

5 November 2012

## Making Sense of Professional Standards for General Insurance: Knowledge and Ability in the Insurance Industry

Some thoughts from the CII on the IMD2 Art 8(8) Provisions

### Summary

This paper sets out some high-level views on the delegated acts provision in Art 8(8) of the European Commission's proposal for a revised Insurance Mediation Directive (IMD2). This paper focuses on the three areas specified:

- Knowledge and ability;
- Appropriate criteria for determining levels of qualifications, experience and skills; and
- Continuing professional development.

### Introduction and Background

The revised Insurance Mediation Directive (IMD2) published in July 2012 calls for enhanced professionalism requirements that go beyond the provisions in the existing IMD. Whereas the existing Directive contains a high-level provision for intermediaries to possess the appropriate knowledge and ability, the new proposal goes into further detail on matters related to professionalism. Among the new requirements, Article 8(8) empowers the European Commission (EC) to adopt delegated acts that specify:

- The notion of adequate knowledge and ability for insurance intermediaries;
- Appropriate criteria for determining professional qualifications, experience and skills required; and
- The steps that insurance intermediaries and undertakings might reasonably be expected to take to update their knowledge and ability through continuing professional development (CPD).

The European Insurance and Occupational Pensions Authority (EIOPA) expects the EC to request from them more detailed guidelines for implementing these provisions. As a first step to both this and the supervisory authority's work to develop training standards for the industry, EIOPA published a report mapping industry training standards across member states.<sup>1</sup> While it described the mandatory requirements set out by competent authorities in varying

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<sup>1</sup> European Insurance & Occupational Pensions Authority, *Report on a mapping exercise on Industry Training Standards applied by national competent authorities*, 9 Oct 2012.

levels of detail, it represented an incomplete picture because it omitted additional requirements that have been imposed on practitioners by professional bodies.

To assist in EIOPA's forthcoming work on the IMD2 delegated acts provisions, we have prepared this paper setting out some views on how these could be implemented. For each of the three areas (knowledge and ability; criteria for determining qualifications levels and experience; and steps for CPD), we have:

- set out some detail, based on our own experience, on what could be involved;
- provided illustrations and examples of the work that we have been doing in these areas; and
- proposed possible high-level implementing measures to reflect actions by both competent authorities, professional bodies where relevant, and the industry itself.

### **Box 1: Professional body regulation, not self-regulation**

In some member states, professional bodies such as the Chartered Insurance Institute in the UK, or the Insurance Institute of Ireland, have a role in devising and delivering professional standards to the industry.

In some cases, this is done by assisting the national competent authority, such as implementing the requirements for retail investment advisers set by the Financial Services Authority (FSA) Retail Distribution Review, or providing qualifications and CPD systems to satisfy the Irish Minimum Competency Code. However, the vast majority of the CII's members are qualified on an entirely voluntary basis as a result of industry competitive influence. The CII regulates these individuals by setting standards of conduct and competence, and requiring their compliance.

This is not "self-regulation" because the CII is independent of the industry, and has a specific public protection remit under its Royal Charter to "secure and justify public trust and confidence in the profession". Although liaison with the industry occurs to assess needs, the CII sets the standards and confers them on individual practitioners through examinations, qualifications, CPD, and conduct requirements.

The CII enforces these standards with disciplinary measures. In 2011, the CII reviewed over 370 disciplinary cases among its active members. Most of these cases derived from members failing to meet CPD requirements, the remainder due to conduct infringements.<sup>2</sup>

To avoid confusion with the term "self-regulation" (which has non-binding connotations), this paper proposes the more appropriate label: "professional body regulation".

## **1. Knowledge and Ability:**

This normally refers to not only technical knowledge and ability, but also to the individual's day-to-day conduct. Knowledge and ability can be encompassed by the term "competence" and this usually dominates any policy discussions about the subject. The latter element is often overlooked, but it is as important because conduct is about how the practitioner applies technical competence to real situations.

### **a) Technical Competency:**

This constitutes the *type* of information that the practitioner doing a particular job in the industry would reasonably be expected to know, and several definitions exist. For example, our own *Insurance Competency Framework* defines competency as "the knowledge and skills that individuals *must have* to perform effectively at work."<sup>3</sup> These fall into two categories:

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<sup>2</sup> CII Disciplinary & Appeals records.

<sup>3</sup> The Chartered Insurance Institute, [The Insurance Competency Framework](#), published 27 April 2012, p.4. See also the UK Financial Services Authority [Training and Competence Sourcebook](#) TC 1.1.4G: "having the skills, knowledge and expertise needed to discharge the responsibilities of an employee's role".

- **Role-specific or specialist competencies:** the specialist knowledge and ability unique to specific roles in the various disciplines within insurance such as underwriting, claims, and broking. For example, for underwriting this includes risk perception and assessment, pricing risk, and underwriting process and management. Listing all the competencies for each role is probably more appropriate at the member state level.
- **Core competencies:** these are the core areas of knowledge and ability required for *all* roles within insurance. Many of these could conceivably be set out at EU level and could include:
  - knowledge of insurance principles and practice;
  - regulatory compliance, legal environment and operational risk;
  - applicable ethical principles, including their reason and application (see section (b) below);
  - disciplinary and enforcement procedures; and
  - generic business competencies (customer understanding, organising, negotiation/persuasion, etc).

Given the complexity of this task, it may be appropriate to begin the process by developing lists of general and role-specific competencies.

### **Suggested EIOPA action:**

Development of a list of core competencies for the insurance industry in the areas outlined above.

Suggest that member states oversee the development of role-specific competencies for key roles in the insurance industry. This should be done by competent authorities in association with market practitioners such as professional associations.

### **b) Conduct:**

This refers to practitioners and firms acting ethically, operating in accordance with the law and good practice, and respecting consumers and treating them fairly. This must be an ongoing assessment and therefore beyond the concept of an individual “being of good repute”. Several opinion surveys suggest that customers assign high importance to the ethical conduct of the practitioners serving them. For example, in a survey of retail consumers conducted for the CII:<sup>4</sup>

- 80% said they were less likely to trust advice from a broker they believed was not committed to a clear code of ethics;
- Nearly 90% would not trust those who did not commit. The same number would expect them to be punished if they failed to do so and/or be more comprehensively regulated; and
- Over 90% deemed it unacceptable that no insurance brokers are obliged to abide by a clear code of ethics. Just 3% thought this was acceptable.

In a 2011 survey for the CII of small and medium sized businesses:<sup>5</sup>

- 72% expected insurance brokers to be subject to disciplinary procedures if they fail to act ethically;
- 87% of respondents considered ‘ethical behaviour’ an important part of professionalism; and
- 89% expected insurance brokers to adhere to a clear code of ethics that ensures they act in their best interest.

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<sup>4</sup> Several research projects including: CII Consumer Survey by YouGov, June 2009, sample size 2,064 adults in Great Britain; CII Consumer Survey by Opinium, April 2012, sample size 2,015 adults in Great Britain.

<sup>5</sup> CII SME Survey by Opinium, August 2011. Sample size: 310 insurance decision-makers in GB businesses in the following categories: micro (6-10 employees), small (11-49) and medium (50-249). Results weighted to reflect the proportions of these firms in the UK (according to Department of Business, Innovations and Skills data).

## Box 2: The role of professional body regulation in improving industry conduct

In the UK, professional bodies have a role in improving practitioner conduct in a way that supplements or even enhances the statutory regulation regime. Membership of the Chartered Insurance Institute requires compliance with our Code of Ethics, which:

- applies to all CII members (over 110,000 practitioners as of September 2012) whatever their role, not just those undertaking FSA regulated activities;
- is enforced with a formal disciplinary and appeals procedure which could result in public sanction, fines, and/or expulsion from membership (thereby removing the practitioner's right to carry a designation). In 2011, the CII reviewed 35 disciplinary cases involving the conduct of its active members (not including CPD offences).

To implement good conduct across the industry in Europe, the best practice is not just having principles, but also communicating and embedding this behaviour in a way that creates an appropriate culture. Competent authorities would ensure that insurance firms have taken steps to develop good conduct and ethical practices within their organisation and be able to provide evidence on how they do this. This might involve:

- **Developing:** requiring firms to develop or abide by principles underpinning good conduct and ethical practices.
- **Communicating:** conveying these principles to individual practitioners at all levels, explaining why they are important, their application in day-to-day practices, and the consequences of not applying them. Best practices should include practical staff training and communications material.
- **Embedding:** these principles must be reflected in the activities, business decisions and culture at all levels within firms. One approach might be for competent authorities to ask firms to provide evidence of how they have embedded these practices. Another approach might involve incorporating conduct assessment into the regulator-firm supervisory relationship.

There is a link between more ethical practices and lower regulatory risk. Insurance undertakings and intermediaries that can clearly demonstrate close adherence to ethical conduct principles throughout their culture and practices should be given some sort of supervisory recognition.

### Suggested EIOPA action:

Suggest that member states ensure that insurance firms (both undertakings and intermediaries) have taken steps to consider good conduct and ethical practice within their organisation.

Suggest that member states ensure that this good conduct is communicated and embedded among staff and firms across the industry.

## 2. Appropriate Criteria for Determining Levels of Qualifications, Experience and Skills

While the competencies cover the *types* of information practitioners should know, expectations about the *extent* of their knowledge and ability in these areas will be determined by various factors, including the level of seniority, responsibility and public protection required.

### a) Levels of Qualification and Standards

Qualification levels should be used to measure the extent of knowledge. For example, the CII *Insurance Competency Framework* is linked to three qualification levels:

- **Certificate** requires the candidate to be able to know, identify, outline and understand the material.

- **Diploma** is aimed at preparing the candidate for more senior levels that involve not just the possession of knowledge, but also the ability to apply it regularly in day-to-day situations. In terms of learning outcome descriptors, the candidate must be able to demonstrate interpretation, explanation and analysis. Finally,
- **Advanced Diploma** takes this a step further, and generally requires candidates to demonstrate all these skills plus application, examination, review, critical analysis, evaluation and assessment.

Some member states have already introduced minimum qualification levels for certain roles. It may be appropriate for the EU to work towards the same goal, with a view to introducing minimum standards of competence and conduct for specific roles that pose a higher public or regulatory risk. Staff providing advice to consumers may need to interpret, explain and analyse; whereas staff holding authoritative positions within firms may need to demonstrate critical analysis, evaluation and assessment.

### **Box 3: The role of professional body regulation in raising industry standards**

While some member states may not have minimum required standards, professional body regulation is playing a vital role in ensuring that the industry demonstrates and improves competence and professionalism.

The CII offers professional qualifications that demonstrate technical competence. Firms are encouraged to adopt these standards (by making them mandatory for more posts, or incorporating them into their internal training schemes). This creates a *de facto* industry minimum standard through competitive means.

The UK does not impose mandatory minimum qualification standards on general insurance practitioners. However, the volume of people taking exams suggests the presence of a *de facto* minimum standard. For example, in 2011, over 110,000 exams were undertaken and 132,288 sets of study materials were mailed out.

#### **Chartered Status:**

Similarly, the CII offers Chartered status, which requires an Advanced Diploma qualification (loosely equivalent to a full university degree), in addition to having mandatory ethics and CPD obligations. There is no statutory requirement to hold this status, yet about 18,000 individual practitioners do so (Chartered Insurance Broker, Chartered Insurer, or Chartered Insurance Practitioner) as of September 2012.

The requirements for Chartered exceed the regulatory minimum standards of other member states. For example, the EIOPA mapping paper describes the Irish Minimum Competency Code (MCC) as one of the more stringent mandatory regimes in the EU.<sup>6</sup> Its established minimum qualification level for general insurance is Certificate level (EQF Level 2/3), well below Chartered level.

#### **Firm-level Initiatives: Chartered Status:**

The CII has been working with firms to raise professional standards among staff and to instil a professional corporate culture at all levels. For example, “Chartered firm” status is awarded to firms that meet stringent senior management teams qualification criteria, as well as ethics and CPD standards for all staff. These firms can carry the Chartered title in their promotional material. As of August 2012, 153 general insurance firms had Chartered firm status, including:

- 133 Chartered Insurance Broker firms including large companies such as Lockton, Towergate, and Bluefin, as well as many regional insurance brokers that are part of major networks such as Willis Commercial Networks, Unitas, Brokerbilty, Cobra and Broker Network. They account for over £8bn of gross written premium (GWP) in 2011, or over half of the entire UK commercial GWP.<sup>7</sup>

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<sup>6</sup> EIOPA Report on Industry Training Standards, *op.cit.* Note 1, p.10, especially Footnote 16.

<sup>7</sup> Sources: CII records and Datamonitor industry data.

- 20 Chartered Insurer firms, including major EU insurance undertakings such as Allianz, AXA Commercial, Amlin, Ageas, Chubb, Zurich and Talbot. These firms employ over 20,000 employees, representing over 40% of the total headcount in the UK commercial insurance market.<sup>8</sup>
- In 2012, Chartered firms (both insurers and brokers) controlled about £16bn of premium income, or 40% of the entire UK general insurance GWP.<sup>9</sup>

In terms of evidence, isolating a robust causal link between higher professional standards and improved customer outcomes is a complex task. In fact, it has eluded regulators, professional bodies, think tanks and academic researchers for many years.<sup>10</sup> However, the CII is just completing the benchmark phase of a major research project to measure the impact of raised professional standards on both consumer and small business customers.<sup>11</sup>

Even so, there is very consistent evidence from several sources that the existence of more professional practitioners instils higher levels of customer trust and confidence. Opinion surveys suggest that businesses and consumers alike recognise that professional status (not just qualification level) is inherently more trustworthy, even if they cannot identify exactly why this is the case.

#### Box 4: What professional *status* means to customers

Research by the CII (and others) into business insurance buyers indicates a clear support for Chartered status:

- 71% of SME insurance buyers say they are more confident and trusting of the advice from Chartered individuals than other qualification levels. A similar proportion said they are more trusting of this advice.<sup>12</sup>
- 62% of accounting firms and 68% of solicitors regard holding Chartered status as important for evaluating a new financial adviser.<sup>13</sup>

These sentiments are also reflected by retail consumers, as indicated by separate surveys conducted by the CII and Skandia:<sup>14</sup>

- Of those customers who had a view, 64% said they would be more likely to use a Chartered practitioner for retail investment advice than otherwise.
- Over 65% of consumers expect insurance and financial services advice professionals to have a full degree or Chartered status, and 63% said they would not trust the advice of such a professional if they were not qualified to degree/Chartered level.
- In the survey by Skandia, retail investment consumers think Chartered status is as important if not more so than independence:
  - When asked about independent status, 51% said they would prefer an independent adviser, and only 1% chose a non-independent one. 32% did not mind, believing the *quality of advice* was most important.
  - Then when researchers asked the same consumers on their thoughts towards Chartered status itself, 86% believed the status was attractive, with 49% thinking it was extremely attractive.
  - Finally when asked what was more important, 67% said they would prefer a non-independent adviser with Chartered status.

<sup>8</sup> Industry headcount derived from a combination of Association of British Insurers data and general industry views.

<sup>9</sup> Sources: CII records, Datamonitor and Axco Insurance industry data.

<sup>10</sup> See for example, Jackie Wells and Mary Gostelow, [Professional Standards and Consumer Trust: A Summary of Existing Research](#), for the FSA, March 2011; and Andy Friedman et al, [Professional Standards Bodies: Standards, Levels of Compliance and Measuring Success](#), PARN for the FSA, Sep 2009.

<sup>11</sup> See [Measuring Professional Standards: Demonstrating Positive Outcomes from Doing the Right Thing, A Discussion Paper](#), CII Paper in Professionalism no.12, Feb 2012.

<sup>12</sup> CII SME Survey, *op. cit.* Note 5.

<sup>13</sup> JP Morgan Asset Management, *Professional Connections: Creating Opportunities for IFAs and other Advisory Professionals*, May 2012. Survey of over 200 legal and accountancy firms.

<sup>14</sup> Source: Skandia Consumer Survey, July 2012, sample size 706 UK adults who are financial decision makers.

Chartered Insurance Broker firms hold considerable value in their status:<sup>15</sup>

- 82% believe Chartered status enhances the perception of their business as a professional organisation in the eyes of potential new staff, and a similar proportion think the same about existing staff;
- 76% believe that Chartered status enhances the perception of prospective customers, while 73% think the same about existing customers; and
- 91% would recommend the status to other insurance brokers.

For those states that have not yet introduced industry minimum qualification standards, migrating to higher levels of professionalism can be a complex and controversial process. Clearly there are multiple approaches to meeting the minimum qualification standards across the EU.

Some member states may prefer to set mandatory regulatory requirements, and impose these on the industry; either directly by their national competent authority, or via independent professional or awarding bodies. Others may opt for professional body regulation. Any guidelines set by EIOPA must reflect these approaches. Member states would weigh up the following considerations:

- **Cost and industry buy-in:** immediate mandatory requirements by national competent authorities would face stiff opposition. They would constitute a sudden regulatory intervention on the industry carrying substantial costs, especially in the light of the significant increases in regulation in other areas. Those opting for professional body regulation would enjoy better support, as costs may be justified if improving standards have associated commercial benefits (such as increased public trust and confidence, improved international competitiveness).
- **Control over implementation:** those requiring immediate mandatory requirements would set the standards quite quickly and closely control their implementation processes. Professional body regulation would offer less control by the national competent authority over standards and the processes to meet them. Some parts of the industry may be less perceptive about the commercial benefits than others.
- **Timeframe for implementation:** mandatory minimum requirements by competent authorities would be quicker, with a specific enforcement date. However, this would need to allow the industry to embed these changes, especially if the increase in standards is significant. Professional body regulation may take much longer, as the industry has to embed these standards gradually, using competitive influences.

On balance, while the professional body regulation approach may enjoy a better result with the industry, especially in the light of other financial regulatory burdens; the timeframe may be too long from an EU perspective. One compromise may be to impose a medium-term deadline for member states to ensure the minimum standards are in place and fully embedded. This would:

- Allow the member state (and EIOPA) to maintain some control by calling for an increase in standards and inferring that it could call for statutory regulation in the future if adequate steps are not taken;
- Give the industry an opportunity to develop and embed raised standards on its own terms;
- Allow a review process to assess implementation. This could be done at EU or member state level, or both;
- Provide a justification for direct regulatory intervention if the standards are not met, or if they are insufficiently embedded across the industry.

### Suggested EIOPA action:

EIOPA could develop guidelines for member states setting out:

- a) **The roles that should require a minimum qualification level:** these could be drawn from the key roles developed by member

<sup>15</sup> CII Member Survey of Insurance brokers, Nov 2011, sample size: 1,250 members.

states suggested above, and the guidelines could include questions to help member states assess the level of potential public risk.

- b) **The minimum qualification level appropriate for those roles:** the guidelines could include an agreed list of learning outcome descriptors from which an appropriate minimum qualification could be drawn.
- c) **An implementation/evaluation process:** the guidelines should set out suggestions on the process for implementation (including national competent authority and professional body regulatory options), a suggested review and evaluation process, and a timeframe in which the qualification standards should be embedded. The guidelines should mention that those states opting for a professional body regulation route should consider a subsequent review of how the standards are being embedded. This would help determine whether additional competent authority regulations should be introduced in order to meet the required standards.

After an agreed timeframe of several years, EIOPA could undertake an evaluation/mapping exercise across the EU to assess the scope for regulatory convergence. It would then determine whether steps could be taken at the EU level to develop pan-European qualification standards.

## b) Professional Experience

The key point here is that years of experience can mean nothing if a practitioner’s conduct is less than professional. Therefore, assessing experience should be about:

- Quality of work during those years of experience;
- Number of years the practitioner has been submitting CPD returns;
- Any disciplinary action against the individual; and
- Proving the individual’s technical competence and conduct.

This last point leads to the debate over whether professional experience could fulfil the knowledge and ability requirement. We would argue that experience on its own is not sufficient, and that examinations and qualifications are the best form of objective assessment. There is scope for “alternative assessment” such as oral interviews, but this may be too detailed for the EU level. Nevertheless, we suggest that any EU level guidelines should have an element to objectively assess the individual’s technical competence and conduct.

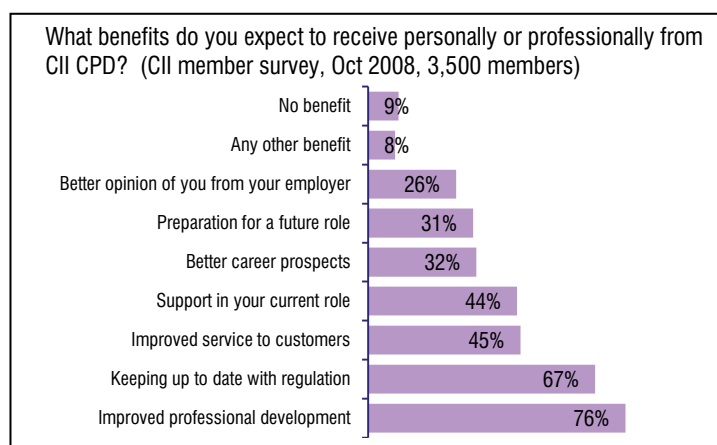
### Suggested EIOPA action:

Suggest that member states wishing to count experience as part of demonstrating knowledge and ability should have in place mechanisms to assess the *quality* of this experience using the above elements.

## 3. Continuous Professional Development (CPD)

The general principle here, and as set out in the EIOPA mapping exercise on industry training standards, is to provide a mechanism to ensure that practitioners keep their knowledge and ability updated. Compared to the long history of awarding bodies and examinations, the idea of CPD is still in its infancy. Whereas examinations and other associated assessment methodologies have become quite advanced in both objectiveness and sophistication, decision-making about what and how to maintain competence has largely been left to the individual practitioner.

The concept of professional experience has largely dominated this thinking. However, as discussed above, while experience is important in developing techniques and practices, it does not give any indication of adherence to the correct principles or quality of conduct. Good practices learned for exams





can be forgotten in weeks or months, and replaced by bad habits engrained over several years. Practitioners themselves are seeing the benefit of CPD, not just in helping them to keep up to date with regulation, but also in enhancing their career prospects (see chart above). In today's world, customers also understand the value of keeping knowledge updated:

- nearly 70% of consumers feel that a mandatory CPD requirement would help to win back their trust in professionals working in the financial services and insurance sector;<sup>16</sup> and
- over 75% of SME insurance buyers expect insurance brokers to be subject to a CPD scheme.<sup>17</sup>

### **Box 5: The role of professional body regulation in delivering CPD**

Some member state competent authorities may not require the completion of CPD as mandatory for authorisation. However, practitioners in that market may be members of a professional body that has more stringent mandatory requirements. In some cases, the national competent authority may regard membership in such bodies as sufficiently predominant that they see no reason to duplicate the CPD regime through regulation.

For example, holders of CII qualifications (be it in either general insurance, mortgage credit or investment advice) are required to complete 35 hours of CPD each year, of which 21 has to be structured. This is strictly enforced, and in 2011, the CII dealt with 337 disciplinary cases concerning members not fulfilling their CPD requirements.

There are various types of CPD schemes and ways of assessing compliance:

- **Types of Scheme:** these could be based upon points or hours, and include basic (any type of activity) or structured element (the activity must have clearly defined learning outcomes: in other words, some form of training).
- **Method of Assessment:** this could range from an entirely self-declaration approach, whereby individuals would be expected to do CPD and might have it assessed as part of their supervisory relationship; or there could be annual practicing certificates, such as the Statement of Professional Standing being issued to UK financial advisers under the Retail Distribution Review.

### **Suggested EIOPA action:**

Require member states to introduce a CPD scheme for appropriate members of staff in insurance undertakings, both general insurance and for insurance with an investment element [pursuant to IMD2 Art.8(1)].

Require member states to introduce a process to ensure compliance with this CPD scheme [pursuant to IMD2 Art.8(1)]. This could be done either directly or through professional body regulation. For example, membership in good standing in a professional body that has a CPD scheme could be regarded as fulfilling this requirement.

Suggest that member states consider incorporating CPD assessment as part of their supervisory relationship with insurance undertakings. This would review the extent to which firms have embedded CPD into their employee training practices and career structures.

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The CII is the world's leading professional organisation for insurance and financial services, with over 110,000 members in 150 countries. We are committed to maintaining the highest standards of technical expertise and ethical conduct in the profession through research, education and accreditation. In 2012 we are celebrating our Centenary as a Chartered body. For more information on the CII and its policy and public affairs function, including examples of the range of issues in financial services and insurance that we cover, please see: [www.cii.co.uk/policy](http://www.cii.co.uk/policy). Please do not hesitate to contact me: +44 (0)20 7417 4783; [laurence.baxter@cii.co.uk](mailto:laurence.baxter@cii.co.uk)

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<sup>16</sup> Survey by YouGov for the CII, June 2008. Total sample size 2,064 adults in Great Britain.

<sup>17</sup> CII SME Survey, *op.cit.* Note 5.