

# Perfect partners

Referrals between solicitors and financial advisers need not be a one-way street, says **Ian Muirhead**; in fact, setting up joint ventures could be the first step in a new business strategy made possible under the Legal Services Act

**SOLICITORS HAVE MIXED** views about independent financial advisers (IFAs). Some assume that all IFAs still sell products for commission. Some are misled by descriptions such as 'wealth manager' into referring clients, contrary to SRA rules, to advisers who are not only commission-based but also tied to a restricted number of product providers. Others are firmly wedded to the new model IFA whose emergence has been encouraged over recent years by the Financial Services Authority, and who work on a fee basis and possess advanced technical qualifications.

The subject of financial advice has come to the fore because it is one of the disciplines which lends itself to integration with legal work in the post-Legal Services Act world. Private client solicitors are continually dealing with clients' money but have often been wary of IFAs and preferred to refer their clients to stockbrokers. However, the stockbroker's stock-picking proposition is now fast being superseded by other approaches to investment which concentrate on diversification through asset allocation, combined with tax efficiency and the containment of costs. Also, there is a growing awareness that financial advice cannot sensibly be confined to investment and necessitates a global view of clients' financial planning needs.

Those solicitors who have referred clients to IFAs in the past have usually expected to be remunerated by a share of the commission received by the IFA (an arrangement which has sometimes resulted in their being implicated in the consequences of IFAs' inappropriate advice). However, the Solicitors Regulation Authority is now enforcing strictly the requirement of rule 2.06 of the Code of Conduct that any commission which is retained by solicitors must be justified in fee terms, and consequently most solicitors now prefer not to receive commission; which in any event some admit to always having regarded as 'tacky'. Instead, the motivation for referring clients is the wish to ensure that the client receives good quality advice which will reflect well on the solicitor as the referrer. In some cases, IFAs have also been able to make reciprocal business referrals, but these are rarely a major consideration.



## Joint ventures

No doubt prompted by the Legal Services Act, some solicitors are looking to move beyond the referral relationship, and the model which is proving increasingly popular is that of the joint venture – a company or LLP (depending on tax considerations) in which the solicitors and IFAs are both shareholders, but which is managed by the IFAs who also take responsibility for compliance with the onerous regulatory requirements of the FSA. JVs can either be authorised directly or as appointed representatives of an existing IFA firm; and they can be positioned to service the needs of the participating firm or promoted as a common resource for firms within a locality, in which case an additional class of

'B' shares might be created for the benefit of the non-equity participants. In some cases, the JV could in the fullness of time evolve into an alternative business structure (ABS).

Solicitors are sometimes rightly concerned about the ethics of a JV. Acknowledging the requirement of rule 21 of the Code of Conduct that their financial interest must be declared to clients, some wonder whether a JV can always be the best source of advice for a client. The answer, of course, is that it cannot – except arguably in the case of firms whose focus is on a particular business specialisation. This has prompted some solicitors to go off down the blind alley of presenting clients with a choice of three IFA firms – a solution which has no regulatory substance and is probably contrary to the principles of client care because it shifts the responsibility to the

client who is even less well equipped than the solicitor to make a judgment.

One solution which has been adopted is to regard the JV as the principal conduit for a firm's financial advice, and to agree that the JV will delegate to some of the other IFA firms, with whom the law firm may have had a relationship in the past, work which falls outside the expertise of the JV, thus creating a hub and spoke structure. IFAs are much better equipped to judge horse flesh among their peers than are solicitors; and firms which permit fee earners to entertain individual IFA relationships will inevitably be abandoning any pretence of quality control.

A major advantage of the JV is the sense of proprietorship which it engenders on the part of solicitors towards 'their' JV. This is helpful both in creating a sense of common purpose and in assisting practitioners to take a wider view of their clients' needs. The ability to provide an integrated client service is an important antidote to solicitors' current over-reliance on transactional business and a major step towards building on-going client relationships. Fee-based IFA firms invariably provide annual or more frequent reviews of

financial plans and investment portfolios, and by copying solicitors into these reviews the JV's advisers can not only remind the client of the solicitor's interest but also provide the opportunity for the solicitor to interject with his or her own advice.

The JV can also provide a means of assisting the law firm to build its own client database. IFAs are required as a pre-condition of providing advice to undertake a formal 'know your client' procedure and to document this in a uniform way, thus enabling them to populate the client database which is the basis of every IFA back office IT system. Solicitors are necessarily restricted in their ability to share client information, but IFAs are subject only to data protection constraints.

Solicitors will usually wish to avoid exposing themselves to the attentions of the FSA by accepting directorships in a JV, but can benefit financially as shareholders subject to the important proviso that any dividend they receive should not be based on commissions and therefore fall foul of rule 2.06. The JV must work on a fee basis and must account to its clients for any commissions received in the same way as if it were a law firm.

How, then, should a solicitor identify suitable IFAs with whom to work, whether on a referral basis or as a partner in a JV? Independence, direct authorisation by the FSA, and fee-based remuneration should be among the key criteria, as should professional qualifications, disciplinary record, and listing with the professional body (see box below for details).

### New dawn

Solicitors have in the past complained that referral relationships with IFAs are a one-way street, and IFAs are coming to recognise that if they are to achieve a meaningful relationship with solicitors they must ask themselves, à la JFK, not what solicitors can do for them, but what they can do for solicitors. This means providing advice which complements and enhances solicitors' advice and focuses on the main areas where legal and financial expertise intersects, namely: trusts and estate; advice to older clients; family work; personal injury and Court of Protection; corporate, property; offshore; and portfolio management.

Beyond the specialisations, investment is likely to be a principal business area, and in this respect solicitors need to have bought into the particular approach adopted by the IFA – whether this be advisory or discretionary, active or passive, in house or delegated – if they are to be able to recommend the IFA to a client with confidence. IFAs should therefore be asked to justify their approach in a documented form which will enable this to be explained to clients.

The overriding consideration is that solicitors should have confidence that the IFAs with whom they work share their professional culture. *Citywire Wealth Manager* magazine has conducted research among trustees in some of the larger law firms to identify the factors which influence their selection of investment providers, and invariably the most important consideration is relationship. Past investment performance and the quality of the advisers' reports are secondary; and the strength of the process of the investment firm and the size of the firm are rated as relatively unimportant.

Fee-based IFAs are craving recognition as professionals, and are set to play a key role in the professional services firm of the future.

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### Identifying suitable IFAs – key criteria

#### Independence (conflict-free)

In July 2009, the SRA reiterated its guidance on rule 19 of the Code of Conduct by stating specifically that solicitors must not refer their clients to tied or multi-tied IFAs (such as St James's Place) who are only permitted to advise on a limited range of products.

#### Direct authorisation by the FSA

The significance of this requirement is that IFA firms which are authorised indirectly, via IFA networks, are subject to the influence of those networks, some of which are substantially dependent on product providers for financial support. For this reason, the SRA does not permit law firms to join IFA networks. To check, go to [www.fsa.gov.uk/fsaregister](http://www.fsa.gov.uk/fsaregister) and if this shows 'Current status: Authorised', the firm is directly authorised.

#### Fee-based remuneration

The principle behind rule 2.06 of the Code of Conduct (which requires solicitors to account to clients for any commissions received) is that the client's interests may be prejudiced if the adviser is paid by a third party. The fact that product providers often vie for business by offering extra commission underlines the problem. Professional IFAs work on a fee basis like other professionals.

#### Qualifications

The Financial Services Authority is

insisting that IFAs should be qualified to QCF level 4 by the end of 2012, but most fee-based IFAs have already attained this level and many have progressed further to the status of chartered financial planner or certified financial planner. Advisers specialising in specific areas of business may also have qualifications with which solicitors may be more familiar, such as the STEP exam in trusts for IFAs, the Resolution accreditation for financial neutrals and the Society of Later Life Advisers' accreditation, which is associated with Solicitors for the Elderly.

#### Disciplinary record

The FSA register will also disclose any disciplinary issues which an IFA firm may have experienced and which may reflect on its quality standards and integrity. Click on disciplinary history.

#### Listing

Listing in the Law Society endorsed Directory of Professional IFAs ([www.sifa-directory.info](http://www.sifa-directory.info)), which can also be accessed via the Law Society's website ([www.lawsociety.org.uk](http://www.lawsociety.org.uk)). Eligibility for listing demands compliance with all the above criteria and searches can be made by reference to location or business specialisation. The site also provides access to free compliance support, technical handbooks and marketing material.