Brighton rock

The FSA's new tack on independent financial advisers raises challenging questions for the legal profession, says **Stuart Bushell**

Music fans will have noticed that recent years have seen a dramatic decline in the popularity of independent 'indie' bands and labels. The FSA and SRA are unlikely, on balance, to be copying this development, but the notion of 'independent financial advice' could be similarly endangered.

In early August the Financial Services Authority issued a circular letter to the UK's Law Societies, the designated professional bodies (DPBs) which derive their authority from the FSA to regulate the exempt regulated activities of their members. The letter explained how the FSA intends from 1 January 2013 to redefine the basis on which the firms it regulates will be able to claim independent status, and it invited the DPBs to consider whether this definition was appropriate for the purposes of their prohibition against solicitors referring clients other than to IFAs for financial advice.

Until now, the SRA has followed the FSA definition. This requires FSA-regulated firms claiming independent status to be able to provide their clients with access to the whole market for investment products and to offer them the option of paying for their services by fees. Firms which do not satisfy these criteria are regarded as being 'tied' or 'multi-tied', depending on whether they are aligned to a single product provider or a number of providers.

The FSA's proposed new definition extends the 'whole of market' requirement for beyond what might generally be understood as packaged investment products to include exotica such as 'unregulated collective investments' and 'exchange traded funds', and it is allied to the somewhat fuzzy concept of impartiality. Firms which do not satisfy these criteria are to be classified as 'restricted' and will be required to provide their clients with verbal warning of this status. At the same time, the FSA will be tackling the issue of commission bias by introducing 'adviser charging', whereby charges are incorporated in product costs, on a basis which is consistent between product providers.

Problematic definition

For the DPBs, the problem which this new definition presents is that it would exclude from independent status, and therefore preclude solicitors' client referrals, a large number of investment firms whose independence in the sense of freedom from third-party influence has never been in doubt – most notably stockbrokers. To satisfy the new definition stockbrokers would need to equip themselves to advise on life and pensions products, which they are most unlikely to wish to do.

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There is a clear argument that 'whole of market' is an inappropriate basis for defining independence. A solicitor is no less independent for choosing to specialise in a particular area of the law, and financial advisers should logically be in the same position. However, the FSA had a different starting point from the DPBs, arising from the need created by the 1986 Financial Services Act to distinguish between advice provided by the tied sales forces of the life and pensions companies, and advice provided by firms and individuals working for themselves (and hopefully their clients). It is the legacy of this thinking which still dictates the FSA's ongoing approach to independence.

Small wonder, then, that the FSA should suggest that the SRA and other legal DPBs might consider whether they wish to adopt a different definition. Requiring solicitors suddenly to abandon long-standing relationships would clearly be inimical to the interests of clients. Consequently there seems to be no alternative but for the SRA to accept the FSA's invitation to take a different approach. The question is how to reconcile the principle of freedom from third-party influence with the complexities of the market for investment advice.

There is a clear case for maintaining the prohibition against organisations such as St James's Place, 92 per cent of whose sales are of their own products. SJP are owned by a bank, but so also are some stockbrokers whose ability to access investments from across the spectrum is unrestricted. Where do you draw the line? In the case of alternative business structures, the SRA judges the relevance of ownership in individual cases, but are solicitors able to make similar judgements when it comes to the suitability of recipients of client referrals?

There are those who argue that the FSA has given up on independence and that its greater concern is to maximise the availability of financial advice in whatever form. If so, it will be for the professions – and the legal profession in particular – to maintain the principle which runs through the professional ethic like the writing in Brighton rock.

Stuart Bushell is legal affairs director of SIFA (Solicitors Independent Financial Advice) and was the Law Society's director responsible for Legal Services Act transition