

# Building trust and confidence in retail financial services - a new professional framework

## CII RDR Position Paper 5

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

## by Rt. Hon The Lord Hunt of Wirral, President of the CII

In the CII position paper ‘A professional body for retail financial services’ published in October, we outlined our ideas for the establishment of a new framework to raise professional standards in financial advice and related disciplines. As promised in that paper, we have developed these ideas to assist the industry to arrive at a consensus on the next steps.

The context in which these ideas are presented is, of course, the FSA’s Retail Distribution Review. A careful reading of the discussion paper published by the FSA in June reveals that many of the proposals advanced in it are matters where both the industry and the regulator will need to work in parallel to achieve the desired effect.

In particular, the proposals to raise professional standards – whether of knowledge or of behaviour – require the industry and its professional bodies to raise their game to match regulatory principles.

A primary issue, which is a matter of common concern to both the FSA and the industry, is trust and confidence. Trust and confidence by the public in the financial advice they receive, in the probity and standing of the individuals and firms with whom they have dealings, in the security of their investments and in the reliability of their insurances.

The public must benefit from the RDR or there is little point to it. Similarly, our ideas for a new professional framework will be of little value unless the public believe that the professional standards board and the professional bodies we are proposing will act in the public interest to prevent – and if necessary to punish – professional malpractice.

There will be a cost to establishing a professional framework of the kind we are advocating. But I firmly believe that this will be insignificant compared with the far greater industry and public cost of mis-selling or other public failings which have tarnished the reputation of retail financial services in recent years.

Therefore, we make no apology for advocating mandatory membership of a professional body and the step-changes in standards advanced in this paper.

We put forward the case before the industry. Our fervent hope is that the unique opportunity of the RDR debate will encourage a positive response.



# 1. Summary

The CII's position paper no.1 ('A professional body for retail financial services?'), published in October, set out an overview of the possible professional response to the FSA's Retail Distribution Review and to the challenge of establishing, against the background of more principles-based regulation, appropriate and consistent standards of knowledge and behaviour across the retail financial services industry in its dealings with the public.

This paper sets out in more detail the characteristics of a single professional standards board and professional bodies to be the custodian of these standards, along the lines of arrangements operating in other professional sectors. It sets out in summary the possible models for the professional body identified in the consultancy exercise, carried out by Deloitte on behalf of the CII, to establish an appropriate strategic framework for retail financial services professionalism. It then develops one model – that which appeared in the first position paper – and goes on to suggest the next steps towards an implementation process.

- Continuing professional development whose form and content would be guided by the professional bodies, and practice standards support;
- New complaints handling functions to deal with professional malpractice issues, reporting to the professional standards board;
- The ability to deal with serious breaches of professional standards arising from either complaints or disciplinary processes via meaningful sanctions imposed by the professional standards board.

## **The new framework, in summary, would consist of:**

- A single structure of professional standards for all retail financial services market personnel engaging with customers, comprising a hierarchy of educational and technical standards related to defined sector job function, and a common framework of ethics which would apply to all;
- A single, independent professional standards board, with significant 'lay' representation, supported by the retail financial services sector and the regulator, whose function would be to create, oversee and develop these standards including an independent disciplinary function with substantial public interest representation;
- Recognition, by the professional standards board, the retail financial services sector and the regulator, of professional bodies, whose function would be to support this new professional framework, applying the standards to their members, overseeing criteria for entry to and continuance in the sector and issuing practising certificates;

## 2. Trust and confidence

Whether we like it or not, we must accept that there is a developing culture of cynicism about financial services – a lack of trust and confidence which manifests itself in public comment and private decision-making. And this encompasses all the facets of financial services, from products which were thought to be low risk but which turned out to have hidden weaknesses, to the often well-meaning attempts by financial advisers to show people how to manage their money better by using financial instruments whose true nature is not easily understood by the customer.

From fear of losing life savings to the loss of occupational pensions, financial fears of the public dominate the headlines. Personal pensions, mortgage endowments and equity release, whilst helping many to manage their finances, have in many other cases dashed the expectations of individuals and families who had put their trust in the financial services industry. Other ‘high profile’ scandals have exacerbated the generally negative perception.

Clearly it is beyond the scope of the CII or other professional bodies to solve this problem in its entirety. The proposals in our position paper no.1 and in this paper are an attempt therefore to define an area where intervention to raise professional standards could result in improvement in one part of the financial services market – those who give, and support the provision of, financial advice and related services.

In this context, it is worth noting that the CII’s Charter tasks it with helping members – through improvements in practice, tests of competence, supervision and control over professional standards and assurances of trustworthiness – to secure and justify the confidence of the public.

## 3. The scope of our proposals

The financial advice sector is hard to define for the purpose of raising standards because activities peripheral to financial advice per se may undermine its integrity. We therefore prefer a wider definition which starts with those practicing financial advice or financial planning – i.e. those who offer to the public financial services involving advice, risk, discretion or fiduciary duties – but extends into marketing and sales of retail financial products, the management or supervision of advisory services, limited forms of advice or guidance, paraplanning and administration relevant to client outcomes. These functions all have the ability to adversely affect public perceptions of the industry's 'outreach' to the general public and hang together because a failing in one can be attributed to the whole. In using the term 'financial advice' in the remainder of this paper, we are using it with that broad meaning.

As indicated, our proposals address how one part of the financial services sector, financial advice in the broad sense just described, can become more professional.

Financial advice of course has an important role in helping the public to navigate the shoals of investment risk to achieve a satisfactory return on their money; 'satisfactory' being the outcomes needed by the client. Unfortunately, the issue which is so much debated, and raised by the RDR proposals, is that not all financial advice does this job effectively. Much of it fails to address financial strength, alternative scenarios (including adverse market conditions) or post-sale ongoing risk. Not all of it avoids conflicts of interest. Therefore, financial advice has its own reputational issues.

For the reasons given above, our proposals are not a panacea. There are many wider issues affecting trust and confidence in financial services. But we believe, as evidently do the FSA, that raising professional standards for financial advice can be an important contribution to the public good. And, if the proposals advanced here find acceptance in the industry, we believe that there are wider applications in related areas of advice, such as general insurance and mortgages.

## 4. The professional body idea

In a recent survey on professional standards commissioned by the CII, 74% of Members of Parliament rated medical doctors as the most professional, leading over other professions such as architects (59%), accountants (48%) and lawyers (45%). Financial advisers scored only 14%.

What characterises these other professions is that they have all subscribed for many years to professional bodies. Not all these bodies have at all times been highly regarded but, by and large, they have addressed emergent professional issues, evolving their frameworks of standards to meet new challenges. Perhaps more important is that they have encouraged in the individuals practising in their respective professions an 'esprit de corps' which takes pride in professional and ethical behaviour.

Although, as pointed out in our position paper no.1, the job of being a financial adviser calls for similar skills and characteristics to those expected in these other professions, it is a failing of the financial services industry that attempts to create for it a professional body along the lines of those which exist for the other professions, have fallen largely on stony ground. Industry disunity, and competitive pressure have often been seen as the cause.

Clearly, there are bodies which carry out part of the remit of the professional body, mainly in providing examinations and qualifications. But improvements in practice, conduct of business, the implications of ethical precepts, supervision, control and discipline have been left to successive regulators, whose requirements have often been vigorously contested, despite the valid principles which frequently lie behind the regulatory suggestions. Much of the comment on the current RDR proposals is of this nature.

Our recommendation is that the industry should now use the opportunity of the RDR to work together to create an effective professional framework to complement principles-based regulation, along the lines set out in this paper.

## 5. Which model?

Principles-based regulation – the lifting of the burden of prescriptive rules – leaves more scope for initiative on the part of market practitioners in implementing high level regulatory principles. The corollary of this freedom is increased scope for standards to fall where short term commercial objectives are allowed to take precedence over service to and fair treatment of customers. The extent to which the new freedom is harmful to customers is dependent to a considerable extent on the framework of standards to which market practitioners give their allegiance.

In considering possible solutions for future professional standards, we have considered three possible frameworks:

- A free market in standards;
- Tiered professional standards;
- Professional control.

**A free market in standards** is essentially the status quo. Under this, the market is left to determine its own approach to professionalism within FSA principles and rules. Whilst there is no over-riding compulsion to achieve industry-wide standards beyond the FSA principles and rules, professional bodies can, as now, present compelling propositions to the market to persuade firms and individuals to achieve an ‘edge’ over the competition by raising their game in professional terms.

Minimum examination standards are maintained at their current levels, or (as suggested by the FSA’s long term aims for training and competence) are determined by firms with reference to Financial Services Skills Council guidelines. Other (ethical, fiduciary, technical or procedural) standards emerge over time either as a result of individual initiative by firms, or in response to customer complaint, or as the result of guidance from the FSA and professional or trade bodies.

**Tiered professional standards** recognises a defined range of service models in the market, embodying standards to help those performing the roles needed to make these models work a framework which ensures a professional outcome for the public. A common set of ethical values applies to all practitioners. Examinations, continuing development, technical and skills standards vary depending on role; lower tiers, carrying less responsibility, have less onerous requirements.

A single, independent professional standards board is responsible for monitoring and disciplining individuals. The FSA continues to authorise and monitor firms, working closely with the standards body. Professional bodies have a more formal role than at present in setting standards and liaising with the professional standards board; with individuals offering financial advice services being required by their firm to maintain membership of a professional body and adhere to its requirements in terms of examinations, CPD, ethical, technical and skills standards. The FSA, if it has the power, might incentivise firms to take this stance.

**Professional control** is a much more structured and enforced regime significantly raising the bar on professionalism within the industry. A consistent and high level of qualification and a successful period of supervised work experience monitored by the professional body are needed before any financial advice service can be given to the public.

The FSA continues to authorise and monitor firms but professional bodies set compulsory standards for individuals and no-one can practice unless a member with a practising certificate. Individuals need to show that they have met the required standards on a regular basis or they are disbarred. A single professional standards board monitors compliance. The FSA mandates membership of a professional body by individuals; firms also must be members to ensure their support for the standards of individuals. Only severely limited activities are permitted to non-members so firms are only able to recruit from the ‘pool’ of professional body approved individuals.

## 5. Which model?

The choice between these alternatives is as much pragmatic as determined by the professional needs of the industry. We need to start from where we are; we do not have a blank canvas to work on.

But, in view of the inherent weaknesses in the current **'free market'** framework, it is improbable that that it would lead to the desired step-change in professional standards and public confidence favoured by the RDR and forward thinking elements in the industry.

**'Professional control'** provides for a strong and clear advance in professional standards along the lines of other professions. But the dislocations to the industry en route to the objective would be considerable and costly – and probably disproportionate. There is the further issue of enforcing the change against the background of Government policy which, currently, favours one regulator and makes no provision for the formal, statutory recognition of self-regulation.

Accordingly, we have concluded that **'tiered professional standards'** is our preferred approach. It fits with industry trends (and the RDR proposals) and, although there is a cost to implementation, we believe it is manageable. It empowers the industry to take the decision to make professional body membership mandatory, albeit with such support as the FSA are able or willing to give. In this scenario, the move to a more professional industry would be led by those individuals and firms whose commitment is to higher standards. But the transition would also be aided by the stark contrast between those who espoused the new professional ethos and those who were perceived as having failed to do so.

The remainder of this paper considers in more detail that option.

## 6. One professional standards board

We believe it would be wrong to insist there should only be one professional body. There are benefits to competition in providing services to sub-sets of the market, some of whom will have their own particular professional focus. Other professions have more than one body and, where there is not, often differences of emphasis lead to quasi-autonomous groupings within the one body.

However, there needs to be a way of maintaining consistently high standards so that competition does not work in a malign way to reduce the rigour of requirements.

Accordingly, we suggest a single professional standards board, with significant lay representation, to ‘designate’ and oversee the professional bodies, working closely with the FSA. This should have an independent chair with appointments being consistent with Nolan principles. Its functions might include:

- Creation of a single structure of professional standards, recognising a hierarchy of educational and technical standards for defined retail financial services functions and a common framework of ethics which would apply to all;
- Approval of the standards presented to it by the professional bodies;
- Initiating introduction by professional bodies of new standards where suggested by observation of the market and by complaints and monitoring experience;
- Enforcement;
- Creation of an independent disciplinary system;
- Oversight of complaints handling.

To establish such a body, an industry consensus and FSA support would be essential. The debate following the publication of this paper must therefore establish these conditions for further work to proceed to the creation of the professional standards board. The CII’s existing professional standards board provides a strong model on which to build.

## 7. ‘Designation’ of professional bodies

The professional bodies need themselves to meet standards to ensure they fulfil the purpose for which they are set up. Separation from the regulator is important because the industry is here making its own contribution to the creation of standards rather than giving effect to regulatory requirements so, even if the Financial Services and Markets Act contained powers to enable the FSA to ‘approve’ the professional bodies for the purposes we are describing here, it is doubtful whether that would be desirable.

Accordingly, we recommend that the independent professional standards board should establish a framework of standards against which the professional bodies are tested and ‘approved’ as fit for purpose. These standards would include a corporate governance model for the professional bodies.

The professional bodies would then support the single framework of professional standards.

## 8. Standards of entry

As indicated by the title of our suggested approach, the entry (and career progression) standards for members of the professional bodies would be tiered. The precise nature of these tiers will emerge from the RDR debate but we have set out our suggestions in our RDR paper 3, ‘Higher standards for retail financial advisers: managing the transition’.

As suggested in the RDR Discussion Paper, the appropriate qualification for each level would need to be established by analysis of the requirements of the relevant job roles. Ancillary functions (i.e. those performed by personnel, not advisers, but related to the advice process) could be assessed by reference to the level of responsibility and knowledge needed to perform them and mapped into the above structure.

In our view this is an urgent piece of work which could be started now in order to allay some of the uncertainty created by the RDR Discussion Paper. It could be carried out by the CII with a view to communicating, within the timescale of the RDR, agreed tiered knowledge standards to replace those in force at present. The Financial Services Skills Council might have a role in this work. These standards would then need to be approved by the professional standards board. Academic standards would be regulated by the Qualifications and Curriculum Authority (QCA).

In view of the FSA’s move to more principles-based regulation for training and competence, the new levels would probably need to be enforced by the industry, using the new professional framework. The professional bodies would have an important role in educating consumers about the new standards.

## 9. Standards of continuing knowledge

At present, the nature and content of continuous professional development (CPD) is left to the individual and the firm, being their interpretation of the action needed to respond to the general principle that competence should be maintained, laid down by the FSA. Professional bodies are currently largely reactive to the work individuals choose to carry out to fulfil CPD requirements, whether of the FSA or the professional body. This would need to change. Professional bodies would set the standards for CPD.

For example, flowing from the definition of roles, and given an appropriate level of market knowledge and expertise within a professional body and its advisers, it should be possible for essential new knowledge for each role to be stipulated and distributed to professional body members, using on-line tutorials and assessments. Firms could have access to this data to help fulfil their competency responsibilities and so they could endorse continuation in practice (and so retention of a practising certificate) by their employees or agents.

Performance of CPD for a job role would determine acceptability of an individual by professional bodies on an ongoing basis and be one of the criteria for retention of an individual's practising certificate.

We would envisage an extensive database of knowledge, organised to fit with the job roles, including regular alerts about important changing information. Practice standards functions in the professional bodies would give 'how to do it' guidance and provide practical 'tool-kits'. In other words, significant support would be available to practitioners relevant to their advisory activities.

## 10. Standards of behaviour

A high level code of ethics is an essential feature of a profession. However, it is doubtful if this has much effect without application to the specific circumstances in which members work.

One way to assist application would be to provide case studies of ethical issues and their resolution.

Another would be to spell out the implications of the code in guidance; perhaps in serious cases or where there were significant procedural problems, guidance could be put through the FSA 'sturdy breakwater' confirmation process.

## 11. Monitoring

The professional standards board would develop monitoring of professional body members. There would at least need to be:

- Regular reporting;
- Sampling of client experience;
- Monitoring of complaints.

'Whistleblowing' by members could be considered.

Information from this monitoring could be the basis for corrective or disciplinary action or lead to the raising of general standards.

A close relationship with the FSA would be needed. Discussions about how this would work, given the principle of regulatory confidentiality, would be an early need.

## 12. Complaints

The complaints handling function would report to the professional standards board which would be the single point of complaint for customers.

It must be emphasised that the issues on which the public could complain to the professional body would be confined to professional malpractice and not issues where financial redress could be expected or which were the province of the regulator or the Financial Ombudsman Service. Sanctions would nevertheless apply in cases of malpractice and these would need to be considered by the professional standards board.

## 13. Discipline

The professional standards board would oversee the creation of an independent disciplinary system. This would have sanctions against individuals guilty of professional malpractice, including;

- Suspension from membership;
- Public reprimand;
- Removal of practising certificate.

An appeal machinery would be available and publicised to members.

## 14. What we need to do now

The next step is for the industry to indicate its view about the professional body approach as a way forward.

If there is a clear preference for adopting this approach, expressed within the context of the RDR debate, the professional bodies aspiring to be 'designated' could then begin the work of creating a constitution for the new professional standards board and establishing professional standards. The CII's own Professional Standards Board would, if desired, make available its experience in this process.

## 15. Conclusion

We commend the ideas in this paper and the four earlier position papers to the industry and to the FSA.

It is without doubt that the time is right for a renewed attempt to establish a more professional culture within the industry, with the primary aim of better service to the public.

On the assumption that regulation becomes more principles-based, we believe that the ideas set out in our position papers are consistent with the general thrust of the RDR.

It would be essential to ensure there is clear demarcation between the regulatory and the activities of the professional body(ies).

There is a need to gauge, through the industry's response to our papers and the FSA feedback on the RDR, the level of support for the professional body concept and to the specific constituents of the package we outline. The means of establishing mandatory professional body membership – regulatory incentivisation or industry enforcement or both – needs to be decided. Early feedback would enable the current momentum to be maintained. We are pleased that the initial response to our earlier papers has been very supportive and we now need to have further views.

There will be a cost – effectively the cost of professional body membership for all employees and support for them through exams and continued learning plus the cost of the new professional standards regime. We do not anticipate that these costs will, in real terms, be any higher than costs of membership or qualifications today. It is possible that savings in the cost of firms' own complaints handling and training and competence regimes could be identified as the new professional body service is developed. But the main benefits are far greater: an independent endorsement that a firm – or even better, the whole retail market – has embraced professional practice and an emerging awareness that public trust – intangible but essential – is on an upward path.

**Send your views on this paper to  
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