

Report on responses to the SRA's Consultation document issued in July 2012

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Introduction

1. This report follows the SRA's recent consultation on the future of independent financial advice (the consultation) and sets out our response to the matters raised by respondents.
2. The consultation dealt with two matters; firstly, the need to consider revising certain language used by the SRA and, secondly, a consideration of Outcome (6.3) of the SRA Code of Conduct 2011 (the Code) and the SRA's current position about referrals of clients needing investment advice to independent intermediaries.
3. By way of background, we explained in the consultation that some of the language used by the SRA, namely its references to "packaged products" and "independent intermediaries", was outdated and did not reflect the language being adopted by the FSA with its own Retail Distribution Review. It is proposed that these terms are replaced by the phrases "retail investment products" and "independent financial advisers" as appropriate and where necessary in the SRA Handbook.
4. We also explained that there was a need to reconsider the SRA's current requirement, expressed as outcome (6.3) in the Code, when solicitors refer clients needing, or likely to need, investment advice to a third party. The current mandatory requirement is that such referrals are made to "independent intermediaries" and the wording is as follows:

"if a client is likely to need advice on investments, such as life insurance with an investment element or pension policies, you refer them only to an independent intermediary".
5. The consultation contained three options with alternative methods of dealing with such referrals, namely:
 - Option 1 – to retain Outcome (6.3) but to update the language as described in paragraph 4 above
 - Option 2 – to remove Outcome (6.3) but to add a new Indicative Behaviour about referrals to independent financial advisers
 - Option 3 – to amend Outcome (6.3) so that clients are in a position to make informed decisions about referrals in respect of investment advice.
6. The SRA's preferred option is option 3 on the basis that it the most outcomes-focused response to the conduct issues presented in this scenario.

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7. We sought views on the change of language and the various options for dealing with Outcome (6.3). The consultation was published on 31 July 2012 and closed on 10 September 2012.

Responses received

8. We publicised the consultation via our website and in the legal press and also contacted some stakeholders directly to invite them to consider the proposals. We are pleased to have received 62 responses to the consultation which expressed a variety of views from a range of organisations such as law firms, some local law societies, an equality group recognised by the Law Society, independent financial advisers, tied financial advisers, various trade organisations and representative groups, individuals with an academic interest, the Financial Services Consumer Panel and the Law Society of England and Wales. We invited a representative group of the respondents to meet with us at a Reference group meeting in early October 2012 so that we could explore some of the points raised.
9. Many of the respondents expressed viewpoints based on their own position in the financial services market or their particular client base. We are grateful to everyone who responded and for the perspective that they have provided which has helped with our understanding of the issues.

Consultation Questions

Question 1 asked:

Do you have any comments to make about the suggested change of terminology and removal of references to independent intermediaries and replacement with language arising from the FSA's Retail Distribution Review in terms of authorised advice and retail investment products?

10. 29 respondents broadly agreed with the suggested changes, 2 respondents disagreed and 30 respondents offered no opinion. The opinions expressed ranged from viewpoints that changes were inevitable because of the Retail Distribution Review through to the view that the changes would not remove the confusion and that the changed terminology did not take into account some types of advice relating to non-retail investment products. For example, the Association of Private Client Investment Managers and Stockbrokers (APCIMs) made the point that many of the services provided by their members fell outside the scope of the Retail Distribution Review.

We agree that the current terminology which appears in the Code is out of date and should be harmonised with the terms used by the FSA (and its successors).

Herbert Smith

We believe that any formula which results in professional advisers automatically referring their clients only to firms offering "independent advice" will be extremely problematic, not least because the term "independent advice" as defined by the FSA is only relevant to business within the scope of the RDR (i.e. advisory services in relation to a restricted list of "retail investment products").

APCIMs

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Our response

10. We welcome the comments we received. We are pleased that this change is generally supported and we will ask the SRA Board to approve these changes. We remain of the view that if the language of the Handbook is not now amended to reflect language used by the Financial Services Authority then the SRA may add to unnecessary confusion about requirements in this area.

Question 2 asked:

Which of the three options do you prefer in respect of chapter 6 of the SRA Code of Conduct?

11. The breakdown of responses was as follows:
- Option 1 – preferred by 26 respondents
 - Option 2 – preferred by 1 respondent
 - Option 3 – preferred by 22 respondents
 - No specific preference expressed – 12 respondents.
12. With regard to the 26 respondents who preferred option 1, the breakdown is as follows:
- 2 financial services trade/representative bodies
 - the Law Society and one local law society
 - 1 academic response
 - 3 law firms
 - 17 financial services businesses authorised by the FSA.

Several respondents who favoured option 1 gave similar reasons in their responses for this preference: that the SRA must preserve the requirement for independent advice as only this is in the client's best interest; that the SRA must consider the FSA Guidance Consultation 12/3; that any change on the part of the SRA would mean that increasing numbers of IFAs would be forced to become restricted advisers; that this was the only option which did not compromise SRA Principle 3 and the duty not to allow your independence to be compromised.

It is blindingly obvious that only Option 1 preserves the principle of referrals being confined to independent financial advisers. So those who favour maintaining the status quo will wish to state their preference for option 1.

Lovewell Blake Financial Planning Limited

When suggesting advisers to clients, solicitors need to be able to advise on what they believe their particular client's best interests to be and the recommendation of a particular individual adviser, whether an independent or restricted, is most important in satisfying those interests

Tanners Solicitors LLP

13. The respondent who preferred option 2 was from a law firm which dealt with the interests of vulnerable clients such as clients with a mental disability or minors. They

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preferred option 2 over option 3 on the basis that some clients would not be in a position to take any part in the decision-making process and as a consequence it would be difficult to demonstrate that the outcome had been achieved.

As investment decisions are often complicated, at the more complex end of the scale, we would suggest that many clients would not be able to make their own decisions with regard to such matters, despite any support or encouragement from others

Law firm response

14. With regard to the 22 respondents who preferred option 3, the breakdown is as follows:
- 3 financial services trade/representative bodies
 - 1 academic response
 - 8 law firms
 - 9 financial services businesses authorised by the FSA
 - Financial Services Consumer Panel

The respondents who favoured this option were generally of the opinion that greater flexibility would be in the best interests of clients as it would facilitate consumer choice. Common themes which ran through these responses: only option 3 supports outcomes-focused regulation; the solicitor would be able to consider the needs of the client without any restraints imposed on them by others; it would enable the client to be part of the decision-making process; that labelling of service was not a key to the quality of advice.

15. The Financial Services Consumer Panel's response to the consultation was of interest. This is an independent statutory body set up to represent the interests of consumers in the development of policy for the regulation of financial services. Their response was offered in the context of both the FSA's Retail Distribution Review and the SRA's more outcomes-focused supervision regime and they supported option 3 on the basis of consumer choice and the client being given sufficient information to make a decision that would support their needs, rather than automatically being referred to a particular type of adviser. The Panel's view was that the potential cost as well as suitability of the product were factors that should be considered in the decision-making process.

We prefer option three as being the most appropriate way forward. We support consumer choice and think it entirely right that the client should be provided with sufficient information to make a decision on the type of advice service that would meet his/her needs, rather than automatically being referred to an independent financial adviser. This is particularly important given the potential cost of independent financial advice and the availability of possibly more appropriate and cost-effective advice services, such as restricted advice

Financial Services Consumer Panel

If Options 1 or 2 were to be chosen, a client who asks a solicitor for a recommendation would automatically have less freedom of choice in the selection of the adviser than they would have if they made that decision themselves – a decision which the FSA clearly believes that many retail clients are perfectly capable of making themselves. It would seem perverse that, simply by asking a solicitor for a recommendation, a client should significantly narrow his or her options and may not even be aware that that is the outcome

DAC Beachcroft Solicitors LLP

We believe that option 3 provides a means by which clients' interests can be served best without imposing a solution which might not always reflect the particular facts and circumstances.

Herbert Smith

Our response

16. We welcome the wide range of views expressed. We have noted that some of the respondents have challenged our expressed preference and have said, amongst other things, that option 3 would change a solicitor's duties to their client and that the risk to clients of receiving poor advice will be heightened.
17. A number of respondents who favoured option 1 gave reasons relating to Principle 3 (not allow your independence to be compromised) as a reason for maintaining the requirement for a referral to an IFA. We are of the view that there is no intention, or unforeseen consequence, that a change in policy would contradict the requirements of Principle 3. We continue to believe that option 3 is appropriate given the nature of outcomes-focused regulation. Our view is that solicitors must be independent of all third parties and make decisions based on the best interests of their client; in other words, regardless of whether a referral is made to an independent adviser or a restricted adviser, this must be an independent decision on the part of the solicitor made, where possible, in conjunction with the client, and free from any constraints. Solicitors must react to a client's request for investment advice in an outcomes-focused manner and the current outcome compromises their ability to do so.
18. Our preference therefore remains with option 3 and we recommend that the SRA Board approves amendments to the SRA Code of Conduct to allow this change to happen. We do take note of the comments and concerns expressed about vulnerable clients, and the possibility that not all clients will be in a position to be involved in the decision-making process, and will ensure that this situation is recognised by the wording of the outcome. We have also taken note of the comments raised, particularly by those who preferred option 1, about the risks attached to any lack of competence on the part of solicitors and will ensure that any Handbook change is supported by a communications programme so that solicitors are well-informed about what will be expected of them. The SRA Code of Conduct describes the need to achieve the outcome that the service delivered to the client is "competent" (outcome (1.5)) and this includes the need to have competence when making such a recommendation.

Question 3 asked:

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Do you have any comments on the possible impact of these options in terms of effects on legal firms and protection of clients' interests?

19. Those respondents who commented on question 3 had various concerns including:
 - The reputation of the profession would be under scrutiny if there were any changes
 - That the risks to the SRA Compensation Fund would alter
 - That there would be a possible rise in negligence claims as a result of a policy change
 - That solicitors did not have the appropriate competence to make decisions relating to investment advice
 - That the solicitors overriding duty was to be impartial and that this may be at risk if there were policy changes

20. During the reference group meeting further comments and queries were raised. For example:
 - Some of the respondents suggested that any change may lead to a lack of independence on the part of the law firm, and that there would be an increase in negligence claims because of referrals being made in circumstances where the solicitors lacked the competence to make informed decisions. The SRA has made enquiries about this point and the current position in respect of negligence claims and has not found any evidence.
 - Other respondents queried whether the word "independent" was being used correctly by the SRA citing anecdotal evidence that the term had first been used by the Law Society to ensure that solicitors referred clients needing investment advice to advisers who were independent of the law firm rather than independent in the sense now used by the financial services industry. The feeling expressed by some respondents was that it would be better to focus on the need to comply with the relevant SRA Principles and in particular Principle 3 (you must not allow your independence to be compromised) and Principle 4 (you must act in the best interests of each client).

21. The SRA has researched the origins of the 'independent' terminology, and the reasons why the Law Society first adopted this language.

22. In the past, there was no blanket requirement that clients needing investment advice to could only be referred to an independent financial adviser. Initial requirements about referral to an 'independent intermediary' only related to the selling of endowment life insurance policies. It appears that these provisions requirement were introduced in response to concerns about the mis-selling of endowment mortgages in the late 1980s.

23. A statement of the Law Society Council on 23 March 1988 gave the view that "*it is in the best interests of anyone who is likely to need to invest in a long-term endowment life insurance policy that he or she should receive advice from an independent intermediary authorised to give investment advice.*" Solicitors were required to "*either act as independent intermediaries themselves and assess the client's requirements, survey the market, recommend the best policy available and arrange for the transaction, or they should introduce the client to another independent intermediary who will do the same.*" The Council considered that "*the solicitors duty to give his client independent advice would not be discharged*

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by referring such a client to an adviser who is not an independent intermediary.” However, it noted that where a client did not need advice on an endowment policy, it was possible that the “particular client’s interests dictate that he should be referred to a tied agent’s office,” in which case “the client should be informed that the office only has investment products from a single company to offer.”

24. In July 1999 the SRA issued guidance which extended the circumstances in which a referral should only be made to an independent intermediary. Clients requiring advice “on investing in an asset that can rise or fall in value – for example, an endowment policy, life insurance with an investment element, or a pension policy... must only be referred to independent intermediaries authorised to give investment advice.” The SRA also clarified that ‘independent intermediary’ has the same meaning as the Financial Services Authority gives to “independent financial advisers”.

Our response

25. We acknowledge that there are risks with any change of policy and we are grateful to those who have responded to our consultation, and joined us at the reference group meeting. However, as far as is possible with the data and other evidence available, we have not found any obviously adverse consequences. However, if the Board agrees to a change in policy we will monitor the position carefully.

Question 4 asked:

Do you have any comments on the costs and benefits of the options as identified in the cost benefit analysis?

26. The SRA decided to withdraw the cost benefits analysis from the consultation documents and did not deal with this question

Question 5 asked:

Do you have any other comments to make on these proposals?

27. There were very few additional comments as most respondents focused on questions 1-3 in their response. Of those who did reply to question 5, there were not any common themes as was the case with the other questions and, in the main, this question was used by respondents to quite naturally express a viewpoint from their perspective of the financial services market and their position within it. For example, one respondent urged the SRA and the profession to consider the longer-term picture expressing the view that the IFA market will change dramatically, and become smaller, within two years of the FSA’s Retail Distribution Review. Another respondent suggested that the focus of attention should be on a consideration of the impact of good and bad advice as well as on the independent versus restricted advice debate.

Independent Advice is not necessarily better Advice. All advisers post RDR have to meet a minimum standard of qualifications and the same number of CPD study hours.

IFA Consulting Limited

Our response

28. Having taken into account all the responses, and having conducted further research, the SRA remains of the view that there is a need to change the current outcome as it is not an outcomes-focused approach to the conduct issues which must be considered when making a referral. In other words it is out of line with the new focus in the SRA Handbook and in particular the outcomes-focused Code.
29. Whilst a number of different views were expressed in the responses, and discussed in the reference group, the main point of contention was whether independent or restricted advice was the best type of recommendation to make. The SRA's view is that regardless of whether the adviser is independent or restricted, the recommendation must be appropriate to the needs of the client and the onus is on the solicitor to demonstrate that his or her decision to make a referral has been prompted by considerations relating to what is in the client's best interest. The SRA's expectation is that the solicitor would act independently, and free of any constraints, when making a decision. With this in mind, the SRA believes that option 3 provides the most outcomes-focused solution; the solicitor is not subject to any pre-existing restraints and the client is involved in the decision-making process. However, the concerns about vulnerable clients are credible and therefore the SRA intends to recommend option 3 to the Board with the proviso that the position of clients, who through a particular vulnerability or for any other reason, cannot be involved in the decision-making, is included in the outcome. This recommendation is made in the context of the SRA's overarching regulatory approach which is outcomes-focused and risk-based. The decision made by the solicitor and their firm would need to be justifiable on these grounds and with reference to the all-pervasive SRA Principles and other sections of the Handbook which would be relevant such as the outcomes in chapter 1 of the SRA Code of Conduct 2011 which arise in respect of client care.
30. Regardless of the decision made by the Board, we will continue to monitor the work of the FSA, and its successor in due course, and watch the post RDR market with interest to ensure that SRA policies are in alignment.

Timetable and next steps

31. We welcome the wide range of comments and we are grateful to all those who have taken time to provide very thorough responses. This has provided us with an invaluable insight into the issues from various different perspectives. This response document will be put before the Board who will now be asked to consider the policy initiatives.
32. We intend to put our proposals for the change of language in the SRA Handbook and for a new outcome (6.3) to the SRA Board for approval. If the SRA Board makes a decision to approve these changes, the changes to terminology in the SRA Financial Services (Scope) Rules 2012 must be approved by the FSA, and all the changes must be put before the Legal Services Board for approval.
33. We would anticipate that any rule revisions would be released by the end of 2012 (subject to the LSB approval) and that this would be accompanied by a communications programme.

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Annex A List of respondents

- The Law Society of England and Wales
- SIFA
- The Goodman Partnership
- Clive Barwell
- FB Wealth Management Ltd
- Andrew Dickson Ltd
- Lovewell Blake Financial Planning Ltd
- APCIMs
- Cane Cohen Ltd
- IFA Consulting LLP
- Aegon
- Alexander Forbes Consultants & Actuaries Limited
- David Severn Consulting
- Wrigleys Solicitors LLP
- Barton Financial Planning Ltd
- Ideal Financial Planning Ltd
- Birmingham Law Society
- Tanners Solicitors LLP
- Financial Services Consumer Panel
- IFS (Professional Connections) Ltd
- Fortitude Financial Planning Ltd
- DAC Beachcroft Solicitors LLP
- Herbert Smith LLP
- Page Russell Ltd
- IFA Centre
- Irwin Mitchell LLP
- Linder Myers LLP
- Perceptive Planning Ltd
- Association of Independent Financial Advisers

Note: The remaining respondents asked not to be named or did not supply details.