

# A professional body for retail financial services?

## CII Position Paper 1

Retail Distribution Review

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The CII is the world's leading professional organisation for insurance and financial services. It maintains the professional, ethical and technical standards of the industry.

The CII works with corporate business to develop organisation wide solutions for ensuring ongoing competitive advantage through technical and professional competence of employees at every level.

Individually, qualified CII members commit to Continuous Professional Development (CPD) through enhancing their knowledge to maintain their professional standing. Its 90,000 members in 150 countries make up the largest professional body in the financial world.

As a society, we all rely on professionals to maintain accurate and relevant knowledge and to give appropriate and unprejudiced advice. The CII ensures that we can trust in the competence and conduct of insurance and financial services professionals the world over.

*The knowledge, and how*

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# Foreword

## Professionalism – A vital piece in the RDR Jigsaw

The financial services industry has faced a tough time over the past decade or so in terms of public trust and esteem. We have taken quite a battering. Some of this has been self-inflicted in terms of scandals which have damaged perceptions of the industry in the public mind, but it is very frustrating that we should all be tarred with that brush.

This has been deeply damaging as the public has approached the industry with scepticism – or worse, stayed away. How can we reverse this decline?

One way to ensure we rebuild public trust – and it is not a short-term or easy fix – is to build professionalism throughout our industry so that we match the attributes, capabilities and behaviours of the best of other professions. I have made ‘professionalism’ my presidential year theme precisely because I perceive a direct link between enhanced professional standards and improving public confidence and trust amongst consumers.

The Chartered Insurance Institute sees it as its mission over the next few years to work with others – a coalition of the willing you might call it – to argue the case for raising standards.

We have already started this process by commissioning an independent report - ‘Professionalism and Reputation’, as a contribution to the FSA’s retail distribution review (RDR). This provides a comparative overview against other professions and sets out actions we need to take to ensure our industry raises its standards. I understand why some of our members regard the RDR with apprehension and concern, but I urge colleagues throughout the industry to grasp this opportunity to shape the process and ensure the outcome creates a step-change on levels of professionalism.

Professionalism is not simply about passing exams, important though this is. It is a declaration to the public at large that the advice given by an individual or firm is of the highest quality; is based solely on the needs of the customer; is provided by someone who is not exceeding his or her level of competence; is governed by a code of ethics; and is subject to consistent monitoring, with effective discipline applied to those who transgress.

**It is, therefore a commitment to an overall standard of excellence.**

The Chartered Insurance Institute and the Personal Finance Society are determined to go on arguing the case for enhanced professionalism – which will be a challenge to our members, to the many others in the industry who are not members of a professional body and also to the CII itself, as one of the professional bodies that will need to raise their games as well.

**As part of the process of responding constructively and positively to the ideas contained in the FSA’s Discussion Paper on RDR, the CII has decided to launch a series of position papers which will map out the way ahead on some of the issues at the heart of the debate.**

This paper sets out some ideas which we hope will meet with approval and act as a basis for practical reform. We look forward to hearing your views and discussing them with any interested parties.

### Lord Hunt of Wirral



# 1. Summary

The Financial Services Authority Discussion Paper 07/1 (RDR) has highlighted the issue of "Professionalism" within retail financial services. A major input to the work leading to this paper was the research carried out by Deloitte and Touche, on behalf of the Chartered Insurance Institute, on the development of a strategic framework for retail financial services professionalism.

This paper takes as its cue the proposals in DP07/1, which focus on retail investment marketing and intermediation, but we emphasise that the scope of the professional body described in the following arguments is as wide, potentially, as the retail financial services sector (and therefore embracing not only retail investment but also mortgages and insurance).

## - Regulatory background

The debate on professional standards in financial services pre-dated the current regulatory regime, but gained little traction in the industry. The desire by the regulatory authorities to focus more on the outcomes within retail financial services has redefined the nature of the debate, and increased its intensity. This has culminated in the FSA's Retail Distribution Review. Within that Review, one of the five themes was specifically devoted to "Professionalism and Reputation" – an acknowledgement of how significant this topic is viewed by the FSA and by the industry itself.

In general terms, the FSA's policy of moving to a more principles-based regulatory regime has been welcomed by the financial services industry. However, a necessary corollary of any regulatory dividend consequent upon a general industry lowering of risk will be the nature and quality of the service and information that consumers receive. Consumers must have the reassurance that the firm, and in particular the person, they are dealing with has the right knowledge and skills, can be trusted and

will act with the highest integrity.

In the absence of these high quality standards of knowledge and behaviour, government will be under pressure to continue to regulate the minutiae of conduct of business by means of prescriptive rules and supervision, as at present.

Retail financial services practice embodies many of the characteristics seen in the established professions, notably, complexity, the requirement for professional judgement, the impact on fundamental human needs and the high potential risk for the customer. These characteristics point to a need for professional standards.

## - Absence of Professional Standards

Since there has been no pressing desire to create a coherent set of industry-sponsored recognised professional standards, the checks and balances on behaviour that such standards would have supplied have been provided by other mechanisms. In practice, this has fallen primarily to the FSA and its predecessor regulators, which have regulated firms and required them to control individuals, under the threat of regulatory sanction.

We believe that a professional body could achieve the desired outcomes more effectively and with significant advantage to the consumer.

It would address directly what is seen by many as the weakest aspect of the current retail financial services regulatory framework, the application of professional standards in the activity of individuals, whether of their own volition or as a consequence of management or supervision. It would invite a partnership between industry practitioners and the professional body to establish a new industry culture, sensitive to and understanding of the public good, as a foundation for building trust and confidence.

## - Proposals

We propose the following:

- **A single framework of ethics and tiered technical and skills-based standards for individual retail financial services market practitioners related to defined sector functions;**
- **A single, independent professional standards board for the retail financial services sector, whose function would be to create, oversee and develop these standards including an independent disciplinary function, with substantial public interest representation;**
- **Recognition by the retail financial services sector and the regulator of a professional body (or bodies), whose function would be to support this new professional framework, applying the standards to their members, overseeing new criteria for entry to the sector and issuing practising certificates;**
- **More specified continuing professional development and practice standards support;**
- **New complaints handling functions, reporting to the professional standards board as well as the professional body's own governing board;**
- **The ability to deal with serious breaches via meaningful sanctions;**

We would see implementation of the ideas in this paper as a phased programme, perhaps starting with financial advisers but moving on to encompass all sector functions relevant to service to the public.

The substantial support of all stakeholders – the industry, consumers, regulators and Government is essential for successful implementation.

## 2. Professionalism In The UK

We suggest that the following characteristics of any service sector point to the need for professional standards:

- A high degree of complexity;
- High potential risk for the customer;
- A need for professional judgement and objective advice or guidance;
- The service is only valued if the professional acts in the best interests of the customer;
- Fundamental human needs (such as for health, financial security, housing) are directly or indirectly affected.

Professions such as law, medicine, accountancy, actuarial and architecture all have these characteristics. The complex nature of these services means that (1) significant education and experience is needed if practitioners are to be qualified to provide them competently and (2) customers are unlikely to have sufficient knowledge or expertise to be able to manage effectively without professional assistance.

The established professional bodies in other sectors, therefore, generally have the following common features in their requirements for individuals:

- Codes of practice or conduct which describe expected standards of behaviour;
- Practice standards guidance;
- High entry standards in the form of examinations which are not easy to pass and require an initial lengthy period of study;

- Measures to ensure that a high degree of skill, knowledge and expertise is maintained, a particular feature of which is continuing professional development and training;
- Effective regulation, increasingly in the form of a monitoring and disciplinary function independent of the professional body;
- Subjection to objective censure and accountability for breach of expected technical and ethical standards;
- The ability to deal with serious breaches via meaningful sanctions;
- Penalties for unprofessional conduct (including being named publicly and, potentially, being disbarred and unable to practice) which are sufficiently serious to act as a deterrent.

More details can be found in the CII publication 'Professionalism and Reputation', 2007.

### 3. Professionalism In Context

Government policy has long recognised the need to encourage people to save more and to ensure that they are adequately protected from the twin risks of dying too early or living too long without adequate financial provision. The regulatory environment is designed to support this policy stance by the creation of a regulatory regime that has as its aim appropriately designed financial products supplied in an ethical manner to consumers, who are capable of understanding what they have bought and are confident that they will be treated fairly in their dealings with the supplier.

The regulatory regime is not one of “zero-failure”; it is, rather, one in which prudential supervision and conduct of business are increasingly designed to be “lighter-touch”, allowing for a greater regulatory focus upon the unregulated behaviours exhibited by companies and individuals (i.e. a less tick-box approach). However, there is little doubt that Government’s policy objectives have not been fully realised to date: consumers’ trust of financial institutions is fragile, their knowledge of financial products is weak, and organisations experience sub-optimal operating outcomes.

Professional qualifications in retail financial services pre-date the inception of conduct of business regulation in 1988 and there has been a steady proliferation since, but they have made no obvious contribution to solving the reputation and performance issues arising in the retail distribution of financial products. This may be because professional qualifications without a framework which addresses also standards of behaviour are irrelevant to, or have little bearing on, such issues. It may also be because the power of professional qualifications, training and standards has never been harnessed to good effect in this arena.

Considerable effort have been made by bodies like the CII and Personal Finance Society (and its predecessor bodies) to increase professionalism over recent years and levels of membership of professional bodies have been increasing – but this progress requires a further step-change to move the industry to a new level of professionalism.

In reality, no one measure, by itself, can act as a universal solution to a problem that has existed for so many years; indeed, the problem of ensuring appropriate standards in retail investment was recognised at Government level as far back as the early 1980s, in the context of the review by Professor Jim Gower, which led to the Financial Services Act 1986. The difference now is that the observations made at Gleneagles by FSA chairman, Sir Callum McCarthy, and the subsequent Retail Distribution Review, have produced a considerable measure of agreement within the retail financial services industry that the current position cannot continue indefinitely. There exists a rare opportunity to examine all the policy options potentially available and to establish an appropriate balance between them.

In an industry that has relied traditionally on the acquisition of new business through face-to-face advice and selling to customers, standards of conduct and competence appear to have self-evident utility. Professional standards of conduct and knowledge represent powerful controls over the advice and sales processes. To the extent that they are effective, other controls may be reduced or even removed. As such, professional standards can be in the interests of all stakeholders;

- Individuals investing their time in study to attain professional qualifications can secure a livelihood and a standing that can sustain them through a working lifetime;
- Consumers have the reassurance that the person they are dealing with can be trusted and that, in the event of difficulty, they have certain recourse to redress and disciplinary arrangements;
- Organisations can see costs reducing over time, a better quality of business secured and a reduction in reputational and regulatory risk;
- The State can draw back to a lesser regulatory role, ensuring that the market and the professional regime are working appropriately.

## 4. A recognised professional body for retail financial services

Historically, there has been no consensus in the retail financial services sector strong enough to lead to the creation of a professional body on the lines of the traditional professions, except of course in the specialised field of actuarial services.

In this vacuum, alternative standards setting arrangements have been created:

- Firms are required to be authorised by a regulator (the FSA) and individuals who give advice must be registered as approved persons;
- Behaviour expected of firms and individuals is prescribed by FSA regulations;
- FSA monitors firms and firms monitor individuals;
- The Financial Ombudsman Service deals with customer complaints not satisfactorily dealt with at firm level, as an alternative to the courts;
- Minimum examination standards are approved by the Financial Services Skills Council;
- Sanctions against firms (and sometimes, but rarely, individuals) emanate from the FSA;
- Bodies such as the CII have focused their activities on the provision of examinations and learning products. Codes of ethics have been developed and have sanctions but need to be developed.

Notable gaps exist in the impact of this system on individuals. For example:

- **Practising certificates** are not issued to individuals so they are not usually directly disciplined, except by their firm;
- **Ethical behaviour**, rather than mere compliance, is capable of considerable further improvement;

- **Individual practice standards** are left to firms, which means that there is no framework, except that provided by the regulator (whose emphasis is mainly on the performance of firms), to encourage adequate and consistent levels of performance of individuals across the sector;
- **Examination standards** are low for financial and mortgage advisers and non-existent elsewhere in the sector;
- **Continuing professional development** standards vary widely across the sector and there is no mechanism to ensure that knowledge essential to the service being provided is acquired and tested;

A professional body could fill these gaps. We believe that, were it to do so effectively, the result would be a significant step-change in practice standards. But effectiveness of the professional body in applying standards to those not already convinced and not willing to be professional voluntarily, would be conditional on regulatory and industry support.

## 5. The regulatory challenge: the need to raise standards

The FSA has a clear and well articulated policy objective of moving to a more principles-based regulatory regime, which ‘places greater reliance on principles and higher –level rules, and allows firms more discretion to achieve outcomes that are appropriate for their particular business’. This approach has been welcomed by the financial services industry, which regards the principles-based approach as more proportionate and less bureaucratic as a regime, specifically offering

- A more risk-based approach, meaning that firms will have to consider how to manage their own risks;
- More focus on the individual responsibilities of senior management and the culture of firms;
- Industry bodies working with the regulator to provide guidance or set standards;
- A regulatory dividend (as yet undefined) where the industry succeeds in lowering risk.

The successful delivery of the revised regulatory approach is dependent upon two key policy elements;

- Consumers, who are informed, capable and empowered; and
- Information, that is clear, easy to understand and not misleading.

In the absence of those elements, the market for retail financial service will remain an inverted one, with consumers exercising little power in the value chain and, as a consequence, continuing to display weak demand for ‘advice’ or ‘products’. It was therefore appropriate that, when the FSA launched the main phase of the Retail Distribution Review in November 2006, three of the five themes that the FSA had identified were concerned with the way in which consumers received information and were encouraged to make financial decisions;

- the impact of incentives
- professionalism and reputation
- consumer access to financial products and services.

Although the debate on the RDR is still to run for many months, early indications are that a professional body (or bodies) could be a central feature of the reform of the retail investment distribution sector. Further, the FSA’s consultation on industry guidance (DP06/05) offers the opportunity for professional bodies to produce guidance which would be confirmed and monitored by the regulator, so that monitoring could be simplified provided the guidance was followed.

The FSA, in DP07/1 and DP07/4, offers some hints as to the degree of support for the professional body concept which might be deployed. Unfortunately, at this stage, there is a lack of clarity about these proposals, understandably because we are in the discussion phase and it is up to those who wish to do so, to make a case for particular outcomes.

We have represented to the FSA in the past, and reiterate the point, that a material ‘regulatory dividend’ would be needed to cause the sector to invest in a professional body on a widespread basis. Improved reputation is too long term and too nebulous to be a primary motivator.

Of course, a direct approach would be to mandate membership of a professional body by all individuals performing relevant customer services. (Part of this approach could be the delegation of the retail customer functions in the FSA’s ‘Approved Persons’ regime to a professional body.) We would ideally wish to explore this option but we are conscious that it would possibly entail primary legislation and might, therefore, not be an immediate solution.

If, as DP07/1 suggests, certain types of activity should require individuals to attain an incremental qualification (e.g. Chartered or Certified Financial Planner or Diploma in Financial Planning), that is no guarantee that the individuals concerned would join the professional body offering the relevant qualification.

Our suggestion is that establishing a professional body structure as outlined in this paper would increase the quality of advice and so reduce the risk of mis-selling or other customer detriment. It therefore would justify a lighter regulatory touch in monitoring and this could justify lower regulatory fees.

The test which the FSA would need to apply to a firm to justify this ‘regulatory dividend’ would therefore be the commitment of the firm to a professional body in a specific agreement between the firm and that body, as well as the existence of current, ‘clean’ practising certificates on the part of the firm’s partners, directors, managers and employees.

A covenant would need to be negotiated with regulated firms requiring that relevant individuals were engaged with the professional body or bodies at recruitment stage and required to be members throughout their careers with the firm.

Clearly, the issue of regulatory support is a matter of concern if membership of a professional body is to be seen as a duty rather than just a choice. However, it is within the power of the industry, if it chooses to unite on this issue, to mandate a professional body which would confer a similar obligation. We will be taking this debate back to both the FSA and the industry in the coming months.

## 6. Our Proposals

The key to success will be the level of engagement by all stakeholders, - companies, advisers, consumers, regulators and Government.

On the assumption of such support, we propose:

1. **A single ethical framework** for all retail financial services individual market practitioners, recognising different technical and skills-based standards for defined functions. This set of standards should be under the aegis of a single, independent professional standards board for the retail financial services sector, with significant public interest representation. Periodic sampling of customer opinion would help to gauge the level of public trust and point the way to needed service improvements.
2. **A hierarchy of professional levels** to recognise graded levels of service to customers, with clearly defined tiers of qualification and continuing professional development, alongside clear labelling of the service offered, to enable customers to differentiate between the available options. The qualification levels would be more professionally aspirational than the current minimum standards regime. This hierarchy of roles and qualifications would provide over time career paths for practitioners.
3. **A professional body or bodies** would support this framework, with entry standards related to the defined functions, and with new disciplinary functions with substantial public interest representation.
4. **Annually renewable practising certificates** would differentiate the individuals subscribing to the professional body or bodies from those who did not. They could be withdrawn if the bodies' requirements were seriously breached. The risk-rating of a firm (for regulatory or PII or other purposes) would then take into account the existence, status and levels of the practising certificates held by its partners, directors, managers and employees.
5. **A student class would exist** for those not yet qualified, with career advice.
6. **Continuing professional development** would be more prescriptive than at present. A practice standards facility would issue 'how to do it' guidance and tool-kits. These standards of practice would interpret and give practical application to the high level code of ethics, in particular dealing with conflicts of interest. Where confirmed by the FSA, they would act as a 'sturdy breakwater' in regard to the regulator's own supervision.
7. **Monitoring would be shared with the regulator** but, in so far as it was carried out by the professional standards board and the professional body or bodies, it would be on a sample basis, making use of a variety of tools, including 'mystery shopping'.
8. **An accessible and effective complaints mechanism** would be created with the ability to feed complaints experience back to the practice standards functions, which would then have the ability when issuing guidance to take account of emergent trends in public concern. The complaints handling function would have a dual reporting line, to the professional body's governing board and to the professional standards board.

## 7. Next Steps

The debate which is launched by this paper is an invitation to explore the extent to which a professional body, created and supported by the industry, with regulatory support, could be the way for the retail financial services sector itself to take control of individual standards within a more permissive FSA regime applying to firms.

We will develop the suggested professional body framework in a second paper, which will also describe how the CII would adapt itself to the new, self-regulatory approach to the standards of individuals which we propose and suggest a timetable for implementation.

We would welcome your views on this paper. We would emphasise that the goal is not a set of standards imposed in the way of statutory regulation, but that the professional body or bodies, governed by their practitioner members, would seek to guide the profession to its own standards, the spirit of which would inform the day-to-day activity of each and every member. This would be consistent with the FSA's move towards principles-based regulation. In the context of the RDR it would deliver a step change in levels of

professionalism but within a realistic timeframe.

Experience suggests that any industry or group of like-minded people who wish to improve their reputation in the eyes of customers or others must first take ownership of that reputation and then put in place arrangements to ensure that what they do is of the highest repute and protected from those who would undermine it. That is what we are proposing for retail financial services. We hope we have your support.

**We would welcome your comments or thoughts on this paper and any of our future position papers on RDR – please contact David Thomson, Director of Policy and Public Affairs – [david.thomson@cii.co.uk](mailto:david.thomson@cii.co.uk) – with your comments.**

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