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Rebuilding trust: regulation of financial advisers in the UK

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Key points

- The 2006 UK *Retail Distribution Review* identified much-needed reforms to the retail investment markets. It suffered chronic problems arising from the provision of conflicted advice by financial advisers to their clients. The global financial crisis (GFC) added intense urgency to the need for reforms.
- As a result, commission-based charging for financial advisers were banned in 2012, and the requirements under the suitability rule were more sharply defined.
- This article traces the trajectory of the pre- and post-GFC reforms and the ways in which the judicial interpretations of the legislative reforms played an important role in regulating the retail investment markets.
- The article points to evidence that the reforms improved the quality of financial advice in a practical sense and has helped build consumer confidence in financial advisers. The analysis of this article is confined to the legislative text on the suitability rule and its interpretation by the UK courts.

1. Introduction

The UK was hit hard by the global financial crisis (GFC) beginning in 2008. The crisis forced UK policy-makers to reconsider the existing regulatory framework which governed the financial sector. Among other measures, two legislative reforms were introduced and enacted in response to the financial crisis: the 2009 Banking Act and the 2010 Financial Services Bill. The reforms aimed at developing a 'framework for crisis management and the structure of supervision', which involved dealing with ailing banks and also establishing a Council for Financial Stability.[1] To the mind of the regulators, the root causes of the GFC were intertwined with deeply embedded problems in the retail investment market. The crisis merely exposed these previously latent fallibilities.[2]

The reforms in the retail investment sector began prior to the GFC. In 2006, the Retail Distribution Review (the *RDR 2006*) was launched by the Financial Services Authority (the FSA)—the predecessor of the Financial Conduct Authority (FCA)—to identify and recommend reforms to deal with endemic problems within the UK investment market. One investigatory area centred on the use of commission as a way of paying for financial advice, under which, arguably, the interests of financial advisers were misaligned with those of their clients. The *RDR 2006* recommended commission-based payments be

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1 Menno Fenger and Lucia Quaglia, 'The Global Financial Crisis in Comparative Perspective: Have Policy Makers "Learnt Their Lessons"?' (2016) 18(5) Journal of Comparative Policy Analysis: Research and Practice 502, 509.

2 Ibid.

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eliminated in favour of an 'adviser charging' model.[3] In 2013, the ban on commission was implemented as 6.1A.4 R in the Conduct of Business Sourcebook (COBS).

Before the *RDR 2006* reforms, one perennial problem was that 'the adviser's interests were often aligned with the provider of a financial product, not the customer'.[4] This created 'poor quality financial advice and negative consumer outcomes', which had an adverse impact on consumer confidence in financial advisers.[5] Consumers were found to be considerably confused over the types of services being offered.[6] Trust was closely related to a consumer's experience of engaging an adviser. Those who had been recently advised were 'more trusting of their own adviser than they were of the financial advice sector in general' and distrust was most prevalent among those 'who had had no contact with an adviser for at least five years'.[7] Trust seems, simply put, to be 'driven by professional standards, while distrust is driven by advisers not acting in the customer's best interest'.[8] This perception was particularly harmful given that a lack of transparency actively compelled consumers to 'rely heavily on advisers'.[9] The GFC exerted a significant influence on the behaviour of investors. The 'volatility of financial markets' dis-incentivized many individuals from riskier investments,[10] thereby reducing trust in the financial system overall.[11]

The UK's existing regime is predominantly sourced from the EU's Markets in Financial Instruments Directive (MiFID II) and its Implementing Directive.[12] While early iterations of the suitability rule in UK law can be traced back to the Financial Services Act 1986, since 2007, the FSA had issued rules for the implementation of the suitability contained in the EU's Markets in Financial Instruments Directive (MiFID I) and explicitly employed the terminology of MiFID I.[13] The 'suitability rule' is arguably the most important element of the regulatory framework in regulating financial advisers. It has also become the key principle in regulating financial advisers in Anglo-American jurisdictions.[14]

3 House of Commons Treasury Committee (UK), *Retail Distribution Review* (Executive Summary, 17 February 2011) 62–63.

4 ibid <https://publications.parliament.uk/pa/cm201011/cmselect/cmtreasy/writev/rdr/m128.htm>.

5 Europe Economics, *Retail Distribution Review: Post Implementation Review* (Report, 16 December 2014) 6.

6 ibid 33.

7 Financial Services Authority, *Consumer Purchasing and Outcomes Survey 2010* (Consumer Research No 84, May 2011) 19.

8 ibid.

9 Financial Services Authority, *Describing Advice Services and Adviser Charging* (Consumer Research No 78, June 2009) 14.

10 Europe Economics (n 5) 11.

11 Ibid 12.

12 Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC [2004] OJ L 145 ('MiFID I'); Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU [2014] OJ l 173 ('MiFID II'). For an account of MiFID I/MiFID II in the UK context, see eg Kern Alexander, 'England and Wales' in Danny Busch and Cees van Dam (eds), *A Bank's Duty of Care* (Hart Publishing 2017) 249–84.

13 Financial Services Authority, *Responsibilities of Providers and Distributors for the Fair Treatment of Customers: Feedback on DP06/4* (Policy Statement 07/11, July 2007).

14 For example, in Australia, advice given by providers must be appropriate to the client (s 961G Corporations Act). Notably, the term 'appropriate' is used differently in the UK and Australian contexts. In the UK, it deals with execution only with no advice is given, while in Australia, this term is used as part of the suitability test. In the USA, advisers owe their clients a duty to provide only suitable investment advice. See US Securities and Exchange Commission, Regulation of Investment Advisers by the US Securities and Exchange Commission, 24 March 2013.

While acknowledging suitability is a vast topic, for the present purpose, our discussions will be confined to the regulation of financial advisers in the retail investment market.

In recent years, the level of public trust in the UK's financial advisers has improved. A research report conducted in 2018 reveals that 57 per cent of the clients trust their adviser or firm, while just 18 per cent have low levels of trust.[15] This is in contrast with an earlier survey conducted in November 2014, which indicated only 28 per cent of consumers trust their financial advisers.[16] The level of trust in the advice by individuals in the UK is noteworthy and seems to outperform that experienced in at least some of its common law counterparts like Australia.[17] A decade after the GFC, this survey gives us an opportunity to review and reflect upon the UK's approach to governing financial advisers through not only the institutional design, but also the manner in which judges interpret the law.

We argue that, inter alia, while the 2013 commission ban had obviously positive impacts on trust and confidence in the financial advisory profession, this mechanism alone is insufficient to explain the improvement of public trust in the profession. Litigation regarding alleged breaches of the suitability rule and the relevant jurisprudence built around it has played a role in holding financial advisers more accountable than had previously been the case. The UK courts were, as detailed below, also supportive of giving effect to the adviser's duties.

Against this backdrop, the remainder of this article proceeds as follows. Section 2 examines the reforms that took place in the UK in regulating financial advisers in the mist of the GFC. The focal point of Section 2 will be the development of the key principle in financial adviser regulation—the suitability rule. More specifically, Section 2 traces the trajectory of how financial advisers in the UK are regulated by anchoring our analysis in both the historical and the contemporary contexts. Section 3 then looks into the effects of the reforms arising from the abolition of commission. In Section 4, we provide a detailed account of the relevant case law on the interpretation of the suitability rule and illustrate the manner in which the UK courts give effect to it. Section 5 concludes.

2. The suitability rule

The Financial Services Act 1986 conferred regulatory functions on the Securities and Investments Board (SIB).[18] In their 1986 draft rules, the SIB first imposed 'conduct of business' requirements on the financial advice sector. The rules obliged firms to 'take

15 Edward Ripley and others, *The Changing Shape of the Consumer Market for Advice: Interim Consumer Research to Inform the FAMR* (FCA Report, August 2018) 13.

16 Statista, 'Levels of Trust in Financial Institutions in the United Kingdom (UK) 5 November 2014, by Institution' *Statista* (Web Page) <https://www.statista.com/statistics/350716/uk-financial-institutions-trust-levels/> accessed 21 June 2021.

17 Chris Pash, 'Trust in Financial Planners Is at an All-Time Low But Australians Still Want Advice' *Business Insider* (Webpage, 14 November 2018) <https://www.businessinsider.com.au/financial-planners-trust-all-time-low-advice-2018-11> accessed 21 June 2021; ASIC, *Report 627, Financial Advice: What Consumers Really Think* (Report, August 2019) (reporting that there is 'significant distrust of the financial advice industry'—for instance, there is 49 per cent of survey participants agreed that 'financial advisers were more interested in making themselves rich than in helping their customers'.)

18 Financial Services Act 1986 (UK), s 114(2).

reasonable steps to ascertain from its customer…facts about his personal and financial situation' to ensure 'proper performance of services'.[19] Despite not using the term 'suitability' explicitly, it represented an early iteration of a suitability rule under UK law.[20] The aim of the Financial Services Act 1986 was to significantly increase the level of responsibility attributed to a firm, requiring it to take reasonable steps in its duty to provide personalized advice to customers.[21]

Foundational principles of client-specific and tailored advice stemmed from this legislation, emerging from the demand for a comprehensive overhaul of the financial services industry.[22] Reform was particularly necessary, given the changing conditions of the market, including from increased international competition and new markets, as well as technological advancements.[23] Responding to these economic circumstances, the London Stock Exchange 'relaxed its rules on membership' and 'fixed commissions'.[24] The first central principle advanced in the creation of this legislation was the framework of self-regulation, which was reorganized as the SIB—later as the FSA and then the FCA—and was the primary rationale behind regulatory rules.[25]

Under this umbrella, the SIB's Conduct of Business (the COB) rules specifically advanced principles of customer protection, obliging firms to (1) ascertain information about the personal and financial situation of customers, (2) ensure that the firm is giving the best advice (although this rule could be reframed as 'best execution' for professional or experienced investors), (3) disclose conflicts of interest and (4) provide a detailed customer agreement.[26]

The COB rules were preserved under the Financial Services and Markets Act (FSMA) 2000, though by that time the SIB had been rebranded as the 'FSA'.[27] Rather than laying

19 David Barnard, 'The United Kingdom Financial Services Act, 1986: A New Regulatory Framework' (1987) 21(2) The International Lawyer 343, 351. As Julia Black and Richard Nobles pointed out, between 1988 and 1994, three major regulators involved in governing firms engaged in the sales of investment products (ie SIB, Lautro and Fimbra) more or less shared a common set of rules by requiring 'any person advising on or recommending an investment product to obtain sufficient information from the customer as to his/her financial circumstances (the 'know your customer' rule)' and 'to advise only those products which were suitable for the customer', among others. These duties, in particular the suitability rule, 'have been repeatedly emphasised by SIB to be key elements of the investor protection regime'—though what did they require in practice 'has been a matter of considerable debate'. See Julia Black and Richard Nobles, 'Personal Pensions Misselling: The Causes and Lessons of Regulatory Failure' (1998) 61(6) Modern Law Review 789, 791.

20 Bob Freeman, 'FSA Gets Tough on Client Suitability' *Professional Adviser* (London, 20 January 2011) 25; Roger McCormick, 'The Financial Services Act 1986' (1987) 6(1) International Financial Law Review 23, 23.

21 Iris H-Y Chiu, 'The Nature of a Financial Investment Intermediary's Duty to His Client' (2008) 28(2) Legal Studies 254, 263.

22 Barnard (n 19) 343; Charles Abrams, 'The New Investor Protection Regime' (1987) 2(1) Business Law Review 29, 29.

23 Barnard (n 19) 344; Tim Herrington, 'Financial Services Act 1986 and the New Regulatory Framework' (1988) International Business Lawyer 69, 69.

24 Herrington, ibid.

25 The SIB was originally established in 1985 and was granted its powers by the Financial Services Act 1986 (UK). A series of financial scandals occurred in the early 1990s which eventually lead to a restructure of the regulation of the financial services industry. It was renamed as the Financial Services Authority in 1997 and its powers were then derived from the Financial Services and Markets Act 2000 (UK). The FSA was officially abolished on 1 April 2013. Its functions were separated into new entities—the Financial Conduct Authority and Prudential Regulation Authority—and the Bank of England; Lord Bruce-Gardyne, 'The Operation of the Financial Services Act 1986' (1987) 3(Autumn) Statute Law Review 186, 187; Abrams (n 22).

26 Barnard (n 19) 343, 351–3; Abrams (n 22) 29, 33.

27 The SIB was renamed as the 'FSA' in 1997: Select Committee on Treasury, Third Report (February 1999) para 4 at <https://publications.parliament.uk/pa/cm199899/cmselect/cmtreasy/73/7302.htm> accessed 21 June 2021.

out financial advice obligations directly, the FSMA empowered the FSA to issue statements of principle for such conduct and required that these be elaborated upon by a code of practice (ie COB).[28] The Act outlined the associated disciplinary regime: failure to comply with the statements of principle would constitute misconduct and was subject to action by the FSA, which could impose a financial penalty or issue a statement of censure.[29] The FSA could also prohibit any individual whom it considered 'not fit and proper' from performing services as a financial adviser.[30]

As noted, before the GFC the notion of suitable advice was already located in Principle 9 of the FSA's Principles of Business, which refers to 'Customers: relationships of trust'. The principle states that '[a] firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment.' In July 2006, the FSA introduced an initiative called 'Treating Customers Fairly' (TFC), featuring six outcomes that the FSA expected businesses to incorporate into their processes and culture. Outcome 4 stated that '*where consumers receive advice, the advice is suitable and takes account of their circumstances*'.[31] The FCA continued to support the Principles of Business and the TFC which are included in the FCA's Handbook.[32]

The first EU Markets in Financial Instruments Directive (MiFID I) took effect in 2007 as a push to standardize the regulation of particular sectors across the region, while leaving the Member States the freedom to choose how to implement it. MiFID I required EU Members to regulate businesses that provide services to clients in relation to 'financial instruments' and the venues where they are sold.[33] Article 19(4) of MiFID I required that where investment advice is provided, the firm must obtain the necessary information about the client and their situation in order to recommend 'investment services and financial instruments that are *suitable* for him'.[34] In 2007, the FSA issued rules for the implementation of the suitability and appropriateness tests contained in MiFID I.[35] In the same year, the COBS came into practice.

28 Financial Services and Markets Act 2000, s 64(1) and (2). Statements of principle set out in general terms the kinds of behaviour required from approved persons, while the code of practice helps determine whether or not a person's conduct complies with this statement of principle: Financial Services and Markets Act 2000 (UK), s 64(2); Explanatory Note to the Financial Services and Markets Act 2000, para 144.

29 Financial Services and Markets Act 2000 (UK), s 66(1), (2) and (3); Explanatory Note to the Financial Services and Markets Act 2000, para 131.

30 Financial Services and Markets Act 2000 (UK), s 56 ('prohibition orders'). Writing in the context of FSMA, Colin Scott and Julia Black pointed out that financial advisers are 'required to advise on and recommend only in investment products that are suitable for the consumer' and such a duty 'is coupled with a requirement that the adviser "know the customer"'. The suitability and know your customer rules are, according to them, 'central planks in the investor protection regime, and have been likened to the "fitness for purpose" standards that apply in the sale of goods'. Colin Scott and Julia Black, *Cranston's Consumers and the Law* (3rd edn, Butterworths 2000) 210, 211.

31 Financial Services Authority, *Treating Customers Fairly—Towards Fair Outcomes for Consumers* (Discussion Paper, July 2006) 3 (emphasis added).

32 The FSA was officially abolished on 1 April 2013 and superseded by the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA).

33 'MiFID II', *Financial Conduct Authority* (Web Page, 24 July 2019) <https://www.fca.org.uk/markets/mifid-ii> accessed 21 June 2021.

34 MiFID I, art 19(4) (emphasis added).

35 Financial Services Authority, *Responsibilities of Providers and Distributors for the Fair Treatment of Customers: Feedback on DP06/4* (Policy Statement 07/11, July 2007).

In other words, the suitability requirement was not an explicit regulatory rule until the introduction of reforms levelled by the MiFID I, effective from 2007.[36] MiFID I represented the EU's intent to reshape the firm/investor relationship and formulate strict regulations for suitability assessments.[37] It was designed to 'establish a rigorous investor protection regime. . .to encourage the development of a stronger retail market.'[38] The change arguably marked a critical juncture where the suitability regime shifted from a principle-based one to a relatively more 'interventionist' and 'regulatory' one with the imposition of detailed assessment requirements.[39] This included requiring the detailed collection of information on the investor's income and assets, as well as the investor's risk profile, risk-taking preferences and time horizon.[40] This represented, moreover, an evolution of more principle-based interpretations based on the self-regulatory principles of 'due skill care and diligence' established in 1986.[41] Additionally, the COBS was implemented as the successor to the COB, at the same time that MiFID I came into force in November 2007.[42]

Then came the GFC. As a by-product, the GFC arguably accelerated regulatory changes.[43] How to manage product mis-selling risks facing retail customers had been longstanding issues within the UK financial system.[44] The crisis accentuated these harms, reflecting the problems 'created by asymmetry of power and information between providers, advisers and consumers, together with unsustainable business models'.[45] In the view of the regulators, the GFC amplified pre-existing and deeply embedded problems with the retail investment market. The crisis merely exposed some of those previously latent fallibilities.[46] In all this, the crucial element of investor trust in advisers went out of the window, necessitating the 'requirement to rebuild trust: trust in the system and trust in those who operate it'.[47]

36 Niamh Moloney, 'Large-scale Reform of Investor Protection Regulation: The European Union Experience' (2007) 4 Macquarie Journal of Business Law 147, 156; Richard Stones, 'It All Depends on What You Mean by "Client"' (2006) 1 International Financial Law Review 1, 3.

37 Chiu (n 21).

38 Moloney (n 36) 147, 157; David Smith, 'Surviving or Thriving Under the MIFID' (2008) 13(1) Corporate Finance Review 12, 13.

39 Moloney (n 36) 147, 165; Chiu, (n 21).

40 Moloney (n 36) 147, 166

41 The suitability requirement after the MiFID reforms is established as creating more standards, for instance a detailed risk profile and information on the investors assets: *Legal & General Assurance Society Ltd v Financial Services Authority* [2005] All ER (D) 154 [127].

42 *Bank Leumi (UK) Plc v Wachner* [2011] EWHC 656 (Comm) [9].

43 Before the GFC, the UK regulator had focused on a principle-based approach as opposed to a rule-based approach—that is, the regulator set forth a set of principles reacting to risks and evidence and allowed firms to determine how to act within these principles. After the GFC, Sir Hector William Hepburn Sants, the successor of John Turner, admitted the limitation of the principle-based approach, noting that 'A principles-based approach does not work with individuals who have no principles'. For a detailed recount, see Julia Black, 'The Rise, Fall and Fate of Principles Based Regulation' (2010) (LSE Law, Society and Economy Working Papers 17/2010).

44 See eg Eilís Ferran, 'Regulatory Lessons from the Payment Protection Insurance Mis-selling Scandal in the UK' (2012) 13 European Business Organization Law Review 247.

45 House of Commons Treasury Committee (UK), *Retail Distribution Review: Fifteenth Report of Session 2010-12* (Report No 15, 2010-12), Ev 24.

46 Ibid.

47 Andrew Massey, 'Nonsense on Stilts: United Kingdom Perspectives on the Global Financial Crisis and Governance' (2011) 11(1) Public Organization Review 61, 73.

While the GFC itself did not necessarily change the fundamental trajectory of regulatory reforms, it did serve as a catalyst for the reforms proposed back in the *RDR 2006*, the need for which became pressing because of factors including the considerable loss of consumer confidence, and widespread 'irresponsible lending and investment practices, fraud, auditing deficiencies and poor disclosure'.[48] More directly, the GFC also 'highlighted limits in the ability of non-retail clients to fully appreciate investment risks'.[49] In the EU, the MiFID II regime maintained the client categorization regime under MiFID I, while changing some rules in relation to how firms deal with municipalities and local public authorities. Additional requirements such as periodic suitability assessments and reports were incorporated through COBS 9, also drawn from MiFID II.[50] We will return to these in detail below. In our view, these measures could be seen as a response to the concerns accentuated by the GFC. Addressing the fears that the risk was inadequately assessed, stringent risk assessments were necessitated in the reformed suitability regime.

In 2010, the FSA raised concerns about the level of unsuitable advice in the market. Despite regulatory standards, many firms under financial pressure maintained lax standards to 'maintain income streams, resulting in an increase in unsuitable sales'.[51] At the same time, firms were not discussing the implications of changes which involved 'extra cost', and instead maintained a 'one size fits all business model' that was not sensitive to the individual objectives of clients.[52] More particularly, the FSA found that risk profiles were diverse—and financial advisers found it difficult to 'devise strategies for clients with a suitable balance of risk and return'.[53]

In 2014, demands for further reform catalysed the introduction of MiFID II, effective in 2018.[54] By and large, MiFID II confirmed the importance of the suitability assessment outlined in MiFID I,[55] but further expanded on suitability obligations. An additional burden was placed on firms to consider risk and clients' profiles in a complex way: this responsibility was not absolved by the use of electronic systems.[56] Moreover, firms were required to 'provide clients with a statement on suitability'—known as the 'suitability report'—when providing a personal recommendation.[57] These new requirements have been

48 Robin Bowley, 'Regulating the Financial Advice Profession: An Examination of Recent Developments in Australia, New Zealand and the United Kingdom and Recommendations for Further Reform' (2017) 36(1) University of Queensland Law Journal 177, 178.

49 Financial Conduct Authority, *Markets in Financial Instruments Directive II Implementation—Consultation Paper III*' (Consultation Paper No CP16/29, September 2016) 36.

50 Taylor Wessing, 'Suitability' (User Guide, 10 February 2017) 1 <https://united-kingdom.taylorwessing.com/en/news/mifid-ii-user-guides> accessed 21 June 2021.

51 Financial Services Authority, *Financial Risk Outlook: Retail Intermediaries Sector Digest* (Digest, 2010) 9.

52 Ibid.

53 Ibid.

54 According to art 65 of MiFID I, it was meant to be periodically reviewed. And, per MiFID II Preamble (1), 'Since further amendments are to be made, it should be recast in the interests of clarity.'

55 European Securities and Markets Authority, *Guidelines on Certain Aspects of the MiFID II Suitability Requirements* (Final Report, 28 May 2018) 4.

56 Ibid.

57 Ibid

incorporated into the COBS as a separate chapter (COBS 9).[58] The suitability provision was expanded with the additional assessment of the client's 'risk tolerance and ability to bear losses' added to the provision now located in Article 25(2).[59] Despite Brexit, MiFID II is still binding in the UK and its rules are applied by the FCA.[60]

The suitability requirements in MiFID II apply to investment services that provide investment advice or portfolio management to clients. The degree of suitability assessment however varies depending on the type of client: namely, whether they are a retail, professional or eligible client.[61] Retail clients are required to be subject to the greatest degree of assessment, followed by professional clients then eligible counterparties.[62] As regards professional clients, the investment firm is entitled to assume the client 'has the necessary level of experience and knowledge for the purposes of assessing suitability'.[63]

COBS 9 incorporated the changes embedded within MiFID II, including additional demands such as periodic suitability assessments and periodic suitability reports.[64] The COBS 9.2.1R[65] requires a firm to 'take reasonable steps to ensure that a personal recommendation. . .is suitable for its customer'.[66] The COBS 9.2.2R further outlines several facets of a client's circumstances to be examined in the process of determining suitability for an individual client.[67]

58 Financial Conduct Authority, *Markets in Financial Instruments Directive II Implementation—Policy Statement II* (Policy Statement, July 2017) 85 ('*MiFID II Implementation*').

59 MiFID II art 25(2). In MiFID I, Article 19(4) only required that the advisor must consider the client's 'financial situation and his investment objectives', whereas in MiFID II, the wording in art 25(2) is 'financial situation including his ability to bear losses, and his investment objectives including his risk tolerance'.

60 Financial Conduct Authority, *The MiFID 2 Guide* (Release 42, September 2019). To maintain its market access rights to the EU, the UK has equivalence arrangements in various areas, including financial services. To this end, the UK firms would be required to comply with MiFID II and additional requirements as required by the EU. This has been made clear in the Consultation Paper. Draft technical standards on the provision of investment services and activities in the Union by third-country firms under MiFID II and MiFIR issued by ESMA on 31 January 2020, the day on which Brexit officially became effective. It remains to be seen, therefore, how would both parties negotiate such equivalent arrangements that can affect the UK's framework on financial advisers. In addition, ESMA released a statement on that day stating that per the Withdrawal Agreement, the UK will still be bound by EU law (including MiFID II/MiFIR) during the transition period from 1 February 2020 until 21 December 2020: ESMA, *ESMA: Update on Governance and Reporting Obligations Following the UK's Withdrawal from the European Union* (Public Statement, 31 January 2020) <https://www.esma.europa.eu/sites/default/files/library/esma90-368-186_public_statement_-_brexit_update_-_january_2020.pdf> accessed 21 June 2021.

61 MiFID II Preamble 79.

62 MiFID II art 25(6).

63 Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organizational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive [2016] OJ L 87 art 54(3).

64 Wessing (n 50).

65 Contained within the Financial Conduct Authority's ('FCA') Handbook, the United Kingdom Conduct of Business Sourcebook ('COBS') establishes rules applicable to designated investment firms. COBS replaced the earlier Sourcebook ('COB') in November 2007: Simon Collins, 'The Regulatory Framework' *Chartered Insurance Institute* (Web Page, 21 November 2018) <https://www.cii.co.uk/fact-files/law-and-regulation/the-regulatory-framework/> accessed 21 June 2021. The Handbook contains binding obligations backed by enforcement action from the FCA, as well as interpretive assistance related to the Financial Services and Markets Acts ('FSMA'). Hence, the court must interpret the FSMA through the lens of the COBS provisions: Burges Salmon, 'Interaction between Regulatory Enforcement and Civil Proceedings' (Briefing, June 2014) 1 <https://www.burges-salmon.com/-/media/files/publications/open-access/financial_services_series_issue_9.pdf> accessed 21 June 2021.

66 Financial Services Authority, *Assessing Suitability: Establishing the Risk a Customer is Willing and Able to Take and Making a Suitable Investment Selection* (Finalized Guidance, March 2011).

67 Ibid.

The requirement constitutes an assessment on the suitability of any recommended investment,[68] not only factoring in 'the risk a customer is willing to take', but 'the client's capacity for loss and their objectives and circumstances'.[69] This holistic evaluation reflects the core elements of 'suitability'—objectives, financial situation and knowledge and experience of a client—requiring firms to consider both subjective preferences—such as attitudes towards risk taking—and objective circumstances like financial capacity.[70] The amalgamation of COBS 9.2.2R considerations can be summarized by the expression 'the risk a customer is willing and able to take'.[71] This necessitates the collection of specific details from clients to inform 'personal recommendations'.[72]

COBS 9.4 further requires firms to 'provide a "suitability report" if a retail client decides to take action as a result of this recommendation'.[73] COBS 9, which was introduced following the implementation of MiFID II, likewise places additional demands on firms to obtain necessary information to make a suitability assessment and recommend investments accordingly.[74] COBS 9 specifically encapsulates all MiFID II suitability requirements. In particular, these enhanced requirements include periodic suitability assessments and periodic suitability reports.[75]

3. The ban of commission in 2013 and its implications

One investigatory area of the *RDR 2006* centred on commission-based models for paying advisers, under which arguably the interest of financial advisers was misaligned with those of their clients. Product providers such as managed investment funds would pay a commission to an adviser for arranging the adviser's client to invest with the product provider. As a result, the client would usually receive investment advice from the adviser for 'free'. However, different product providers provided different rates of commission. Advisers were therefore incentivized to recommend investment products to their clients that resulted in the highest commission for the adviser, rather than the product that would necessarily be in the client's best interests. The *RDR 2006* criticized the conflicting interests concerning commission payments and proposed a system where firms charge clients on a

68 Financial Conduct Authority, *The Assessing Suitability Review—Results* (Review, May 2017) 8.

69 Mark Loosmore, 'The Suitability of Risk Assessment' *Professional Adviser* (London, 24 March 2011) 25; 'Assessing Suitability' Financial Conduct Authority (Web Page, 6 March 2020) <https://www.fca.org.uk/firms/assessing-suitability> accessed 21 June 2021.

70 The Committee of European Securities Regulators, 'A Consumer's Guide to MiFID: Investing in Financial Products' (2008), 6. Financial Services Authority (n 66) 2.

71 Financial Services Authority (n 66) 2.

72 For a sample of discussion on this issue, see eg Robin Bowley, 'Regulating the Financial Advice Profession: An Examination of Recent Developments in Australia, New Zealand and the United Kingdom and Recommendations for Further Reform' (2017) 36(1) University of Queensland Law Journal 177, 184; Ronald Janssen and Bert Kramer, 'Risk Management and Monitoring in Private Banking' (2015) 18(3) The Journal of Wealth Management 8, 9.

73 Ibid; MiFID II art 25(6).

74 *MiFID II Implementation* 85.

75 Wessing (n 50); ESMA, *MiFID II Supervisory Briefing: Suitability*, (Supervisory Briefing, 13 November 2018) 2.6 (32); COBS 9A.3.2(4); COBS 16A.2.1.

fee-for-service basis.[76] The proposal recommended all firms should be paid through 'adviser charging', comprising 'charges that they have set out upfront and agreed with their clients'.[77] Charges should 'reflect the services being provided to the client, not the particular product provider, or product, being recommended'.[78] In June 2007, the FSA released a Discussion Paper, analysing the flaws of commission-based models in financial advisory firms.[79]

The GFC further prompted the UK government to institute regulatory reforms—'to lessen the prospects of a recurrence of similar crises'.[80] One such reform was the ban on conflicted remuneration structures.[81] Amid the GFC, in November 2008 a Feedback Statement was released by the regulator, reflecting input from industry stakeholders and consumer groups.[82] The Feedback Statement provided a clear conception of desired changes in the retail investment market. The Statement outlined proposed recommendations from the outset to give the market sufficient time to implement changes over a period running through to 31 December 2012.[83]

In June 2009, a Consultation Paper affirmed the proposed commitments set out in the Feedback Statement.[84] In the intervening months, the regulator continued to refine proposals by engaging with firms, trade associations, and other industry stakeholders. The Consultation Paper clarified the revised changes and set a four-month consultation period.[85] A March 2010 Policy Statement formed the final iteration of the consultative process. This finalized the rules on remuneration to be incorporated by the end of 2012.[86] In 2013, the ban on commission was implemented as 6.1A.4 R in the COBS. Generally, there were three harms to the consumer that the ban sought to deal with.[87]

76 House of Commons Treasury Committee (UK), *Retail Distribution Review* (Executive Summary, 17 February 2011)<https://publications.parliament.uk/pa/cm201011/cmselect/cmtreasy/writev/rdr/m128.htm> accessed 21 June 2021.

77 Financial Services Authority, 'Distribution of Retail Investments: Delivering the RDR—Feedback to CP09/18 and Final Rules' (Policy Statement, March 2010) 25 ('2010 *Policy Statement*').

78 Ibid.

79 Financial Services Authority, *A Review of Retail Distribution* (Discussion Paper, June 2007) <https://www.fca.org.uk/publication/discussion/fsa-dp07-01.pdf> accessed 21 June 2021 (Discussion Paper).

80 Ibid.

81 Ibid.

82 Financial Services Authority, *Retail Distribution Review: Including feedback on DP07/1 and the Interim Report* (Feedback Statement, November 2008) <https://www.sfc.hk/web/doc/EN/general/general/lehman/Review%20Report/Exhibit%203.pdf> accessed 21 June 2021.

83 Ibid 4.

84 Financial Services Authority, *Distribution of retail investments: Delivering the RDR* (Consultation Paper, June 2009) <https://www.fca.org.uk/publication/consultation/fsa-cp09-18.pdf accessed\12/03/2020> accessed 21 June 2021 (Consultation Paper).

85 Ibid 4–5.

86 2010 Policy Statement (n 77).

87 The first related to consumer perception of the advice industry. Low levels of consumer confidence in the sector necessitated remuneration reforms which 'could complement significant improvements in the professionalism of the advice industry'. Detaching advisers from latent bias also amplified consumer confidence in the market: Feedback Statement. The second centred on transparency for consumers. The perception that 'advice is free if the adviser receives commission' remained common and perniciously created a false characterization of the industry: Discussion Paper. A ban on commissions would 'clarify the services being provided and their relative costs' (Feedback Statement (n 82) 58) distinguishing the actual cost of advisory services by 'showing these separately from other product costs'. Feedback Statement (n 82) 58. This encourages advisory firms to 'explain the value of their services', correcting the presumption that financial advice is free: Discussion Paper (n 79) 57. Greater transparency empowered consumers to access the most appropriate advice and apply pressure on service suppliers: Feedback Statement (n 82) 57.

Equally, reforms were designed to deliver several advantages to firms and product providers.[88]

Since its implementation in 2013, the policy has undergone extensive review. In August 2015, the Financial Advice Market Review (FAMR) was launched, which continued the work of the *RDR 2006*, and once again reviewed ways to stimulate the development of the UK market for all consumers.[89] The 2016 FAMR Final Report affirmed that commission payments biased the recommendations of product providers.[90] Commission not only impaired transparency in financial advice, but also actively distorted the incentives relating to the advice presented to consumers.[91] The recommendations implied that the suitability rule of itself was inadequate in overcoming the problems that commission-based payments create in placing the adviser in a conflicted position.[92] In other words, there is a high risk that the adviser will be driven by the financial incentive to recommend the product that provides the highest commission rather than the product that best serves the client's interests. Worse still, the products that offered the highest commission often did so because they were inherently problematic. The product might have been unduly risky or entailed inferior investments, which would have led advisers to avoid recommending them to clients if they were not incentivized otherwise.[93]

The post-*RDR 2006* approach required advisers to employ 'a transparent charging structure'. It replaced commission payments with charging methods, such as hourly or fixed fee rates.[94] This reform has been supported by the majority of respondents to the FAMR Call for Input.[95]

Existing disclosure requirements were insufficient for customers who did not understand this well: Discussion Paper (n 79) 50–1. The culmination of a lack of transparency constitutes the third and most tangible detriment—direct mis-alignment of adviser and consumer interests creates adverse investment outcomes. Product providers recognize that a commission-based model is likely to distort the outcomes of advice; this incentivizes them to 'use commission rates to attract market share': Discussion Paper (n 79) 49. Centralizing the fee determination interaction as one between provider and adviser: Discussion Paper (n 79) 53.

88 As substantial detriments for consumers analogously threaten the long-term viability of firms (Discussion Paper 48), sustainable business practice depends on the fair treatment of customers and the appropriateness of a product. Moving from 'a model that relies heavily on up-front revenue' to 'recurring revenue models' incentivizes firms to adopt such long-term business strategies: Discussion Paper 52. Framing remuneration arrangements as a discussion between consumer and adviser also re-shifts the basis of competition 'away from remuneration towards the quality and price of products and services': Discussion Paper 51. Product providers such as Prudential and Scottish Life introduced customer-agreed remuneration (CAR) in the belief that 'the quality and profitability of the business. . .increased since it introduced CAR': Discussion Paper 55.

89 Financial Conduct Authority, *Financial Advice Market Review* (Final Report, March 2016) 3.

90 Ibid 46.

91 Ibid.

92 Financial Conduct Authority (n 89) <https://www.fca.org.uk/publication/corporate/famr-final-report.pdf> accessed 21 June 2021.

93 There is also an issue of trail commissions. Trail commissions refer to 'ongoing payments from within a super/investment or insurance account' paid to a financial adviser: Michael O'Hara, 'Grandfathered Commissions Explained' *Financial Planning Perth* (Blog Post, 9 August 2018) <http://www.michaelsmusings.com.au/features/grandfathered-commissions-explained/> accessed 21 June 2021. These were incurred by some investment products purchased before 31 December 2012: 'Trail Commission' *Financial Conduct Authority* (Web Page, 18 April 2016) <https://www.fca.org.uk/consumers/trail-commission> accessed 21 June 2021. Following Retail Distribution Review reforms, commissions—including trail commission—were banned on new investment products purchased after 31 December 2012: 'Trail Commission' *Financial Conduct Authority* (Web Page, 18 April 2016) <https://www.fca.org.uk/consumers/trail-commission> accessed 21 June 2021. However, 'a financial adviser. . .can continue to receive trail commission for advice on investments. . .bought before 31 December 2012'.

94 Ibid 45.

95 Ibid 46.

Before the ban on commission was introduced in December 2012, many consumers seemed to believe that 'advice was free of charge and did not understand the impact that commissions would ultimately have on their investment product returns'.[96] Financial advice was disproportionately used by the affluent, while low-income consumers often viewed fee-based advice 'as an unattractive option'.[97]

Prior to the enactment of the commission ban, media responses broadly acknowledged the argument that consumer confidence would be improved, but many were also concerned about financial exclusion. The concern was that people would be dissuaded from seeking financial advice due to upfront fees.[98] Some dubbed the new rules 'the death of the salesman'.[99] Industry analysts believed that clarifying the costs of financial advice would disincentivize customers from seeking advice, with a survey suggesting that 'nine out of 10 consumers would only pay up to £25 for an hour's financial advice, compared with the mooted £50–£250 an hour fee range expected in the review'.[100]

Some respondents complained that the *RDR 2006* rendered financial advice less accessible through unaffordable charging methods. Concerns noted that the 'the advice charge must be taken upfront', suggesting that the *RDR 2006* 'removed some flexibility in the way advisers can charge for single-premium products'.[101]

While many commentators have said that the transition to adviser charging 'has been a lot less tough than previously imagined',[102] concerns have arisen about the potential manifestation of an 'advice gap' that disadvantages less-wealthy consumers. The first element of this critique centres on the difficulty of engaging new clients after the reforms.[103] Clients are 'most likely to be charged an upfront fee', which has deterred new investment.[104] Some investors are disincentivized from paying for professional advice with clearly apparent costs compared to more 'opaque' commission payments.[105]

The extension of this decreased demand had transformative effects on the industry. A study of compensation methods affirmed that investment advisers catering to low net worth clients were more likely to charge through commissions than hourly fees.[106]

96 ibid 6.

97 Financial Services Authority, *Consumer Perceptions of Basic Advice* (Consumer Research No 70, November 2008) 8.

98 Emma Simon, 'Your Adviser Can No Longer Take Commission on Sales' *The Telegraph* (Web Page, 31 December 2012) <https://www.telegraph.co.uk/finance/personalfinance/investing/9772551/RDR-Your-adviser-can-no-longer-take-commission-on-sales.html>.

99 Patrick Collinson, 'FSA Ban on Commission-Based Selling Sparks 'Death of Salesman' Fears' *The Guardian* (Web Page, 31 December 2012) <https://www.theguardian.com/business/2012/dec/30/fsa-ban-commission-selling-death>.

100 Ibid.

101 Ibid. However, adviser charging rules already facilitate flexibility in payment options, including allowing firms to 'receive an adviser charge in instalments' in relation to ongoing services, regular-premium products and single-premium products. The Report recommended that the FCA actively assist firms and advisers to become aware of such flexible charging options.

102 Fiona Murphy, 'Adviser Charging: Fair or Foul?' *Professional Adviser* (11 February 2014) 10–11.

103 Ibid.

104 Ibid.

105 Lukas Deana and Michael Finke, 'Compensation and Client Wealth among U.S. Investment Advisors' (2012) 21(2) Financial Services Review 81.

106 Ibid.

Presumably, in the aftermath of the ban on commission, it was possible that the number of financial advisers would likely either decrease, or cease to 'cater to low and moderate net worth households'.[107]

As a consequence, the cumulative systemic effect of this policy was disproportionately likely to affect poorer households. Under the *RDR 2006* reforms, fee-based financial intermediaries may be more likely to exclude customers below a certain income or asset threshold.[108] Unprofitable accounts were dropped and the number of employed advisers was accordingly reduced.[109] Principally, evidence demonstrates that investors who receive financial advice 'accumulate more wealth and feel better prepared for retirement than non-advised individuals with similar socio-economic characteristics'.[110] This meant that the economic risks of lower-income households being excluded from financial investment advice potentially outweighed the benefits of the ban, particularly noting the noticeable increase in non-advised sales of financial products from 33 per cent to 67 per cent in the UK.[111] This was especially the case given onerous administrative and compliance costs, with banks and building societies concluding that there was 'no cost-effective solution acceptable to mainstream investors'.[112] This has led some commentators to suggest that it may be better to promote a fiduciary standard of care than pursue the elimination of commission.[113]

However, the issues of bias in commission payments were also prominent in discourse leading up to the ban. Commission payments 'have been at the heart of mis-selling scandals involving policies such as mortgage endowments and personal pensions'.[114] The FSA indicated that the changes to the fee-paying structure were likely to result in more suitable advice, stating that 'consumers will know what they are buying upfront, how much it will cost them and also have the peace of mind that it was recommended to suit their needs'.[115] Additionally, the distortive effect of commission on advice meant that the sale of policies was not necessarily in the customer's interest. The FSA claimed that the commission ban meant that 'firms offering independent advice will have to demonstrate that their recommendations are based on a comprehensive and unbiased analysis of the market, and that any product selection is made in their clients' best interests'.[116]

After the banning of commission, in the first instance, the number of advisers did drop in the years following the ban—'from about 40,000 in 2011 to about 31,000 by January

107 Ibid.

108 Pierre Lortie, 'A Major Setback for Retirement Savings: Changing how Financial Advisers are Compensated Could Hurt Less-than-Wealthy Investors Most' (2016) 9(13) The School of Public Policy Publications 22.

109 Ibid 23.

110 Ibid 8.

111 Ibid 24.

112 Ibid 23.

113 Deana and Finke (n 105).

114 'Financial Advisers' Commission to be Banned from 2012' *BBC News* (Web Page, 26 March 2010) <http://news.bbc.co.uk/2/hi/business/8589042.stm> accessed 21 June 2021.

115 Ibid.

116 Ibid.

2014'.[117] Despite the decrease in advisers, however, it was unclear whether an 'advice gap' did actualize.[118]

It should also be recognized that levels of trust in financial advisers may be affected by many events in the broader context.[119] As such, it may be difficult to 'attribute any changes in levels of trust to the *RDR 2006*—or the commission ban—specifically'.[120] The majority of respondents to the Financial Advice Market Review's Call for Input felt that 'the RDR had been successful in increasing professionalism in the advice industry'.[121] Trust in financial advisers among existing clients remained high, which was likely derived from the ongoing adviser–client relationship.[122] Some evidence indirectly suggested increased engagement by consumers, as disproportionately more clients began paying for advice compared to a smaller number who stopped investing.[123]

Overall, before the commission ban, consumer distrust in the financial advice industry was prevalent, with commission at the centre of endemic mis-selling scandals in the UK.[124] Despite this, the public and financial advice industry broadly feared that reforms would disincentivize customers from accessing financial advice. The industry also feared that, as a consequence, it would be weakened by decreased demand, exerting consequences for the number of advisors retained.[125]

After the ban, professionals in the industry indicated that the ban on commission had improved the quality and suitability of advice. Arguably, as a result, the primary metric by which advisers are remunerated is via their competence in providing suitable advice, necessitating higher standards of inquiry into assessment procedures.[126] Increased transparency re-aligned the focus of advisers to the individualized needs of customers, given

117 Jeremy Burke and Angela Hung, *Financial Advice Markets: A Cross-Country Comparison* (RAND Corporation, 2015) 25.

118 Conflicting evidence arises: with one 2013 survey finding that 47 per cent of 250 financial advisers surveyed 'recently turned away clients because the cost of their service had become disproportionately high'. In contrast, another study found that 83 per cent of advisers had capacity to advise additional clients. Only 19 per cent 'claimed they would not advise on accounts below a certain threshold'. Ultimately, a subsequent study conducted by Towers Watson suggested that supply and demand for advisers was broadly aligned, producing no evidenced advice gap. Even if an advice gap existed, it may have been small or negligible, given that only 14 per cent of non-advised clients indicated that they did not seek advice because of an associated fee. Less than 15 per cent of advisers stopped servicing 'smaller' clients and surveyed advisers 'on average, refused to advise only three clients because of profitability concerns'. Clients were also likely able to seek advice from an alternative firm if rejected initially.

Findings have additionally supported the claim that the reforms would lead to a reduction of biased financial advice. After RDR 2006, 'flows into high-cost investments' have reduced, with an observable increase in investment 'into funds with lower fees'. The percentage of retail flows in share classes with the highest annual management charges dropped from 60 to 20 per cent between the implementation of RDR 2006 and May 2014. (Burke and Hung (n 117) 25, 26–27)

119 Europe Economics (n 5) 25.

120 Ibid.

121 Financial Conduct Authority (n 89) 17.

122 Europe Economics (n 5) 25.

123 Ibid 28.

124 See n 114.

125 Patrick Collinson, 'FSA Ban on Commission-Based Selling Sparks "Death of Salesman" Fears', *The Guardian* (Webpage, 31 December 2012) <https://www.theguardian.com/business/2012/dec/30/fsa-ban-commission-selling-death> accessed 21 June 2021.

126 According to a former UK mutual life company executive, advisers were more likely to provide suitable advice in order to attract clients when their payment was transparent—advisers were incentivized to justify why their expertise was most attuned to the needs of the client and hence warranted the payment of a direct fee: Bob Veres, 'How the UK RDR Ban on Commissions Increased Demand for Financial Advice', *Kitces* (Blog Post, 19 December 2016) <https://www.kitces.com/blog/uk-rdr-commission-ban-increases-financial-advice-demand/> accessed 21 June 2021.

that advisers had to provide further justification for their expertise where the threshold of the customer's buy-in was higher.[127] When the customer had to be incentivized to pay a fee and did not assume that the service was free, a higher and more suitable quality of service was necessary.[128] Nonetheless, some fears materialized as affordability did emerge as a greater concern than access.[129]

In the first instance, it is inconclusive whether the reforms contributed to an increase or decrease in engagement—with the evidence only indirectly suggesting that access had improved.[130] Nonetheless, it seems that encouraging customers to reconsider their views on the industry may leverage increased integrity and trust to encourage advice-seeking.[131] To the extent that consumer demand is largely influenced by trust, the remaining difficulty is the high cost of advice. This issue continues to be followed up and moderated by the FCA looking into robo-advice and lowering advice costs.[132]

As the adverse ramifications of the ban progressively subside, it does seem that tangible benefits have eventuated. The vast majority of those who were aware of the reforms reported that the industry had improved, their perception being that advisers were becoming more professional and trustworthy.[133] Similarly, advice professionals noted that advisers were required to provide more suitable advice, as their incentives were influenced by the ban.[134] Professionals themselves have changed their minds about the efficacy of the ban, which constitutes a significant influence for those who do engage with the industry.[135] The main remaining issue of perception relates to the question concerning the behaviour of those who are unaware of the changes and hence remain unwilling to engage with the industry due to mis-selling in the past.[136]

4. The court decisions on the suitability rule

Interpreting the suitability rule

It seems that a court's rationale for its final determination may have been significantly more principle-based prior to 2013, given that suitability requirements were not as comprehensive and detailed as they were after 2013.

In a 2011 decision, *Mohamed Magdy Zeid v Credit Suisse*, Teare J acknowledged there was no material difference between COB and COBS when it comes to the assessment of the suitability of the financing.[137] COBS rules are simply more explicit than COB rules.

127 Ibid.

128 Ibid.

129 Financial Conduct Authority (n 89) 6.

130 Europe Economics (n 5) 28.

131 Ibid 27.

132 Siobhan Riding, 'Watchdog Probes Financial "Advice" Gap', *Financial Times* (Online, 1 May 2019) <https://www.ft.com/content/f675a6e2-6bf4-11e9-80c7-60ee53e6681d> accessed 21 June 2021.

133 Financial Conduct Authority (n 89) 17.

134 Veres (n 126).

135 Ibid.

136 Financial Conduct Authority (n 89) 6.

137 *Mohamed Magdy Zeid v Credit Suisse* [2011] EWHC 2422 (Comm) [122].

For example, in *Mohamed Magdy Zeid v Credit Suisse*, when financing is used to purchase a product, when assessing suitability, the financing itself must be considered. This requirement was implicit in COB but is the subject of express guidance in COBS.[138] In the appeal case of *Zaki v Credit Suisse (UK) Ltd*,[139] Rix LJ observed that COB 5 was less specific about assessing suitability.[140] COBS 9.2 supplemented these factors, identifying considerations imputed onto the COB 5.3.5 inquiry.[141] This seems to suggest that COBS acts as a clarifying mechanism that can be used to retrospectively shed more light on the analysis of COB cases. In this sense, it is fair to say that it may not necessarily be the standard of suitability that has become more stringent; rather, it is the mechanisms or metrics through which suitability is assessed.

An adviser needs to exercise greater care when recommending riskier products. In *Mahmoud Haji Haider Abdullah v Credit Suisse (UK) Limited*,[142] Baker J took the view that 'if a riskier product is presented to an advisory client without its riskier nature being brought squarely to the client's attention and explicit confirmation being obtained from him . . .that he is content to be exposed to the greater level of risk, there will be a real prospect that the COBS suitability duties will not have been discharged.'

In *David Rocker v Full Circle Asset Management*,[143] the court considered the client, Mr Rocker's, risk-taking preferences and his risk profile. It was found that the adviser, Full Circle Asset Management, acted in breach of the suitability obligations because 'it did not do sufficient to ascertain the detail of Mr Rockers attitude to risk; it did not undertake a sufficiently detailed attitude to risk assessment'. This was evidenced by the fact that there was no documented assessment at the time and also by the detailed process subsequently undertaken on a later date.[144]

Post-2013 decisions seem to clarify the requirements of the assessment process regarding suitability. *Full Circle Asset Management Ltd v Financial Ombudsman Service Ltd*[145] involved an evaluation of whether suitable measures were considered in a risk assessment. The Court decided that vague classifications such as 'medium risk investor' meant that the process of investigation was not sufficiently suitable for the client, Mrs King.[146] Additionally, *David Rocker v Full Circle Asset Management* emphasized the inadequacy of the adviser's record keeping and suitability reports: they provided evidence about the sufficiency of the suitability assessment.[147]

In earlier cases, the courts seemed more concerned with the quality (substance) of the advice, rather than the process involved. For example, in *Zaki v Credit Suisse*[148] and

138 Ibid.
139 [2013] 2 All ER (Comm) 1159.
140 Ibid 1201 [39] (Rix LJ).
141 Ibid.
142 [2017] EWHC 3016 (Comm) [168].
143 *David Rocker v Full Circle Asset Management* [2017] EWHC 2999 (QB).
144 Ibid [272].
145 [2017] EWHC 232 (Admin).
146 Ibid [58].
147 *David Rocker* (n 143) [272].
148 *Zaki* (n 139).

Al Sulaiman v Credit Suisse,[149] it was recognized that the suitability of the advice itself was the primary vector of analysis—it does not matter if the process is unsuitable if the advice is suitable.[150] In deciding whether or not the recommendations were suitable, Teare J found in *Zaki* that '[i]f they were not suitable then it adds nothing to enquire whether Mr Zaki's approach to obtaining and recording information and classifying the claimants lacked the required rigour and care.'[151] As the court observed, 'failures of process do not matter unless they lead to a failure of substance'.[152]

David Rocker v Full Circle Asset Management further supported a greater focus on ongoing suitability assessments and documentary evidence of attitude to risk assessments.[153] Given the increasingly strict characterizations of the procedural aspect of suitability, it suffices to say that suitability requirements have become more standardized and this has brought more certainty in determining how or whether the requirements are met. In a way, this would undoubtedly have practical effects by complementing the guidance set forth under MiFiD II and ESMA and FCA for the profession in meeting those statutory requirements—that is, advisers' compliance with required suitability procedures.

This raises another question: whether the court's stricter reading of the procedural requirements would undermine or supplement the focus of the suitability of the advice itself in a substantive sense. In fact, the courts examined not only whether the suitability procedures were followed by the advisers, but the real and practical suitability of the advice. Although the courts are adhering to a procedural test they have adopted a stricter reading of those requirements. There is no evidence to suggest that the courts have shifted their examination away from the question whether the advice was in a substantive sense suitable for the plaintiff. This probably begs another question: whether the courts would maintain their traditional stance and shift their focus away from the substantive merits of advice to the procedural aspect of the provision of advice.

The suitability rule has also increasingly required more personalized advice. In a sense, the requirements imposed on advisers have become more stringent regarding compliance with the rule. Advisers' assessments which simply state, for instance, that the client is a 'medium risk investor' are no longer sufficient. In 2017, the court in *Full Circle Asset Management Ltd v Financial Ombudsman Service Ltd*[154] found that categorizations such as 'medium risk investor' are inherently vague and amount to evidence that the adviser has not sufficiently investigated investor requirements.[155] The fact that the attribution of a 'medium risk investor' also happened to align with a 'medium risk investment' merely affirmed the vagueness of the classification.[156]

149 [2013] EWHC 400 (Comm).
150 *Zaki v Credit Suisse (UK) Ltd* [2011] 2 All ER (Comm) 1159,) 1184-5 [99] (Teare J).
151 Ibid.
152 *OHare & Ors v Coutts & Co* [2016] EWHC 2224 (QB) (9 September 2016) [212].
153 *David Rocker* (n 143) [269], [272].
154 [2017] EWHC 232 (Admin).
155 Ibid [45] (Nicol J).
156 Ibid.

Another 2017 decision, *David Rocker v Full Circle Asset Management*,[157] identifies further problems with the generalized categorization of a client's risk appetite. The court found that if an attitude to risk was markedly different in a new investment, express agreement and extensive record-keeping is needed to its ensure suitability.[158] This may suggest that suitability is no longer just about correctly categorizing a client on inception, but actively maintaining appropriate suitability standards subject to specific personal requirements. This contrasts with *Worthing & Anor v Lloyds Bank*, where the Court found that 'there was no obligation under the COBS Rules to carry out a fresh risk assessment' since the 'defendant had examined suitability at the time of the original investment. All that was required was to see whether the claimants' objective circumstances or subjective objectives or the material facts . . .had altered in any way that made the investment no longer suitable for them. Neither the wording of COBS 9.2.1 R nor any good reason requires that the original exercise be repeated *de novo*.'[159]

In *Jackson v Tenetconnect Ltd*, the Court found that the adviser had a duty to review the suitability afresh and it would be in breach of the duty by endorsing the original assessment simply because nothing of significance had happened in the interim.[160] The obligation to 'maintain' the currency of the suitability assessment, whether on a continuous or at least periodic basis would no doubt make compliance on the part of advisers more onerous.

Overall, COBS 9 was not materially different from the COB regime. It simply required more detailed metrics for compliance than was required by COBS. While the suitability rule more or less has remained the same in a substantive sense, it is safe to say, as a result of litigation, the courts in the UK have given effect to and shed light on how advisers must meet their suitability obligations. Later cases, however, did appear to contain more detailed references to COBS and specific procedural requirements, for example, the processes of record keeping and suitability reports were explicitly considered as major considerations in *David Rocker v Full Circle Asset Management*.[161] The courts play a noticeable role in the interpretation of the rules. They have shifted away from the principles-based approach. In doing so, the standards of suitability rule have been shifted if not lifted. What has emerged from the case law is clear: the requirements surrounding the suitability rule have become more elaborated or detailed which in practice, places more onerous requirements on advisers in meeting their advisory obligations.

The effects of commission

In analysing these suitability-related cases, the role of the commission ban provides another useful perspective. As noted above, a ban on commission was intended to eliminate incentives to provide conflicted advice. This renders the predominant incentive that of serving the interests of the customer as the primary mechanism to achieve profit, as firms

157 *David Rocker* (n 143).
158 Ibid [124]–[125] (Morris J).
159 [2015] EWHC 2836 (QB) 8.
160 *Jackson v Tenetconnect Ltd* [2017] WLR (D) [507].
161 *David Rocker* (n 143).

can no longer rely on perceptions that 'advice is free if the adviser receives commission'.[162] Moreover, the commission ban and the suitability rule also reflect the dynamic between two objectives of consumer protection: transparency and quality advice. Pre-existing law has primarily been directed at transparency through information disclosure, but low thresholds for recommendations allowed advisers to place their interests above clients.[163] The ban on commission has intersected with both, by mandating transparent profit disclosures but also by incentivizing behaviours that elevate client-specific product quality for the sake of profit under the new regime.

The presence of commission seemed to have made it more likely for advisers to recommend misaligned products.[164] Half of the decisions which involved a breach expressly mentioned the presence of a commission charge.[165] In *O'Hare v Coutts & Co*, for instance, the persuasiveness of the adviser Mr Shone was influential in encouraging the client Mr O'Hare to take 'considerably higher risk'. It was 'not surprising' the client accepted higher (and intolerable) risk given that Coutts had to sell products on commission for the relationship to be commercially viable.[166]

Commission acts as an incentive for an adviser to follow the money and provide advice that maximizes their commission rather than serve the client's best interests. In *Mohamed Magdy Zeid v Credit Suisse*, immediately after referring to the manner in which Mr Zaki was remunerated, the judge went on to state that '[i]t is unrealistic to suppose that he did not, at least from time to time, cross from the territory of information into the territory of recommendation or advice. . ..'[167]

Additionally, the presence of commission made it more likely for an adviser to breach the suitability provisions.[168] This was because an adviser who received commission often served the predominant purpose of selling a product to the advisor's clients, as opposed to merely providing them with information. Consequently, commission may have increased the likelihood of an advisory relationship being found. *In Zaki v Credit Suisse (UK) Ltd*, although the discussion of investments was in part centred around the provision of information, the adviser Zaki's role was also 'to sell products to Mr Zeid', given that '[h]e received a share of CSUK's commission'.[169] This suggests that receiving a commission increases the likelihood that an adviser will be found to have 'cross[ed] from the territory of information into the territory of recommendation or advice'.[170]

162 Financial Services Authority (n 79) 49.

163 Stephen Corones and Thomas Galloway, 'The Effectiveness of the Best Interests Duty—Enhancing Consumer Protection? (2013) 41 Australian Business Law Review 5, 13.

164 *Westwood Independent Financial Planners v Financial Conduct Authority* [2014] All ER (D) 88 (Jan), [182] (Sinfield J).

165 *Rubenstein v HSBC Bank plc* [2013] 1 All ER (Comm) 915; *Westwood*, ibid; *Zaki* (n 150).

166 *O'Hare* (n 152) [216] (Kerr J).

167 *Mohamed Magdy Zeid* (n 137) [89].

168 'Advice on the merits' is to be distinguished from the mere giving of information. The FSA's Perimeter Guidance Manual ('PERG' 2.7.15 and from the discussion of the meaning of advice by Flaux J. In *Bank Leumi (UK) PLC v Wachner* [2011] EWHC 656 (Comm) [85], [307].

169 *Zaki* (n 150) 1181 [89] (Teare J).

170 Ibid.

5. Concluding remarks

Prior to the commission ban, policy-makers assumed the requirement that statutory duties imposed would overcome the problem of financial advisers preferring their own interests over their clients'. The assumption proved to be misplaced, which in turn threatened consumer confidence in the retail investment industry and the viability of the industry. All this was known before the GFC and instigated the *RDR 2006*.

This article mapped the historical trajectory of the legislative reforms in the midst of the GFC and critiqued their viability. Although the suitability rule or its variation has been in place since 1986, as a result of the reformative measures, these developments discussed in the article revealed that the suitability rule has been tightened while commission-based advice has been severely curtailed. This article also examined the manner in which the courts have given efficacy to the suitability rule.

Also noticeable is that the application of the suitability rule has shifted from a more principles-based approach to a rule-based approach, even though changes in rules over the last several years did not drastically change the underlying principles of suitability requirements. This is partly thanks to the courts, under which more comprehensive standards and procedures have been developed to meet the suitability requirement. The impact of a commission ban in this sphere is difficult to quantify and should be contextualized within the extensive platform of reforms advanced within the *RDR 2006*. By removing the misalignment of an adviser's self-interests by banning commission, this has arguably sharpened the focus on advisers' compliance with more objective standards, namely the suitability rule.

Although there have been concerns about commission-based payments shutting out lower-income investors from receiving financial advice, on balance, it is fair to say at least that insofar as consumer confidence in the advisory industry is concerned, the reforms seem to have had some measure of success.

Consequently, while the GFC did not radically reshape the suitability rule, it did serve as a catalyst that led the UK regulatory bodies to respond to the market failures by implementing new initiatives over the past decade. Indirectly, the GFC rendered the objectives of reforms more urgent for the financial sector in the UK—eg by exposing flaws in the risk assessment process which led to a more stringent suitability assessment and reporting regime.

The significance of consumer trust should not be underestimated. If consumers are unable to trust financial advisory advice, it is hardly likely they will seek it. If, then, the reforms have maintained or bolstered consumer trust or confidence on the solid basis that the reforms have mitigated the temptations arising from commission-based payments, then this is all the good for consumers and the industry. In acknowledging that the abolition of the commission had positive impacts on trust in the financial advisory profession, it must be said that this alone is insufficient in explaining the improved level of consumer confidence in the profession. As noted, litigation regarding alleged breaches of the rule

and the related jurisprudence that has developed regarding the rule, and its implementation has played an important part in the UK. In many ways, the UK courts were supportive of giving effect to the advisor's duties. It is also safe to conclude the UK courts were interpreting the suitability rule in a fashion that gave the rule more efficacy.

The combined actions of the legislature and the courts have played a role in ensuring financial advisory services are not unfairly compensated for the benefit of advisers and financial product providers at the consumer's expense. This has resulted in relatively higher levels of consumer confidence and trust in the advice they receive. This in turn promotes a more efficient financial investment market place, which is not only to the benefit of individual consumers but to the industry and the economy as a whole.