps can a married couple take to minimise Inheritance tax ?**
   Answer Reference: Section 1.4.2

6. **What is a potentially exempt transfer?**
   Answer Reference: Section 1.4.2

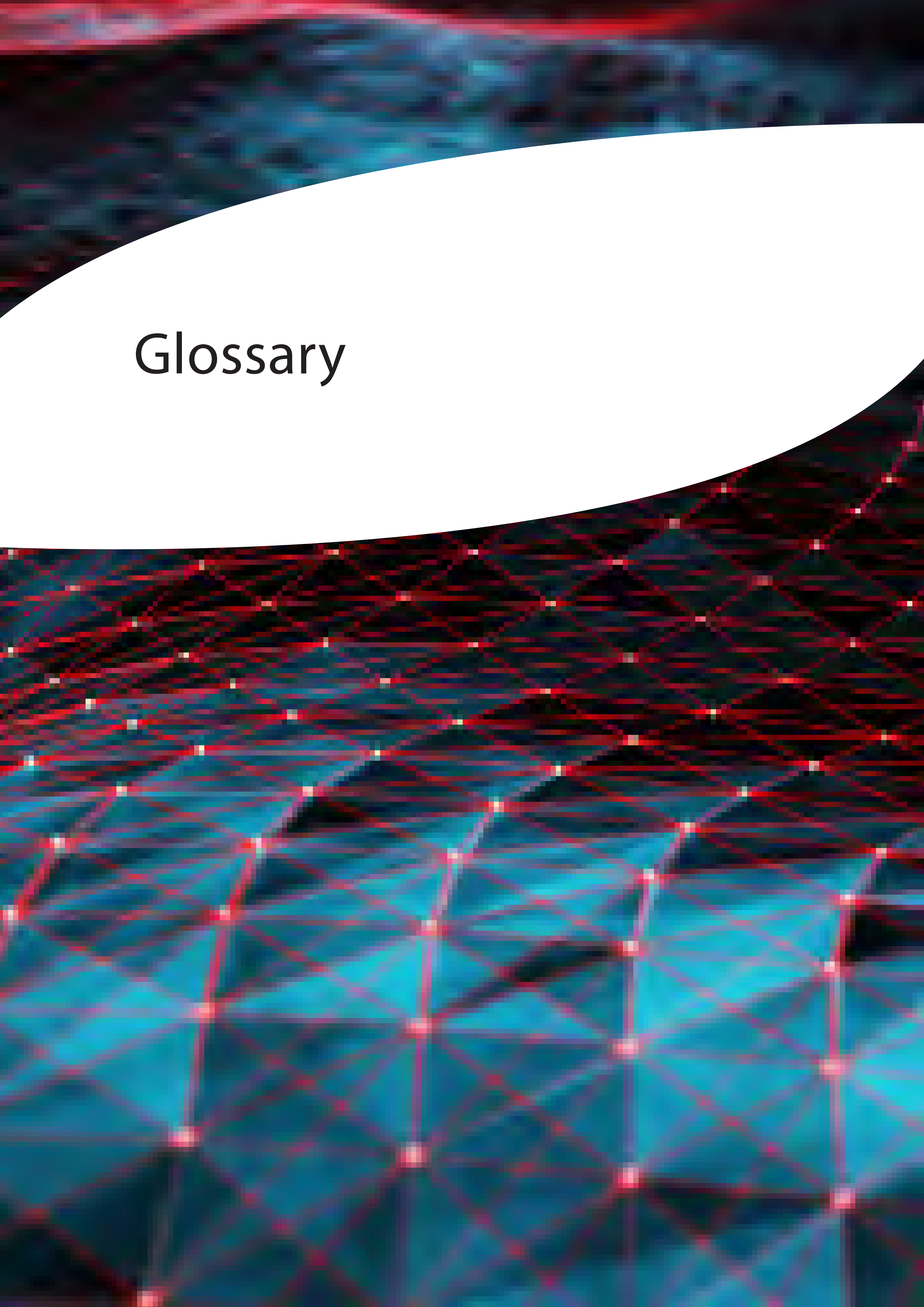
7. **Transactions in what assets give rise to SDRT?**
   Answer Reference: Section 1.5.1

8. **What type of wrapper facilitates unlimited withdrawals without any tax penalties?**
   Answer Reference: Section 2

9. **What type of wrapper allows the investor to redeem up to 5% of the initial amount invested each year without any tax penalty?**
   Answer Reference: Section 2

10. **What type of fund might have 'reporting fund status', and what are the implications for a platform holding that asset?**
    Answer Reference: Section 3.2

Glossary



Accumulation Units/Shares

Units/shares where net income is automatically retained in the price of the units/shares.

Aggregation

The process of consolidating a large number of buy or sell orders from retail clients into a single market order.

Annual Management Charge (AMC)

A charge collected automatically from the scheme property of a collective investment scheme, usually defined as a percentage of the assets under management in the fund.

Annuity

A type of insurance product used to generate an income in retirement. The money saved in a pension product can be used to purchase an annuity, which is generally intended to pay a set level of income until the death of the annuity holder (though some annuities are index-linked, and some will continue until the death of the holder's spouse).

Authorised Fund Manager (AFM)

The role defined in the COLL rules as operating a regulated CIS (either the manager of a unit trust or the authorised corporate director of an OEIC).

Authorised Unit Trust (AUT)

A unit trust scheme authorised by the Financial Conduct Authority. Authorised unit trusts can be offered for sale to the general public.

Benchmark

A standard against which the performance of a security, mutual fund or investment manager can be measured. Generally, broad market and market-segment stock and bond indexes are used for this purpose.

Beneficial Owner

The person or entity who ultimately benefits from the asset. See also *Registered Owner.*

Best Execution

Term used to describe the obligation on a firm to achieve the best possible result when transacting on behalf of a client.

Bonds

Bonds are essentially IOUs; the issuer of the bond receives money from the initial buyer of the bond and undertakes to pay the holder of the bond regular interest and then return the money (the capital) at a particular future date. The regular interest rate that is paid by the issuer is known as the coupon rate, and the date on which the interest is paid is known as the coupon date.

Capital Gains Tax (CGT)

Capital gains tax is payable by the individual taxpayer at the rate equivalent to the taxpayer's highest rate of tax on gains arising from the sale of securities and other assets.

Cash ISA

A type of ISA that can contain a range of cash deposits and similar assets. Withdrawals are permitted without any restriction.

Central Securities Depository (CSD)

An entity which provides a central point for market interactions in a particular security, whether the settlement of transactions or the issuing of new securities.

Client Assets Sourcebook (CASS)

Part of the FCA Handbook covering those rules relating to the processing and control of client money and custody assets.

CISI
CHARTERED INSTITUTE FOR SECURITIES & INVESTMENT

Closed-Ended Fund

An unauthorised CIS or Alternative Investment Fund (AIF) that has a fixed number of shares so is traded on an exchange and priced according to supply and demand.

Collective Investment Schemes (CISs)

Assets that generate an investment return through trading in other assets. Unit trusts and OEICs are the main examples used in the UK.

Collective Investment Scheme Sourcebook (COLL)

Part of the FCA Handbook covering those rules relating to the operation of authorised CISs.

Conduct of Business Rules Sourcebook (COBS)

Part of the FCA Handbook covering those rules relating to the conduct of business by companies authorised by the FCA to conduct investment and other business under FSMA.

CREST

Computerised system for the transfer of financial instruments such as bonds and equities traded on the London and Dublin Stock Exchanges.

Custodian

A financial institution performing the regulated activity of 'safeguarding and administration of investments'. This includes holding the assets for its clients, and managing the rights associated with those holdings (such as income events and other corporate actions).

Defined Benefit (DB) Pension Scheme

A pension scheme established by a sponsor (such as an employer) where each member is guaranteed a specific income (normally related to their salary). If the scheme has insufficient assets to pay this income, then the shortfall has to be met by the sponsor. See also *Defined Contribution (DC) Pension Scheme*.

Defined Contribution (DC) Pension Scheme

A pension scheme where each member's income at retirement is dependent upon the contributions made and the performance of the assets purchased. Sometimes known as a Money Purchase Arrangement. See also *Defined Benefit (DB) Pension Scheme*.

Derivative

Financial instrument whose value is dependent upon the value of another asset (or basket of assets). Examples include traded options and financial futures.

Discretionary Investment Manager (DIM)

An investment manager that makes the buy/sell decisions without referring to the account owner (client) for every transaction. The manager, however, must operate within the agreed-upon limits to achieve the client's stated investment objectives.

Equities

Equities, or shares, are direct investments in companies. Holding shares in a company is the same as having an ownership stake in that company.

Exchange-Traded Fund (ETF)

An investment fund traded on a global stock exchange in the same manner as a typical equity. The price of an ETF reflects the value of its investment portfolio.

Financial Conduct Authority (FCA)

The UK regulator overseeing the conduct of retail and wholesale financial business and market regulation for all firms, and prudent regulation of all firms not prudentially regulated by the Prudential Regulation Authority (PRA).

Financial Ombudsman Service (FOS)

An independent service to investigate unresolved complaints against UK-regulated firms.

Financial Services Compensation Scheme (FSCS)

The UK's statutory scheme to compensate customers of authorised financial services firms if that firm is unable to honour its obligations to those clients.

General Investment Account (GIA)

A type of wrapper which offers no preferential tax treatment. This type of account is usually available to all private individuals, as well as charities, and may be operated in joint names (eg, married couples or business partners).

Gilts

Bonds issued by the UK government.

Group 1 Units/Shares

CIS units/shares that the holder purchased in a previous accounting period (and on which any return of capital due has already been effected).

Group 2 Units/Shares

CIS units/shares that the holder purchased in the most recent accounting period (and on which no return of capital has yet been made).

HM Revenue & Customs (HMRC)

The branch of the UK government that administers and collects tax from individuals and companies.

Independent Financial Adviser (IFA)

A financial adviser who selects investments from the complete range of product providers who offer products in the sector in which the adviser specialises.

Individual Savings Account (ISA)

A form of investment wrapper created by the government and allowing tax-efficient investment. Multiple types of ISA products now exist, each having slightly different rules, with the investor having an annual subscription limit which caps the total value that can be subscribed into ISA products during that tax year.

Initial Charge

A charge which may be applied to new investment in a CIS, calculated as a percentage of the price. For a dual-priced CIS, the initial charge is included within the offer price; for a single-priced fund, the initial charge would be in addition to the quoted price.

Insured Personal Pension

A type of personal pension scheme offered by an insurance firm, allowing investors to invest in a set range of investment funds.

Investment Bond

A single premium life insurance policy that has a small element of life insurance that is paid out after the insured person's death.

Investment Objectives

The reason why an investor is investing. For example, it might be to increase income, grow capital or plan for future events, such as the need to pay-off a mortgage or to fund retirement.

Investment Trust

A form of collective investment found mostly in the UK. Investment trust shares are traded on stock exchanges, like those of other public companies.

Junior Individual Savings Account (JISA)

A type of ISA, which can be opened by the parents of children up to age 16 (and by the child themselves between the ages of 16 and 18). Withdrawals are not permitted until the JISA matures (on the child's 18th birthday).

Lifetime ISA

A type of ISA specifically designed to help people save for a first-time property purchase, with various features not present in other types of ISAs.

Model Portfolio

A pre-defined allocation of assets designed for a specific set of targets and objectives and level of risk, which can be adapted for any investor who has the same desired outcomes.

Net Asset Value (NAV)

This is the value of the underlying shares held in the portfolio, based on quoted mid-market prices, together with other assets, less liabilities divided by the number of shares in issue.

Nominee or Nominee Company

A legal entity which is specifically set up to hold investments on behalf of others.

Non-Complex Financial Instrument

Any type of asset which satisfies the regulatory criteria so that an appropriateness test need not be conducted when dealing in the asset for a client.

Offshore Bond

A type of insurance bond where the product is created and domiciled in locations outside the UK where companies can offer customers growth on their funds that is largely free from tax.

Offshore Fund

An investment scheme of which the trustees or operators are not resident in the UK.

Onshore Bond

A type of insurance bond where the product is created and domiciled in the UK.

Open-Ended Investment Companies (OEICs)

OEICs (pronounced 'oiks') are companies that are established for collective investment purposes.

Pension Input Amount

The total gross contributions made into a pension scheme by an individual and any third-party (such as an employer) during a pension input period.

Personal Pension Scheme (also known as Personal Pension Plan)

A UK tax-privileged individual investment wrapper, with the primary purpose of building a capital sum to provide retirement benefits (although it will usually also provide death benefits).

Platform Operator

A regulated firm that provides a platform service.

Platform Service

A service that involves arranging, safeguarding and administering investments, and distributing retail investment products that are offered to retail clients by more than one product provider.

Portfolio Rebalancing

The process of realigning the weightings of a portfolio of assets. Rebalancing involves periodically buying or selling assets in your portfolio to maintain the original desired level of asset allocation.

Probate Valuation

A valuation for inheritance tax purposes as at the date of death.

Product Providers

A company that creates and markets ISAs, pensions and other wrappers made available on a platform. The term also applies to the operator of packaged financial products such as unit trusts and OEICs.

Property Authorised Investment Fund (PAIF)

A PAIF is a form of open-ended investment fund whose investment portfolio comprises predominantly real property or shares in UK real estate investment trusts (REITs) and similar entities. PAIFs can have up to three different sources of income: property income, interest income and dividends.

Prospectus

Every CIS is required to have a prospectus. It contains details which investors and professional advisers would reasonably require before making a judgement about the merits of investing in a company.

Real Estate Investment Trust (REIT)

A type of closed-ended investment trust specialising in the ownership of real estate (which will often operate those properties) to generate investment returns. UK REITs must distribute 90% of their income to investors, be UK resident, and be publicly listed on a stock exchange recognised by the FCA.

Reduction in Yield

Term to describe the effect of charges upon the investment returns realised.

Register

A list of the shareholders of a company or unit trust.

Registered Owner

The person or legal entity who is registered in a share register as being the owner of the asset. See also *Beneficial Owner*.

Regulated Market

An investment exchange allowing particular assets to be bought and sold by members of the exchange on behalf of their customers.

Reporting Fund

A type of offshore bond where HMRC regulations treat the disposal of part of the holding as a capital gain.

Risk Profile

A methodology used by financial advisers to measure a client's appetite for risk.

S32 Buyout Bond

A pension transfer plan scheme where part of a DC company pension scheme is transferred to a scheme in the name of the individual members. No additional pension contributions can be paid in a S32 Buyout scheme.

Section 104 Holding

A person's total holding of a particular share, regardless of the number of transactions which have resulted in that balance. The average purchase price of the Section 104 Holding is used to calculate capital gains tax liability when selling that share.

Segregation

In respect of client asset rules, the need to physically and legally separate client safe custody assets (including client money) from the firm's own assets.

Self-Invested Personal Pension (SIPP)

A type of UK government-approved personal pension scheme which can allow the member to invest in a wide range of investments approved by HMRC.

Senior Management Arrangements, Systems, and Controls sourcebook (SYSC)

Part of the FCA Handbook covering those rules relating to the governance arrangements for a regulated firm.

Service Level Agreement (SLA)

Part of a service contract in which a certain level of service is agreed upon.

Share Incentive Plan

A tax-efficient means by which employees can become shareholders in their employer's company.

Stamp Duty Reserve Tax (SDRT)

A taxation charge which applies to agreements for the sale of securities if the transfer of ownership does not require a stock transfer or other stampable instrument.

Stocks & Shares ISA

A type of ISA that can contain a range of qualifying investments. Withdrawals are permitted without any restriction.

Straight-Through Processing (STP)

Working practices and systems that enable transactions to move seamlessly through the processing cycle, without manual intervention or redundant handling.

Tail Swallowing

The process of selling some proportion of the rights granted to an investor in a rights issue in order to take up the remainder of the rights without the investor having to pay any cash.

Tax Voucher

A document sent to an investor that shows the amount of income to which the holder is entitled (whether paid out or reinvested) and the value of the tax credit due to the investor or, in the case of an interest distribution, the amount of income tax deducted.

Valuation Point

The date and time at which the NAV of an open-ended fund is calculated, which enables the dealing prices to be determined.

Venture Capital Trust (VCT)

A highly tax-efficient UK closed-end CIS designed to provide private equity capital for small expanding companies, and capital gains for investors. VCTs are companies that are listed on the London Stock Exchange that invest in other companies which are not themselves listed.

Wealth Manager

A private client stockbroker or private bank providing an investment management service.

Web Portal

A dedicated web page to enable a user to access information from a supplier firm (such as a platform operator).

Wrapper

A financial services product, defined by terms and conditions, in which an investor might hold and trade assets. Most wrappers available on a platform will enable some form of tax exemption/ tax efficiency.

Multiple Choice Questions

Multiple Choice Questions

The following questions have been compiled to reflect, as closely as possible, the standard that you will experience in your examination. Please note, however, they are not actual exam questions.

1. **Section 32 of the Finance Act 1981 attempted to give flexibility to pension arrangements in the light of what underlying change?**

   A. Employers closing or changing their defined benefit schemes

   B. The Retail Distribution Review (RDR) banning commission payments

   C. The introduction of automatic enrolment to workplace pensions

   D. The introduction of pension drawdown

2. **Mr Smith is 43 years old and wishes to open a Lifetime ISA. Which of the following best describes the position?**

   A. Mr Smith simply needs to apply to a LISA manager

   B. Mr Smith can save using a LISA, but cannot use the savings to purchase a house

   C. Mr Smith can save using a LISA, but will not receive any government bonus

   D. Mr Smith cannot open a LISA

3. **The process of consolidating a large number of relatively low-value buy or sell orders from retail clients into a single order that can be serviced by the destination firm is called:**

   A. modelling

   B. settlement netting

   C. order netting

   D. aggregation

4. **The HMRC rules concerning PAIFs require these funds to:**

   A. pay their income as a dividend distribution

   B. split their income into three types of source for tax reporting purposes

   C. offer income accumulation rather than income units

   D. gain reporting fund status

5. **In respect of STP transactions, what does 'API' stand for?**

   A. Automated Processing Initiative

   B. Accelerated Parameter Identification

   C. Assisted Portfolio Index

   D. Application Programming Interface

6. **Which of the following best describes the implications of fund suspension on a platform?**

   A. All orders already submitted to the AFM will be accepted, but no further trades can be instructed

   B. The platform is allowed to submit further trade orders to the AFM, and the AFM must store these in a queue

   C. The AFM will decide whether or not it stores trade orders in a queue while the fund is suspended

   D. Regulations prevent a platform from accepting and issuing trade orders for a fund that has been suspended

7. **Which of the following would NOT form part of a firm's 'value assessment' under the Consumer Duty?**

   A. The costs incurred by the firm in providing its products/services

   B. Whether the firm's price would be considered an outlier if compared with general rates and charges available in the market

   C. Whether the charges applied for one of the firm's products differ from those of a similar product offered by the firm

   D. A regular customer satisfaction survey

8. **The FCA requires firms to provide retail clients with which set of general information about the firm?**

   A. The name and address of the firm, the name of the individual who is responsible for managing this client's business and the name of the body that regulates the firm

   B. The name and address of the firm, the contact details necessary to enable a client to communicate effectively with the firm and the name of the body that regulates the firm

   C. The name and address of the firm, the contact details necessary to enable a client to communicate effectively with the firm and a statement that telephone calls may be recorded

   D. The name and address of the firm, the name of the individual who is responsible for managing this client's business and a statement that telephone calls may be recorded

9. **The CASS rules require a platform that never holds assets on its own premises to perform which of the following checks and reconciliations of customers' assets?**

   A. Internal custody record check and physical asset reconciliation

   B. Internal custody record check and external custody reconciliation

   C. External custody reconciliation and physical asset reconciliation

   D. Internal custody record check and 'total count' check

10. **Which of the following would be described as 'rebalancing'?**

    A. Exercising a right under a corporate action

    B. Re-registering assets between spouses to benefit from tax allowances

    C. Selling assets and buying others in order to benefit from lower costs

    D. Performing transactions to align a set of investments with a model portfolio

11. **How often must an internal custody record check be performed?**

    A. Daily

    B. As often as is necessary, but at least once a month

    C. As often as is necessary, but at least once every three months

    D. As often as is necessary, but at least once every six months

12. **Which of the following would you most expect to be included in a KPI dashboard view for a technology service?**

    A. Breaches of SYSC

    B. Complaints referred to the FOS

    C. Contact details of key vendors

    D. Average numbers of users or transactions

13. **You have been informed that ABC High Income is about to convene a meeting seeking approval from its investors to convert into an OEIC. As a platform operator, what is the first step you need to take?**

    A. Immediately perform a corporate action in your own system converting the holding from the unit trust to the OEIC

    B. Schedule a corporate action in your own system converting the holding from the unit trust to the OEIC to be performed on the target date

    C. Pass on the details of the event to the decision-makers and ask for their instructions

    D. Do nothing until you receive confirmation that the event will take place

14. **Which of the following is an example of tail swallowing?**

    A. New shares cost £7, rights are trading at £1.75. Investor sells four rights and buys one share

    B. New shares cost £7, rights are trading at £1,40. Investor sells two rights and buys two shares

    C. New shares cost £7, rights are trading at £2. Investor sells all their rights and does not acquire new shares

    D. New shares cost £7, rights are trading at £3. Investor takes up all their rights

15. Which of the following lists of investments incur no tax charge when held in a SIPP?

A. Stocks, shares, futures and options listed on a recognised exchange; gold bullion; works of art; and unauthorised unit trusts

B. Stocks, shares, futures and options listed on a recognised exchange; gold bullion, commercial property ground rents and unauthorised unit trusts

C. Stocks, shares, futures and options listed on a recognised exchange; residential property ground rents; and unauthorised unit trusts

D. Stocks, shares, futures and options listed on a recognised exchange; gold bullion; commercial property ground rents; and works of art

16. From what age can a person generally take benefits from their pension?

A. 55

B. 60

C. 65

D. 65 for women and 68 for men

17. A particular asset is domiciled in Europe and is labelled as a UCITS. Which of the following terms is most likely to describe this asset?

A. Equity

B. SICAV

C. Structured product

D. Pension

18. In what way does an ETF differ from an investment trust share?

A. It is listed on a stock exchange

B. It can be held in an ISA

C. Capital gains are exempt from CGT

D. A seller can redeem their holding in exchange for a proportion of the fund's assets

19. Superb Platforms plc has its own nominee company, Superb Nominees plc, which has appointed Bank of California (CALI) as global custodian. CALI, in turn, has appointed Bank of London as subcustodian for the UK. Which of those entities would be a direct member of CREST?

A. Superb Nominees

B. Bank of California

C. Superb Platforms

D. Bank of London

20. For which of the following reasons might an STP-enabled firm continue to support fax messaging?

A. Fax transmissions have higher reliability

B. Fax machines act as a back-up mechanism if the primary STP was to fail

C. The transmission confirmation message is legally admissible

D. A fax message is less expensive to send

21. When investors purchase CIS units via a platform, whose name would appear on the fund register?

A. CREST

B. The platform operator's nominee

C. The investor in all cases

D. The investor, if the platform is performing aggregated trades

22. COLL rules require CIS redemptions to be settled by which date (assuming all necessary documentation has been provided)?

A. Trade date + three business days

B. Trade date + three calendar days

C. Trade date + four business days

D. Trade date + four calendar days

23. What is the maximum value of a trade that can be settled by the Faster Payments Service?

A. £100,000

B. £250,000

C. £1 million

D. No limit applies

24. What is the purpose of TeX?

A. It carries order and fulfilment messages between platforms and fund managers

B. It detects regulatory breaches within dealing processes

C. It mandates common standards for processing reregistration instructions

D. It mandates common standards for processing and settlement of buy/sell instructions

25. Which statement most accurately describes the income that is distributed to holders of accumulation units or shares in a CIS?

A. The income is automatically reinvested in the fund and, as a result, the price of the units does not fall. The income is still, however, subject to income tax in the tax year when it was distributed

B. The income is automatically reinvested in the fund and, as a result, the price of the units rises. The income is not subject to income tax but is added to the cost of the units/shares for CGT calculation purposes

C. The income is automatically reinvested in the fund and, as a result, the investor is allocated further units/shares. The income is still, however, subject to income tax in the tax year when it was distributed

D. The income is automatically reinvested in the fund and, as a result, the investor is allocated further units/shares. The income is not subject to income tax but is added to the cost of the units/shares for CGT calculation purposes

26. What is 'equalisation'?

A. A mechanism to re-align a portfolio with the investor's original asset allocation

B. The mechanism that resolves safe custody reconciliation differences

C. A mechanism to recognise part of a distribution as being a return of capital rather than income

D. An obligation under RDR to replace commission payments

27. An authorised CIS has been experiencing a high volume of redemptions, and the AFM needs to cancel units due to today's unit dealing activity. If the investment manager confirms to the AFM that the fund's assets are not sufficiently liquid to complete the cancellation (without selling at a substantial loss), which of the following techniques might the AFM apply?

A. Implement soft closure

B. Implement a queued redemption policy

C. Implement hard closure

D. Implement a deferred redemption policy

28. A customer holds a life assurance policy on your platform, and the insurer has become insolvent. What is the maximum amount that the investor could claim from the FSCS?

A. 100% of the first £50,000 of the loss

B. 90% of the actual loss with no upper limit

C. 90% of the first £50,000 of the loss

D. 100% of the actual loss with no upper limit

29. Which of the following investors does NOT qualify for compensation from the FSCS?

A. Charity A, which has assets of £3.18m, 44 employees and a turnover of £6.15m pa
B. Private investor B who is a UK citizen and resident, who has an annual income of £6.7m
C. Company C, which has assets of £3.22m, 40 employees and a turnover of £6.25m pa
D. Charity D, which has assets of £5.2m, 49 employees and a turnover of £10.3m pa

30. Which of the following types of instruction would NOT be carried via an STP message?

A. Notification of an investor's death
B. Reregistration
C. Holdings and/or valuation information
D. Buy/sell orders

31. Following a transaction in a CIS, the message that forms the starting point for the disaggregation process in a platform's records is the:

A. acknowledgement of receipt of the order message by the message carrier
B. acceptance of the order by the platform provider
C. settlement of the transaction by the platform's custodian
D. electronic confirmation note issued by the fund manager

32. Which of the following applies where an ISA application is not in writing?

A. The ISA manager will act on the application, and need take no further action unless the investor subscribes in the following year
B. The ISA manager can act on the application, but must receive a signed copy of the ISA declaration from the investor
C. The ISA manager can act on the application, but must provide the investor with a copy of the ISA declaration by email, fax, or post
D. The application must be rejected, as all ISA applications must be completed in writing

33. When an investor purchases units/shares in an authorised fund, part of the price paid is deemed to be a payment for the income that the fund has already earned in the current accounting period. When the fund next distributes income, such money:

A. is known as equalisation, and is repaid to these investors as a return of capital
B. is known as stabilisation, and is repaid to these investors as a return of capital
C. is known as equalisation, and is repaid to these investors as additional income
D. is known as stabilisation, and is repaid to these investors as additional income

34. What aspect of regulation is addressed by CASS 6.3?

A. Client money protection

B. Corporate governance

C. Internal audit

D. Selection and appointment of a custodian

35. Which of the following elements would NOT be considered when determining the reduction in yield?

A. Cost of advice services

B. Tax amounts payable to HMRC

C. Cost of platform services

D. Costs built into the assets

36. Which of the following is a corporate action by which a company splits off a section to be an independent company, and issues shares in that new company?

A. Scrip dividend

B. Demerger

C. Conversion

D. Voluntary

37. Which of the following is a 'time-related' condition of a security transaction order?

A. Limit

B. Fill or kill

C. Stop-loss

D. At best

38. Why do advisers use model portfolios and what do model portfolios try to reflect?

A. Advisers use model portfolios to measure customers' objectives and attitude to risk. Model portfolios try to reflect a particular set of investment objectives and risk appetite

B. Advisers use model portfolios to measure customers' objectives and attitude to risk. Model portfolios try to reflect only one particular benchmark index

C. Advisers use model portfolios to reduce the cost of serving investors and to ensure that all investors with the same objectives have the same outcome

D. Advisers use model portfolios to reduce the cost of serving investors by standardising the risk assessment of its target market

39. Which of the following statements is true about the MWRR?

A. It cannot be used to measure the performance of a fund if transactions have taken place during the period under review

B. It can be used to measure the performance of a fund whether or not transactions have taken place during the period, but might only be calculated through trial and error

C. It can only be used to measure the performance of a fund when multiple transactions have taken place during the period

D. It is the most widely used method of measuring the performance of a fund that has had deposits and/or withdrawals for the period

40. What is the purpose of professional indemnity insurance?

A. It protects firms and individuals against legal claims for negligence

B. It protects firms and individuals who are fined by the regulator for failing to use due diligence when recommending a platform

C. It protects firms and individuals against investment losses

D. It protects firms and individuals from loss upon the failure of a bank or custodian

41. An adviser enters a buy order for an ISA wrapper into a platform, but the particular asset entered on the screen is not eligible as an ISA investment. What should the platform's technology do with this order?

A. Accept it, but change the wrapper to the general investment account where there are no restrictions regarding asset class eligibility

B. Notify HMRC

C. Send it to a repair queue where the order can be amended by its instigator

D. Process the order but send a warning message to the instigator

42. If a MiFID firm does not issue contract notes, which type of regulatory reporting would include 'essential information' about an executed trade?

A. Statement of designated investments or client money

B. Periodic reporting

C. HMRC reporting

D. CMAR

43. A UK investor holds a fund asset that has 'reporting status'. What is the taxation consequence if the investor sells this holding?

A. The value is deemed to be income, and taxable at 40% in all cases

B. The fund must be in an ISA or pension wrapper, so no tax will be applicable

C. The investor is liable for 20% tax, regardless of their income level

D. The value is deemed a capital gain, taxable at a maximum rate of 20%

44. A customer is able to take a complaint to the FOS providing that:

A. it is more than eight weeks since the complaint was raised and there has been either no response or an unsatisfactory response. If there has been a response, it was dated not more than eight months ago

B. it is more than six weeks since the complaint was raised and there has been either no response or an unsatisfactory response. If there has been a response, it was dated not more than six months ago

C. it is more than eight weeks since the complaint was raised and there has been either no response or an unsatisfactory response. If there has been a response, it was dated not more than six months ago

D. it is more than six weeks since the complaint was raised and there has been either no response or an unsatisfactory response. If there has been a response, it was dated not more than 12 months ago

45. Following the introduction of the personal savings allowance, savings institutions which pay interest on customer cash balances normally apply which rate of tax to those interest payments?

A. No tax is deducted by the institution

B. Deduct income tax at the basic rate

C. The institution must deduct tax once it has paid the investor more than £5,000

D. The account holder's marginal tax rate

46. What is the personal allowance for 2025–26 for a person living in England and earning £70,000 pa?

A. £2,000

B. £9,000

C. £12,570

D. £50,270

47. Which of the following is a potentially exempt transfer?

A. A gift made to any person during the deceased's lifetime, providing that the giver survives for seven years after the date of the gift

B. A gift made to a qualifying charity during the deceased's lifetime

C. A gift of less than £3,000 made during the deceased's lifetime

D. A transfer of assets between husband and wife

48. What rule applies to unused annual allowance for pension savings?

A. It can be transferred between spouses

B. It can be carried forward to the next tax year

C. It can be carried forward for up to three tax years

D. It cannot be used if a pension transfer takes place

49. Jill placed £300,000 in an investment bond ten years ago and it is now valued at £320,000. No previous withdrawals have been made. What is the maximum amount Jill can withdraw from the bond before the end of year ten without an immediate tax liability?

A. £10,000

B. £15,000

C. £120,000

D. £150,000

50. What amount can be subscribed to a stocks & shares Junior ISA in the 2025–26 tax year?

A. £4,000

B. £4,368

C. £9,000

D. £20,000

Answers to Multiple Choice Questions

1. A Chapter 2, Section 2.3.4

Section 32 of the Finance Act 1981 was an attempt to help give flexibility over pension arrangements while employers were closing or changing aspects of their defined benefit pension schemes. It allowed the accrued rights in the scheme to be traded in for an insurance policy that would pay the holder a particular level of benefit.

2. D Chapter 2, Section 2.1.2

An investor can only open a LISA until their 40^{th} birthday, and can only make subscriptions until they are 50 years old.

3. D Chapter 4, Section 1.1

Aggregation is the consolidation of multiple orders received during the day into a single market order.

4. B Chapter 1, Section 2.2.1

In order to avoid distortion in the tax paid by investors, a PAIF will pay a distribution that contains three distinct streams of income.

5. D Chapter 4, Section 1.5

Application programming interfaces (APIs) are a computerised facility by which the platform's internal systems generate outgoing messages and receive/process incoming messages without manual intervention.

6. C Chapter 1, Section 2.5.2

When a fund is suspended, no buy or sell orders will be actioned (though the fund manager might choose to accept orders and hold them in a queue until the fund reopens). The fund manager should, of course, keep all unitholders and potential unitholders informed of the situation if a suspension becomes necessary.

7. D Chapter 6, Section 4.3

The FCA's non-Handbook guidance highlights certain factors that a firm should consider when performing a 'value assessment' including:

- The costs incurred by the firm in providing its products/services;
- Whether the firm's price would be considered an outlier if compared with general rates and charges available in the market, and
- Whether the charges applied for one of the firm's products differ from those of a similar product offered by the firm.

8. B Chapter 6, Section 1.1.3

Firms must provide retail clients with:

1. the name and address of the firm, and the contact details necessary to enable a client to communicate effectively with the firm
2. the languages in which the client may communicate with the firm, and receive documents and other information from the firm
3. the methods of communication to be used between the firm and the client including, when relevant, those for the sending and reception of orders
4. a statement of the fact that the firm is authorised and the name of the competent authority that has authorised it – in the case of a UK-based platform operator, this would be the FCA itself, but, if the operator was based in another country, this would be the FCA equivalent in that country.
5. the nature, frequency and timing of reports to the client on the performance of the service
6. a summary of the firm's conflicts of interest policy.

9. B Chapter 6, Section 1.3.1

A firm that never held assets on the premises would not need to perform a physical asset reconciliation.

10. D Chapter 3, Section 4.3

Where the model portfolio is pre-loaded into the platform, the platform's technology can automatically calculate the investor-level transactions required – either at the start of the account or subsequently (ie, to ensure that investment levels remain aligned with the chosen model – a process known as 'rebalancing' the portfolio).

11. B Chapter 6, Section 1.3.1

The internal custody record check should be performed 'as often as is necessary' – but at least once a month.

12. D Chapter 3, Section 5.4

Examples of measured values for a technology service that might be included in a dashboard include:

- availability of the application over a period of time (downtime measurement)
- transaction speeds
- response times
- functional errors reported by the system, and
- average number of users or transactions.

13. C Chapter 5, Section 4

When a platform operator receives notice of such a meeting, it needs to pass on the details to its adviser customers and end-investor customers (the decision-makers) and ask for their instructions before attending the meeting and voting on their behalf (known as proxy voting).

14. A Chapter 5, Section 4.2

Tail swallowing involves selling the portion of rights necessary to pay for the rights being taken up. In this way, the net effect for the investor is that they gain some new shares without having to pay any of their own money – though, of course, as a result, their proportionate ownership in the company will reduce. In this question, only 'A' is an example of an investor taking up some of their rights without any cash outlay.

15. B Chapter 2, Section 2.3.1

The assets that are not subject to a tax charge when held in a SIPP are:

- stocks and shares listed on a recognised exchange
- futures and options traded on a recognised exchange and contracts for difference (CFDs)
- carbon credits
- authorised UK unit trusts, OEICs and other UCITS funds
- unauthorised unit trusts that do not invest in residential property
- unlisted shares
- investment trusts subject to FCA regulation
- deposits and deposit interests
- commercial property
- ground rents (as long as they do not contain any element of residential property)
- traded endowments policies, and
- gold bullion.

But SIPP rules exclude residential property and 'exotic' assets like vintage cars, wine, coins, stamps and works of art.

16. A Chapter 2, Section 2.3.1

The investor is able to withdraw value from their pension (known as 'taking benefits'), though they are generally only allowed to do this once they are 55 years of age, and there are specific rules about the income a person receives from their pension.

17. B Chapter 7, Section 3.2

Schemes established in major EU fund centres (such as Ireland or Luxembourg) will commonly be *sociétés d'investissement à capital variable* (SICAVs – investment companies with variable capital). Funds domiciled within the EU may operate according to European Directives such as UCITS or the 'Alternative Investment Fund Manager's Directive' (AIFMD).

18. D Chapter 1, Section 2.1.4

In the event that a seller cannot find someone to buy their ETF shares, it is possible instead for that holder to redeem their portion of the fund's assets (ie, in return for their ETF shares they receive a proportionate amount of the fund's portfolio rather than simply receiving cash).

19. D Chapter 4, Section 2.5.2

In many countries, the registered shares are held within a central securities depository (CSD) – in the UK, this is called CREST. The local subcustodian would have the direct relationship with the CSD of its jurisdiction.

20. B Chapter 4, Section 1.4

Fax messaging is also relevant – either as a primary transmission channel for some firms, or a back-up mechanism in case their STP system experiences difficulties.

21. B Chapter 4, Section 2.2

The AFM will show the platform as holding units (in the name of the platform's nominee company). The fund's register will not feature the names of the platform's clients, although they are all beneficial owners of the units registered to the platform.

22. C Chapter 4, Section 1.7.1

The COLL regulations require CIS redemptions to be settled on the fourth business day following the trade (known as T+4) or once the AFM has received all the duly executed instruments and authorisations to effect the transfer of title back to the AFM.

23. C Chapter 4, Section 1.7.2

The maximum value accepted by the Faster Payments Service is currently £1 million, though each bank imposes its own transaction limit.

24. C Chapter 4, Section 2.4

TeX's purpose is to make electronic transfers between platforms/fund managers accurately, within five working days, using standardised agreements and contracts that are based on STP principles. TeX mandates common standards to cover liability issues, SLAs and a dispute resolution process, and has achieved cross-industry support and agreement to use standard messages to transfer assets and wrappers between platforms of all types.

25. A Chapter 5, Section 2.2.2

For an accumulation unit, the entire income allocation is moved to the capital account of the scheme, where it becomes available for investment purposes. As a result, the unit price of an accumulation class does not fall at the accounting reference date and so the investor does not need to receive additional units because the capital value of the units they already hold now reflects the income they have 'earned'.

26. C Chapter 5, Section 2.2.3

Equalisation is a mechanism by which income 'bought' by an investor during the accounting period of a collective investment scheme is treated as a return of capital rather than as taxable income.

27. D Chapter 1, Section 2.5.1

Deferred redemptions is a technique that allows the AFM of some COLL funds to move forward all redemption instructions received for a given dealing day, so that they will instead be actioned on the following dealing day. There is a separate approach not available to COLL funds, but which might be encountered for other types of fund. Some unauthorised funds may allow the fund manager to queue redemption instructions, processing them over time but in the order they were received.

28. D Chapter 6, Section 8.3

The compensation level for compulsory insurance products (eg, third-party motor insurance policies) and long-term insurance is 100%; for all other policies, it is 90%.

29. D Chapter 6, Section 8.1

The FSCS is available to retail customers that are defined as:

- Private individuals.
- Small charities and small businesses. To qualify, charities and businesses must have assets of less than £5.1 million, not more than 50 employees, and a turnover of less than £10.2 million pa.

30. A Chapter 4, Section 1.5

The range of messages that can be sent includes:

- buy/sell orders
- reregistration
- settlement and trade matching confirmations
- price reporting, and
- holdings and/or valuation information.

31. D Chapter 4, Section 1.5

Once the fund has been valued and the price of the deal is determined, the AFM sends the platform an electronic contract note (sometimes called an electronic confirmation). This message is the starting point for the platform's disaggregation process, by which the bulk transaction is broken down into its constituent transactions for each platform investor.

32. C Chapter 2, Section 2.1.3

Where the application is not made in writing (eg, by telephone or online), the ISA manager must still ensure the declaration is made and evidenced. The declaration should be read back on a telephone application, or replayed on-screen for internet applications. Further, the ISA manager should then email/fax/post to the applicant a copy of the declaration. The investor's signature is not required.

33. A Chapter 5, Section 2.2.3

'Equalisation' is the concept designed to recognise that investors will have effectively 'bought' a portion of the income received, which has tax implications. The equalisation amount is deemed by HMRC to be a return of capital, not income.

34. D Chapter 6, Section 1.3.1

CASS 6.3 requires firms to exercise all due skill, care and diligence in the selection and appointment of a third-party custodian, both when making the initial appointment and also when reviewing the performance of the custodian.

35. B Chapter 3, Section 6.1

The total cost of investing includes three elements:

1. Cost of advice services.
2. Cost of platform services (which may be bundled).
3. Costs built into the assets (eg, the initial charge and AMC of a CIS fund – which may differ between the classes available on differing platforms).

These cost elements may be combined to determine the reduction in yield.

36. B Chapter 5, Section 3.4

A demerger is where one company splits off a section of its corporate structure to become a new independent company, resulting in extra shares in the new company.

37. B Chapter 4, Section 1.3

A 'fill or kill' order is time-related.

38. C Chapter 3, Section 4.3

To avoid the expense of creating individual portfolios for each customer and also to avoid the situation when two clients (both with the same objectives and risk appetite) have portfolios that produce widely different returns, adviser firms employ the concept of model portfolios.

A model portfolio is a pre-selected portfolio of assets with a specific set of targets and objectives and level of risk, which provides a guide for any investor who has the same desired outcomes.

39. B Chapter 3, Section 4.4.1

The MWRR is one method of measuring the internal rate of return of an asset (ie, understanding the extent to which performance of the asset, rather than transactions undertaken, has generated a return for the investor). Unfortunately, if the rate of return is the unknown variable, it is necessary to use trial and error to determine the value of 'r' to satisfy the equation.

40. A Chapter 3, Section 4.8

Professional indemnity insurance protects against legal claims based on negligence.

41. C Chapter 4, Section 1.4

A common approach is for the platform to establish a 'repair queue' to which instructions are routed if for some reason the automated processes stall. Given the need for platforms to ensure trade orders are processed by the next dealing point, the repair queue will be closely monitored, and any items remaining there for too long a time will be escalated to management.

42. B Chapter 6, Section 1.1.5

Essential information is contained on contract notes issued following transactions. Periodic reporting should include most of the 'essential information' fields that would have appeared on any occasional reporting (if the firm had not been managing investments for the client).

43. D Chapter 7, Section 3.2

A UK investor is subject to capital gains tax (at a maximum rate of 20%) on the disposal of a fund with reporting status.

44. C Chapter 6, Section 7

If more than eight weeks from the date of your complaint has passed and you have not received a final response, or you are dissatisfied with the final response you have received (at any stage of the process) you can write to the Financial Ombudsman Service (FOS). You must refer your complaint to the Financial Ombudsman within six months of the date on the final response.

45. A Chapter 7, Section 1.2.3

The savings institution will pay the income to the saver without deducting any tax amount. If the saver owes any tax they must pay the relevant sum through their HMRC Self Assessment.

46. C Chapter 7, Section 1.2.2

In 2025–26, the personal allowance in England is £12,570, though this is reduced by £1 for every £2 the individual earns above a level of £100,000.

47. A Chapter 7, Section 1.4.2

If the benefactor survives for seven years after making a gift to someone, the gift is generally exempt from inheritance tax, no matter the value.

48. C Chapter 2, Section 2.3.2

The rules permit an individual to carry forward any unused annual allowance from the previous three tax years.

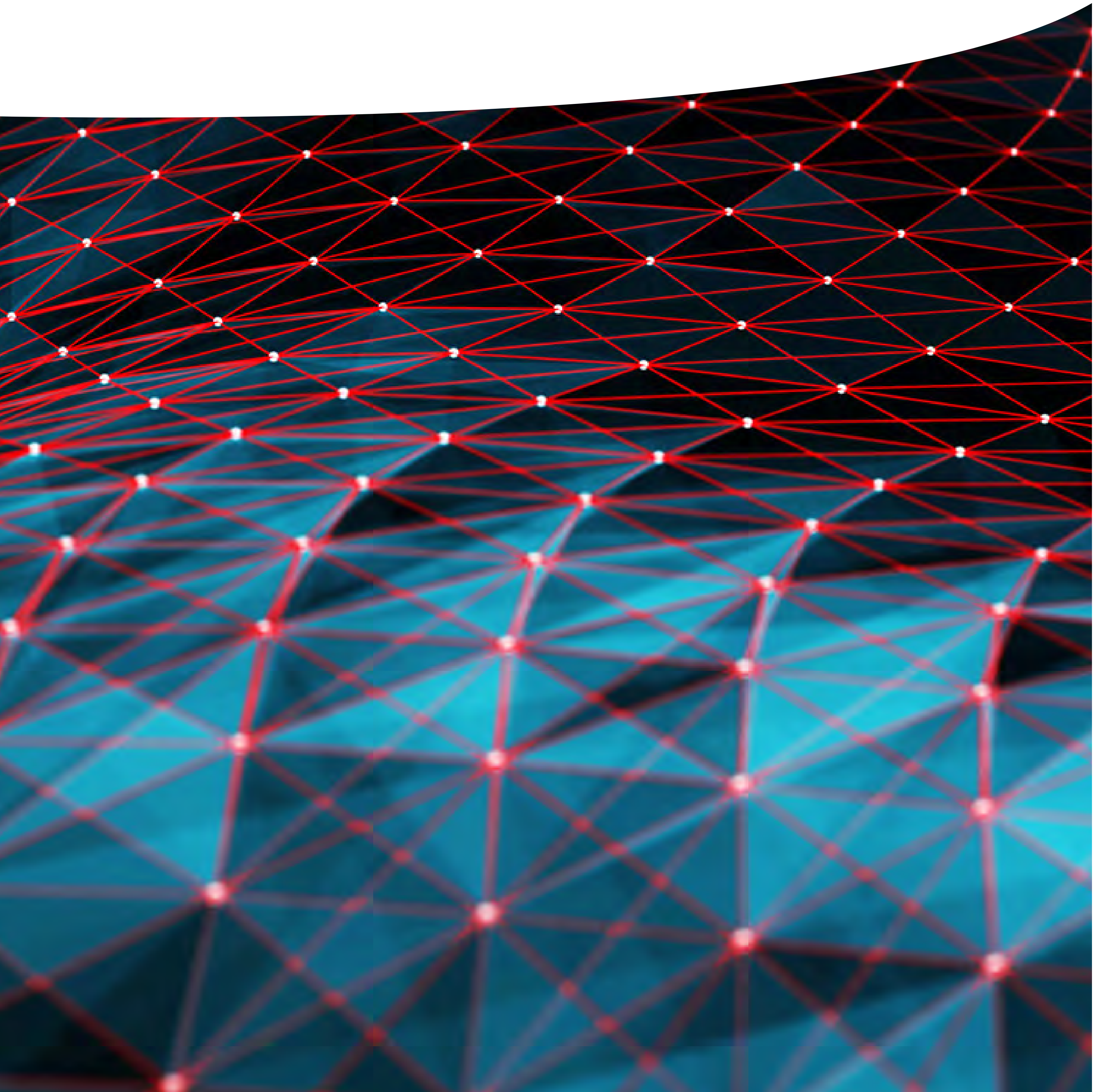
49. D Chapter 2, Section 2.2

The main benefit to an investor of using insurance bonds is that up to 5% of the investment can be withdrawn each year as income without being subject to UK income tax. If this allowance is not used in a particular year, it can be carried forward to the following year.

50. C Chapter 2, Section 2.1.2

The annual allowance for subscriptions into a JISA in the 2025–26 tax year is £9,000.

Syllabus Learning Map



Syllabus Unit/ Element		Chapter/ Section
Element 1	**Platform Assets**	**Chapter 1**
1.1	**Introduction** On completion, the candidate should:	
1.1.1	Know how a platform is structured: • wrappers • assets	1
1.2	**Assets** On completion, the candidate should:	
1.2.1	Know: • the difference between hard and soft closure • the difference between deferred and queued redemptions • the implications for the platform and the client of fund dealing being restricted or suspended	2.5

Syllabus Unit/ Element		Chapter/ Section
Element 2	**Platform Wrappers**	**Chapter 2**
2.1	**Wrappers** On completion, the candidate should:	
2.1.1	Know the range of typical wrappers available: • general investment accounts • protection policies • investment bonds – onshore, offshore • ISAs • pensions	1
2.1.2	Know the regulatory limitations and restrictions associated with these wrappers: • contribution limits • restrictions around withdrawals • restrictions around investment eligibility • restrictions around client eligibility • ISA guidance notes – applications & transfers, subscriptions, investment activity, reporting, void & repair • pension regulations – HMRC Pension Tax Manual (allowances, tax reclaim, investor documentation, member benefits, death benefits, benefit crystallisation events) and FCA requirements (default investment option, investment pathways, cash warnings)	2

Syllabus Unit/ Element		Chapter/ Section
2.1.3	Know the advantages these wrappers provide: • tax treatment of contributions/withdrawals • tax treatment of investments held/income applied within these wrappers • pension drawdown	2.5

Element 3	**The Market and the Platform Service Provider**	**Chapter 3**
3.1	**Platforms in the Market** On completion, the candidate should:	
3.1.1	Understand how platforms support distribution for product providers and investment providers	1.1
3.1.2	Know the range of tools and services that may be provided by a platform	2
3.2	**Charging Structures and Revenue Streams** On completion, the candidate should:	
3.2.1	Know: • the difference between the different charging structures that platforms can apply • the revenue streams that platforms can generate for their owners	3
3.3	**Investment Decisions** On completion, the candidate should:	
3.3.1	Understand: • the appropriateness and suitability requirements • the circumstances in which a platform would block a client from trading in a particular asset	4.2
3.3.2	Understand the principles and application of: • model portfolios • advisers • wealth managers • discretionary investment managers	4.3
3.3.3	Understand the benefits and risks of using model portfolios pre-loaded to the platform	4.3
3.3.4	Know the range of research, portfolio planning and performance measurement tools that platforms can offer	4.4
3.3.5	Know the control processes that firms may implement around platform dealing	4.5
3.3.6	Understand the purpose of portfolio rebalancing	4.6

Syllabus Unit/ Element		Chapter/ Section
3.3.7	Understand the differences between and implications of simultaneous and sequential fund switch tools	4.7
3.3.8	Know how the liabilities that arise from the provision of portfolio and dealing tools is managed by platforms and user firms	4.8
3.4	**Relationships** On completion, the candidate should:	
3.4.1	Understand the structure and importance of a platform's relationship with associated risks, and appropriate governance structures for dealing with: • retail investors • financial advisers • discretionary investment managers	5
3.4.2	Know how the platform operators manage the risks of their various relationships: • custodians • fund managers • wrapper providers • outsourced service providers	5.2
3.4.3	Know the key elements of a Service Level Agreement	5.4
3.5	**Selection of a Platform** On completion, the candidate should:	
3.5.1	Understand the features of platforms that inform the selection process	6.1
3.5.2	Understand adviser's obligations in relation to platform selection, including ongoing due diligence	6.2
3.6	**Customer Agreements** On completion, the candidate should:	
3.6.1	Know: • the purpose and the main content of the platform's customer agreements • the appropriate circumstances for changing a customer agreement	7

Syllabus Unit/ Element		Chapter/ Section
Element 4	**Transactions and Ownership**	**Chapter 4**
4.1	**Context of Transactions** On completion, the candidate should:	
4.1.1	Understand the issues that exist for platform providers in relation to online dealing (cut-off points, volume spikes, timely execution requirements)	1.1
4.1.2	Know the range of dealing that: • may be available for listed securities (live dealing, limit orders, aggregated deals) on different platforms • platforms may provide including portfolio construction and asset allocation	1.1
4.2	**Processing Investor Transactions** On completion, the candidate should:	
4.2.1	Know: • the methods by which investor transactions are executed • the role of market makers, brokers and retail service providers in the trading process	1.4
4.2.2	Know: • the regulatory requirements for settlement • the different methods of settling investor transactions	1.7
4.3	**Ownership of Assets** On completion, the candidate should:	
4.3.1	Know: • the requirements for the establishment, maintenance and contents of the platform's records of asset ownership • who can be recorded as a holder of an investment	2.1
4.3.2	Know: • the requirements for the collection of beneficial holder details • how third party interests are recorded	2.2
4.4	**Custody Services** On completion, the candidate should:	
4.4.1	Understand the different types of custody model and how they are used: • pooled • segregated • multiple nominees • investor's own name	2.3

Syllabus Unit/ Element		Chapter/ Section
4.5	**Transfer Requirements** On completion, the candidate should:	
4.5.1	Know the internal/external transfers that may take place	2.4
4.6	**The Chain of Custody** On completion, the candidate should:	
4.6.1	Know the chain of custody	2.5

Element 5	Asset Servicing	Chapter 5
5.1	**Income events** On completion, the candidate should:	
5.1.1	Know: • the sources of income • the different treatment of income for income and accumulation shares/units • equalisation and the purpose of Group 2 units	2
5.2	**Corporate Actions** On completion, the candidate should:	
5.2.1	Know the obligations of a platform in relation to each type of corporate action	3
5.2.2	Know: • the processes used to communicate, respond to and implement corporate actions • the range of additional services that platforms can offer advisors/investors	4
5.3	**Asset Valuation** On completion, the candidate should:	
5.3.1	Know: • how the value of platform assets is updated • the control processes that platforms may apply in relation to investment pricing	5.1
5.3.2	Understand the impact of pricing errors on client investments	5.2
5.3.3	Understand how platforms value 'legacy' or off-platform assets	5.3

Syllabus Unit/ Element		Chapter/ Section
Element 6	**Regulatory Framework**	**Chapter 5**
6.1	**FCA Regulations** On completion, the candidate should:	
6.1.1	Know the key rules and regulations that apply to services provided by platforms: • COBS – 2.2 and 2.2A Information disclosure before providing services, 6.1 Compensation arrangements, 16 and 16A Reporting information to clients, 11 and 11A – best execution • CASS – 6 custody, 7 client money (including statutory trust and fiduciary responsibilities) • SYSC – Systems and Controls, Record-Keeping, Treatment of shortfall, Business Continuity Planning, Disaster Recovery, Risk Assessment	1
6.1.2	Know the regulatory risks associated with the above	1
6.1.3	Know a firm's obligations in relation to the recording of breaches	1
6.1.4	Understand client categorisation (retail vs professional) and the implications of those designations	1
6.1.5	Know the reporting obligations of platforms in relation to their clients, particularly those set out in COBS 16 & 16A: • durable medium • content and timeliness for occasional reporting • content and timeliness of periodic statements	1
6.1.6	Understand the purpose of target market information	1.4
6.2	**Disclosure and Illustrations** On completion, the candidate should:	
6.2.1	Know the key disclosure information available to investors and their relevance to the type of wrappers and assets: • PRIIPs Key Information Document • Key Investor Information Document • Pre-investment Disclosure Document	2.1
6.2.2	Understand the purpose of illustrations and: • how growth rates are set • why growth rates vary by wrapper and by asset • ex ante costs and charges	2.2
6.2.3	Understand how the effect of charges is different from the level of charges	2.2

Syllabus Unit/ Element		Chapter/ Section
6.3	**Regulatory Reporting** On completion, the candidate should:	
6.3.1	Know the types of regulatory reporting required: • complaints • Payment Services Regulations • Client Money and Asset reporting • transaction reporting • FCA returns	3
6.4	**Conduct Risk and Treating Customers Fairly** On completion, the candidate should:	
6.4.1	Know the outcomes arising from the FCA's approach to managing conduct risk within firms	4
6.4.2	Understand the particular implications for platforms of FCA Consumer Outcomes 3, 5 and 6	4
6.4.3	Know: • the key principles of consumer duty • what constitutes a vulnerable customer • firms' obligations towards customers	4
6.4.4	Know: • what a value assessment is • a firm's obligation with respect to its value assessment	4
6.5	**Data Protection and Information Security** On completion, the candidate should:	
6.5.1	Know the key principles of the Data Protection Act 2018 and information security	5
6.5.2	Know the key elements of an information security policy: • physical • logical • encryption	5
6.5.3	Understand how the Data Protection Act 2018 and information security risks are managed by platforms	5
6.5.4	Know the context and principles of the Digital Operational Resilience Act	5
6.6	**Three Lines of Defence** On completion, the candidate should:	
6.6.1	Understand the principles of the 3 lines of defence model	6

Syllabus Unit/ Element		Chapter/ Section
6.7	**Complaints** On completion, the candidate should:	
6.7.1	Know the regulatory requirements in relation to complaint handling: • timescales required • role of the Financial Ombudsman Service	7
6.8	**Investor Protection** On completion, the candidate should:	
6.8.1	Know the scope of the Financial Services Compensation Scheme (FSCS): • eligible investors • eligible investments • protection limits	8
6.9	**Regulatory Issues when Onboarding Investors** On completion, the candidate should:	
6.9.1	Know the importance of the following to investor onboarding: • anti-money laundering checks • know your customer • sanctions	9

Element 7	Taxation	Chapter 5
7.1	**Taxation and Wrappers** On completion, the candidate should:	
7.1.1	Know which taxes apply to specific investments: • income • capital gains • inheritance • transaction	1
7.1.2	Understand the tax advantages of the following wrapper types: • ISAs • pensions • insurance bonds	2
7.1.3	Understand how investment bonds are used within tax planning	2.1
7.1.4	Understand the content of tax vouchers	3.1
7.1.5	Understand the tax treatment of offshore funds with Reporting Fund status	3.2

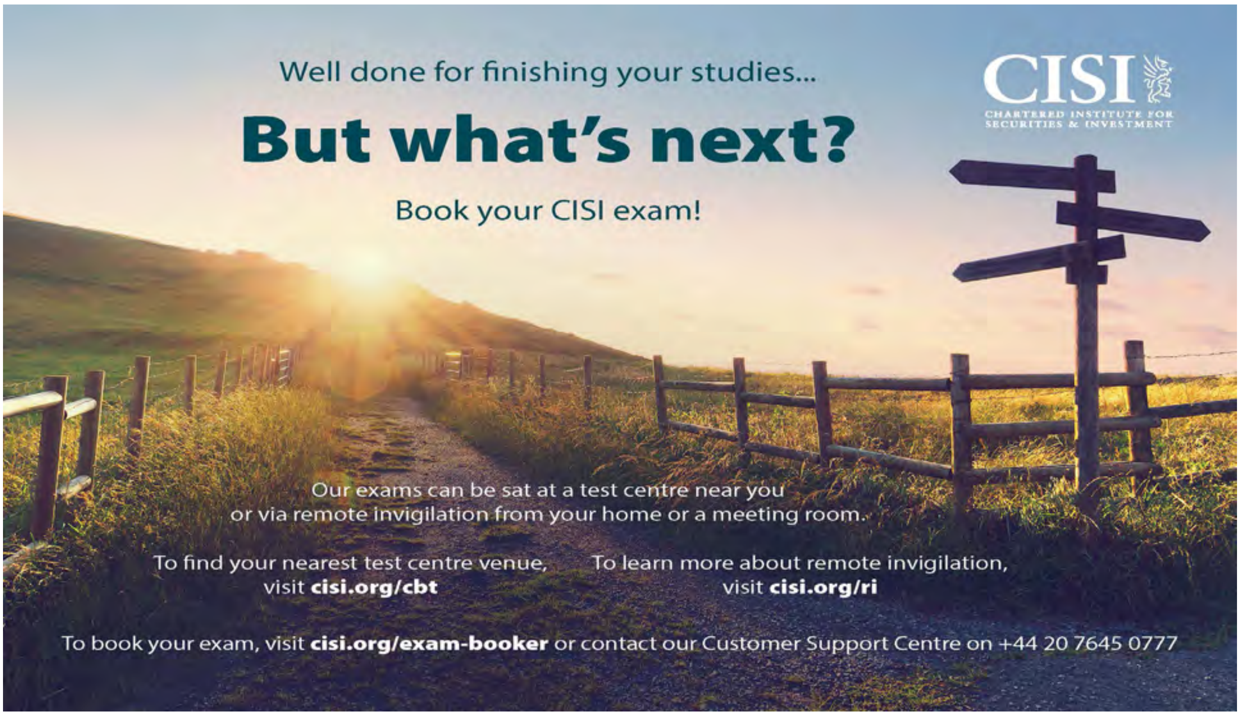
Syllabus Unit/ Element		**Chapter/ Section**
7.1.6	Know the range of additional services that platforms can offer advisers/investors: • tax reporting • tax planning • trust and estate administration services	4

Examination Specification

Each examination paper is constructed from a specification that determines the weightings that will be given to each element. The specification is given below.

It is important to note that the numbers quoted may vary slightly from examination to examination as there is some flexibility to ensure that each examination has a consistent level of difficulty. However, the number of questions tested in each element should not change by more than plus or minus 2.

Element Number	**Element**	
1	Platform Assets	4
2	Platform Wrappers	5
3	The Market and the Platform Service Provider	9
4	Transactions and Ownership	12
5	Asset Servicing	7
6	Regulatory Framework	9
7	Taxation	4
Total		**50**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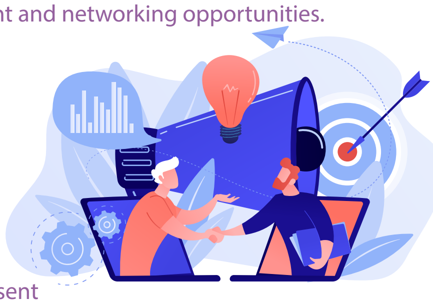

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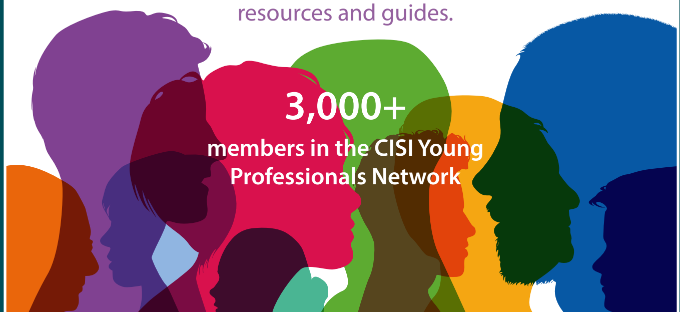

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