

**Application made by the Solicitors Regulation Authority Board to the Legal Services Board under Part 3 of Schedule 4 of the Legal Services Act 2007, for the approval of changes to regulatory arrangements relating to client referrals to third parties for financial advice.**

1. The purpose of this paper is to ask the Legal Services Board to approve changes to the SRA's regulatory arrangements, concerning the referral of clients by law firms to third parties for financial services.

**A Rational for change**

2. Solicitors often need to refer clients to third parties for financial services. For example, personal injury clients may require investment advice following the award of damages, property clients may seek advice in respect of their mortgage arrangements and litigation clients may require after the event insurance. The SRA Board considers that the current requirements about referrals for investment advice are no longer appropriate or consistent with an outcomes focused regulatory strategy.
3. The third parties that a firm might refer its clients to for financial services are authorised and regulated by the Financial Services Authority (FSA). Some of the terminology and definitions in the SRA Handbook are borrowed from the FSA Handbook.
4. The FSA is making changes to its Handbook, following the Retail and Distribution Review. These changes will take effect on 31 December 2012. The SRA Handbook should therefore be amended accordingly, with effect from 1 January 2013.
5. On 31 December 2012 the FSA will adopt a new standard for financial advisers that provide 'independent' advice. Independent financial advisers will have to consider all types of investment products that might be suitable from all firms across the market. If an adviser can only consider certain products, product providers, or both, their advice will be classed as 'restricted' advice.
6. The FSA has also widened the range of products that the independence requirements apply to. The FSA's aim is to better reflect the range of products that are recommended to retail clients and to ensure that retail consumers receive a consistent level of regulatory protection. To this end, the FSA has created a new definition of 'retail investment product' in its Handbook. The definition covers products that were previously described as 'packaged products.' It also includes unregulated collective investment schemes, all investments in investment trusts (not just those in investment trust savings schemes), structured investment products and other investments that offer exposure to underlying financial assets, but in a packaged form, which modify that exposure compared with a direct holding in the financial asset.

**B Details of the SRA's current regulatory arrangements**

7. All law firms authorised and regulated by the SRA must comply with the SRA Handbook when referring their clients to a third party providing financial services.

8. Outcome (6.3) states:

*"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".*

9. A related indicative behaviour, IB(6.2) states:

*“any referral in respect of regulated mortgage contracts, general insurance contracts and pure protection contracts to a third party that can only offer products from one source, is made only after the client has been informed of this limitation.”*

10. The SRA Financial Services (Scope) Rules 2001 refer to ‘packaged products’ in Rules 5.1 and 5.3.

11. Rule 5.1 states:

*“Packaged products (except personal pension schemes)*

*(a) A firm must not recommend, or make arrangements for, a client to buy a packaged product except where:*

*(i) recommending, or arranging for, a client to buy a packaged product by means of an assignment;*

*(ii) the arrangements are made as a result of a firm managing assets within the exception to rule 5(4) below; or*

*(iii) arranging a transaction for a client where the firm assumes on reasonable grounds that the client is not relying on the firm as to the merits or suitability of that transaction.”*

12. Rule 5.3 states:

*“Securities and contractually based investments (except packaged products)*

*(a) A firm must not recommend a client to buy or subscribe for a security or a contractually based investment where the transaction would be made:*

*(i) with a person acting in the course of carrying on the business of buying, selling, subscribing for or underwriting the investment, whether as principal or agent;*

*(ii) on an investment exchange or any other market to which that investment is admitted for dealing; or*

*(iii) in response to an invitation to subscribe for an investment which is, or is to be, admitted for dealing on an investment exchange or any other market.*

*(b) this rule does not apply where the client is:*

*(i) not an individual;*

*(ii) an individual who acts in connection with the carrying on of a business of any kind by himself or by an undertaking of which the client is, or would become as a result of the transaction to which the recommendation relates, a controller; or*

*(iii) acting in his capacity as a trustee of an occupational pension scheme.”*

13. The SRA Financial Services (Conduct of Business) Rules 2001 refer to “packaged products” in rule 8.1 and in note (iii) to rule 13.1.

14. Rule 8.1 of the SRA Financial Services (Conduct of Business) Rules 2001 states:

*“If a firm arranges for a client on an execution-only basis any transaction involving a packaged product, the firm shall send the client written confirmation to the effect that:*

*(a) the client had not sought and was not given any advice from the firm in connection with the transaction; or*

*(b) the client was given advice from the firm in connection with that transaction but nevertheless persisted in wishing the transaction to be effected; and in either case the transaction is effected on the client’s explicit instructions.”*

15. Note (iii) to rule 13.1 states:

*“Where the transaction involves a packaged product, there is a specific requirement to confirm in writing the execution-only nature of a transaction (see Rule 8 above).”*

16. ‘Execution only’ denotes a transaction which is effected by a firm for a client where the firm assumes on reasonable grounds that the client is not relying on the firm as to the merits or suitability of that transaction.

17. The SRA Handbook glossary defines the following terms:

“Independent intermediary  
in Chapter 6 of the SRA Code of Conduct means an independent financial adviser who is able to advise on investment products from across the whole of the market and offers consumers the option of paying fees”

“Packaged product  
means a life policy, a unit or share in a regulated collective investment scheme or an investment trust savings scheme, whether or not held within an ISA or PEP or a stakeholder pension scheme.”

## **C Nature and effect of the proposed alterations to the SRA’s regulatory arrangements**

The Amendment to Regulatory Arrangements (Financial Services) Rules [2012], as approved by the SRA Board, are attached at **annex 1** for your information.

### ***Changes to regulatory arrangements concerning the referral of clients to third parties for financial services.***

18. The SRA Board has decided to delete the current outcome (6.3) and to replace it with the following:

*“O(6.3) clients are in a position to make informed decisions about how to pursue their matter.”*

19. The effect of this change is that regulated individuals will no longer be obliged to refer clients who need investment advice to an independent financial adviser. Regulated individuals will have to consider what referral is in the best interests of their client, in accordance with Principle 4 of the SRA Handbook which states that they must *“act in the best interests of each client.”*

20. The SRA Board considers that the existing regulatory arrangements are overly prescriptive and may prevent firms from referring clients to a financial adviser who provides restricted advice, in circumstances where that would be in the client’s best interests.

21. By removing the reference to an independent intermediary, the SRA is not signaling that a regulated individual can never refer to an independent financial adviser, or that they must always refer to a restricted adviser. It is for the solicitor to assess what is in the client's best interests and to provide appropriate guidance to allow the client to make an informed decision on how to pursue their matter.

### **Changes to the SRA Handbook Glossary**

22. The SRA Board has decided to replace the definition of an 'independent intermediary' in the SRA Handbook glossary with the following:

“independent financial adviser  
means an adviser who provides unbiased and unrestricted advice based on a  
comprehensive and fair analysis of the relevant market and discloses this in writing to the  
client.”
23. The SRA Board has also decided to replace references to a 'packaged product' in the SRA Handbook with references to a 'retail investment product.' This will have the meaning given in the FSA Handbook.
24. These amendments are in response to the changes flowing from the FSA's Retail Distribution Review and will provide compatibility between the SRA Handbook and the FSA Handbook after 31 December 2012.
25. Replacing references to 'packaged products' with references to 'retail investment products' will extend the SRA's existing standards of conduct for firms to transactions concerning a broader range of products. This integrates the findings of the FSA's Retail Distribution Review into the SRA Handbook, to the extent that the narrower definition of 'packaged products' does not reflect the full range of products that may be sold to retail consumers.

### **D Statement in respect of the Regulatory Objectives**

26. The SRA must, so far as is reasonably practicable, act in a way which is compatible with the regulatory objectives established in the Legal Services Act 2007, and in a way that it considers to be most appropriate for the purpose of meeting those objectives.
27. The SRA Board is satisfied that the requested alterations are compatible with the regulatory objectives and are the most appropriate means of meeting these objectives as regards the referral of clients to third parties for financial services.
28. The changes set out in this paper promote and maintain adherence to the professional principles by underlining the importance of acting in the client's best interests when making a referral to a third party financial adviser. The proposed change place the interest of consumers and, in consequence, the public interest at the heart of the SRA's regulatory arrangements. The revised outcome 6.3 empowers consumers to decide what is in their best interests, supporting the objective of increasing public understanding of the citizen's right and legal duties, without diluting the independence of the profession.
29. The SRA Board is satisfied that the amendments support the constitutional principles of the rule of law and promote competition in the provision of services, by widening the pool of financial service providers that firms can legitimately consider making referrals to within the limits of what is in the best interests of the client.
30. Finally, the SRA Board is concerned that the existing Outcome 6.3 indirectly provides a form of economic protection for a section of the financial services market. This potential distortion of the market is not aligned to the SRA's regulatory objectives and the amendment addresses this.
31. The SRA Board has not identified an adverse effect on any of the regulatory objectives as a result of the proposed amendment.

## **F Statement in respect of the Better Regulation Principles**

32. The SRA Board considers that the requested alterations fulfil this organisation's obligations under section 28 of the Legal Services Act to have regard to the Better Regulation Principles.
33. The amended Outcome 6.3 is a proportionate and targeted regulatory requirement, in the sense that it is the least prescriptive requirement that achieves the necessary level of protection for consumers and the public interest.
34. The changes to the SRA Handbook Glossary are motivated by the principle of consistency. The standards the SRA applies to firms providing financial services to retail consumers should be consistent for all products that this group is likely to be sold. Furthermore, it is important that where the FSA and the SRA make reference to the same definitions that these are used in a joined up and consistent way.
35. The SRA has consulted publicly on the proposed change and taken account of the views of stakeholders in developing this policy. It has therefore acted in an accountable way in developing this change to the regulatory arrangements and, subject to approval by the Legal Services Board, will ensure that changes are published and implemented transparently.

## **G Statement in relation to desired outcome**

36. The desired outcome is to establish appropriate and effective standards that apply when firms refer clients to a third party for financial advice, so that clients are in a position to make informed decisions about whether they should be referred to an independent or restricted adviser.

## **H Stakeholder engagement**

37. The SRA Board approved proposals to issue a consultation on both changes to language and three options for amending outcome (6.3). The consultation was issued on 31 July and closed on 10 September 2012. The SRA received 62 responses from respondents representing a variety of different perspectives from solicitors, financial services firms, various trade and representative bodies, the Law Society of England and Wales and the Financial Services Consumer Panel. The responses from financial services firms and the trade bodies gave the perspective of an independent or tied adviser depending on their position in the market and some of the legal responses were also of this nature depending on whether they were firms which were dually regulated by the SRA and the FSA ('authorised professional firms') or had separate businesses providing independent financial services.
38. A group of the respondents, representing the range of different viewpoints, were invited to a reference group meeting in October 2012 and provided further information about the financial services marketplace and the future of independent advice in the light of the FSA's Retail Distribution Review.
39. For further detail on the responses to the consultation paper, the views of other approved regulators and the SRA's conclusions following consultation, please refer to the attached SRA Board paper.

**I Statement in relation to impact on other Approved Regulators**

40. The changes to regulatory arrangements should not have an impact on other approved regulators.

**J Implementation Timetable**

41. The SRA intends to implement the amendments on 1 January 2013, subject to the approval of this application by the Legal Services Board.

**K SRA contact for matters relating to this application**

42. If the Board have any queries in relation to this application, please contact:

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**Annex 1 Amendment to Regulatory Arrangements (Financial Services) Rules [2012]**

**Annex 2 SRA Board Paper on Independent Financial Advisers, November 2012.**