



## HELPING CONSUMERS UNDERSTAND WHO ADVISES THEM AND WHAT IT MEANS FOR THE LAW OF AGENCY

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### Introduction

AIFA's recent work on why consumers do not engage fully with Financial Services Institutions (FSIs) has shown that they do not know who to trust. Trust and trustworthiness are crucial to any exchange relationship, and nowhere is this more apparent than in financial services. The long-term nature of many financial products, their complexity, and the importance of financial assets to individual well being, mean that customers perceive high levels of risk when making purchase decisions. They typically lack specialist knowledge and may have difficulty in judging product performance. The costs of making a mistake are considerable.

Faced with such risk and uncertainty, many customers are dependent on FSIs to offer advice and products of an appropriate type and quality - and must trust them to do so. However, there is a growing concern about the extent to which FSIs are trustworthy and the extent to which consumers feel able to trust them.

This concern has been exacerbated by media coverage of the financial services sector, which has tended to highlight poor relationships between customers and FSI's, while also focusing on 'negative' stories such as pensions 'holes', endowment shortfalls, penalty fees for overdrafts, the mis-selling of Payment Protection Insurance (PPI) and, of course, the banking crisis. This lack of trust is a serious cause for concern as it results in consumers being disengaged from FSIs, which shrinks the market and damages the economy as a whole.

A major contributor to this lack of trust is that consumers are confused about the role of FSIs as they are unsure of whether they are receiving impartial and independent advice or being sold a product. IFA Promotions found 84% of UK adults admit they do not understand the different types of financial "advice" available. Research indicates this trust could be rebuilt if consumers clearly understood the service they were being offered, and knew exactly who was "on their side".

We believe this can be achieved through the RDR which provides an opportunity to restore consumer trust through clearly highlighting and re-establishing the concept of the 'law of agency'.

## “Law of Agency”

“Agency” in the legal sense is the contract whereby one party, the **agent** (i.e. IFA), is authorised to do certain acts on behalf of another party, the **principal** (i.e. the client). The agent contracts on behalf of the principle who is bound by the agent: a direct contract is created between the principal and the third party. What matters is the substance of the relationships.

### “Agent of the Client“

YouGov research commissioned by AIFA indicated that when considering the most important features of an FSI, consumers believed that dealing with a firm that is on their side, or “agent of the client”, is the most important consideration (leaving aside the price of a product). We believe this underlines the importance of the differentiator that advisers work on behalf of and as agents of their clients.

We believe an IFA is the only true agent of the client. Only an IFA can properly give true advice as they are legally bound to put the best interests of the client first, and avoid all conflicts of interests.

Further we believe that the benefits to the consumer in offering absolute clarity of whether a firm is ‘agent of the client’ or otherwise will go a long way to restoring trust in the sector. YouGov research showed that when buying financial products, 77% of people thought knowing an FSI was on their side would build trust in FSIs, while 81% thought knowing whether they were being sold a product or advised to buy one, would build trust.

Unclear motivations have damaged trust, and the RDR is the opportunity to restore trust through the development of a position that is entirely clear: consumers can choose between those who are the “agents of the client” (“advisers”) and those who are the “agent of the firm” (in the sales arena). It is vital that this clarity is also maintained in name, with terms such as “sales adviser” immediately causing confusion and removing clarity.

We believe that only those firms that are willing to accept the obligations of being the “agent of the client” should be able to call themselves advisers. YouGov consumer research showed 73% of those questioned expect IFAs to work for their interest and not for anyone else’s. These firms are clearly on the side of the consumer and will act in the consumer’s long term interests. Indeed, legally this would represent an increase in burden and responsibilities for advisers, but this is an addition burden that firms would be willing to accept to facilitate improved consumer clarity.

The point of the IFA's relationship with the client is to provide good, objective and disinterested advice in the client's best interests. An IFA therefore owes the following duties to his client:

- To follow the lawful instructions of his client
- Not to delegate his authority
- To account to his client for the client's money and property which is under his control
- Only to act within the limits of his actual authority

- To perform his duties with reasonable skill and care, and with reasonable dispatch
- To act loyally and in good faith
- Not to use his position as IFA to acquire for himself property, contracts or other benefits
- Not to put himself in a situation where his interests will conflict with those of his client
- To disclose all material facts to his client and to refrain from divulging confidential information to third parties
- Not to make a secret profit (such as undisclosed commissions) or accept bribes
- Document the agency agreement and clearly define the scope of the agent's authority and their duties
- Fully understand the requirements of regulation.

The main duties owed by the client are:

- To pay the IFA remuneration for their services.
- To act in good faith; avoid conflicts; and not make secret profits.

This requirement to act as the agent of the client builds on existing market definitions such as "independent" and "whole of market", although it more elegantly, and robustly, communicates the key difference between professional advisory firms and those who may act in the interests of others.

#### "Agent of the Product Provider"

Sales representatives, on the other hand, are the agents of the product provider and their job is essentially to sell the products of the provider which they represent. FSA regulation aims to ensure that those sales are suitable and fairly made.

The representative will take a detailed fact-find and establish the customer's financial objectives and attitude to risk, work out from the products offered by the provider which one is suitable for the customer and make an appropriate recommendation to buy that product.

That recommendation may well be based on an expert and skilled analysis of the customer's financial position but, in the end, the representative is still essentially trying to sell the products of his or her principal - the provider (or a group of providers in a multi-tied firm. No matter how much skill and expertise they put into the recommendation, it remains a recommendation to buy and it is wrong to call that recommendation "advice".

Thus "advice" should mean an objective recommendation given by a person whose main and overriding duty is to act in the best interests of the person receiving the advice - the client. In other words, the adviser needs to be independent of all ties and influences which might affect what he or she says to the client. That is the position of an IFA.

The representative is just that - the representative of the product provider(s). No matter how skilled and expert the representative, he or she remains the agent of the provider whose products and interests he or she is bound to promote.

What that representative says to the customer cannot amount to more than a recommendation. It is not objective and disinterested advice. The point of the representative's dealings with the customer is to sell on behalf of the product provider.

It should also be made clear here that we see “independent advice” and “sales” as two sides of the same coin; that they can and should be supportive and increasingly leverage better consumer outcomes. The RDR has been misinterpreted by many commentators who have suggested we face a polarised market of independent advice “versus” sales in which consumers would be “locked in” to one or other route. However this notion is far from being consumer focused, and fails to recognise consumer buying behaviours that exists in all other markets, where people vary between seeking independent advice and opting to make transactions.

Further, we support the notion of a *growing* financial services market where the sales and advisory arenas work *in tandem* serving client needs. Indeed, if properly constructed, the two channels will be mutually supportive providing shared skills and generating better outcomes for consumers. The ‘myth of scarcity’ (that all financial services companies are fighting to serve a shallow pool of consumers) is just that; restoration of trust will lead to more consumers engaging with the financial services industry as a whole.

## Disclosure

In order to help consumers understand this distinction between agent of the client and agent of the product provider more clearly, as well as the services they are being offered, all forms of disclose to consumers, both written and oral, should be based on everyday language which moves away from industry jargon. It is crucial that the labels used to describe the FSI make absolutely clear to consumers the distinction between the various business models and what they can deliver.

Regulatory proposals to allow tied and multi-tied company representatives to call themselves ‘sales advisers’ (as currently set out in the RDR Feedback Statement, but which we believe should be labelled as ‘Company Representatives’ as it is a clearer term in everyday usage) create a muddy middle ground which will only continue to confuse customers and damage trust. AIFA agrees fully with the FSCP which shares the belief that the term “sales advice” is “devoid of meaning”.

AIFA also strongly agrees with Which? when it says, “There has to be a clear distinction between those offering unbiased advice and those simply trying to sell products. It must be made crystal clear to consumers what type of service they are receiving and how they are paying for it”.

Consumers clearly value the concept of independent and unbiased advice. IFA Promotions found 95% of people believe it is important that the adviser can recommend the most suitable products from the whole of the market; and 88% say it is important that an adviser has no commercial ties to product providers. YouGov consumer research commissioned by AIFA in 2007 produced similarly high statistics - 75% of those who receive advice from an IFA expect them to be someone that can select a product from the whole of market to best suit their needs while 73% of those questioned expect IFAs to work for their interest and not for anyone else's.

Further research conducted by YouGov on behalf of AIFA in July 2008 indicated that when considering the most important features of an FSI, consumers believed that dealing with a firm that is on their side, or agent of the client, is a key consideration. This therefore makes clarity of the FSI's role the most important feature when consumers are considering who can help them and who they can trust. We believe this further underlines the importance of the differentiator that advisers work on behalf of and as agents of their clients.

It is also important that the disclosure regime insists that the limits of the firm's scope, and individual's competence, are set out clearly so that the client may better judge the value of the service offered.

## **Financial promotions**

Changes to the current disclosure regime are necessary – but not sufficient by themselves to bring significant improvement. Disclosure occurs once a potential customer has engaged with a firm. However by that stage they may feel under-pressure to continue with the process.

AIFA therefore proposes that a new financial promotions regime is introduced which helps the public understand what the firm can offer them even *before* they enter into a conversation. This would include not only above the line advertising but also the signage on any retail premises – and most certainly the firm's websites and all promotions.

We would also like to see financial promotions make absolutely clear to consumers what firms are unable to offer customers and any potential 'dis-benefits', as in this past this has not been made clear by many in the industry.

## **The Insurance Market**

The Law Commission has recently published a policy statement regarding the status of intermediaries when obtaining and passing pre-contract information from the consumer to the insurer. The issue is important because it affects the options open to the insurer if the intermediary misrepresents or fails to disclose matters that are relevant to the risk.

The present legal position for the insurance sector, based on the law of agency, is that the intermediary normally acts as the agent for the insured (the client) and in

such circumstances the insurer may be entitled to avoid the policy on the grounds of misrepresentation/non-disclosure.

However the Law Commission has now proposed a new statutory code for identifying who the intermediary is acting for when obtaining and passing pre-contract information to the insurer. The proposals state that insurers should bear responsibility for intermediaries within their control but not for the actions of genuinely independent agents. In other words the Commission is proposing that tied-advisers and salespeople are agents of the product provider, while independent advisers are the agents of the client.

This is a significant announcement from the Law Commission and exactly the situation we wish to see the RDR clarify for the IFA profession – it recognizes the motivations and loyalty of the different financial services representatives.

## **Conclusion**

The RDR provides the perfect opportunity to highlight and re-establish the concept of the law of agency: demonstrating to consumers they have the choice to engage with those who are the “agents of the client” (“IFAs”) or those who are the “agent of the product provider” (sales people). The law of agency clearly defines who is acting on whose behalf, and sets out the legal duties of both the agent and the principal.

AIFA believes that the benefits to the consumer in offering absolute clarity of whether a firm is the ‘agent of the client’ or otherwise will go a long way to restoring trust in the sector. Unclear motivations of financial services “representatives” have damaged trust, and the RDR is the opportunity to restore trust through the distinction afforded by those working for the client without potential conflict of interest. This will help to restore trust in financial services as a whole.

The proposed distinction, which enjoys an elegant simplicity, seeks to address the heart of the problem. It is also important to recognise that independent advice and sales can work in tandem serving client needs; it is not a case of independent advice versus sales. They can and should be supportive and increasingly generate better consumer outcomes.

In order to help consumers fully understand this distinction, all forms of disclosure need to be free of industry jargon and based on everyday language which is easy for consumers to relate to. It is also important that the disclosure regime allows consumers to comprehensively judge the value of the services offered. Therefore consumers must be informed of the limits of the firm’s scope, and individual’s competence in order to assist them with this judgement. Additionally the financial promotions regime needs to help consumers understand firm’s offerings before they even enter into any dialogue, in order to prevent them from landing in a situation where they feel under pressure to purchase a product which they do not necessarily want or need.

We believe all of these measures combined will go a long way to help consumers understand who is on their side, and as a result, restore their faith and trust in financial services.