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Independence

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The Solicitors Regulation Authority has decided to abandon, with effect from 1 January 2013, the prohibition against solicitors referring their clients to tied and multi-tied financial advisers.

The SRA's current guidance, issued in July 2009, states: "*Firms must always act in the best interests of their clients. This means that they must refer clients to independent financial advisers for investment advice*", and a typical response to the proposal for change was that of a Law Gazette journalist who wrote "*In what possible regard will it be to the client's advantage to be referred to an adviser with an ulterior motive? An adviser, lest we forget, who benefits from willfully ignoring any product that does not line their own pocket."*

The need to review the prohibition arose from the decision by the Financial Services Authority, as part of its Retail Distribution Review ('RDR'), to re-define the term independent financial adviser as being one whose advice is not only impartial and unbiased but also addresses the whole of the relevant market in financial products. The result is that when the RDR is implemented on 1 January 2013, the term "independent" will have a different meaning in the context of financial services from that which is defined in the English dictionary and is a fundamental principle of the legal profession, namely being free from third party influence.

The SRA's consultation on the subject, which was launched, ironically, on 4 July 2012, American Independence day, put forward three options:

1. to maintain the prohibition and adjust the wording of the Code of Conduct
2. to introduce a new Indicative Behaviour "*which describes referral to an independent adviser*" or
3. to require that clients should be put in a position to make informed decisions about any proposed referral (this being the SRA's preferred option).

It is the SRA's preferred option which has now been adopted, after an extended consultation period which attracted an unprecedentedly large volume of responses. Outcome 6.3 will require that in future "*clients are in a position to make informed decisions about how to pursue their matter*". This wording is so vague that it demands the further guidance which the SRA intends to provide, and it can be criticised also for perpetuating the assumption that solicitors do not look beyond the "matter" in hand and are not concerned with developing the relationships which will assist them to maintain client loyalty and provide the platform for the provision of the wider service offering which many will need if they are to compete effectively in the post-Legal Services Act market. However, it is clear that if clients are to make informed decisions, solicitors will need themselves to be better informed about the quality of financial advice their clients are likely to receive, and this will need to be demonstrated for compliance purposes.

One of the main factors influencing the SRA's decision was the suggestion put forward by the stockbrokers' trade body, APCIMS, the Association of Private Client Investment Managers and Stockbrokers, that if it SRA had adopted the FSA's new definition of independence as its criterion this would have denied solicitors the ability to refer clients to those stockbrokers who, although usually qualifying as impartial and unbiased, would not have wished to satisfy the 'whole of market' test by including life and pensions advice in their business proposition. It is the success of this lobby which has opened the door to those APCIMS member firms which operate

a multi-tied proposition, and whose previous attempts to access the legal market had been thwarted by the prohibition.

The SRA consultation paper also suggested that the maintenance of a prescriptive prohibition would have been inconsistent with Outcomes Focused Regulation, and this view appears not to have been altered by a forceful response to the consultation by ex-FSA Director David Severn, who wrote "*In my opinion the SRA has allowed itself to be hoodwinked by those who claim that rules would not accord with an outcome focused approach. Clients of solicitors need to be referred to investment firms that will give unbiased advice that is not contingent on making product sales and which gives access not only to a broad range of investment solutions but also to the best solution for the client, not one that is constrained by the fact that the investment firm deals with only a restricted range of investment products or a limited number of product providers*."

The consequence of the abandonment of the prohibition will be that solicitors will be free to refer clients to all and sundry financial advisers, regardless of whether their advice is influenced by a third party. Among these will be the bank salespeople whose unsatisfactory practices are regularly reported in the national press. There seems little doubt that this could pose a major risk not only to the reputation of individual firms but also to that of the professional as a whole.

The Solicitors' Compensation Fund could also be impacted, potentially becoming subject to the same massive compensation claims for mis-sold products as those which are currently crippling the Financial Services Compensation Scheme. Firms which referred clients to Sedgwicks for mortgage advice in the 1980s will recall that when the endowment mis-selling scandal broke in the 1990s, it was they, the solicitors who referred their clients for advice, who had to pick up the tab. The Chief Executive of the Law Society has recently expressed concern about the possible impact of claims on the Fund relating to ABS firms, but there must be an equal risk arising from solicitors' involvement with tied financial services salespeople.

The removal of the prohibition will place a heavy onus of responsibility on solicitors to demonstrate that they and their clients are making informed decisions and that referrals will be in clients' best interests. They will need to be seen to have conducted due diligence on their proposed referees before making any referral, and this will represent a major improvement on two unsatisfactory practices which currently prevail, namely giving clients a list of three local IFAs and leaving them to make their own choice, or permitting partners and fee-earners unbridled discretion to refer to whomever they wish, in defiance of any attempt at central co-ordination or quality control.

As firms are coming to appreciate, the basis of Outcomes Focused Regulation is that firms should install management systems and controls, the operation of which should make the Code of Conduct to a large extent a matter of best practice. The referral process, therefore, would be expected in future to involve firms' managements in creating a compliance audit trail which demonstrates that they have investigated the available sources of financial advice locally, having taken an initial view as to which advisers are likely to most suitable to the needs of the firm, having then undertaken due diligence on the likely candidates, having created a panel of advisers in accordance with the Lexcel recommendation, and then promulgated the decision to all members of the firm and kept both its composition and its observance under regular review.

Independent financial advisers will be able to help themselves and their solicitor connections by supplying assessment criteria, providing due diligence on themselves and possibly also on the stockbrokers with whom they and/ or their solicitor connections may work, and supplying

Authorised Third Party Agreement templates, Terms of Business and suggestions as to the data which might be included in firms' Risk Registers. They will also, of course, be able to highlight the advantages of conflict-free advice, and may feel it appropriate to refer to the Law Society's own response to the SRA Consultation, which read: "*a requirement to ensure that clients are referred to third parties who will provide genuinely independent advice seems to us to be a sensible approach which provides necessary protection to both client and solicitor. The alternative proposition is to open up the market for referrals by solicitors to providers with an agenda that is predicated on self interest and tied arrangements rather than a transparent market wide assessment. This cannot be in the best interests of clients.*"

Significantly, Outcome 6.1 of the SRA Code is to be retained. This effectively reiterates the third SRA Principle, which demands of solicitors that "*you must not allow your independence to be compromised*". This raises the question of solicitors' in-house financial advisers. In the context of the Code and solicitors, independence has a different meaning from that now being attached to the word by the FSA, and this does not relate to the scope of the service offered (if it did, all specialist law firms would have to shut up shop). It follows therefore that solicitors would be able to employ (or continue to employ) financial advisers who satisfy the SRA meaning of independence but might be classified as restricted by the FSA; but they would be prohibited from employing tied or multi-tied advisers (or operating as sales offices for product providers). A double standard would therefore apply as between in-house and referred business.

Giving the overriding mandate of the Legal Services Board to encourage competition, it seems unlikely that the preservation of professional standards will be the major consideration in the SRA's forthcoming guidance. The divergence of priorities between the SRA and the Law Society in this respect is striking. However, one might hope that most solicitors would instinctively regard the independent status of referees not only as more in-keeping with their own professional standards but also as the safer course for compliance purposes.

The need to assess the respective merits of different advisers should also assist solicitors to appreciate the synergy between the legal and financial disciplines in such areas as older client affairs, collaborative divorce, estate planning and Court of Protection investment, and to think beyond the arms-length client referral process to the greater advantages of working together with financial advisers to provide a complementary client proposition.

Sir Nigel Knowles of DLA Piper suggested a similarly client-centric business model when he wrote in the Daily Telegraph in October 2010: "*The past two years have witnessed …. a desire for holistic advice from advisers, as opposed to individual services in silos delivered on a transactional basis. This means that law firms must re-shape their relationships with their clients so that they become trusted adviser.*" More recently, the CEO of the Legal Services Board, Chris Kenny, spoke of the Board's wish to develop "activities-based" regulation, which might deny solicitors the right to practise in particular areas of the law without additional specialist qualifications which address the needs of the target clientele.

For the private client, the combination of legal and financial services provides the ideal basis for the trusted adviser role, and to the extent that a formalised client referral process is about to become a compliance requirement, what may seem to many as a strange and perverse decision by the SRA may yet prove to have beneficial consequences.