

About personal financial advice and the people who dispense it...

Did you realise...?

That most advisers need formal qualifications? There are more than 80 qualifications in total? Or that some advisers are 'directly regulated' by the FSA and some aren't? That the term 'financial adviser' (in the eyes of the FSA at least) applies only to advisers offering investment-related advice? And that mortgage advisers and insurance brokers can also call themselves independent financial advisers?

What financial advisers do

When it comes to personal financial planning one of the biggest challenges most people face is 'choice': there appears to be too much of it. While it's true to say that at first glance one investment, mortgage or insurance policy can look very much like another, the fact is they're all different. And that's where professional personal financial advice comes in.

Depending on his or her area of expertise, an adviser is able to i) identify the differences between each product and more importantly, ii) understand how significant those differences are. It's that ability — coupled with a thorough knowledge of their client's needs, circumstances and expectations — which enables a qualified adviser to recommend one seemingly identical product in preference to another.

However, being able to find one particular financial product out of perhaps thousands that best meets a client's needs is really nothing more than the tip of the advisory iceberg. A growing number of advisers are capable of preparing intricate and all-encompassing lifetime financial plans for their clients: a highly-detailed blueprint which takes account of the many variable financial and personal changes that occur throughout a person's life. The ultimate aim of such a plan is to enable the client to achieve his or her personal financial goals.

What's in a name?

Another problem people seeking financial advice face is the way advisers describe their services, or their particular area of expertise. Does an investment adviser offer the same services as a financial planner? Are all mortgage advisers also mortgage brokers? And what about those wealth managers — where do they fit in?

The Financial Services Authority (FSA) identifies three distinct types of adviser and areas of advice:

- **Financial advisers**
- **Insurance intermediaries**
- **Mortgage advisers**

Not all advisers are the same

Different advisers specialise in different areas of advice, although some individuals are qualified and able to advise on more than one area. If you're dealing with a firm of financial advisers, the firm may employ people who specialise in any of the following areas and indeed other subjects relating to personal finance.

- A **financial adviser** can (for example) help you make investments in unit trusts and stocks and shares, establish or transfer a personal pension, or set up a trust or an equity release scheme on your behalf
- **Insurance intermediaries** are able to source appropriate life, critical illness, private medical and home insurances etc., as well as provide guidance on income and payment protection products and business and commercial insurances
- **Mortgage advisers** provide mortgage-related advice including — but not limited to — buy-to-let mortgages, remortgages, and, if qualified to do so, mortgage payment protection insurance and equity release schemes

From January 2013, any individual or firm which provides financial advice will be required to spell out the scope of their expertise both in terms of the areas of advice they specialise in (investments, insurance and mortgages) and the scope of their recommendations – derived from an unrestricted or a restricted range of choices.

What a financial adviser isn't

Advisers advise, full stop. They do not produce financial products such as mortgages, investments or insurance policies — that's what 'product providers' do. Product providers being the institutions such as banks, insurance companies, investment managers, building societies etc. that create the financial products financial advisers advise on. Even where a product provider such as a bank or building society employs their own advisers, those advisers are not usually involved in the creation of their employer's financial products.

Becoming authorised

Apart from a few exemptions¹, any firm or individual engaged in a regulated financial service market activity in the UK must be authorised by the FSA. Once authorised, firms and individuals are monitored by the FSA on a regular basis — through on site visits and other processes — to ensure they continue to meet the required standards.

(Since December 2001, the FSA has maintained a register of all the firms, individuals and other bodies which fall under its jurisdiction. Although all financial advisers are listed by name on the register, persons providing mortgage advice only need to show the names of the firm's directors or the person or persons approved by the FSA for particular functions such as compliance.)

When applying for authorisation, firms and individuals must provide the FSA with as much supporting documentation as the authority asks for, such as:

- a business plan;
- compliance procedures;
- advisers' personal details;
- an opening balance sheet;
- a forecast closing balance sheet for the first year of trading;
- a monthly profit and loss account for the first year of trading;
- a monthly cash flow forecast;
- a copy of the latest annual accounts (if trading for more than one year);
- a Professional Indemnity Insurance quotation

And once authorised...

Directly authorised firms and individuals must have sufficient capital and reserves to be able to meet their financial obligations at all times and must submit a report every six months to the FSA proving that to be the case.

Financial advisers must have between £10,000 and £50,000 of their own funds in reserve. If the firm also advises on mortgage or insurance products — and depending on the amount of income generated by those activities — the firm will also have to set aside 2.5% - 5% of that income each year. Firms holding client monies are required to maintain more financial reserves than those that don't.

Mortgage advisers and insurance intermediaries must have reserves equivalent to 2.5% - 5% of their annual income.

Firms or individuals that do not have sufficient reserves to meet the FSA's requirements risk losing their permission to conduct business.

Insurance – all firms and individuals

All directly authorised firms and individuals are legally required to have Professional Indemnity Insurance (PII). PII is intended to cover claims arising as a result of mistakes made by the firm itself, or any individual who is employed in connection with the firm's business including partners, directors, self employed individuals and any appointed representatives.

¹ Solicitors, accountants and actuaries which carry on certain regulated activities that are incidental to the firm's main business are exempt, as indeed are local authorities or certain types of housing bodies engaged in insurance mediation or mortgage activities.

Independent, multi-tied or tied?

Independent advisers

Irrespective of which of the three areas of advice the individual or the firm specialises in, when advisers describe themselves as being '**independent**' then before making any recommendation to a client the adviser must have reviewed and considered (in theory at least) every product available on the market. In other words, their recommendations are taken from the *whole of the market* that's what the term independent means in relation to the provision of investment, mortgage and insurance-related advice. (**Independent financial advisers are also known as IFAs.**)

Multi-tied and tied advisers

Not all advisers are independent: rather than having an unrestricted choice of products to choose from, some advisers prefer to draw their recommendations from a smaller pool of products. A '**multi-tied**' adviser's recommendations will be derived from a limited range of products, whereas a '**tied**' adviser is only able to recommend the products of one company. Multi-tied and tied advisers cannot use the word independent when describing the nature of their service. (The exception being when a financial adviser draws from the whole of the market for investment recommendations, but a limited number of product providers for mortgage and/or insurance recommendations.)

No matter whether an adviser is independent, multi-tied or tied, they can only recommend products which meet the client's requirements.

Directly authorised or appointed representative?

Advisers — firms and individuals — are either **directly authorised** or **appointed representatives**. Directly authorised entities are directly regulated by, and answerable to, the FSA: authorised representatives on the other hand, are members (or agents) of a 'network', which is authorised by the FSA. Although appointed representatives are not permitted to perform some of the regulated activities that directly authorised firms and individuals can, there should be no difference in the quality of advice either type of adviser offers.

How advisers get paid

Independent and multi-tied advisers can choose how they are to be remunerated. They can charge (the client) a fee, or take a commission from the product provider they work for, or a combination of the two. Tied agents are usually paid directly by the product provider. Fee-based advisers can elect to charge a fixed price, by the hour, or on the basis of the value of the portfolio they advise on or manage. Any commission payments a fee-based adviser receives may be rebated to the client or in the case of a financial adviser, added to the client's investment portfolio.

Financial advisers, (as distinct to mortgage advisers and insurance intermediaries) must tell their clients if they are going to receive any commission from their investment recommendations.

From January 1 2013, financial advisers — i.e., those firms and individuals that provide investment-related advice — will not be allowed to take commissions from product providers and will instead charge a fee for their advice. That fee can either be paid outside of the contract or deducted from the contract itself.

The qualification maze

In previous times advisers didn't need any formal qualifications to dispense advice. Experience coupled with the ability to listen, relate and communicate were the main and only skills required. Although still useful, if not essential, those interpersonal skills in themselves are no longer sufficient for an adviser to do business. Advisers must now prove — in the form of FSA-recognised qualifications — that they have the technical knowledge to provide financial advice.

Unfortunately for clients (and advisers) the qualification side of things is far from straightforward. There are more than 80 different qualifications and designations, some of which replace previous qualifications and not all of which are issued by the same examining body². To attain the qualifications they need, advisers have to study (in their own time) and sit classroom-style examinations. Even when qualified, advisers are duty-bound to monitor and keep up with industry changes — what's officially referred to as 'continuous professional development'. As well as enabling the adviser to practice, attaining the right qualifications makes him or her eligible for membership of a professional body, obliging the adviser to adhere to a specific code of conduct.

A Levels and B Levels...

To be in business and before providing any form of specific advice, financial advisers, for example, must hold a *Certificate in Financial Planning* (Cert FP) previously known as the *Financial Planning Certificate*. If a financial adviser chooses to broaden the scope of their service by providing mortgage advice for example, then they will require an additional appropriate qualification such as the *Certificate in Mortgage Advice and Practice* (CeMAP).

Although the Cert FP and the CeMAP qualifications — which are deemed 'A Level' qualifications — enable advisers to practice and to provide 'generic' financial advice on a range of products, they are no more than base-level qualifications. In order to prove expertise in specialised aspects of personal financial advice, many advisers elect to acquire 'B Level' qualifications, which equate to a university degree.

Financial advisers

As well as holding qualifications which relate directly to the provision of investment advice, financial advisers who wish to advise on related subjects such as pensions, trusts and inheritance tax planning for example, will need further qualifications to do that. Additional qualifications are required if financial advisers also provide clients with mortgage and insurance advice. The premier designation for financial advisers is that of *Chartered Financial Planner (CFP)* — a title that's bestowed by the *Personal Finance Society*.

By January 2013, all financial advisers will be required to hold an Ofqual accredited level 4 qualification, such as the *Chartered Insurance Institute's Diploma in Financial Planning*.

Insurance intermediaries

Insurance intermediaries that deal only with non-investment insurance contracts — i.e., motor, household or pet insurances for example — do not require any formal qualifications. Whereas firms or individuals advising on with-profits or unit-linked life assurance policies, private medical insurance, or long term care insurance for example, must hold the relevant qualifications.

Mortgage advisers

Every mortgage adviser must hold one or more of the following qualifications: the *Chartered Insurance Institute (CII) Certificate in Mortgage Advice (Cert MA)*, the *ifs School of Finance Certificate in Mortgage Advice and Practice (CeMAP)* or the *Mortgage Advice and Practice Certificate (MAPC)* which is issued by the *Chartered Institute of Bankers in Scotland (CIOBS)*. Additional qualifications are required if the adviser wants to advise on matters relating to equity release and/or commercial mortgages.

² The examining bodies are: *Chartered Insurance Institute, Personal Finance Society, ifs School of Finance, Chartered Institute of Bankers in Scotland, CFA Society of the UK, Chartered Institute for Securities & Investment, Institute of Financial Planning and the Pensions Management Institute.*

Summary

- There are three main areas of financial advice: **investments, mortgages and insurance**
- Every firm or individual engaged in a regulated financial service market activity must be authorised by the FSA
- Some advisers are permitted to advise on all three areas; some advisers specialise in just one area
- With very few exceptions, all advisers must hold appropriate qualifications
- An adviser can be a firm or an individual
- **Independent** financial advisers derive their recommendations from an unrestricted choice of product providers
- **Multi-tied** advisers derive their recommendations from a restricted choice of product providers
- **Tied** advisers are only able to recommend one product provider's products
- Product providers create investment, mortgage and insurance products – not advisers
- An adviser can be directly authorised by the FSA, or be an appointed representative of a network, which is directly authorised by the FSA
- Advisers are paid through fees, or commissions or a combination of the two