Higher standards for retail financial advisers: Managing the transition

CII RDR Position Paper 3

Retail Distribution Review

The Personal Finance Society

CII

The Personal Finance Society CII

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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

Foreword

by Trevor Matthews, Deputy President of the CII

The CII Group has been at the forefront of the debate on professionalism and standards in retail financial services. Whilst taking nothing away from the dedication and talent of individual advisers, the Institute has consistently argued for the need to raise general standards yet higher if financial advisers, collectively, are to achieve the status of “professionals” – a status to which they naturally aspire and which gives significant benefits to consumers and financial services organisations. This paper, one in a series of papers published by the CII Group, suggests the next steps we believe the industry should take to raise standards of advice to a higher level.

Financial advisers are the industry’s window on the world, the point of contact with the consumer. No sustainable reform in financial services is possible without high quality financial advisers, and standards cannot be raised without the skills and commitment of those advisers.

Financial advisers deal with economic fundamentals of society – the twin risks of living too long or dying too early – and their actions and skills are at the very heart of public policy. At a more human level, they deal with the hopes and aspirations of consumers.

The retail distribution review (RDR) presents an opportunity to drive up the standards of professionalism in our industry – for some this may be an uncomfortable journey. Change can be hard especially when the regulatory dividend appears distant and the cost and effort much more immediate. However, opportunities to influence industry change do not occur often, and we have one such opportunity. We have the chance to craft an approach that gives financial advice its true recognition – as a proper profession – but action is needed now.

Success will be measured by the trust placed in the industry by its stakeholders, particularly by consumers; a trust enjoyed by true professionals, but one that must be earned and continually worked at if it is to be preserved.

It is right that we demand the highest standards of our financial advisers, but at the same time, we must address the very serious question of how advisers are enabled to reach those standards. I believe this paper sets out a practical roadmap for the industry to debate and try to develop a consensus. It allows the industry to start to focus on how we can ‘manage the transition’ that will be required when the FSA consultation is completed next year. I do hope that you will engage with the ideas that are put forward in this paper.

1. Summary

The FSA's Retail Distribution Review proposes that financial advisers should be trained and qualified to a higher level than currently. This is partly a recognition that standards should be improved and partly a means of restoring consumers' faith in financial advice, following a number of reputational problems in the past.

The industry, as a whole, agrees with this view and has signalled its commitment to move to higher standards as set out in the recommendations of the working groups which fed into the FSA's Discussion Paper.

Qualifications are only part of the story; standards of behaviour, through membership of a professional body which commits members to a robust code of ethics and formalised, rigorous continuous personal development (CPD), are also integral to raising standards. **Professionalism must be seen as a package of measures not just increased qualifications.**

In order to drive the step-change in standards, the CII proposes a review of the minimum benchmark qualification requirements and the introduction of professional body membership as the norm for financial advisers. Specifically the CII proposes:

- The Diploma in Financial Planning (incorporating a test of application of knowledge) should be the standard for all existing advisers above the primary advice tier within six years.
- Within four years, if all advisers above the primary advice tier in a firm are not Diploma holders, a mechanism for them to have advice 'signed off' by a Diploma qualified supervisor should be put in place for a further two years.
- Ultimately, Chartered Financial Planner should be the standard for PFPs to aspire to, as suggested in the RDR DP07/1. We believe it is a necessary aim to increase the number of chartered advisers if financial advice is to be considered a true profession over time.
- All new advisers should be required to achieve the current benchmark qualification (Certificate in Financial Planning) within 12 months and then adhere to the timescales applicable to existing advisers thereafter.
- Primary advisers should be required to hold the current Certificate in Financial Planning subject to the nature of primary advice being defined more effectively.
- All advisers should join an appropriate professional body and subscribe fully to its code of ethics and conduct, continuous professional development (CPD) and rigorous monitoring to ensure that these standards are being maintained.
- The industry and the FSA to confirm that there is a consensus for mandatory membership of a professional body within the framework described in CII position paper 1 ('A professional body for retail financial services?').

Note

To avoid confusion where we refer to advisers we mean all Registered Individuals (RIs) including IFAs, multi-tied and tied advisers offering regulated investment advice (excluding those currently out of scope for the RDR).

We are also making the assumption that the general financial advisory category is likely to be temporary.

2. Background and context

As a matter of public policy, successive Governments have created an environment in which consumers are required to take responsibility for their financial well-being. For this policy to be successful, it is necessary to address the issue why consumers of financial services products are so sceptical of the institutions and the people that supply them.

In a succession of financial crises – Equitable Life, pensions and endowment mis-selling, payment protection insurance, and Northern Rock – a prime casualty has been the consumer's confidence in financial institutions and the products they provide. At least part of the blame can be laid at the door of poor financial advice, unprofessional in the recommendations it has made or failed to make, due either to lack of knowledge or ethical failures i.e. professional malpractice. If this continues, it will undermine efforts to persuade consumers to save more and protect themselves more effectively.

The CII commissioned an independent survey of MPs in July following the publication of the RDR Discussion Paper, to establish their perceptions of the professionalism of financial advisers and insurance practitioners compared with other professions. The results confirm the fears of most industry practitioners, in that financial advisers were the lowest ranked occupation, with only 14% of MPs rating them as "good" or "very good". MPs, in this respect, may be no different from the rest of the population in the way they view the retail financial services industry, but this lack of trust amongst policy makers must be a matter of prime concern. Moreover over 90% of MPs surveyed felt the qualifications required should be equal to lawyers and accountants.

The failure of public trust was part of the context in which the FSA launched the Retail Distribution Review ("RDR"). A further element was the development of a less prescriptive regulatory rule book, referred to as "more principles-based". The objective of more principles-based regulation is to allow greater diversity and innovation in the achievement of regulatory outcomes by regulated firms and so focus more on the spontaneous behaviours demonstrated by companies and individuals in their response to regulation. It follows from this that the FSA is expecting a significant improvement in the standard of those behaviours for the new regime to work.

The RDR discussion paper (DP07/1) proposed the creation of a hierarchy of advice;

- 'Professional financial planners' (PFP) and, possibly, 'general financial advisers' (GFA) for those consumers with more complex financial needs, and
- 'Primary advice', for those consumers with less complex needs.

(NB We see these as 'working terms' rather than labels for customers – the final terminology used must be tested to make sure that it resonates with customers. This is absolutely key).

The RDR discussion paper also suggested that these advisers would be trained and qualified to a higher standard than at present and required to demonstrate a greater degree of professionalism, as a means of restoring the public's faith in financial advice and of ensuring that the behaviours shown in the market were of a standard that justified the more principles-based regulatory regime.

The financial services industry has signalled its general agreement to the need for a significant movement to higher standards – indeed this was echoed by our membership survey earlier this year which had 1,600 respondents (the results were published in **'Professionalism and Reputation' CII/Deloitte and Touche (June 2007)**. These improvements, if they achieve the step change required, will help to make an enduring impact on the quality of financial advice in this country.

This position paper also maps out how a 'package of professionalism' might be developed, gaining the support of the industry and the FSA. We see this as a package with a number of essential ingredients: qualifications, continuing professional development and a commitment to ethical standards, all of which would be subject to rigorous monitoring and testing and ultimately disciplinary sanctions if individuals or firms fall short.

3. The need for a "step change" to higher standards

As many of our members observed in the survey supporting our recent report on **'Professionalism and Reputation' (see above)**, the entry levels (i.e. the minimum examination standards for the delivery of financial advice) are too low. Most professions require a degree (or equivalent) for entry – often because the work of the profession is complex; requiring knowledge, skill and judgement. Personal financial products, and their application to particular circumstances, can be very complex, and it seems logical that the standards of entry to the jobs which entail explaining and giving advice on them should be no less demanding than those required by other professions.

Whilst this may be something of a stretch from where we are at the moment – particularly for some of the existing practicing advisers of long standing – we have no doubt that this should be the industry's aspiration.

The FSA has talked of a 'regulatory dividend' for the industry at the end of the process of improving professionalism. We think it is important also to have in mind the 'business dividend' which is likely to accrue from embarking on this journey, in order to answer at the outset any misplaced argument that the case for enhanced professionalism is solely about regulatory and examination issues. We are concerned that many of the 'costs' to the business come at the early stages while the likely regulatory or business benefits are more long term. We believe the FSA needs to spell out in clearer terms to firms what the commercial advantages of increasing standards will be.

If the outcomes proposed in the FSA Discussion Paper are to be achieved then the industry, at the end of this process, will be more successful and trusted with the public, providing a genuine 'business dividend' and a prize worth aiming for.

This cannot happen without consensus within the industry.

4. Vision for a new regime

Personal financial advice is a key enabler of public policy. It benefits the economy at large by enabling a fundamental economic process to take place; the aggregation of small, individual, savings into larger amounts of capital which, via product providers, are used to fund industry and commerce. Just as important, it benefits the consumer at the most personal level, by helping the individual to select the most appropriate method of saving or protecting him or herself. This is a role which all stakeholders should view as vital to the financial welfare of the nation, and in professional terms.

It is also important to remember that consumers are not all the same. It is inappropriate to assume that only the relatively wealthy need to use the services of financial advisers. It may be they are the main group who currently engage with the industry in any numbers, but there is a real need to expand this constituency. This links directly into the Government and FSA long term strategy to improve customers' financial capability.

When consumers take advice they should be able to understand clearly:

- what level of knowledge and experience their adviser has;
- how the adviser will deal with them i.e. what the nature of the service will be;
- how much they will pay for that service, and in what form;
- what the value of that service will be to them;
- what the nature of the on-going relationship will be i.e. this is how an adviser will behave towards a client.

Consumers should be drawn, naturally, to financial advisers because of the quality of their training, expertise and their genuinely high standards of behaviour.

This is a journey – a journey towards professionalism – a journey of increasing skills and knowledge that the best financial advisers are already embarked upon. It builds upon the quality that already exists within the industry and takes it to the next level – a level recognised as a 'mark of quality'.

We believe that quality is characterised in this context by two essential sets of standards: knowledge and behaviour.

4a Competence through standards of knowledge

Financial advisers demonstrate their knowledge and competence every day. We believe that they should acquire this knowledge in a systematic fashion, through qualifications that reflect the complexity and importance of the job that they do and that there is a reliable system for making sure that the knowledge tested by the examinations which lead to the qualifications is kept up to date. Those advisers offering Professional Financial Planning (and General Financial Advice if this prevails) need qualifications that recognise this – at least the equivalent of Diploma level and incorporating a 'practical' test of application of knowledge such as the existing CII AF5 or equivalent. This would be the floor rather than the ceiling in terms of qualifications.

It is important to remember that the customer will increasingly demand that advice should be given by individuals with appropriate levels of knowledge/similar to other professions. Clarity of qualification level could play an important part in this.

We would therefore envisage that Chartered Financial Planner should be an aspirational goal for the profession. To support this, we believe a number of incentives could be put in place to encourage further progression towards Chartered status, for example:

- Firms achieving the appropriate qualification level for their 'tier' to have a 'regulatory scorecard' that could be part of their business credentials which are proactively shared with clients; this could be achieved through Chartered firm status.
- A possible move by professional firms in other disciplines (e.g. law, accountancy) to refer clients to advisers qualified at the chartered level, as opposed to the current professional body practice rules criterion of referring only to IFAs.

It is expected that market forces will drive firms to strive to this level as consumers become more demanding of the nature of expertise available. We believe that the number of Chartered advisers will be a key indicator of how the profession is developing and a key measure used externally to evidence professionalism.

4b Competence through standards of behaviour

Competence is not all about passing exams. Standards of behaviour should be demonstrated through membership of an appropriate professional body, committing members to strict codes of ethics and conduct and to a formalised programme of Continuing Professional Development (CPD) similar to those in place for other professions. Monitoring would need to be rigorous enough to demonstrate ongoing competence.

This, of course, implies an improved code that will deliver sanctions for non-compliance and a much better system for CPD, concentrating on the knowledge which an adviser must have to give reliable, trusted advice.

All the above offers a significant challenge to both individuals and firms to raise their game. But it also provides a challenge to professional bodies to do likewise – particularly if the industry agrees to endorse a more active professional body which supports, oversees and, from a professional malpractice perspective, polices the ‘professionalism package’. As set out in our Position Paper 1 (and in our forthcoming paper describing the professional framework in more detail) this will require changes to professional bodies both in terms of responsibilities and resources.

4c The case for mandatory membership of a professional body?

If the professional framework model we advocate is to work, it will require resource.

We believe that there is a strong argument for introducing mandatory membership of a professional body both to deliver the resource required and to demonstrate that the industry is serious about the step change in standards. Mandatory membership would also ensure that individuals do not act as ‘free riders’, not joining up but enjoying the benefits of improved reputation achieved by those in the industry who ‘play the game’.

There is growing industry support for mandatory membership of a professional body as demonstrated by CII Group member surveys and RDR events around the country. However, it must be a professional body which delivers an overall ‘professionalism package’ that goes beyond the traditional provision of exams and qualifications, and also such bodies must be accountable and subject to external scrutiny themselves.

5. The journey – transition to the new regime

The CII recognises that raising the bar for financial advisers will seem daunting to some and, furthermore, if the process is not managed carefully, consumers could be left with an ‘advice gap’. So we believe that there should be a **process of transition** to the new environment which creates a step change which will benefit the customer.

As an initial step, we propose at the very least that all financial advisers should commit to the new standards of behaviour by joining an appropriate professional body and subscribing fully to its code of conduct and requirements for CPD. This would include those currently defined as being in the primary tier. Professional body membership should be the badge of entry for financial advisers, of whatever level in the industry and irrespective of whatever “tier” of advice they give.

This commitment to professional standards would be a very visible way in which advisers could demonstrate that they were rising to the challenge presented by the RDR.

One option would be to regard non-membership as a negative indicator or a sign of a lack of commitment to appropriate standards of behaviour or ongoing development. However, there seems to be strong support from within the industry to go further than this to make membership of a professional body a mandatory requirement and so provide a step change beyond that of raising examination standards only. Given that support, and the terms in which FSA have presented the professional body concept in RDR discussion paper 07/1, we invite the industry and the FSA to support a move to mandatory membership as part of the step-change required.

We further propose that all advisers above the primary advice level should move to a new benchmark for qualifications beyond the current Certificate level in a reasonable period of time. We believe that, as a first step, the **Diploma in Financial Planning incorporating a test of application of knowledge** should be the minimum. In a longer timescale, we believe that, as described in the RDR discussion paper, advisers above the primary advice level should aspire to reach beyond diploma to the level of Chartered Financial Planner. This would reinforce best practice, and is certainly realistic over a reasonable timeframe – there are over 1000 advisers who have reached Chartered Financial Planner level and there are over 10,000 of our members currently at Diploma level and working their the way towards Chartered status.

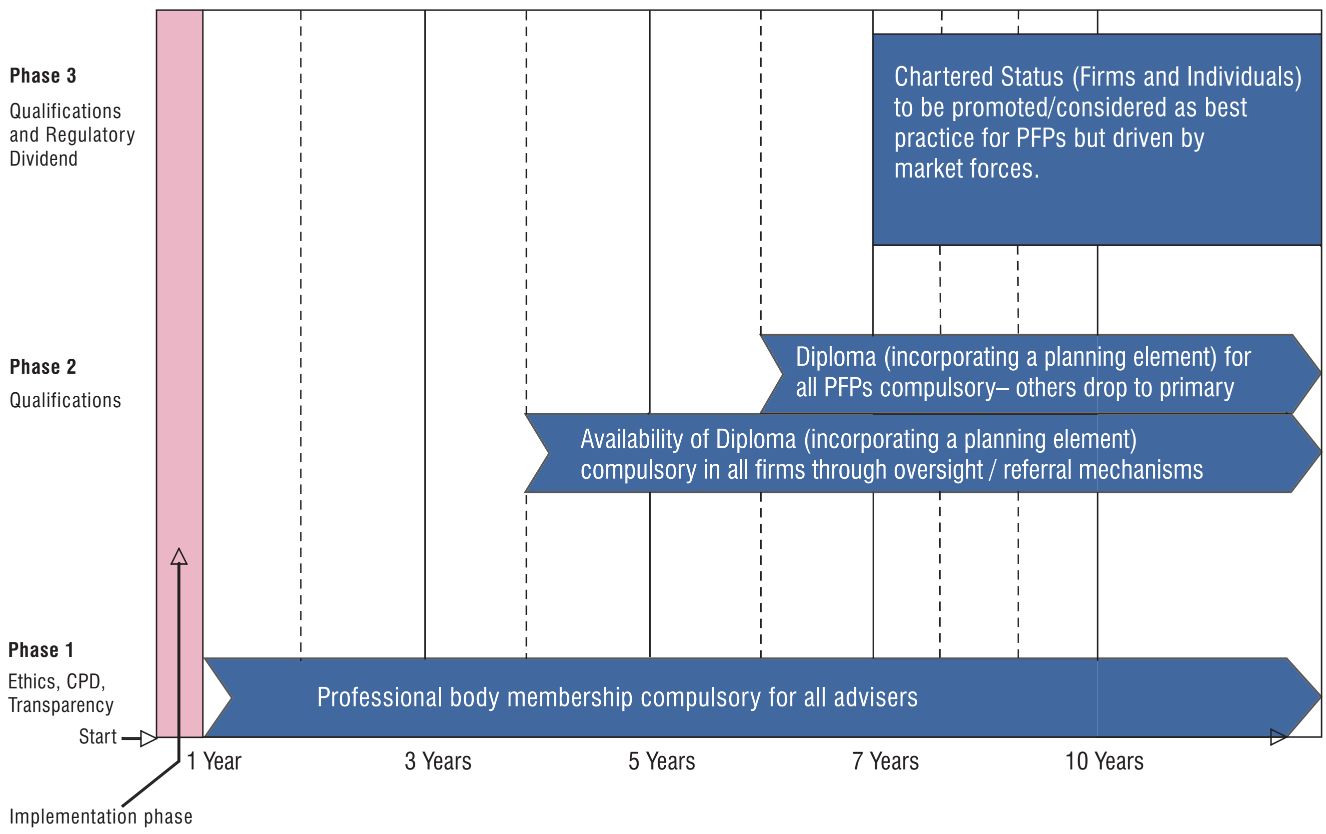
This cannot take place overnight – but the timescale to move to the position outlined here needs to be as swift as possible, to minimise disruption to businesses, but, above all, it needs to be achievable.

We propose that existing advisers should aim to hold the Diploma within four years of the end of the FSA RDR consultation period. Where that is not possible, for a further period of two years, but no longer, advice ‘sign –off’ by a supervising Diploma holder would be permitted. This would most likely take effect within the environment of a firm.

In table 1 we summarise this transition.

Table 1- Managing the transition

Suggested RDR transition to professional financial planning – existing advisers



We further propose that Diploma should be required of all new entrants (that is, those entering from outside the industry or from non-adviser roles) from the outset of the establishment of the new tiers. Such new entrants would also be required to achieve the current requirements of Certificate level qualification within the first year.

Should the debate following from the RDR discussion paper 07/1 conclude, as suggested in that paper, that there should be two tiers of adviser above the basic, primary advice, level (i.e. GFA and PFP), we would expect those tiers to be qualified at Diploma level. However our paper assumes that the GFA category would be a temporary phase.

6. Developing packages of support

The CII and Personal Finance Society will further develop an extensive range of packages for all sectors in the market to facilitate this step change. We envisage this comprising a number of strands:

- Continuous review of examination content to ensure relevance and appropriateness of subject matter.
- Increased frequency and accessibility of exam sittings to reflect demand.
- The development of Personal Finance Society CPD programmes which provide practical help to those wanting support and help through this process.
- Close engagement with providers and distributors to ensure strong business to business support in upskilling advisers.
- Development of suggested qualification pathways to best guide candidates through the process.
- Provision of extensive learning support including e-learning and face to face training.
- Development of bespoke programmes for major corporates encompassing professional membership and qualification programmes.

We are developing these proposals for implementation in 2008 subject to the development of the FSA's proposals.

7. Next Steps

This paper, one in a series published by the Chartered Insurance Institute, is aimed at contributing to the current debate on the issues raised by the FSA's Retail Distribution Review. We have already made suggestions on a professional body framework and on the way in which conflicts of interest should be approached.

We regard the transition to a point where higher standards are regarded as the norm in the financial services industry as one of the key tests of the RDR and the industry's commitment to it – hence this paper.

We would welcome your views on this paper. That discussion, backed up by research that the CII intends to commission, will help inform the final submission that the CII makes to the FSA on the RDR.

Send your views on this paper to david.thomson@cii.co.uk and they will be fed into our RDR Response Group.

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