

Ethics and Financial Advice: The Final Frontier.

A report on the current ethical issues in the Australian financial
advisory sector and the factors that influence ethical decision
making within Australian financial services organisations.

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This report to stakeholders has been prepared by Dr June Smith and is based on her 2010 PhD thesis entitled "Professionalism and Ethics in Financial Planning". A full copy of the PhD thesis is available to download from the world wide web at eprints.vu.edu/15535/-cached. Dr Smith is a Principal of Argyle Lawyers Pty Ltd, a member of Integrated Legal Holdings Limited. Copyright © 2010 Dr June Smith. All rights reserved.

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EXECUTIVE SUMMARY

Context

1. The ability of financial advisers to engage in ethical decision making and ethical conduct in the provision of financial services to Australian consumers is critical to the achievement of widely held objectives to professionalise financial advisers and to ensure quality advisory outcomes.
2. Questions concerning what factors influence an adviser to make an ethical or unethical choice and what ethical issues they face in their day to day advisory practices and within the organisations for which they work, however, have remained largely unanswered.
3. This report outlines the results of empirical PhD research that sought to answer these questions in an Australian context. The study was comprehensive in nature and represents one of the first studies of its kind in the world. It provides unique insight into the most common ethical errors associated with the provision of financial advice, the current ethical issues faced in the provision of financial advice to Australian consumers and the factors that influence ethical decision making within financial services organisations.
4. To assist the reader, the report uses a series of text boxes to identify signposts to reform, roadblocks to quality financial advisory outcomes and suggestions on how to build organisational resilience to ethical risk within the financial advisory sector.

Consumer Complaint Analysis

5. The PhD study included a review of 225 consumer complaints of inappropriate financial advice which were determined by the Courts, the Financial Ombudsman Service (FOS) and the Australian Securities and Investment Commission (ASIC) between 2006 and 2007. The ten most common ethical errors made by financial advisers within those cases are identified on page 16 of this report.

Common Ethical Errors in Financial Advice

6. Integrity issues dominated the consumer complaint analysis. This includes unethical conduct associated with misleading statements about the performance, features and risks of recommended financial products or misleading statements about the business reputations of those associated with the management and administration of financial products or managed investment schemes (35).
7. The findings raise questions about the commoditised approach to financial advice used by some financial advisers and the ongoing failure to accurately match financial products to the needs, circumstances and objectives of clients. The data suggests that financial advisers still struggle with even basic legal concepts such as having a “reasonable basis” for advice and ensuring “suitability” of the advice to the client. This is usually compounded by a failure to appropriately apply tolerance to risk assessments.
8. The complaint analysis highlighted a pattern of overreliance on template statements of advice not tailored to the client’s specific circumstances. The widespread use of substantial templating of advice poses ethical risks of its own and can at times lead to greater risk for consumers. It also hinders the adviser’s ability to fully disclose all matters relevant to an informed decision making process.

9. Many of the forms of unethical conduct revealed by the analysis should have been identified by the AFS Licensee's risk management and compliance systems, but were not. This suggests that AFS Licensees are inadequately identifying some of the key ethical risks associated with the provision of financial advisory services or that those risks are not being appropriately managed, monitored and supervised.
10. Some of the unethical conduct identified may also have arisen as a result of failures in the ethical frameworks of financial advisory firms. This is a historical lesson well learnt, but failures such as these are seemingly repeated across the financial services sector at regular intervals.
11. Ten roadblocks to quality financial advisory outcomes arising from the data are identified on page 18. Amongst them it is noted that the unethical conduct identified in the consumer complaint analysis may be a roadblock to the successful implementation of any new fiduciary standard that may apply to financial advisers from 1 July 2012. There is a real reputation risk for financial advisory firms that cannot ensure their advisers can meet ever increasing ethical and conduct standards.

Competency Levels

12. A series of six competency roadblocks to quality financial advisory outcomes are described on page 33. The data suggests that individual competency levels amongst financial advisers are currently too low to allow them to resolve the complex ethical dilemmas they face in their daily practice with. These low competency levels will also impede their ability to meet any higher professional and conduct standards expected of them in the future.
13. Any attempts to increase standards and conduct across the advisory sector will also need to take into account that contextual factors within organisations have a greater influence on the behaviour, conduct and decision making of an individual than factors such as education and competency levels. The influence of contextual factors will need to be modified commensurate with competency and conduct initiatives.

Lessons from Westpoint

14. The research examined the financial advice provided to consumers to invest in Westpoint as outlined on page 19 of this report.
15. Professional ethics requires a financial adviser to exercise specialist skills and use ethical judgment in the interests of their client and in the public interest. The ten most common forms of unethical conduct identified from the Westpoint case study (outlined on page 20) make it clear that these concepts are currently inconsistently applied within the financial advisory sector.

Focus Group Results

16. A focus group of 20 financial advisers and compliance managers was convened as part of the PhD research. The data from that group session is introduced on page 22. It provides an insightful description of their perceptions and attitudes to the current ethical issues facing them in their respective roles (page 22 and 23) and the factors that they believed may be influencing ethical decision-making in their financial services organisation (page 24 and 25).

17. The key gaps in current ethical frameworks identified as a result of the focus group analysis are described on page 27 of the report. These include perceptions that commercial conflicts of interest within financial services organizations are currently inadequately resolved and that current imbalances exist between the objective to provide quality advice in the interests of clients and the requirement to meet business and profit imperatives.
18. The focus group participants also shared a sense of frustration about the lack of diligence shown by some advisers in following internal compliance procedures and the lack of accountability within firms for not doing so.
19. If the focus group perceptions are representative of the views of the majority in the sector, then this highlights a divergence between *the “STATED” and “LIVED” ethics* within financial services organisations.

Research Questionnaire Data

20. The PhD research also included the distribution of a research questionnaire to 770 financial advisers and compliance officers. The questionnaire measured the ethical reasoning levels of participants, identified relevant demographic data about them and measured the perceptions of participants of the ethical climate and culture and ethical leadership within their financial services organisations. A total of 165 financial advisers and compliance officers from 90 financial services organizations across Australia responded to the questionnaire.
21. The questionnaire findings suggest that there are many individual and organisational factors that influence the ethical decision making of financial advisers and compliance managers within financial services organisations. The findings in relation to these factors are outlined onto pages 31 to 45 of this report.

The Individual Factors that Influence Ethical Decision Making

22. In relation to individual factors, the research has revealed that an individual's cognitive ethical reasoning level is a significant factor influencing the ability of the adviser and compliance officer to exercise judgment in the resolution of ethical dilemmas and to engage in ethical conduct. Ethical reasoning levels were measured using a new profession specific test of moral reasoning for financial advisers called the “Financial Advisory Issues Test”. This test was developed for the study and is ready to be utilized by Financial Advisory firms in their recruitment and training programs. The correlation table describing the test results are attached at Appendix 6.

Ethical Reasoning Levels

23. The findings suggest that ethical reasoning levels amongst financial advisers and compliance managers are currently lower than is required to effectively resolve the complex ethical dilemmas often associated with the provision of advice to consumers. This leads to higher risks of unethical behavior and poor decision making occurring.
24. To assist in resolving the complex ethical dilemmas that financial advisory firms deal with in daily practice, compliance managers and responsible managers also require high levels of cognitive ethical reasoning. Yet ethical reasoning levels amongst compliance officer participants in this study were low. Going forward, the organisational competencies required

for compliance and responsible manager roles, should include competencies in decision making and business ethics.

Age and Experience

25. Another of the study's findings was that individual cognitive ethical reasoning levels are in turn significantly influenced by the age and years of experience of an individual and whether or not they hold a professional designation where they have been previously exposed to ethics training and education.
26. Specifically, younger and less experienced advisers and compliance officers were more likely to engage in unethical decision making and are therefore at higher risk of engaging in unethical conduct than their older and more experienced counterparts.

Professional Designations

27. The study revealed that advisers who hold a professional designation or accreditation have higher ethical reasoning levels than those who do not. In particular, advisers who held the Certified Financial Planner™ practitioner designation licensed to the Financial Planning Association of Australia Ltd (FPA) had the highest levels of ethical reasoning amongst participants.

The Implications

28. These findings have numerous implications for the achievement of quality advice for every consumer. For example, they support moves by some in the industry to introduce a professional year of supervised practice. To complement this initiative, specific mentoring programs for young or inexperienced advisers should be introduced, both within AFS Licensees and within professional associations. This should be coupled with a reframing of induction and recruitment programs to ensure advisers understand their legal, professional and ethical obligations prior to engaging in practice.
29. Financial advisers and compliance officers, when recruited, should be exposed to ethics education and inducted into the ethical climate and culture of the AFS Licensee to reduce the additional risk that decision making will be unaligned to others within the organisation. Internal ethics education programs should also be linked to the reporting, disciplinary and performance management systems within AFS Licensees to ensure current and important messages about acceptable and unacceptable behavior are communicated and reinforced.
30. These findings suggests that all financial advisers within the sector should be encouraged to join a professional association and undertake ethics training and education courses as part of an accreditation process. It seems the adherence to a professional Code of Ethics together with exposure to other professional obligations may assist in raising competency and conduct standards across the sector.
31. Whilst education levels amongst advisers did not influence ethical reasoning levels in this study, the results of the other elements of the study suggest that a move to an undergraduate degree in financial planning, for example, is warranted.

Size of the Organisation

32. The research did not reveal a link between the size of the financial services organisation and the financial adviser's level of ethical reasoning ability. This means that larger financial services organisations, per se, do not have a higher risk of unethical conduct from their advisers than smaller groups, as is commonly thought.
33. However, the results indicate that larger financial services organizations are more exposed to risks associated with poor ethical climate and culture within their advisory divisions and a lack of ethical leadership.

The Contextual Factors that Influence Ethical Decision Making and Conduct

34. In addition to individual factors, there are also a number of contextual factors that were identified from the research as having a significant influence on the ethical conduct of financial advisers and compliance managers and the issues they will take into account when resolving ethical dilemmas. These factors include remuneration structures, the role played by the individual, the ethical climate and ethical culture of a financial services organisation and the presence of ethical leadership. The correlation table outlining the results of this testing are attached at Appendix 8.
35. These are interesting findings for AFS Licensees in particular given it is easier to influence the policies, procedures, values and culture of their organisation than it is to control the personal values, ethical reasoning levels and other demographic factors of the persons who work for them.

Remuneration Structures.

33. In relation to remuneration structures, whilst there was no evidence that financial advisers who received commission payments had lower levels of ethical reasoning ability, the research indicated that remuneration structures and the inherent conflicts of interest associated with some commission and volume based payments, led to unethical outcomes in the provision of financial advice and the failure of advisers to place their client's interests before their own.
34. There was a clear perception amongst the questionnaire's 165 participants and the focus group, that conflicts of interest associated with current remuneration structures within the sector were not managed effectively in all instances by financial advisory firms and constituted a real reputation risk.
35. The research supports the FOFA and industry association reforms to introduce a fiduciary conduct standard, implement fee for service models, ban some forms of commission and volume based payments and introduce an opt in payment mechanism for consumers as a necessary first step towards reducing the unethical outcomes associated with such payments and the conflicts arising from them. However, the significant and complex ethical issues related to conflicts of interest associated with financial services ownership and remuneration structures will remain, albeit in a reduced or different form and requires a more substantial solution.
36. AFS Licensees should be aware of these risks and take into account in their transition to fee for service models, that the setting of sales targets, performance management and rewards structures may still pose ethical risks to the organisation if the wrong or mixed messages are

sent to advisers about the weight they should give to commercial objectives over other interests and values, when resolving ethical dilemmas.

The influence of Ethical Culture

37. Ethical behaviour should be higher in organisations with an effective ethical culture, where leaders and norms encourage ethical conduct and ethical conduct is rewarded and unethical conduct punished.
38. The ethical culture conducted as part of the research revealed that not all financial advisory firms have effective ethics frameworks in place and that there is a significant gap between the stated and real ethical outcomes within organisations. The graph on page 39 highlights, for example, that whilst 80% of participants believed their organisation had a Code of Ethics, less than 50% believed their organisation took disciplinary action against unethical conduct or had regular reporting mechanisms on ethical standards matters and only 21% believed their organization included rewards for ethical conduct outcomes in performance management systems.
39. A series of recommendations to build organizational resilience to ethical risk outlined on page 40, include the proposition that compliance with the Australian Standards on Corporate Governance (with their application subject to size and turn over requirements) and the introduction of integrity based frameworks within AFS Licensees may be the key to a new and invigorated approach to decision making and governance frameworks in financial services. A regulatory response to governance and ethical issues should not always be the preferred approach.

Ethical Climate within Financial Services Organisations

40. Ethical climate is usually defined as a shared perception of what behaviour is right and what behaviour the organisation expects from its members.
41. The ethical climate survey results outlined on page 42 of this report suggest that there are currently very different perceptions between compliance officers and financial advisers about the factors that influence decision-making within financial services organisations, leading to inconsistent outcomes in advisory models.
42. The findings indicated that the compliance officer respondents believed ethical decision making within their financial services organisations was driven by self interest and furthering company profits, rather than client and stakeholder interests. This type of climate has a higher risk of unethical conduct occurring and is consistent with the focus group and consumer complaint analysis data.
43. Conversely, financial advisers perceived that they were able to use their own moral (not the organizations values) to resolve ethical dilemmas in the interests of their clients.
44. These differences suggest that financial services organisations may be sending mixed messages to its compliance and advisory teams about what behaviour is acceptable and unacceptable, the organisation's priorities to be taken into account when making decisions and whether or not unethical conduct will be tolerated in some circumstances.

Ethical Leadership

45. Whilst the presence of ethical leadership within a financial services organisation was significantly and positively related to higher rates of ethical conduct within financial services organisations, programs to identify and nurture these individuals were not identified by the research.
46. Instead, the research highlighted that a lack of ethical leadership in critical organisational roles may have contributed to the systemic unethical conduct and consumer losses identified in the consumer complaint analysis. This included even simple measures, such as a failure to adequately supervise staff and failures to ensure internal processes and procedures were followed.
47. A renewed focus on ethical leadership within financial services organisations is a non regulatory mechanism that may assist in embedding the FOFA reforms, enhancing quality advisory outcomes for consumers and lifting conduct standards, without the need for further legislative intervention.
48. Some of the factors that contributed to the Global Financial Crisis both in Australia and overseas (with the resultant collapse of financial advisory firms and financial products) included the failure of ethical conduct standards among financial services participants, a lack of ethical leadership within certain organizations, a failure of governance systems and organisational cultures linked to self interest. The results of this empirical research suggest that Australian Financial Services Sector is in danger of repeating these failures unless solutions based on integrity frameworks are considered and implemented as a complimentary mechanism to regulatory reform.
49. GFC failures also occurred at all levels of the financial services sector including funds management, superannuation, responsible entities, product manufacture and platform provision and research houses. It is not just financial advisers to whom the lessons of this research are addressed.

The Way Forward

50. All stakeholders are currently seeking to ensure that quality advisory outcomes for Australian consumers become the norm and that the financial advisory sector continues its progress towards professionalization. The research suggests that the imposition of regulatory solutions, such as the Future of Financial Advice reforms (FOFA), in an attempt to raise conduct and professional standards within the financial advisory sector, whilst a necessary first step, may not of themselves be sufficient to achieve their stated objectives, as compliance with the law of and in itself is not a significant motivator to change behaviour.
51. It is further argued that regulatory responses, such as the FOFA reforms, may not always resolve ethical conduct and behavior issues and that a more comprehensive solution may be required. The case for a reinvigorated approach to the use and application of ethics frameworks as part of the solution has been made.

SECTION 1: INTRODUCTION

In the context of corporate governance within financial services organisations, if Compliance means obeying the law, then Ethics is the intention to observe the spirit of the law and act and apply organisational and societal values in the provision of financial services to Australian consumers. The impact of unethical conduct, either within an organisation or within a profession, can be catastrophic.

However, the evidence suggests there are numerous ethical risks related to the provision of financial advice and many factors that may be influencing ethical decision making within financial services organisations, all of which may impact on the quality of financial advisory outcomes that Australians receive.

Yet there has been little, if any research, conducted either internationally or in Australia concerning the cognitive ability of financial advisers to make ethical choices in their respective practices, the current ethical issues they face in the provision of financial advice to consumers or the factors that influence their decision making within financial services organisations.

This report attempts to fill these gaps and generate debate about the current ethical and professional issues associated with the provision of financial advice in Australia. The report provides a summary of PhD research undertaken by Dr June Smith, conducted through the Victoria University Law School and finalised in 2010. The research was supervised by Professors Anona Armstrong and Ronald Francis and Patrick Foley. The study was also conducted with the assistance of the Financial Planning Association of Australia Ltd ("FPA"), of which the author is a member and Argyle Lawyers Pty Ltd of which the author is a Principal.

A Glossary of Terms used in this report is attached at Appendix 1 of this report. Further information about how the research was conducted and its methodology is contained in Appendix 2.

The PhD research had three general objectives as follows:

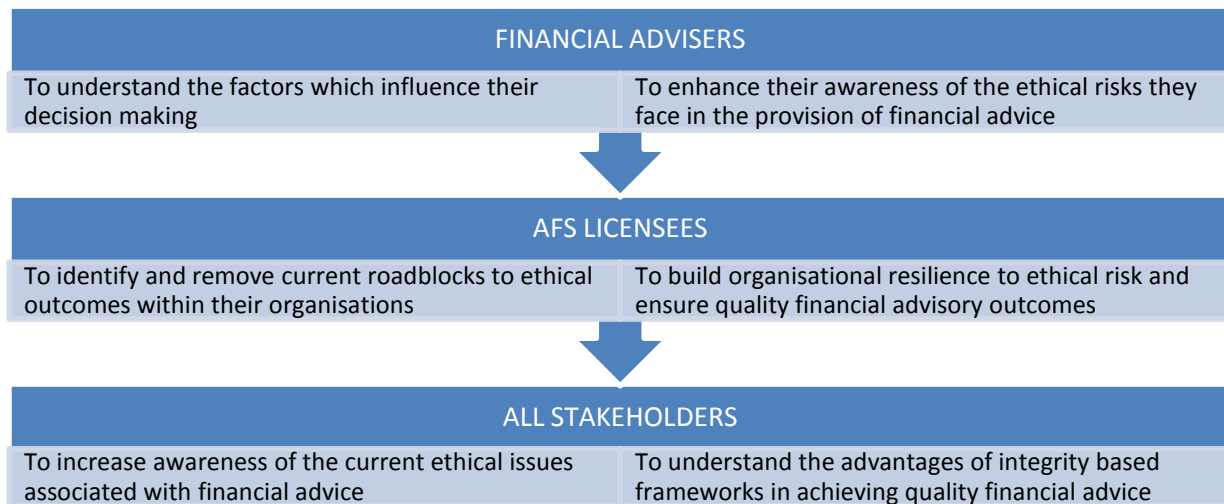
1. To determine the primary types of unethical conduct engaged in by financial advisers in the provision of financial advice to consumers.
2. To identify the current ethical issues facing financial advisers and compliance officers in their respective roles within financial services organisations.
3. To measure the individual, situational and contextual factors that influence the ethical decision making of financial advisers and compliance officers in the provision of financial advice to Australian consumers.

The purpose of this report is to:

- (i) summarise the empirical findings of the PhD research;
- (ii) enhance understanding and insight of the factors that influence ethical decision making within financial services organizations;
- (iii) provide a snapshot of the current ethical issues and trends in financial advice in Australia;
- (iv) identify gaps in current ethical frameworks within Australian Financial Services Organisations; and

- (v) provide recommendations to close these gaps.

The report is designed to assist:



It should be noted that whilst this report uses the terms “financial planner” and “financial adviser” interchangeably, this is because the law and numerous stakeholders currently do not distinguish between different categories of adviser in the sector.

Within the Australian financial services industry, there are many financial advisers who do not consider themselves to be financial planners and many financial advisers who call themselves financial planners when they do not provide holistic advice to clients or follow the traditional six step process. In addition, many of the financial advisers who are the subject of this report do not appear to be members of any one of the numerous professional associations within the sector. Both outcomes are to be lamented. The report’s author is a strong advocate for the proposition that financial planners should be a separate and distinct category of adviser, held accountable to very rigorous professional and competency standards and that all advisers should hold some professional accreditation or membership, for reasons which will become obvious in this report.

This report may also seem to place the spotlight on the advisory sector and infer that only it needs to take responsibility for integrity and governance issues in the sector. On the contrary, some of the patterns and trends outlined in this report are very relevant not only to the financial advisory sector, but more broadly to whole financial services sector.

SECTION 2: THE IMPORTANCE OF ETHICS

Ethical conduct and behaviour are pivotal to the ability of financial advisers to retain the trust and confidence of stakeholder groups and clients and to ensure quality financial advisory outcomes. Financial advisers also require the ability to exercise professional and ethical judgment appropriately in the identification and resolution of the often perplexing and complex dilemmas they face in the provision of advice to clients and in their interrelationships with their Australian Financial Services Licensee, peers and other stakeholders.

Financial Planning, in particular, is also an emerging profession both within Australia and internationally, and requires a strong ethical context to meet stakeholder expectations concerning the conduct and behaviour of its participants.

Financial advice is also becoming increasingly relevant to the economic, social, lifestyle and retirement objectives of Australians and its governments. There is an ever increasing and commensurate need therefore to obtain expert financial planning advice to ensure a financially sustainable lifestyle and to provide for retirement years.

There is a lot at stake. Recent statistics confirm the relevance of financial advice to the Australian economy. The 2008/09 Annual Report of the Australian Securities and Investments Commission (ASIC) (ASIC 2009) estimated that there were 4,803 Australian Financial Service Licensees (AFS Licensees), across 15 financial markets. The Ripoll Report (2009) estimated that there were approximately 18,000 financial advisers who represented 149 advisory groups via 8000 financial advisory groups or 160 dealer groups. Further, it has been estimated that over five million Australians currently seek advice from the 12,000 members of the Financial Planning Association of Australia Ltd (FPA) alone (FPA 2009 Annual Report). Those members invest \$630 billion on behalf of their clients (FPA 2010).

In addition, 11.8 million Australians have superannuation or annuities and 5.7 million Australians own shares (ASIC Annual Report 2009). As at March 2008, superannuation fund assets in Australia were estimated at \$1.1 trillion (Sherry 2008a). It has been projected that the total superannuation pool in Australia will grow to \$2.2 trillion by 2015 and other retirement income assets are expected to grow to \$320 billion in the same period (Smith, M. 2007). In addition, an Investment Trends 2010 SMSF Planners Report has identified that 235,000 self managed superannuation funds (SMSF) received advice from financial planners as at June 2010, with fees from servicing these clients estimated at \$890 million (Money Management Magazine Issue 527 October 2010).

These statistics tell a compelling story. They confirm that the financial advisory market is a growing and burgeoning one which exerts significant influence over the financial assets and economic wellbeing of the Australian public (ASIC 2007f). There is rightly therefore a growing spotlight on how financial advice is delivered and the regulatory and professional regimes that govern it (Smith, J. 2003; Powell 2003).

In terms of the individual adviser, previous research has demonstrated that ethical conduct, behaviour and judgment are linked (Trevino & Youngblood 1990, Abdolmohammadi and Sultan 2002). Accordingly, individuals with high ethical reasoning ability should also display high levels of ethical conduct and behaviour and engage in effective decision making. This report discusses the results of testing of ethical reasoning levels amongst Australian financial advisers and how factors such as age, experience, education level and professional association can also influence an individual's ability to act ethically.

In Australia, as with the law and medicine, financial advisory services are not just undertaken by individuals, but also by institutions. Previous research suggests that 80% of employees make ethical decisions consistent with organisational norms, policies and procedures. Further, social psychology researchers including Milgram (1965) have demonstrated that even good people can act unethically when pressured by a strong corporate culture to be a "team member" and act differently. Accordingly, financial services organisations can have significant influence over the ethical decision-making of employees and agents (Mason & Mudrack 1997).

This report is premised on the view that financial services companies have numerous responsibilities in the provision of services to consumers. These include not only economic and commercial duties to shareholders and to comply with the law, but also social and ethical duties to a broad range of stakeholders. As a result it is critical that these organisations implement effective ethics framework that will assist them to meet this broader range of duties.

Signpost

It has become increasingly clear that the recent Global Financial Crisis was as much a result of failures in culture, governance and integrity as it was about economic and market failure. Indeed, a series of global financial and corporate scandals following the global financial crisis may have also accelerated a new social mantra that society expects financial services organisations in particular to be trustworthy and avoid harming others, even if the law allows business to engage in that behaviour.

Tactics to remain competitive in a modern commercial environment often influence the belief that behaving ethically is not profitable (Ferrell, Fraedrich & Ferrell 2002). Yet, lapses in organisational integrity can have significant consequences in terms of money, distraction and reputation. The legal, financial and reputation fallout from the failure of Westpoint (The Sydney Morning Herald 2007; ASIC 2008a; Jacob 2008), ACR (Egan 2007), Fincorp (ASIC 2007b), Basis Capital (Washington 2008), Storm Financial Group (2009), Great Southern and Timbercorp (2010), amongst others, will be repeated unless historical lessons are learned.

Whilst there is no universally accepted approach to the resolution of many of the ethical issues faced by financial services organisations in the 21st century, governments and other stakeholders are rightly starting to encourage organisational accountability for ethical as well as legal conduct. The ethics and governance structures of financial services organisations are therefore very important to the achievement of quality financial advisory outcomes for Australian consumers, in addition to the professional and ethical competencies of individual advisers.

SECTION 3: CURRENT TRENDS IN UNETHICAL CONDUCT**3.1 What was measured**

A key element of the PhD research was the analysis of 235 decisions made by Australian Courts, the Australian Securities and Investment Commission (ASIC) and the Financial Ombudsman Service (FOS), against financial advisers and AFS Licensees, arising from consumer complaints about negligent or inappropriate financial advice. The purpose of the analysis was three fold. First, to determine the primary areas of financial advice which were associated with a higher risk of unethical conduct. Secondly, to determine the primary types of unethical conduct currently associated with the provision of financial advice and thirdly, to collect data from which to develop the case scenarios used in the Financial Advisory Issues Test.

Information concerning how the research was conducted is attached to this report at Appendix 4.

3.2 Advisory services associated with the highest ethical risks.

Table 1 below outlines the most common types of advisory services that were the subject of the 235 decisions made by the Courts, ASIC and FOS in relation to complaints about financial advice in 2006/07.

Table 1: Common types of advisory services the subject of decisions by external decision makers between 2006 and 2007

Primary type of advice given	AC*	BO**	EU***	FOS#	Total
General investment advice	1	7	0	40	48
Superannuation/SMSF	1	7	2	31	41
Westpoint	6	9	0	25	40
Equities/Shares	0	6	2	14	22
Other managed investment schemes	0	7	0	13	20
Insurance/Insurance broking	0	10	2	5	17
Retirement Planning	0	0	0	9	9
Margin loans/Gearing	0	1	0	7	8
Not available	0	7	0	2	9
Investment Seminars	1	0	0	5	6
Warrants Trading	0	0	0	3	3
Contracts for Difference	0	0	0	3	3
Private company shares/Advice in own shares	1	1	0	0	2
Debentures/Derivatives	0	0	0	2	2
Taxation	1	0	0	1	2
Banking	0	1	0	0	1
Reverse mortgage products	0	0	1	0	1
Centrelink	0	0	0	1	1
Total No. Cases Analysed	11	56	7	161	235

Legend: *AC =Australian Courts, **BO =Banning Order, ***EU = Enforceable Undertaking, #FOS = Financial Ombudsman Service Ltd.

Source: Smith, J. 2010, "Professionalism and Ethics in Financial Planning", a PhD dissertation, Victoria University, Melbourne.

As identified in the table, the primary advisory services that were most at risk of unethical conduct, were advice in relation to general investment advice and superannuation advice. This was followed by financial advice related to Westpoint promissory notes and equities/shares advice. However, when added together, advice to invest in managed investment or property schemes including Westpoint, represented 60 matters determined during the relevant period.

The ethical risks associated with the provision of advice to invest in managed investment and property schemes are therefore significant. Some of these risks have previously been commented on in the Ripoll Report (2009) and have recently been the subject of legislative amendment.

3.3: The most common forms of unethical conduct in financial advice

Table 2 below outlines the ten most common forms of unethical conduct engaged in by financial advisers in the provision of advice to clients, as identified from the consumer complaint analysis. These provide a guide to the most common ethical risks faced by Australian Financial Services Licensees and financial advisers in the provision of advice to consumers. It is noted that in some cases the unethical conduct may also amount to a breach of the minimum legal standards in the Corporations Act (2001) (the Act).

Table 2 demonstrates that integrity issues dominate the analysis. This includes unethical conduct associated with misleading statements about the performance, features and risks of recommended financial products or misleading statements about the business reputations of those responsible for the management and administration of financial products or managed investment schemes (35).

Table 2: The ten most common forms of unethical conduct in financial advice.

No.	Theme	Summary of Unethical Conduct	Primary Ethical Principles	No. of breaches
1	Integrity Issues	Misleading statements as to performance, product features or security, business reputations	Integrity, Professionalism	35
2	Integrity Issues	Using client funds for own purpose	Integrity, Professionalism	29
3	Appropriateness of Advice	Advice did not meet client objectives or circumstances and had no reasonable basis	Competence Objectivity	28
4	Research into product/strategy	Lack of financial product research/ inadequate understanding of financial product recommended	Competence Diligence	23
5	Disclosure obligations	Failure to disclose remuneration benefits and conflicts of interest	Objectivity Integrity Fairness	23
6	Disclosure obligations	Failure to disclose information relevant to client decision	Objectivity Diligence Fairness	22
7	Recommendations/ Advice	Inadequate written advice or failure to tailor advice to client	Diligence Fairness	21
8	Appropriateness of Advice	Inadequate explanation and examination of risks associated with investment	Competence Diligence Fairness	19
9	Integrity Issues	Inadequate explanation of the risks associated with financial product	Integrity, Professionalism	16
10	Compliance	Failure to follow internal procedures and policies of the AFS Licensee	Integrity Diligence	13

Source: Smith, J. 2010, "Professionalism and Ethics in Financial Planning", a PhD dissertation, Victoria University, Melbourne.

The misleading conduct identified took many forms, from misrepresenting the risk of a loss of capital that may be associated with an investment or guarantee, to actively promoting that a financial product had features it did not have. The data suggested that such conduct was often associated with other forms of unethical conduct, such as not acting in the interests of clients and failing to provide the client with all information necessary to make informed decisions as to investment choices (22). The misleading conduct also appears to have been contributed to by a failure of the compliance systems and procedures of AFS Licensees to specifically prevent the behaviour (13).

In addition, using client funds for the adviser's own purposes was a clear issue particularly prevalent in ASIC banning orders (29). The appropriation of client funds was associated with conduct such as falsifying documents and signatures and/or discretionary dealing in financial products without the consent of the client. These matters should have been identified by the AFS Licensee's compliance systems and procedures.

Diligence and Competence in the provision of financial advice were other ethical principles that were the subject of recurring breach. The data suggested that financial advisers are still inadequately researching the features, characteristics and risks of the financial product they recommend. This unethical conduct included the failure to conduct appropriate and independent research into the financial product being recommended (23) and inadequate explanations and examination of the risks associated with particular investment choices (19). This leads to a lack of, or inadequate understanding of, the financial product and a commensurate inability therefore to match product to the client's needs, circumstances and objectives (23).

Objectivity issues, such as the failure to reveal conflicts of interest or fees and commissions earned (23) and the failure to disclose information relevant to the client's decision (22) were also prevalent in the data. It should be noted that this latter conduct also constitutes a breach of the "fairness" principle (a failure to provide financial advisory services in a manner that is fair and reasonable) in that it is considered unfair for an adviser not to provide clients with all the relevant information they require so they may make informed choices as to whether or not to accept the advice given.

If, as suggested by the theory (Martin & Cullen 2006), an organisation's ethical climate helps to determine what advisers believe constitutes ethical behavior at work and what criteria they should use to resolve ethical issues, then the presence of this type of unethical conduct suggests an ethical climate based on self interest may have been prevalent in the organizations where these conduct failures occurred (Victor & Cullen 2001).

The ethical principle of Competency is defined as the provision of competent financial planning services, the maintaining of the necessary knowledge and skill and to be professional, efficient and responsive in all dealings. Competency breaches such as the failure to provide adequate written advice (21) that met the client's objectives or circumstances and that had a reasonable basis (28) were prevalent in the analysis. These were surprising findings given these obligations are also legal obligations that have been prescribed by law since 2004 (see Section 945A of the Act).

Generally, this form of unethical conduct was also associated with a failure to effectively undertake an assessment of the client's tolerance to risk and then utilize that assessment appropriately, or to match financial product recommendations to the client's specific objectives.

One of the current themes in hot debate within the sector is that the remuneration and ownership structures of Australian financial services organisations and the failure to manage conflicts of interest associated with those structures has contributed to unethical conduct by financial advisers (ICAA 2007a, D'Aloisio 2007). Conflict of interest has previously been ranked highly as an ethical issue identified by both management and employees as affecting Australian business (KPMG 2005).

Whilst the consumer complaint analysis did not overtly identify that a financial adviser had recommended a particular investment due to the pecuniary benefits that flowed to the adviser, failures to disclose fees and commissions adequately and the conflicts of interest associated with the receipt of these pecuniary benefits, were forms of unethical conduct identified by the analysis (23).

Further, the receipt of high commissions and benefits from third parties as a result of financial product sales and recommendations, whether or not it suited the interests of the client, were all practices identified in the analysis. The systemic nature of this unethical conduct at times meant numerous clients were affected. The conduct suggests motives other than the client's interests for recommendations made. This was particularly so of advice to invest in managed investment schemes, although it was often advice given by a representative who held authorisation to advise in one financial product only. It will be of interest to see whether the same patterns are repeated

when advice associated with investments in schemes such as those run by Great Southern and Timbercorp (amongst others) is scrutinised as a result of legal and regulatory action.

10 ROADBLOCKS TO QUALITY FINANCIAL ADVISORY OUTCOMES

1. Many of the forms of unethical conduct revealed by the analysis should have been identified by the AFS Licensee's risk management and compliance systems, but were not.
2. The current identification by AFS Licensees of key ethical risks associated with the provision of financial advisory services may be inadequate, or those risks, once identified are not being appropriately managed.
3. The findings raise questions as to the process currently used by some financial advisers to match financial products to the needs and objectives of clients.
4. The complaint analysis highlighted a pattern of overreliance on template statements of advice not tailored to the client's specific circumstances. The widespread use of substantial templating of advice poses ethical risks of its own and can at times lead to greater risk for consumers. It also hinders the adviser's ability to fully disclose all matters relevant to an informed decision making process.
5. Financial advisers still struggle with concepts such as "reasonable basis" and "suitability" and often do not appropriately apply tolerance to risk assessments.
6. Advice to clients with special needs such as the elderly or from non English speaking backgrounds pose unique ethical risks of its own.
7. The unethical conduct identified in the analysis is a current roadblock to the acceptance of professional and ethical responsibility by financial advisers to act in the public interest (APESB 2008) and for the collective wellbeing of other stakeholders (KPMG 2005).
8. It also runs counter to the fiduciary nature of the financial advisory relationship (ICAA 2006a) as recognized at common law. This is an issue for the implementation of any new statutory fiduciary standard that may apply from 1 July 2012. The reputation risk for financial advisory firms that cannot ensure their advisers meet ever increasing ethical and conduct standards are self evident.
9. The data also demonstrated systemic instances of unethical conduct within AFS Licensees, by a number of advisers and across a number of clients. For example, the enforceable undertakings given by Patersons Securities Limited (EU 017029204) and First Capital (EU 017029207) related to advice given to over 500 and 170 clients respectively.
10. Some of the unethical conduct identified may have arisen as a result of failures in the ethical frameworks of financial advisory firms. This is a historical lesson well learnt but failures such as these are seemingly repeated across the financial services sector at regular intervals.

The consumer complaint analysis has implications for the successful implementation of a statutory fiduciary obligation for financial advisers. First, the research suggests that contextual factors have

more influence over ethical conduct outcomes and decision making than factors related to the individual decision maker. A move to a new fiduciary standard, on its own therefore, may not be enough to improve conduct standards across the sector, given the stronger influence of organisational contextual factors on conduct and behaviour. This raises the question as to whether the fiduciary obligation should attach to both the Licensee and the adviser in order for it to be successful. It also suggests that commensurate cultural change will need to take place within financial services organisations for the higher conduct standard to be applied successfully in practice. Secondly, the lack of uniform competency standards across the sector may mean a statutory fiduciary standard cannot be successfully applied across all advisory relationships and services. Thirdly, the data suggests that some AFS Licensees may need to revise systems and procedures to ensure financial advisers can act according to this higher standard.

SECTION 4: LESSONS FROM WESTPOINT

4.1 The Analysis

One of the major sources of litigation during the period 2006/07 concerned financial advice given by financial advisers to invest in Westpoint promissory notes. This litigation has continued with the recent settlement by ASIC of its class actions against Barzen Pty Ltd (formerly Dukes Financial Services Pty Ltd) and Mr Joseph Dukes for \$1 million (ASIC 2010).

Westpoint advice formed a case study for the PhD research and a prism through which to analyse the ethical decision making and conduct of financial advisory participants in practice. Learning the lessons from Westpoint and its aftermath is important. According to ASIC, an estimated \$388 million was lost by investors in the property development scheme. So far ASIC has returned \$24.5 million to almost 1000 investors as a result of actions taken against six Australian Financial Services Licensees in particular (ASIC Media Release 10-195). If history is not to repeat itself, reflection and review of what went wrong and how to fix it is essential.

Table 3 on the next page describes the most common forms of unethical conduct identified from the 40 Westpoint decisions made by FOS, Australian courts and ASIC in 2006 and 2007. The primary form of unethical conduct identified from the Westpoint decisions was misleading statements made to clients about the performance; features and security of the promissory notes; the business reputations of the Westpoint group and its longevity (47). Such misleading conduct constitutes a breach of the ethical principles of integrity, fairness and objectivity.

These misleading statements primarily took two forms; misstatements arising ostensibly from a lack of understanding of the investment and its features (Delmenico v Brannelly & Ors [2007] QDC 165) and statements meant to induce clients to invest (ASIC 2007e). This unethical conduct was usually associated with commoditized advice across a group of clients, rather than tailored advice to individual clients. The case of Evans v Brannelly & ors [2007] QDC 165 for example concerned six clients and the ASIC banning orders in Fung (ASIC 2007k); Humphrey (ASIC 2007j); Wade (ASIC 2007i); Lowth (ASIC 2007h) and Armstrong (ASIC 2007g), all concerned advice to numerous clients.

The data revealed a demonstrated failure in the processes adopted for the provision of financial advice to invest in Westpoint. For example, most of the decisions by external decision makers note a failure to comply with minimum legal obligations such as to understand the client's objectives or circumstances (26), to assess tolerance to risk (21) and to provide a reasonable basis for advice (31). This was coupled with a failure to adequately explain the risks associated with the investment (25) and was compounded by not tailoring advice to the individual client (16).

Table 3: The ten most common forms of unethical conduct arising from Westpoint complaints

No.	Theme	Summary of unethical conduct	Primary Ethical Principles	No. Breaches Identified
1	Integrity Issues	Misleading statements as to performance, product features or security, business reputations	Integrity/ Professionalism	47
2	Research	Inappropriate financial product recommended	Competence	33
3	Appropriateness of advice	No reasonable basis for advice	Competence/ Fairness	31
4	Suitability of Advice	Advice did not meet client objectives or circumstances	Competence/ Objectivity	26
5	Research/Due Diligence	Failure to conduct due diligence of Company behind product/scheme/strategy	Diligence	26
6	Appropriateness of advice	Inadequate explanation and examination of risks associated with investment	Competence/ Diligence/ Fairness	25
7	Research into product/strategy	Lack of financial product research/ No independent research conducted	Competence/ Diligence	25
8	Suitability of advice	Inadequate assessment of risk tolerance	Competence	21
9	Recommendations/ Advice	Inappropriate reliance by adviser on general advice warnings	Objectivity /Fairness	19
10	Disclosure Obligations	Failure to disclose remuneration/benefits	Objectivity/ Integrity	16
10	Recommendations/ Advice	Failure to tailor advice to client/use of template documents	Competence/ Diligence	16

Source: Smith, J. 2010, "Professionalism and Ethics in Financial Planning", a PhD dissertation, Victoria University, Melbourne

In addition, the advice to invest in most of the cases analysed was simply not suitable to the particular client (See FOS decisions numbered 17001; 16818; 16685 and 17937). For example, of the 25 FOS Panel decisions concerning Westpoint analysed as part of the research, nine related to advice to self managed superannuation funds, at least five clients were elderly, retired and in pension phase and three clients on low incomes were invested in Westpoint using a gearing strategy. The speculative nature of the promissory notes and the risks associated with them made them clearly unsuitable investments for these types of clients. It is evident from the data that the current legal framework for financial product advice did not operate effectively to protect consumers in some instances.

The analysis revealed that some advisers recommended clients roll over their existing Westpoint investment when it matured, into another Westpoint property group investment, without conducting further due diligence on the companies or the investment (26). Some investments were rolled over only some three months before Westpoint collapsed (see FOS decisions 17085, 16823, 16662, 17602, 17123 and 17209). This failure to conduct new research and additional diligence meant some advisers also failed to identify that ASIC had already commenced action against the Westpoint companies due to financial difficulty in repaying investments as they matured (Evans v Brannelly & ors [2006] QDC 348).

4.2 The implications

The findings raise questions as to the process currently used by some financial advisers to match financial products to the needs and objectives of clients. This leaves clients with special needs in particular at greater risk.

Signpost

Professional ethics should concern a financial adviser exercising specialist skills and using ethical judgment in the interests of their client and the public interest in the provision of advice. The Westpoint case study makes it clear that these concepts are currently inconsistently applied within the financial advisory sector.

The Westpoint collapse has often been associated with arguments that high commissions were a primary reason for advisers recommending the investment to clients, in breach of their ethical obligations to act objectively and in the client's interests. The data suggests that at the very least there was a failure to disclose the level of fees and commissions payable (16). However, it must also be noted that the interest rates payable to investors as a result of the investment were very high as well. One implication arising from this is that financial markets sometimes provide pecuniary incentives to both advisers and investors to invest inappropriately.

It should be noted that not all of those who invested in Westpoint did so on the advice of a person licensed under the Act and some of the enforcement action taken by ASIC was against unlicensed entities like Kebbel Bank (ASIC 2006e). Yet some ASIC media releases related to Westpoint referred to these unlicensed persons as "financial advisers". In addition, in some of its media releases and banning order registers, ASIC also refers to undischarged bankrupts and other unauthorised persons (ASIC 2004e, 2004f) by that term.

This raises the question of whether the terms "Financial Planner" and/or "Financial Adviser" should be the subject of statutory protection so as to avoid any confusion for consumers about who is an appropriately qualified and regulated financial adviser. The data from this study suggests there is good argument for restricting the use of the term 'financial planner' in particular to those who are licensed or authorised to give financial advice and who meet additional eligibility and competency criteria. These criteria could include, among other things:

- the achievement of an undergraduate degree or other recognised qualification or training in a related field of endeavour;
- the holding of a professional designation and membership of a recognised professional association with a Code of Ethics and Conduct accredited under the Act;
- the requirement to complete annual continuing professional development;
- recognition of a prescribed period of supervised practice prior to being eligible to use the term; and
- the recognition of a statutory fiduciary relationship between the person holding the restricted term and the client.

This action may reduce any confusion for those who seek professional financial advice as to who meets relevant competency standards prescribed by the Act and who does not and avoid the risks that a new statutory fiduciary standard will not be successfully applied to all advisory relationships and services.

SECTION 5: CURRENT ETHICAL ISSUES FACING FINANCIAL PLANNING PARTICIPANTS

A focus group of 20 financial advisers and compliance managers was conducted as part of the PhD research. The data from that group session provides an insightful description of the perceptions and attitudes of financial advisers and compliance officers of the current ethical issues facing them in their respective roles and the factors that they believe may be influencing ethical decision-making in financial services organisations.

Table 4 below outlines the top five responses given by focus group participants when asked about the current ethical issues facing financial planners.

Table 4: Focus group perceptions of the top five ethical issues facing financial planners in the provision of advice to consumers

No.	Ethical Issues Identified by Participants	Corresponding Ethical Principle	Ranking Score
1	To always act in best interest of client.	Professionalism	50
2	Conflict within current advisory models between time pressures; the need for advisers to produce income for themselves (and licensee) and the desire to provide appropriate advice and undertake appropriate research.	Diligence	45
3	Determining an appropriate risk tolerance for clients.	Competence	38
4	To be honest.	Integrity	37
5	Conflicts of interest associated with ownership of financial products by larger financial services organisations/ fund managers. Pressure / conflict between advice in the interests of the client and the Licensee's Approved Product List and possible quotas.	Objectivity	30

Source: Smith, J. 2010, "Professionalism and Ethics in Financial Planning", a PhD dissertation, Victoria University, Melbourne

As indicated in the table, the primary ethical issue identified as facing financial planners in their current role was how to always act in the best interests of the client in the face of other competing interests and duties (50). The focus group identified that this issue went to the heart of the "Professionalism" and was one that most advisers would currently struggle with.

The perceived conflicts that existed for financial advisers between the desire to provide appropriate advice to clients, time pressures within current advisory models and the need to produce income for themselves and their AFS Licensees, were also a significant issue of concern to the group (45).

The third ethical issue identified by the focus group was determining the client's tolerance to risk (38), followed in fourth place by the obligation to be honest (37). The fifth ethical issue was the perceived conflict of interest arising from ownership structures amongst larger AFS Licensees and the impact these ownership structures have on limiting the Approved Financial Product Lists from which financial advisers could give advice. This issue was perceived to be compounded by the impost of performance targets set for the sale of particular financial products within those businesses, which in turn was perceived to impact on the quality and independence of the advice (30).

The second question asked of the focus group concerned the current ethical issues facing compliance officers in their roles. Table 5 below documents the top five responses to this question.

The group perceived that the number one ethical issue facing compliance officers was how to ensure the provision of impartial advice by their financial advisory divisions in an environment where there are pecuniary incentives from financial product issuers for financial planners to recommend that clients invest in certain financial products (40).

Table 5: Focus group perceptions of the top five ethical issues facing compliance officers in their role.

No.	Ethical Issues Identified by Participants	Corresponding Ethical Principle	Ranking Score
1	Provision of impartial advice to clients in an environment where there is pecuniary incentive for advisers from product issuers to sell financial product.	Fairness	40
2	Disciplining advisers when their compliance performance is inadequate.	Competence	39
3	Damage to the profession caused by crises such as Westpoint, leading to increased expectations of compliance officers and due diligence mechanisms.	Professionalism	30
4	The conflict between meeting business needs and profitability versus compliance responsibility. Do overseas parent companies understand Australia's complex compliance framework?	Integrity	28
5	Lack of diligence by advisers in following compliance procedures.	Diligence	26

Source: Smith, J. 2010, "Professionalism and Ethics in Financial Planning", a PhD dissertation, Victoria University, Melbourne

This issue was followed by a perception that compliance officers were sometimes hampered by upper management in their ability to discipline advisers when their compliance performance or conduct was inadequate (39). The perception of the focus group was that compliance officers were at times directly or indirectly pressured by management to take a softer approach.

Tables 6 and 7 on the next page illustrate the emerging ethical themes arising from the focus group data in relation to the professional issues facing financial planning participants in the provision of advice and the contextual and business related ethical issues influencing ethical decision making within financial services organizations. Neither table presents the information in any particular order.

Table 6: Professional and ethical issues facing financial planning participants in the financial advisory process.

Theme	Sub Theme	Professional Ethics Issues Associated with the Theme
Integrity	Honesty	Deceptive and misleading conduct; lying to employees and clients; the integrity of the financial advisory process and the conduct of advisers.
Integrity/ Professionalism	Client interests	The appropriateness of advice given to clients; difficulties with risk tolerance assessment; ascertaining the reasonableness of advice; ensuring appropriate investment selection and asset allocation; acting in the best interests of clients.
Objectivity/ Fairness	Conflict of Interest	Balancing the interests of the client and adviser; overcoming the bias created by remuneration structures and the ownership of financial planning firms; the impact of conflicts of interest on the ability to service clients; the tensions between meeting compliance objectives and meeting sales targets; balancing management and profit imperatives with professional obligations; the acceptance of gifts from clients and suppliers.
Integrity	Disclosure/ Informed decision making	Ensuring adequate disclosure in documents is made to the client; the complicated manner in which fees and commissions are disclosed; ensuring compliant documents; disclosing complex commercial relationships between advisory firms and product manufacturers.
Competency/ Diligence	Competency	Managing the competency levels of advisers to undertake their role; keeping up to date with an expanding legislative framework; ensuring knowledge and training of all staff; managing professional development needs with work commitments; lack of adviser diligence in meeting compliance objectives.
Professionalism	Stakeholder Perceptions	The poor external perceptions of the current quality of financial advice; equivocal internal perceptions of the compliance function; the impact of Westpoint and other market and corporate failures; inadequate communication with external and internal stakeholders.
Professionalism	The subjective nature of ethical decision making	The subjectivity of individual judgment, inconsistencies in the interpretation and definitions applied in the advice process by different individual advisers.

Source: Smith, J. 2010, "Professionalism and Ethics in Financial Planning", a PhD dissertation, Victoria University, Melbourne

The sub-themes outlined in both tables 6 and 7 cover a wide spectrum of ethical risk for advisers and compliance officers alike and range from issues of honesty to the influence of commercial and business links in ethical decision making and stakeholder engagement.

Table 7: Emerging ethical issues associated with the conduct of financial planning businesses.

Theme	Sub Theme	Contextual and Business Issues Associated with the Theme
Objectivity	Links to Distribution networks	The ownership, structure and links between financial services organisations; the distribution of financial products through advisory divisions within larger organisations; the sales practices adopted by financial services organisations; links between product manufacturers and advisory groups.
Integrity	Business Imperatives	Profit pressures and resultant trade-offs in the quality of advice and the enforcement of conduct standards; meeting budgets versus ensuring best practice; competing business goals; the commercial settlements of client complaints at FOS; reconciling management values and objectives with professional and compliant practice; a lack of resources; significant time pressures in the advice process; the multinational nature of some financial advisory firms.
Objectivity	Remuneration Structures	The influence of volume and incentive payments and other soft dollar payments; the setting of fee and commission charges and rates; the impact of sales quotas on quality advice; the links between remuneration structures and conflict of interest; overcharging practices by the AFS Licensee.
Objectivity/ Fairness	Churning/ Switching of financial product	How to undertake an effective gap analysis; the commercial pressure to switch clients who transfer from another dealership into financial products on the new Licensee's approved product list.
Competence/ Diligence	Research and Ratings	The reliance by advisers and AFS Licensees on research houses to research financial products and the impact on advice quality; managing the risk that research committees will set appropriate approved product lists; the validity and veracity of the research conducted, balancing approved product lists and financial product variety and number.
Integrity/ Objectivity	Risk management trade offs	Obtaining balance between managing risk and allowing adviser independence; enforcement tradeoffs between disciplining advisers for unethical conduct and the achievement of commercial objectives; the commercial and professional trade-offs associated with professional indemnity insurance claims management.
Compliance	Independence	Restrictions on the independence of the compliance function; its opinions; its ability to enforce rules and procedures across the organisation; restrictions on independence of external and internal review of compliance functions, the appropriateness and scale of compliance systems.

Source: Smith, J. 2010, "Professionalism and Ethics in Financial Planning", a PhD dissertation, Victoria University, Melbourne

A key element of the focus group findings was the group's belief that ethics was a subjective and intangible concept and that inconsistency in the application of ethical values and conduct standards within financial services organizations was common. If the focus group perceptions on this point are

representative of industry views, efforts to develop and embed new professional standards across the sector may require some element of prescription or enforcement in addition to education programs.

Signpost

The consumer analysis data suggested that AFS Licensees may be inconsistently regulating adviser behavior internally. The focus group participants also shared a sense of frustration about the lack of diligence by other advisers in following compliance procedures and the lack of accountability within firms for not doing so.

This sends mixed messages to advisory divisions that whilst ethical conduct is expected, advisers will not be held accountable for unethical conduct. It is noted in this context that employees and managers commonly blame unethical behavior on external influences such as pressures from supervisors (Trevino 1992) or a lack of resources or accountability by others. However, when coupled with data from the PhD questionnaire that indicates that AFS Licensees do not currently have in place the breadth of systems and procedures required to ensure an effective ethical climate and culture (see later discussion), the focus group comments on these matters in particular have more resonance.

If this data is representative of views within the sector, then this represents a significant divergence between *the “STATED” and “LIVED” ethics* within financial services organisations.

The push to professionalise financial advisers and the introduction of a Professional Standards Advisory Council responsible for setting and administering professional standards across the sector, should lead to a stronger understanding of the ethical obligations of financial advisers and a higher degree of self control of behavior, both hallmarks of traditional professions (Wagner 2004; Miller 2002).

The FOFA reforms seeking to ban certain types of commissions and volume based payments and the move towards fee for service models and opt in mechanisms for consumers, may also assist in resolving some of these current tensions. However, the proposed reforms and other legislative responses will not resolve conduct and behavior issues alone. These legislative changes need to be associated with commensurate changes in organisational culture and values and an increase in adviser awareness of their professional and ethical (as well as legal) obligations.

Increases in competency standards, ethical reasoning ability and ethics training amongst financial advisers will also be needed to ensure that advisory participants have the skills required to meet the conduct standards expected by stakeholders and that these new standards can be applied consistently in daily practice.

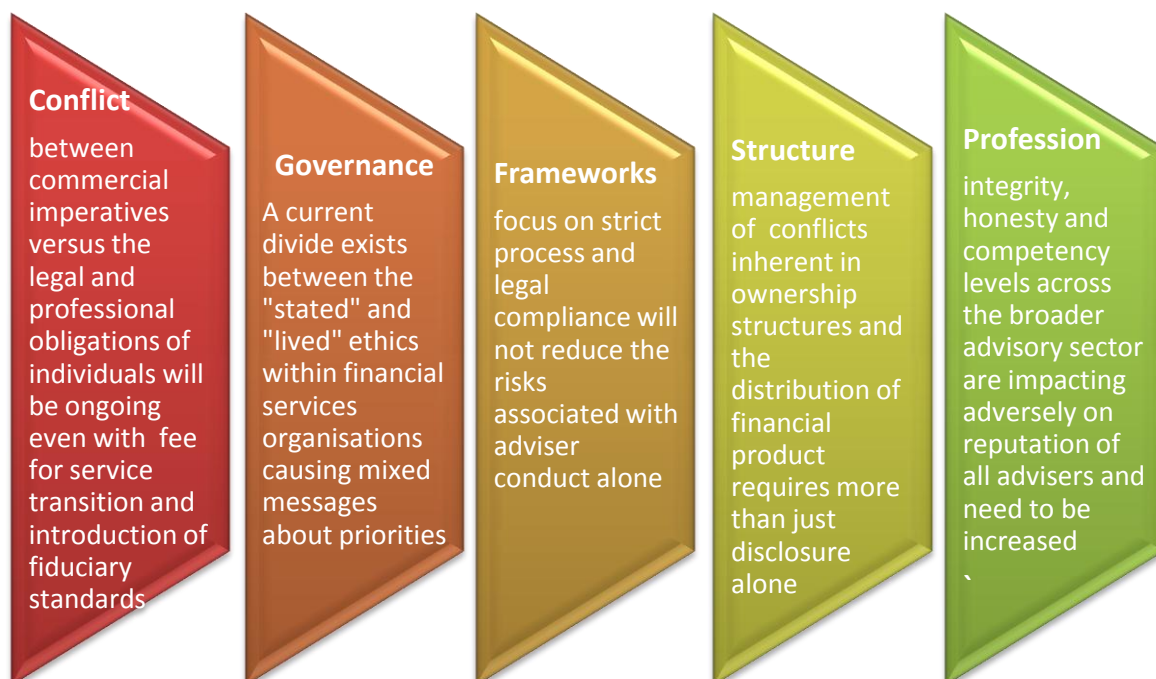
An increased focus across the sector on the role that ethics frameworks and a values based approach to advisory services can play in ensuring quality advisory outcomes, should however assist to embed proposed legislative and professional conduct reforms.

There are many synergies between the primary types of unethical conduct currently dominating financial advice as identified from the consumer complaint analysis and the themes presented in Tables 4, 5, 6 and 7.

Many of the ethical issues raised in the focus group data also seem indicative of the moral hazards that exist for members of other professions between fidelity to an organization, its directions and views on its obligations to stakeholders and the profession's duties to serve the public interest and the client. This may be a theme that the new Professional Standards Advisory Council could examine in more detail.

In conclusion, Figure 1 below summarises some of the key gaps in current ethical frameworks within financial services organisations arising from the focus group data. Each gap increases the ethical risk associated with the provision of financial advice and needs to be closed in order to increase organisational resilience to these risks.

Figure 1: Key gaps in existing ethical frameworks.



SECTION 6: THE FACTORS THAT INFLUENCE DECISION MAKING WITHIN ORGANISATIONS

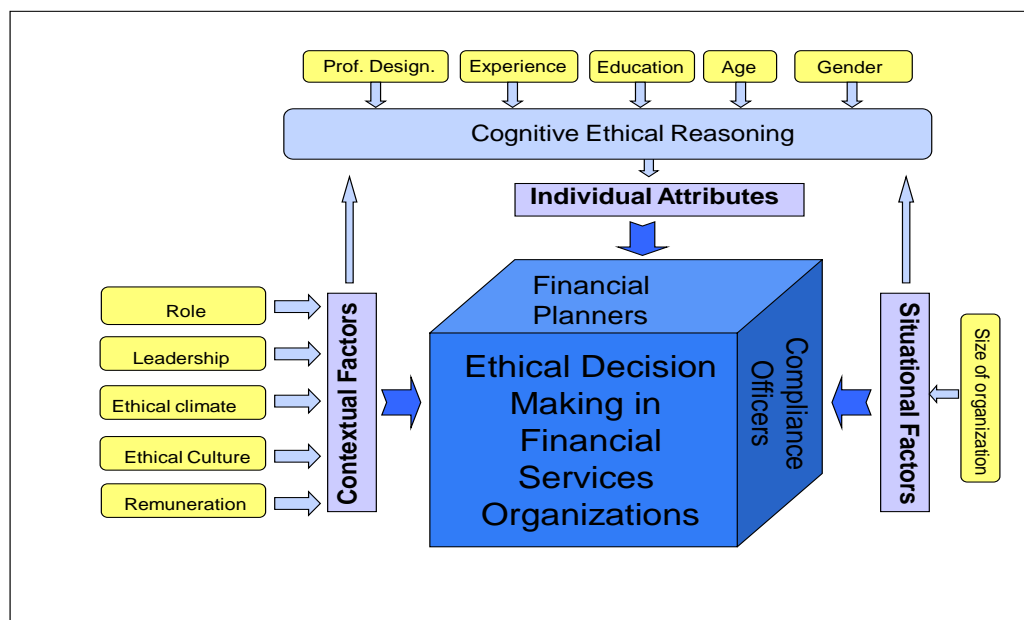
There are numerous factors that influence how individuals make decisions within organisations.

Figure 2 on the next page highlights the key individual, situational and contextual factors measured in the PhD research, including:

- The individual's characteristics, such as their level of cognitive ethical reasoning and individual attributes such as their age, gender, education level, experience and professional designation (Bigel 2000);
- The characteristics of the situation in which the individual finds themselves, including the size of the organization for which the individual works (Hitt 1990); and
- The context or organisational environment in which the decision-making takes place, including the ethical climate (Victor & Cullen 2001) and ethical culture of the organization (Trevino, Butterfield and McCabe 1998); ethical leadership (Schweitzer, Ordóñez & Douma 2004), the

role played by the individual decision maker within the organisation (Van Gramberg & Menzies 2006) and remuneration and reward structures.

Figure 2: The Factors that may influence ethical decision making within organisations



Source: Smith, J. 2010, "Professionalism and Ethics in Financial Planning", a PhD dissertation, Victoria University, Melbourne.

A full glossary of terms is provided in Appendix 1 to this report. However, to assist the reader, for the purposes of this report:

Ethical Reasoning means the ability of a person to reason and exercise judgment when resolving an ethical dilemma;

Ethical Climate means a shared perception of what behaviour is right and appropriate and what behaviour the organisation expects from its members;

Ethical Culture is a subset of organisational culture and is represented by the formal and informal systems, policies and procedures within an organisation that promote, control, enforce and reinforce the organisation's values and ethical or unethical behaviour. Formal systems include codes of ethics; leadership, reporting and authority structures, reward systems and training programs. Informal systems include expectations about obedience to legitimate authority, peer behaviour and other ethical norms; and

Ethical Leadership, represents the demonstration of appropriate conduct by organisational role models via their actions and interpersonal relationships and the promotion of that conduct to their followers through two-way communication, reinforcement and decision-making;

Signpost

Any attempts to increase the standards and conduct of individual advisers across the sector needs to take into account that contextual factors within AFS licensee organisations have a greater influence on behaviour, conduct and decision making than individual factors and must therefore form part of the solution.

SECTION 7: THE INDIVIDUAL FACTORS THAT INFLUENCE ETHICAL DECISION MAKING**7.1 What was measured**

In relation to the characteristics of the individual decision maker, the study explored whether cognitive ethical reasoning levels affected the ethical decision-making of financial advisers and compliance managers and whether ethical reasoning levels were in turn, influenced by the age, gender, experience and education level of the individual and their holding of a professional designation or accreditation.

7.2 What is Cognitive Ethical Reasoning**Table 8: The six stages of moral development according to Kohlberg**

Stage of Development	Description	What is considered to be right
Level One – Pre-conventional	Stage One – Obedience and punishment orientation	Sticking to rules to avoid physical punishment. Obedience for its own sake.
	Stage Two – Instrumental purpose and exchange	Following the rules only when it is in the individual's immediate interests. Right is an equal exchange, a fair deal.
Level Two – Conventional	Stage Three – Interpersonal accord, conformity, mutual expectations	Stereotypical "good" behaviour. Living up to what is expected by people close to you.
	Stage Four – Social accord and system maintenance	Fulfilling duties and obligations to which the individual has agreed. Upholding laws except in extreme cases where they conflict with fixed social duties. Contributing to the society and the group.
Level Three – Principled	Stage Five – Social contract and individual rights	Being aware that people hold a variety of values and that rules are relative to the group. Upholding rules because they are part of a social contract. Upholding non relative values and rights regardless of majority opinion.
	Stage Six – Universal ethical principles	Following self-chosen ethical principles. When laws violate these principles, to act in accord with the principles.

Source: Trevino (1986, p.605).

The development of ethical judgment goes through phases that represent more heightened and significant levels of ethical reasoning. Kohlberg (1969) identified that ethical maturity evolves through six stages or three development phases. These phases are outlined in the table 8 above.

As suggested by table 8, at stage one of Kohlberg's (1969) theory, ethical reasoning is motivated by a desire to avoid punishment or pursue self interest. By stage six, reasoning is motivated by the individual's own conscience and an ability to identify and resolve dilemmas in a wider context involving stakeholder and community considerations. Very few people attain stages five and six of the model. However, in an ideal financial advisory world, most advisers should have attained stage four or five.

Financial advisers require a high level of cognitive ethical reasoning to ensure their decision-making is appropriate and in the interests of clients, whilst balancing the different duties owed by them to the law, their profession, their clients, their AFS Licensee and other stakeholders. High levels of ethical reasoning among financial planners and compliance managers should also mean lower instances of unethical behaviour (Thoma 1994). The ethical risks therefore associated with lower levels of ethical reasoning are self evident.

7.3 The Financial Advisory Issues Test

A profession specific instrument called the Financial Advisory Issues Test (FAIT) was used to measure the cognitive ethical reasoning of 165 financial advisers and compliance officers (representing approximately 90 financial advisory firms) as part of the PhD research. This test is unique as it was developed specifically for the PhD and is the only psychometric test of its type for financial advisers.

The test comprised four profession specific case scenarios that described ethical dilemmas which regularly arise in the daily professional practice of a financial planner. Each scenario was followed by a series of activities that participants had to respond to. These activities and how they were measured are outlined in more detail in Appendix 5.

Figure 3: Case scenarios developed for the FAIT instrument



Case scenario one concerned referral arrangements and was based on a scenario developed and applied by Deakin University (2008) in a study of financial planner loyalties to their profession.

Responses to scenario 1 demonstrated that whilst the survey's participants could distinguish between the client's interests and those of the organisation in making the referral, many participants still deferred to organisational priorities in the resolution of the dilemma.

Recommendations by financial planners to switch clients into investments into financial products associated with their AFS Licensee was raised by the focus group as a key ethical issue facing financial planning participants and was the subject of case scenario two. The responses suggested that the study's respondents were at least aware of the ethical issues related to switching advice and were able to identify and prioritise issues associated with higher levels of ethical reasoning when resolving the dilemma.

There was some contrast among participants in responding to case scenario 3. This scenario considered whether it was ethically appropriate to charge and receive numerous fees and additional benefits from lenders and other third party providers for what was ostensibly the one piece of financial advice. The findings in relation to this scenario tended to support the current industry spotlight on gearing and margin lending practices within the sector. Many participants, for example, overlooked the conflicts of interest associated with the numerous payments received, and from numerous sources, as a result of the recommended strategy. The new margin lending regulation and transition to fee for service models may assist in resolving some of the ethical dilemmas faced by advisers in determining the pecuniary value they should place on the services they provide to clients.

Scenario four of the FAIT instrument raised ethical issues associated with Westpoint and the obligations that members of a profession have to protect broader stakeholder interests, by disclosing the unethical behaviour of colleagues. Overall, responses to this scenario suggested there was some uncertainty amongst participants as to whether the Licensee's interests in handling the matter internally should be given more priority than the interests of the broader community and the profession in exposing unethical conduct to external scrutiny.

7.4 The Individual factors that influence ethical reasoning

The research has revealed that an individual's cognitive ethical reasoning level is a significant factor that influences the ability of advisers and compliance officers alike to exercise judgment in the resolution of ethical dilemmas and to act ethically.

In turn, the individual's age, experience and whether or not they hold a professional designation or accreditation can influence the level of cognitive ethical reasoning held. A correlation table documenting these results is attached at Appendix 6.

Figure 4: The individual factors that influence ethical decision making



7.5 Cognitive Ethical Reasoning

Cognitive ethical reasoning levels amongst the study's participants as a group were lower than expected and were at pre-conventional to conventional levels only. These levels of reasoning do not provide advisers and compliance officers with the ability to consistently apply judgment in the resolution of ethical dilemmas, either in an advisory context or in interpersonnel matters and may lead to a higher risk of unethical conduct or poor decision making in the face of competing personal, organisational and client interests.

7.6 Age and Experience

The research revealed that younger financial advisers (<40 years) and less experienced advisers (<5 years) had lower cognitive ethical reasoning levels than their older, more experienced counterparts and are therefore at increased risk of making unethical decisions.

A mentoring program or close supervision by ethical role models or leaders within the organisation appears warranted as a result of this finding, together with a professional year of supervised practice. It is suggested that these mechanisms should be implemented, particularly in Licensee graduate programs.

7.7 Professional Designation

Holders of the CFP® designation associated with the FPA, had significantly higher ethical reasoning scores than other participants.

The findings related to the CFP® professional designation were not unexpected given all CFP® designees must undertake specific ethics training in financial planning within the CFP® accreditation program (Financial Planning Standards Board 2007), prior to being accredited.

The findings indicate that the attainment of a professional designation may increase levels of cognitive ethical reasoning amongst financial advisers. Access to such designations usually requires exposure to ethics training and continuing professional development in ethics and decision making, which in turn assists in raising ethics competencies amongst accredited advisers.

Professional designations are usually also associated with membership of professional associations. All associations in the Australian financial advisory sector currently have a Code of Ethics to which their members must adhere. Accreditation to professional designations therefore, such as the CFP® practitioner designation, while not a panacea for all unethical conduct, may also add a level of individual accountability for ethical conduct that the law does not and is to be encouraged. Policy makers should consider these findings when setting standards for the financial planning or advice professions.

7.8 Gender

As expected, there was no significant difference between the survey's male and female participants in terms of their ethical reasoning scores and accordingly gender does not appear to be a factor that influences ethical decision making amongst financial advisers and compliance officers.

7.9 Education level

The study's finding that the level of education held by the individual did not influence ethical reasoning scores seems counter intuitive and may be the result of an anomaly in the study's sample. Of the 165 questionnaire participants, 68 respondents had completed the Advanced Diploma and Diploma of Financial Planning and 88 held undergraduate or post graduate degrees. It was anticipated that the more educated an individual was, the higher their level of ethical reasoning would be, but this was not demonstrated in the results.

It does not impact on the overall conclusion from the research data however that increased competency standards across the financial advisory sector are required and will assist to increase conduct and professional standards.

What it may suggest is that there needs to be a renewed focus on specific ethics content within undergraduate degrees and other education programs associated with financial advice, so as ensure that advisers have had some exposure to ethics and decision making training prior to being authorised to give advice to consumers on behalf of an AFS Licensee.

In addition, continuing professional development programs should have compulsory ethics and ethical decision-making training elements. It is noted in this regard that some professional associations within the sector already expect members to complete compulsory cpd points in ethics, either annually or every triennium. It is recommended that such initiatives should be applied across the sector.

Consideration should also be given to increasing organisational competency standards for responsible managers within ASIC Regulatory Guide 105 (ASIC 2003), so as to ensure that responsible managers have training and experience in governance and business ethics, prior to appointment. This again takes on additional importance in light of the complex ethical issues that responsible managers and compliance officers currently deal with in their roles.

COMPETENCY ROADBLOCKS TO QUALITY FINANCIAL ADVISORY OUTCOMES

1. Current ethical reasoning levels for financial advisers and compliance officers alike seem inadequate to equip them with the significant skills they require to provide financial advice in the complex financial services environment.
2. Younger and less experienced advisers and compliance officers have lower levels of ethical reasoning and are therefore at higher risk of engaging in unethical conduct.
3. Advisers who do not hold a professional designation or accreditation also have lower ethical reasoning levels than those who do.
4. Financial advisers and compliance officers, when recruited, should be exposed to ethics education and inducted into the ethical climate and culture of the AFS Licensee to reduce the risk that decision making will be unaligned to others within the organisation.
5. Education courses within AFS Licensees and from National education providers should incorporate ethics training in issues arising from the daily practice of financial advice, stakeholder engagement, organizational and interrelationships.
6. Ethics education programs should also be linked to the reporting, disciplinary and performance management systems within AFS Licensees to ensure current and important messages about acceptable and unacceptable behavior are communicated and reinforced.

SECTION 8: THE SIZE OF THE ORGANISATION

The size of Australian financial services organisation was an interesting factor to consider as part of the study, as 69% of the questionnaire's 165 participants claimed they worked for a large organisation (>50 financial advisers).

The research found no link between the size of the financial services organisation and levels of ethical reasoning of its financial advisory survey participants. However, the theory suggests that the larger the organisation, the more likely that inconsistent ethical decision-making and behaviour will occur (Kitson & Campbell 1996; Nash 1993) due to geographic differences in culture, management and leadership structures across the organisation.

Further, the focus group data suggested that financial advisers in large firms were more exposed to issues such as commercial conflicts of interest that were perceived to increase the likelihood of unethical conduct occurring, thus exposing them to different ethical risks to those employed by smaller firms.

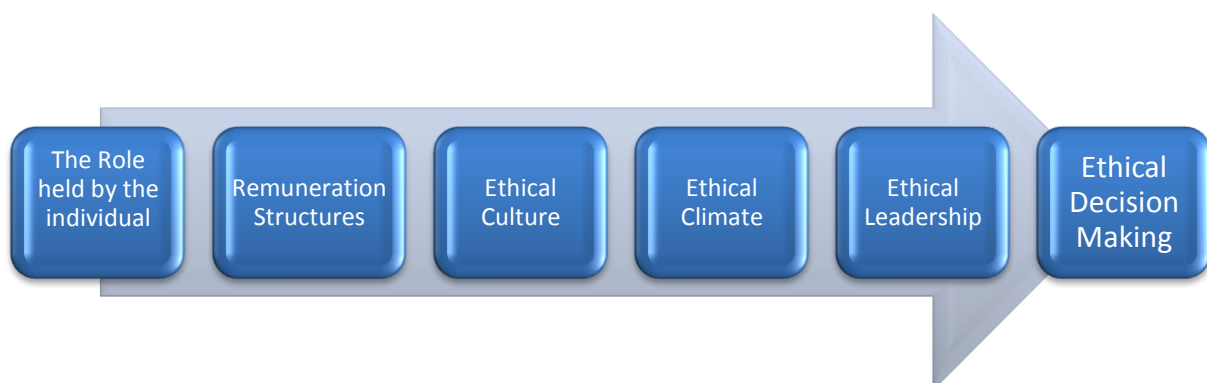
SECTION 9: THE CONTEXTUAL FACTORS THAT INFLUENCE DECISION MAKING.

As with other professions, the professional practice of financial advisers is influenced by the corporation for which they work (Lefkowitz 2003).

Whilst there are numerous contextual factors that have been empirically shown to influence ethical behaviour and ethical decision making within organisations, this study measured the role played by the individual decision maker within the organisation, remuneration and reward structures, ethical climate and culture and the presence of ethical leadership. A correlation table outlining the results of this research is attached at Appendix 8.

What became evident from the data was that contextual factors have greater influence over whether staff and agents of an organisation will make an ethical or unethical choice, than the individual factors associated with the decision maker themselves, such as their age, experience, professional designation and cognitive ethical reasoning level.

Figure 5: The contextual factors that influence ethical decision making



9.1 Role

In terms of the impact that an individual's role within an organization has on both their own ethical decision making and the decision making of others, the research was particularly interested in examining the ethical reasoning levels of compliance managers and how they influenced the ethical decision-making of those they supervised. The ethical judgment of managers can be predictive of a wide range of ethical behaviours in organisations, such as whistleblowing and resistance to pressure from authority figures (Greenberg 2002).

Signpost

Currently, many compliance officers in financial advisory organisations monitor and supervise financial advisers to ensure financial advice to clients meets legal, regulatory and organisational obligations. This means by necessity that they need to:

- have heightened awareness of the types of dilemmas dealt with by financial advisers in the provision of advice;
- understand the key risks that may lead to an unethical outcome; and
- have high levels of cognitive ethical reasoning to ensure they can deal with the often complex stakeholder and intermediary issues in financial advisory divisions or firms.

The focus group perceived that compliance officers were dealing with very complex commercial dilemmas in their current roles, over and above the resolution of ethical dilemmas in the provision of financial advice. These perceptions included the view that compliance officers were burdened with ensuring that clients received impartial financial advice in an environment where there was:

- pecuniary incentives which may be perceived to compromise the objectivity of financial advisers;
- pressure by management in some organizations to take a softer approach to advisers who were non-compliant; and
- pressure on compliance officers to prevent advisory failures such as Westpoint and Storm Financial Group, within their businesses.

In terms of the levels of ethical reasoning demonstrated by the compliance officers who took part in the study, the findings suggested that although compliance officers had significantly lower cognitive ethical reasoning scores than their financial adviser counterparts, this could be explained in terms of their younger age and lower levels of experience.

However, as with younger and inexperienced financial advisers, younger and inexperienced compliance officers may be at greater risk of making unethical decisions and should therefore be subjected to a rigorous induction and mentoring program prior to commencing work within a financial advisory organisation, to reduce the risk that this will occur. Mandatory ethics and governance training is also recommended. It is noted that the Australasian Compliance Institute, of which the author is a member, has taken steps to introduce both professional accreditation and ethics training programs for their membership in the pursuit of such objectives, which is to be commended.

Signpost

In terms of their management role, the focus group data clearly supported the view that compliance officers play a pivotal role in influencing ethical conduct and financial advisory outcomes within financial services organisations. Compliance officers and responsible managers are therefore well placed to assume ethical leadership positions within financial advisory divisions.

As will be discussed later in this report, ethical leadership can have a significant and positive influence over ethical behaviour and decision making within an organisation.

It seems warranted therefore that compliance officers have at least the equivalent ethical reasoning ability of their financial advisory counterparts, together with the skills necessary to resolve ethical dilemmas commensurate with their management roles, so as to assist them to engage as ethical leaders within their organisation.

9.2 Remuneration and Reward Structures

There is international and national recognition that some remuneration practices within the financial services sector, including payment of some commissions, may lead to unresolved conflict of interest and inappropriate or unethical advice (ASIC 2006, Ripoll 2009). There has always been a significant anecdotal link, for example, between commission based compensation sources and unethical behaviour (Fielding & Tyson-Chan 2005; FPA 2005, 2006, 2006).

In addition, as has previously been discussed, failures to fully disclose all remuneration and benefits and associated conflicts of interest, were identified as key ethical issues by both the focus group and the consumer complaint analysis.

The PhD research measured whether there was a link between a financial adviser's remuneration source and their level of cognitive ethical reasoning. The premise was that given low ethical reasoning is associated with self interest, financial advisers with lower levels of ethical reasoning may be attracted to AFS Licensees with commission structures and financial advisers with higher levels of ethical reasoning may be attracted to AFS Licensees with fee for service remuneration structures.

Whilst the findings of this study suggest that unethical conduct arising from remuneration sources is not related to the level of cognitive ethical reasoning of the decision-maker, the consumer complaint analysis, focus group data and the ethical climate and culture survey results suggest that unethical conduct and poor decision making by financial advisers is influenced by remuneration and reward structures as a contextual factor within AFS Licensee organisations.

This conclusion is consistent with the views of numerous academics, including Jackall (1988), Pederson (1999), Thompson (2004) and Finn (2003) who have maintained that it is inevitable that corporate payment structures will place pressure on the ability of individuals to meet conflicting professional and commercial obligations and imperatives.

Building Organisational Resilience to Ethical Risk

1. Whilst the FOFA reforms have three key objectives associated with remuneration structures (such as the introduction of a statutory fiduciary duty, the banning of some commission payments and volume bonus payments and the opt in mechanism for consumers), these objectives may only be successfully implemented in practice if there is a commensurate change in the ethical climate and culture within financial advisory organisations and changes in cognitive ethical reasoning levels amongst financial advisers so that they may have the competencies to act according to higher standards of conduct.
2. The industry's transition to fee for service models is a necessary and welcome step, but the ethical risks associated with self interest ethical climates and the conflicts of interest from remuneration and reward systems will remain, albeit in a reduced form.
3. AFS Licensees should be aware of these risks and take into account in their transition to fee for service models, that the setting of sales targets, performance management and rewards structures may still pose ethical risks to the organisation if the wrong or mixed messages are sent to advisers about the weight they should give to commercial objectives, over other interests and values when resolving ethical dilemmas.

9.3 Ethical Culture**What is it**

The ethical culture of an organisation is a sub set of organisational culture. Ethical culture has been defined by Trevino and Youngblood (1990) to mean the observable manifestations of culture, such as formal and informal systems of behavioural control, that are capable of promoting ethical or unethical behaviour. Formal systems include policies such as codes of ethics, leadership and authority structures, reward systems and training programs. Informal systems include expectations about obedience to legitimate authority, peer behaviour and other ethical norms (Trevino, Butterfield & McCabe, 1998).

Why is it important

Ethical behaviour should be higher in organisations with an effective ethical culture and where:

- formal and informal systems build an effective ethical framework;
- leaders and norms encourage and support ethical conduct; and
- ethical conduct is rewarded and unethical conduct punished.

What was measured

The Ethical Culture Survey used in the research questionnaire comprised nine questions and asked whether the AFS Licensee had implemented policies, procedures and systems required by the Australian Standard on Fraud and Corruption Control (Standards Australia 2003) for an effective ethical culture. The only element not measured was whether the AFS Licensee had a program for the continuous benchmarking of ethical standards.

The “Australian Standards Compliance Index” (ASCI) was developed for the study for the purposes of measuring the existence of these systems and protocols within the organisations of the survey’s participants. The nine areas surveyed included whether the organisation had:

1. • An Internal Codes of Ethics
2. • A published sets of organisational values
3. • A whistleblower policy
4. • Training for advisers in ethics and decision making
5. • Communication strategies to support dissemination of key ethical messages and standards to all staff and stakeholders
6. • Enforcement mechanisms to discipline those responsible for unethical outcomes
7. • Reference to ethical standards in performance management and recruitment systems
8. • Regular organisational reporting on ethical matters
9. • Included ethical conduct outcomes in reward and remuneration systems

The findings

Graph 1 on the next page describes the participants’ response rates to the nine questions in the survey. The results suggest that the systems and procedures associated with ethical culture are important factors that influence ethical decision making within financial services organisations.

The organisations that were the subject of the research questionnaire had traditional and overt formal ethical culture mechanisms in place, such as internal codes of ethics/conduct (81.8%); published sets of organisational values (78.2%), whistleblower policy (77.0%) and adviser training in ethics (73.9%).

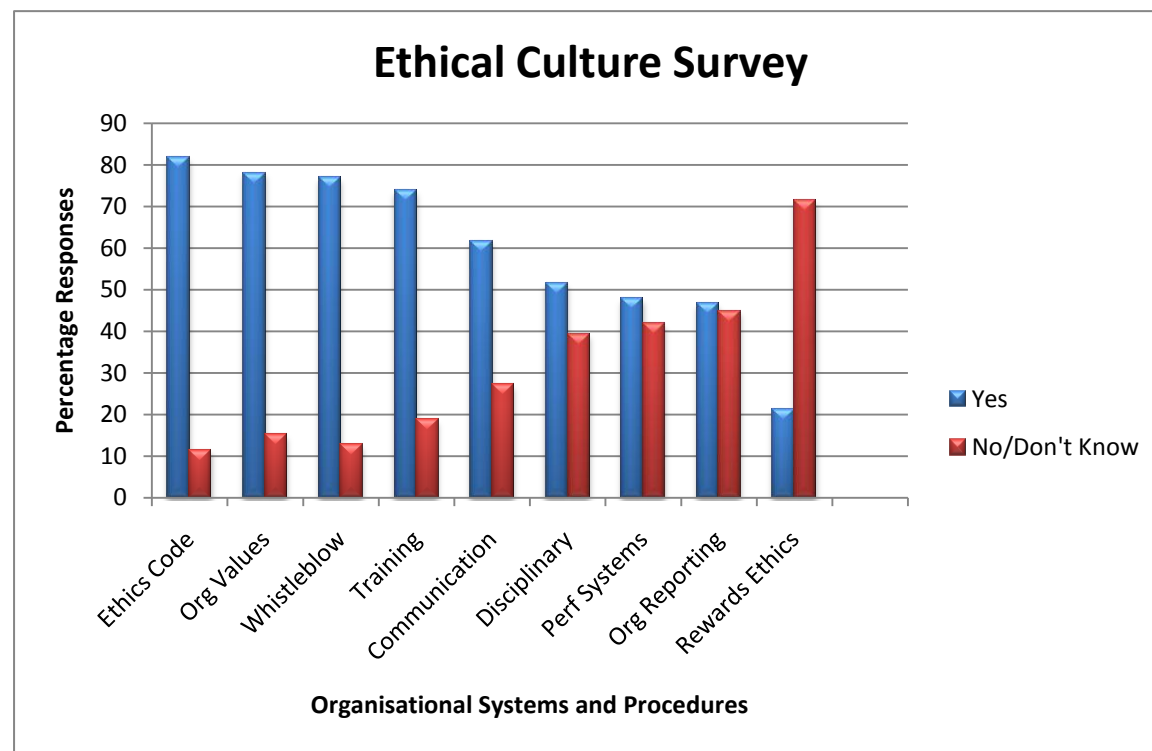
The question then remains: how effective are these systems and procedures in instilling the organisation’s ethical values and conduct standards into every day practice? The data from the survey seems to answer these questions in the negative. The results suggested that the regular reporting of ethical matters was very low (Q.5 - 46.7%). Further, nearly 40% of the 165 respondents did not believe or did not know whether their AFS Licensee even had enforcement mechanisms, such as a staff /adviser disciplinary policy (Q.6 – 39.4% No or Don’t know).

If these results are representative of a lack of enforcement mechanisms across financial services organisations, this may be compounding the ability of compliance officers to take enforcement action against unethical advisers. However, even when in place, the focus group perceived that a lack of organisational will to use enforcement mechanisms was one of the top five ethical dilemmas facing compliance managers in their roles.

The research also identified a significant and positive link between the perception of a strong ethical culture within their Licensee and the individual’s ethical reasoning score. That is: those with higher ethical reasoning levels were more likely to perceive that their Licensee had a strong ethical culture.

This finding is supported by Gephart, Harrison and Trevino (2007) who argued that the stronger the ethical culture within an organisation, the more likely that unethical behaviour would be reduced.

Graph 1: Participant Responses to the Australian Standards Compliance Index.



The Australian Standards Compliance Index results demonstrate that other conventional mechanisms, which may assist management and compliance officers in instilling and enforcing a strong organisational ethical culture, may be lacking within financial services organisations. This includes systems and procedures linking ethical behaviour with performance and reward systems. For example, only 48% of respondents believed their AFS Licensee referred to the ethical standards expected of staff within its performance systems and only 28% believed their organisations formally rewarded people who achieved high levels of ethical conduct.

The theory has suggested that offering rewards for ethical behaviour does not necessarily increase that behaviour (Trevino & Youngblood 1990), although the payment of bonuses and other rewards for meeting sales and finance targets is thought to adversely influence ethical decision making. However, a dearth of mechanisms for rewarding ethical conduct, whilst there are rewards for reaching pecuniary targets, may send ambiguous messages to an organisation's staff and agents as to which behaviour is more highly valued (Wines & Hamilton 2003).

The Australian Standard on Fraud and Corruption 8001 – 2003 (Standards Australia 2003b) applies to Australian financial services organisations, but is not mandatory and its application is subject to size and turnover requirements, amongst other conditions. However, ASIC Regulatory Guide 164 (ASIC 2002a) envisages that AFS Licensees should use such standards as a guide to assist them to meet licensing obligations and to promote a culture of compliance. In addition, the Australian Standard on Compliance Systems (Standards Australia 2006) expects organisations to commit to full compliance with laws, industry standards and ethical obligations. Accordingly, the finding of such low rates of compliance with the Australian standards amongst the AFS Licensees that were the subject of this study, was surprising.

Signpost

The results of the Australian Standards Compliance Index survey again suggest a significant difference between the “stated” and “lived” ethics and values within financial services organisations. *Stated ethics* refers to the presence of codes, systems, policies and procedures that make up the ethical framework of an organisation and articulate how staff are expected to behave and the values they should take into account in their decision making. *Lived ethics* on the other hand refers to whether or not this framework is adequately communicated, enforced, reinforced and is embedded as part of the fabric of organisational life.

If the findings of the Ethical Culture Survey are representative of the broader financial advisory sector, then a significant gap exists between the ethics frameworks that are currently in place within financial advisory firms and those that would be expected to be in place pursuant to the relevant Australian corporate standards.

This should be rectified given ethical frameworks that clearly articulate the ethical conduct expected of members of an organisation and that provide consistency of approach to ethical decision-making, can be a positive influence on ethical behaviour. This is further supported by the evidence from the research that current legal compliance frameworks alone may be insufficient to reduce or prevent the numerous ethical risks that occur in the provision of financial advice.

Building Organisational Resilience to Ethical Risk

1. Not all financial advisory firms have effective ethics frameworks in place. Existing systems and procedures need to be reviewed with a particular focus on those related to the communication and reporting of ethical matters and standards, an upgrading of performance management systems to include reference to key indicators that reward ethical conduct and citizenship and enforcement mechanisms that discipline those who engage in unethical conduct.
2. In addition, it is suggested that ethics frameworks should be integrated with other governance, risk management and compliance systems to ensure the ***Stated Ethics*** of the organisation become ***its Lived Ethics***.
3. It is suggested that compliance with the Australian Standards on Corporate Governance (with their application subject to size and turn over requirements) and the introduction of integrity based frameworks within AFS Licensees may be the key to a new and invigorated approach to decision making and governance frameworks in financial services. As previously mentioned in this report, a regulatory response to governance and ethical matters should not always be the preferred approach.
4. A move away from the current focus on legal compliance frameworks and the implementation of values based systems and procedures that ensure ethical decision making is consistent with the expectations of stakeholder groups, may also assist in the provision of quality financial advisory outcomes to Australian consumers above even the revised minimum standards of conduct expected by the law. The evidence also suggests that current legal compliance frameworks alone may not be sufficient to reduce or prevent systemic unethical conduct within financial advisory firms.

9.4 Ethical Climate

Ethical climate is usually defined as a shared perception of what behaviour is right and what behaviour the organisation expects from its members (Reichers & Schneider 1990; Kelloway *et al.* 1999).

Table 9 below describes the nine ethical climates generally identified within organisations. The different types of climate are also not mutually exclusive, although one is likely to dominate (Martin & Cullen 2006). However, one organisation can have many different ethical climates, changing from division to division or between geographic areas. In a financial advisory organisation, dominant climates focussed on self interest and company profit, to the exclusion of other considerations and stakeholder interests, can lead to a greater risk of unethical conduct.

Table 9: The nine theoretical dimensions of ethical climate

Ethical Criteria	Locus of Analysis		
	<i>Individual</i>	<i>Local/ Organisational</i>	<i>Cosmopolitan/ Society</i>
Egoism	Self interest	Company Profit	Efficiency
Benevolence	Friendship	Team Interest	Social Responsibility
Principle	Personal Morality	Company rules and procedures	Laws and Professional Codes

Source: Cullen, Victor and Stephens (1989, p.58)

A definition of each of the different ethical climate types is outlined in Appendix 7.

Martin and Cullen (2006) and Cullen, Parboteeah and Victor (2003) have suggested that an organisation's ethical climate helps to determine:

- What employees/advisers believe constitutes ethical behaviour at work;
- Which issues employees/advisers consider to be relevant considerations to take into account in their decision making; and
- What criteria and priorities they should use to weigh and resolve issues.

The results of the research are outlined in Table 10 on the next page. Differences between the perceptions of ethical climate and culture of financial planners and compliance officers were measured as part of the research. Compliance officers reported higher levels of Self-Interest and Efficiency climates in their organisations than financial planners, but lower levels of the Personal Ethics climate. A Self Interest climate within a financial services organisation (Situational Context in table 10) would indicate that the focus for decision making is on furthering company profit as a priority and the pursuit of the company's interests before those of the client. An efficiency climate is self explanatory.

It was expected that there would be differences between financial planners and compliance officers of the perception of ethical climate and culture within financial services organisations for a number of reasons. First, compliance managers are at the front line in terms of resourcing and handling

legal, ethical and regulatory issues for their organisation each day and it was assumed that these matters would be uppermost in their thinking.

Secondly, cultural and institutional incentives that may promote or deter unethical behaviour amongst staff and agents may also have different effects on managers because they have different incentives, given their higher position in the organisation (Hoegl 2004). Thirdly, perceptions of ethical climate may differ across departments and employee levels because of differences in departmental tasks and stakeholder accountability (Weber, 1995).

Table 10: The scores associated with the ten Ethical Climate scales

Scale	No. Scale Items	Scale Q's	Alpha	Mean	Median	St.D	N
1. Environment	10	1-10	0.69	5.30	5.40	0.78	139
2. Employee Focus	6	11-16	0.86	5.15	5.17	1.01	144
3. Community	3	17-19	0.85	5.93	6.00	1.00	149
4. Locus of Control	4	20-23	0.86	3.83	4.00	1.56	143
5. Code Implementation	4	24-27	0.78	4.81	4.66	1.21	148
6. Situational Context	3	28-30	0.88	2.58	2.33	1.25	148
7. Efficiency	4	31-34	0.72	4.06	4.00	0.98	143
8. Rules and Procedure	2	35-36	0.8	5.94	6.00	0.76	143
9. Personal Ethics	3	37-39	0.69	6.34	6.67	0.99	144
10. Laws and Professional Codes	3	40-42	0.83	6.23	6.33	0.87	142

Source: Smith, J, 2010, Professionalism and Ethics in Financial Planning”, a PhD dissertation, Victoria University, Melbourne

In contrast to the perceptions of compliance officer participants, the financial advisers perceived that the ethical climate types that prevailed within their organisations were associated with Law and Code, Personal Ethics and Rules. The Law and Code climate would require the financial services participants to comply with the codes and regulation of their profession and other externally generated standards in choosing a course of action (Armstrong, Kusuma & Sweeney 1999). The Personal Ethics Climate would allow them to use their professional judgment, personal and moral beliefs, when resolving ethical dilemmas in the interests of their client and broader stakeholder groups. In a Rules climate, there is a focus within the organisation on internal rules and standard operating procedures, which everyone is expected to follow when making decisions (Applebaum, Deguire & Lay 2005; Liu, Fellows & Ng 2004). These climate types should lead to more ethical behaviour within an organisation.

These gaps in compliance officer and financial planner perceptions about which ethical climate dimensions are prevalent within financial services organizations lead to a very different understanding about the organisational values that denote ethical behaviour within the business and the expectations and boundaries set by the organisation for ethical conduct and decision-

making. It is suggested that such differences may affect a financial planning organisation's ability to comply with its legal and ethical obligations and additionally meet stakeholder expectations of ethical conduct and corporate social responsibility.

Signpost

The results suggest that there is a current mismatch between the perceptions of ethical climate and culture within financial services organizations of financial planners and compliance officers. This has a number of implications.

The three climates perceived by financial advisers to dominate within their financial services organisation, represent Principled Climates in which post conventional thinking dominates (associated with persons with the highest levels of cognitive ethical reasoning). These types of ethical climates have been found to be positively related to ethical behaviour in organisations (Gephart, Harrison & Trevino 2007).

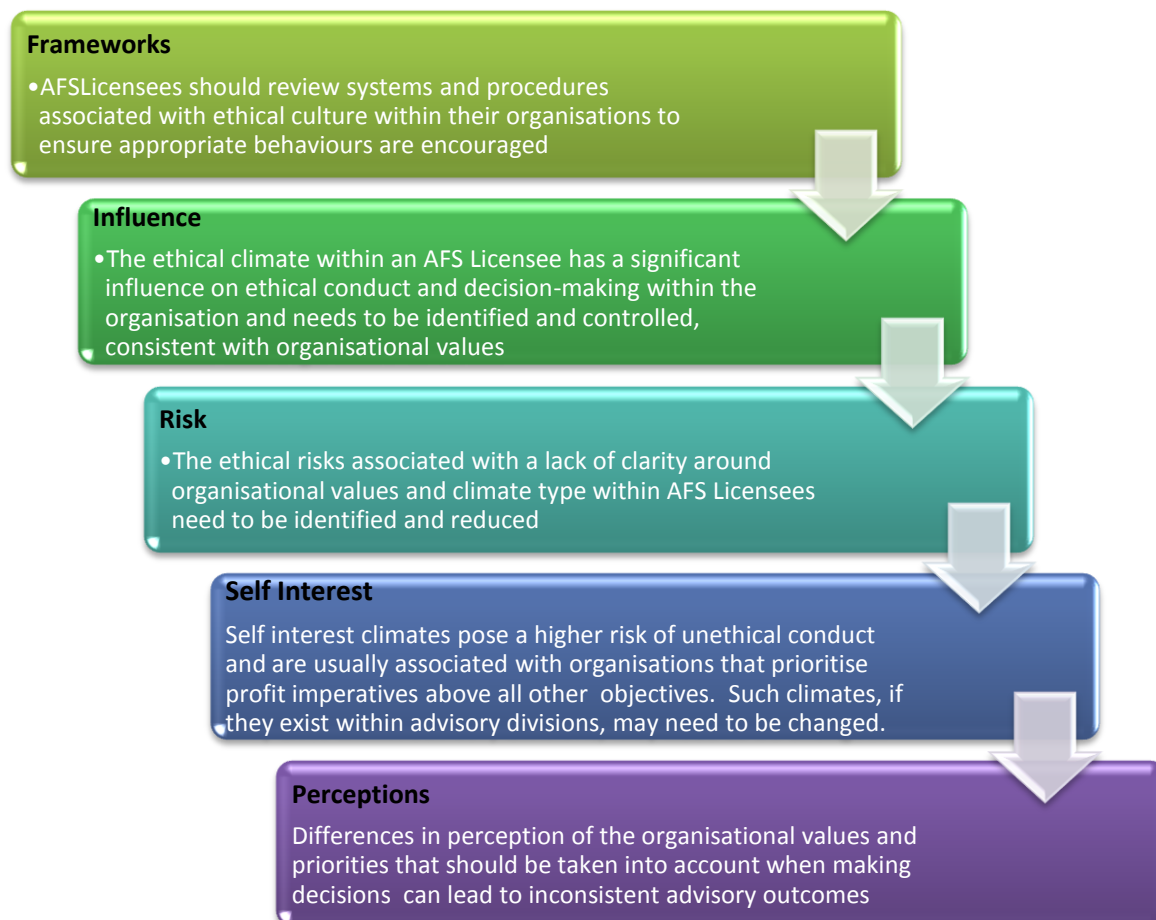
These perceptions of ethical climate however, seem inconsistent with the data from the focus group and the consumer complaint analysis. The data from these stages of the research would have predicted a higher presence of self interest and other egotistical climates.

These perceptions are also inconsistent with those of compliance officer respondents who believed ethical decision making within their financial services organisations was driven by self interest and furthering company profits. This type of climate dimension has been predicted to increase the likelihood of unethical conduct (Gephart, Harrison & Trevino 2007).

The gaps in current financial planning frameworks and the differing perceptions of ethical climate within financial advisory firms identified in this study, may be sending the wrong message to the staff and agents of financial advisory organisations about the conduct that is most valued from them and the priorities they should take into account when making advisory decisions. For example, it can be inferred that if behaviour, such as meeting sales and finance targets, is the behaviour which is rewarded and which is linked to performance pay, bonuses and other rewards outcomes, then this is the behaviour that will prevail. The focus group findings seem to support this conclusion.

The empirical findings further support the conclusion that financial advisers with lower cognitive ethical reasoning scores readily identify with and may be attracted to instrumental climates given the egoistic nature of such climates and their focus on self interest. These climates pose many ethical risks, including that they are positively related to unethical intentions and behaviour (Gephart, Harrison & Trevino 2007).

Figure 6 on the next page summarises five key issues associated with the ethical culture and climate data outlined in this report. These issues concerning Frameworks, Influence, Risk, Self Interest climates and Perceptions have been included to assist Financial Advisory Organisations build organisational resilience to ethical risk.

Figure 6: Building organisational resilience to risk using ethical climate and culture

9.5 Ethical Leadership

Ethical leadership has been defined by Brown, Trevino and Harrison (2005, p.120) as the demonstration of appropriate conduct by role models within organizations through their personal actions and interpersonal relationships and the promotion of such conduct to followers through two-way communication, reinforcement and decision-making

In this research, ethical leadership was measured using a new leadership scale developed for the purposes of the study. The new scale is outlined in table 11 on the next page.

The research data has suggested that ethical leadership within a financial services organisation has a positive and significant influence on rates of ethical conduct within that organisation. The results indicate that perceptions of ethical leadership within an AFS Licensee are associated with perceptions of higher levels of action in the community's interest, higher employee commitment to the organisation and higher obedience to the law and standards of conduct within the organisation. A focus on developing and refining ethical leadership and role models within financial services organisations and particularly within financial advisory divisions therefore seems warranted and perhaps overdue.

These findings are consistent with other research that has found that employee perceptions of their supervisor's ethical leadership was associated with a willingness to report problems to management, organisational commitment and job satisfaction levels (Brown, Trevino & Harrison 2005). Further,

because ethical leaders are seen as caring and fair, relationships are built on open communication between the leader and the follower and a follower's wish to reciprocate the leader's supportive treatment (Trevino, Weaver & Reynolds 2006).

Table 11: The Ethical Leadership Scale

<i>The Ethical Leadership Scale</i>	<i>Corrected Item – Total Correlation</i>
<i>Q1 - The management of this Licensee disciplines unethical behaviour</i>	.540
<i>Q7 - People of integrity are rewarded at this Licensee</i>	.515
<i>Q3 - The senior managers of this Licensee guide decision making in an ethical environment</i>	.510
<i>Q8 - Senior managers in this organisation regularly show that they care about ethics</i>	.472
<i>Q5 - Ethical behaviour is rewarded by this licensee</i>	.401

Source: Smith, J. 2010, "Professionalism and Ethics in Financial Planning", a PhD dissertation, Victoria University, Melbourne

It is argued that ethical leadership within financial services organisations is a mechanism yet to be actively utilised in the development of quality advisory outcomes for consumers. Indeed, the evidence from the consumer complaint analysis indicates that there have been previous instances of failures in ethical leadership within AFS Licensees that have led to systemic unethical conduct and consumer losses. This seems to also be a recurring theme arising from the corporate collapses and financial advisory failures associated with the Global Financial Crisis.

Compliance officers and responsible managers seem logical candidates to fill those roles. The empirical evidence also suggests that senior advisers with professional accreditation should be involved in significant mentoring and leadership roles within advisory divisions.

Signpost

A renewed focus on ethical leadership within financial services organisations is a non regulatory mechanism that may assist in embedding the FOFA reforms, enhancing quality advisory outcomes for consumers and lifting conduct standards, without the need for further legislative intervention.

SECTION 10: CONCLUSION

This report has set out to enhance understanding of the factors that influence ethical decision making within financial services organizations. It has also provided a snapshot of the current ethical issues and trends in financial advice in Australia.

The results of the empirical research summarised in this report should also raise awareness of the ethical risks faced in the provision of financial advice to Australian consumers and some of the current roadblocks to quality financial advisory outcomes.

The empirical research has demonstrated that individual and contextual factors can have a significant influence on ethical decision making and ethical behaviour within financial services organization. These factors include the ethical reasoning ability of the individual decision maker, which in turn is influenced by the decision maker's age, experience and whether they hold a professional designation.

The contextual factors are numerous and seem to have more influence on ethical conduct outcomes than individual factors. These contextual factors include remuneration structures, the role played by the individual decision maker, the ethical climate and culture of the organization and the presence of ethical leadership.

The report has attempted to translate the key findings of the PhD research into practical guidance that can be applied within financial services organisations or by financial advisers and other key stakeholders, to reduce the ethical risks associated with the provision of financial advice and increase consistency in ethical decision making and conduct across the sector.

All stakeholders are currently seeking to ensure that quality advisory outcomes for Australian consumers become the norm and that the financial advisory sector continues its progress towards professionalization. This report highlights however, that improvement in individual conduct and competency standards whilst necessary, may not achieve these objectives on their own. In addition, the study's findings indicate that the current ethical risks within financial advice are complex and significant. It is suggested that regulatory responses may not always resolve these issues and that a more comprehensive solution may be required.

The case for a reinvigorated approach to the use and application of ethics frameworks as part of the solution has been made and is proposed as an alternative or complementary mechanism to the reliance on constant regulatory reform going forward.

APPENDIX 1: GLOSSARY OF TERMS

Ethics - a process of inquiry which requires the decision maker to consider facts in light of important values and morals and explicit forms of conduct normally expected by members of particular groups or professions. These are usually codified in documents such as Codes of Ethics and Practice Standards.

Ethical decision making - the process a financial planner or compliance officer adopted when determining how to respond to a particular ethical dilemma.

Ethical conduct - the conduct of participants which was consistent with the professional conduct standards expected by those professional associations operating within the financial planning sector. Conversely, unethical conduct meant conduct which was inconsistent with those Codes.

Ethical behaviour - encompassing the ethical reasoning of the study's participants and the relationship between this reasoning and their conduct.

Ethical reasoning - the cognitive reasoning adopted by a person when resolving an ethical dilemma.

Ethical Climate – a shared perception of what behaviour is right and what behaviour the organisation expects from its members

Ethical Culture –the observable manifestations of culture, such as formal and informal systems of behavioural control that are capable of promoting ethical or unethical behaviour. Formal systems include policies such as codes of ethics, leadership, authority structures, reward systems and training programs. Informal systems include expectations about obedience to legitimate authority, peer behaviour and other ethical norms.

Ethical Leadership - the demonstration of normatively appropriate conduct through personal actions and interpersonal relationships and the promotion of such conduct to followers through two-way communication, reinforcement and decision-making.

Lived Ethics –the actual behavior, conduct, values and priorities that an organization tolerates and encourages in the pursuit of its strategic and commercial objectives. That is: what it actually does.

Stated Ethics – the presence of values, policies, systems and procedures within an organization that send key messages to stakeholders about how the organization will conduct itself in the provision of services and commercial activity. That is: what it says it will do.

APPENDIX 2: THE RESEARCH CONDUCTED

The PhD study used both quantitative and qualitative research methods in its design to test seven research questions and nine hypotheses.

Table: Conducting the PhD Research

	What was measured	Research Tool used	How measured
1	Consumer Complaints	Analysis against Combined Code of Ethics	Complaint techniques
2	Current Ethical Issues in Financial Planning	Focus Group	Delphi Group techniques
3	Ethical Reasoning	Case Scenarios	Financial Issues Advisory Test
4	Individual Characteristics	Demographic Survey	Correlation testing
5	Size of Organisation	Demographic Survey	Correlation testing
6	Remuneration and Rewards	Demographic Survey	Correlation testing
7	Role	Demographic Survey	Correlation testing
8	Ethical Culture	Ethical Culture Survey	Australian Standards Compliance Index
9	Ethical Climate	Ethical Climate and Culture Survey	Ethical Climate Analysis/Correlation Testing
10	Ethical Leadership	Ethical Climate and Culture Survey	Ethical Leadership Index

The research methods used were:

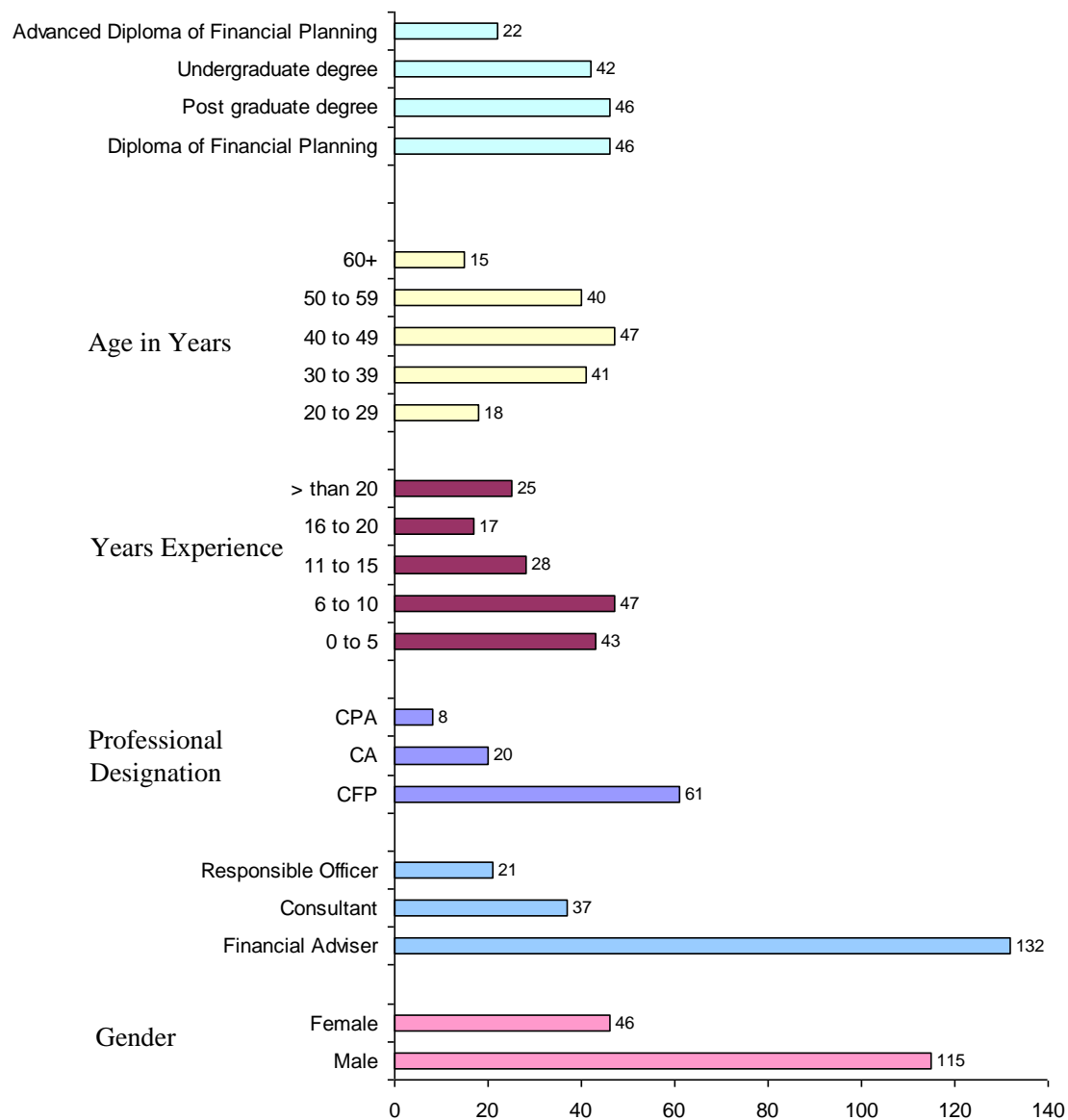
- An analysis of 235 consumer complaints determined by Australian Courts, The Australian Securities and Investment Commission (“ASIC”) and the Financial Ombudsman Service (“FOS”) in 2006/2007, so as to measure the primary types of unethical conduct exhibited by financial planners in the provision of financial advice to consumers.
- A Focus Group of 20 financial planners and compliance managers to identify the ethical issues financial planning participants believed they faced in the provision of financial advice to consumers and some of the factors they believed influence ethical decision making within financial services organisations.
- A research questionnaire distributed to 770 financial planners and compliance officers in 2008 and comprised of four sections as outlined in the following table.

Table: The Different Sections of the Research Questionnaire

Questionnaire Section	Description
Section 1: Demographic survey	Comprising 11 questions concerning the participants' role, education and professional background, age, experience and gender.
Section 2: Ethical Culture Survey	Developed specifically for the study to measure the presence of formal and informal systems and procedures within Australian Financial Services Licensees ("AFS Licensees") that assist in ensuring that stakeholders understand the organisation's values and its expectations in relation to conduct and behavior.
Section 3: Ethical Climate Survey	Developed specifically for the study to measure the attitudes and perceptions of financial planning participants of the current ethical climate within AFS Licensees and its influence on ethical decision-making.
Section 4: The Financial Advisory Issues Test	Developed specifically for the study to measure the cognitive ethical reasoning of financial planning participants.

APPENDIX 3: INFORMATION CONCERNING THE SURVEY'S PARTICIPANTS AND RESPONSE RATES.

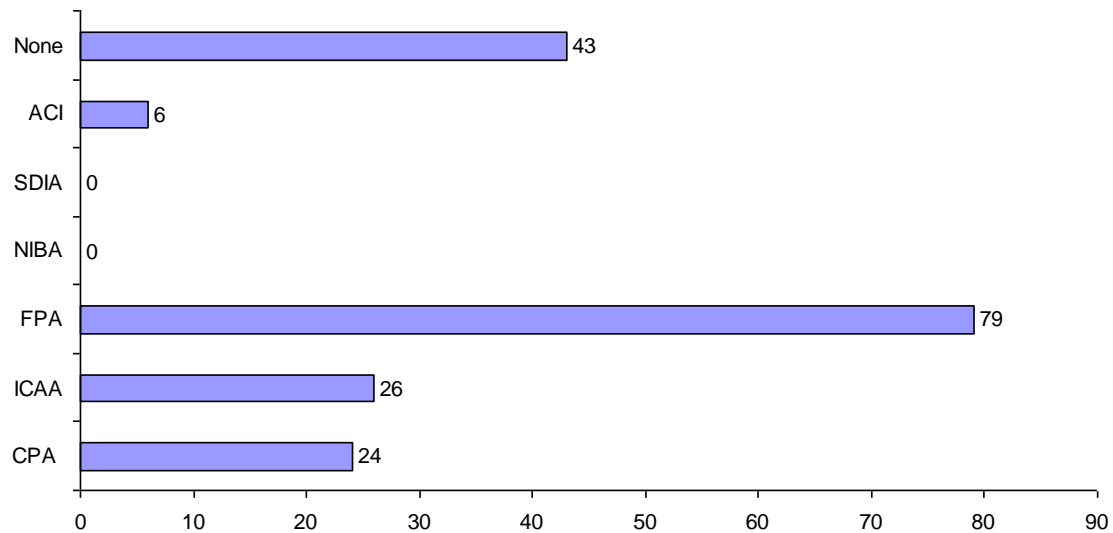
Of the 770 persons who were invited to participate in the study, 165 responded to the survey. Of these, 130 respondents were classified as a financial adviser, 35 participants recorded that they held a compliance role within their organisation and 20 of these were also a responsible manager. Thirteen participants advised that they were members of more than one professional association.

Graph 2: Demographic information concerning the Study's Participants.

Source: Smith, J. 2010, "Professionalism and Ethics in Financial Planning", a PhD dissertation, Victoria University, Melbourne.

Graph 3 below highlights the participants' membership of professional associations in the sector including the FPA, the Institute of Chartered Accountants ("ICAA"), CPA Australia, the Australasian Compliance Institute ("ACI"), the Securities and Derivatives Institute of Australia ("SDIA") and the . National Insurance Brokers Association ("NIBA").

Graph 3: The questionnaire respondents' membership of professional associations



APPENDIX 4: CONDUCTING THE ANALYSIS OF THE CONSUMER COMPLAINTS

Three sources of material in the public domain were used to undertake the analysis. The first source was decisions made by Australian courts between 2006 to 2007 which arose from civil actions by clients that alleged negligent financial advice against financial advisers and AFS Licensees. A total of 11 decisions in financial planning matters that matched the search criteria were made by Australian courts between 2006 and 2007.

The second source was administrative decisions made by ASIC to impose banning orders and accept enforceable undertakings during the relevant period. A total of 56 banning orders and seven enforceable undertakings were made during the period January 2006 to December 2007.

The third source was decisions of the FOS Panel made in 2006 and 2007 in its Financial Planning category. A total of 161 FOS decisions were analysed for the purposes of the research. These decisions comprised 55 Adjudications (decisions made in cases below \$30,000) and 106 Determinations (decisions made in cases above \$30,000).

To undertake the analysis, the Codes of Ethics of four of the professional associations within the financial services sector, namely the FPA, the ICAA, the CPA Australia, and the AFA, were combined into an Ethical Principles Schedule.

This Schedule provided eight defined Principles against which to analyse the conduct of the adviser outlined in the reasons for decision published in each matter analysed. These principles were Integrity, Objectivity, Fairness, Diligence, Competence, Professionalism, Confidentiality and Compliance.

APPENDIX 5: THE FINANCIAL ADVISORY ISSUES TEST

The Financial Issues Advisory test is a moral reasoning or moral judgment test that measures the cognitive ethical reasoning of the respondent. It is similar to the Defining Issues Test, but substitutes the traditional moral dilemmas used in that instrument for profession specific ethical case scenarios. As a profession specific instrument to measure the cognitive ethical reasoning of financial planning professionals was not identified in the literature, this study developed its own.

Unlike the Defining Issues Test, the FAIT instrument consists of four paragraph length hypothetical dilemmas, instead of five. The number of dilemmas was reduced due to the time pressures already on respondents given the length of the main research instrument.

The fact situation for case scenario number 1 was developed by and used with the permission of Deakin University. The scenario described the conflicts of interest that can often result when advice to a financial planning client and other business relationships overlap.

The other case scenarios were developed by a panel of four financial advisory experts convened for the purposes of the study.

Each of the four scenarios within the FAIT instrument contained a unique fact situation followed by a series of activities.

Part A of each scenario asked respondents to provide a yes/no/don't know response to the course of action the financial adviser in the scenario should take.

Part B asked respondents to rate 12 statements on a seven point Likert scale (1=great importance, 2=much importance, 3=some importance, 4=little importance, 5=no importance) based on the preferred relevance of that statement to the resolution of the ethical scenario posed.

Part C required respondents to select the top four issues they believed the adviser should take into account when making his/her decision, in order of importance, with the number 1 as the most important, number 2 as the next most important, number 3 as the third most important and number 4 as the fourth most important issue.

Scores were then measured using the traditional P and N scores of the Defining Issues Test. A new and additional score, the "FAIT" score was also developed and measured in testing.

**APPENDIX 6: CORRELATION TABLE BETWEEN ETHICAL REASONING SCORES
AND THE INDIVIDUAL DIMENSIONS STUDIED**

		1	2	3	4	5	6	7	8	9
1	FAIT	1	<i>0.89**</i>	<i>0.38**</i>	<i>-0.21*</i>	<i>-0.28**</i>	<i>0.28**</i>	<i>0.32**</i>	<i>0.36**</i>	<i>-0.12</i>
2	N2Scorefin	<i>0.90**</i>	1	<i>0.48**</i>	<i>-0.04</i>	<i>-0.24*</i>	<i>0.20*</i>	<i>0.21*</i>	<i>0.21*</i>	<i>-0.13</i>
3	P scoreFin	<i>0.39**</i>	<i>0.51**</i>	1	<i>0.02</i>	<i>-0.21*</i>	<i>0.15</i>	<i>0.16*</i>	<i>0.22*</i>	<i>-0.10</i>
4	Female	<i>-0.22**</i>	<i>-0.06</i>	<i>0.00</i>	1	<i>0.05</i>	<i>-0.06</i>	<i>-0.22**</i>	<i>-0.16*</i>	<i>0.04</i>
	Compliance									<i>-0.03</i>
5	Role	<i>-0.25**</i>	<i>-0.21*</i>	<i>-0.23*</i>	<i>0.05</i>	1	<i>-0.27**</i>	<i>-0.25**</i>	<i>-0.37**</i>	
6	CFP	<i>0.26**</i>	<i>0.19*</i>	<i>0.16</i>	<i>-0.06</i>	<i>-0.27**</i>	1	<i>0.50**</i>	<i>0.29**</i>	<i>-0.03</i>
	Experience									<i>0.06</i>
7	Years	<i>0.29**</i>	<i>0.21*</i>	<i>0.12</i>	<i>-0.22**</i>	<i>-0.23**</i>	<i>0.50**</i>	1	<i>0.54**</i>	
8	Age	<i>0.33**</i>	<i>0.23*</i>	<i>0.25**</i>	<i>-0.16*</i>	<i>-0.38**</i>	<i>0.28**</i>	<i>0.55**</i>	1	<i>-0.01</i>
	Education									
9	Attainment	<i>-0.09</i>	<i>-0.16</i>	<i>-0.13</i>	<i>0.04</i>	<i>-0.04</i>	<i>-0.04</i>	<i>0.03</i>	<i>-0.01</i>	1

N = 161-110, * p < 05 (2 tailed), ** p < .01 (2 tailed)

Spearman's Rho upper diagonal Pearson R lower diagonal

APPENDIX 7: ETHICAL CLIMATE TYPES MEASURED IN THE PHD RESEARCH

The Ethical Climate and Culture Survey used in the PhD research to measure the ethical climate within the survey participants' organisations comprised 42 items and ten sub scales, being nine ethical climate dimensions and an ethical environment scale. The items measured the organizational characteristics, ethical climate and culture of the financial services organisations. The nine ethical climate dimensions included:

Ethical Climate Type	Name used in the study	Description
Employee Focus	Employee Focus	The organisation is perceived as being concerned with the welfare of individuals and groups within the organisation.
Community Focus	Community	The organisation is usually perceived as being focussed on team and social responsibility which considers what's best for everyone and what is right for the customer and the public, when making decisions.
Obedience to authority	Locus of Control	Organisation members are expected to obey the authority and expectations of their superiors when making decisions.
Code Implementation	Code Implementation	Employees are expected to comply with an internal code of ethics to regulate their decision-making.
Self Interest	Situational Context	The organisation's members perceive they are expected to act and make decisions primarily based on furthering the company's interests first.
Efficiency	Efficiency	The organisation is usually perceived as requiring members to take the course of action that will lead to the most efficient outcome.
Rules and Procedure	Rules and Procedure	There is a focus on internal rules and standard operating procedures which everyone is expected to follow when making decisions.
Personal Ethics	Personal Ethics	This climate allows individual members to make decisions consistent with their own personal and moral beliefs.
Law and Professional Codes	Law and Professional Codes	Employees are expected to comply with the codes and regulation of their profession and other externally generated standards in choosing a course of action.

In terms of the mean scores for each ethical climate scale (based on the seven point Likert scale from strongly agree at 7 to strongly disagree at 1), a higher score demonstrated the dominance of an ethical climate and a lower score indicated that perceptions of that ethical climate within the organisation were low (Deshpande 1996; Armstrong, Kusuma & Sweeney 1999).

**APPENDIX 8: CORRELATION TABLE BETWEEN ETHICAL REASONING SCORES AND THE CONTEXTUAL DIMENSIONS
STUDIED OF ETHICAL CLIMATE AND CULTURE**

		1	2	3	4	5	6	7	8	9	10	11	12	13	14
1	FAIT	-													
2	N2Scorefin	0.90**	-												
3	P scoreFin	0.39**	0.51**	-											
4	ASComIsum	-0.01	-0.13	-0.05	-										
5	MnEnviro	0.13	0.05	-0.07	0.29**	.69									
6	MnEmploy	0.01	-0.05	-0.09	0.15	0.58**	.86								
7	MnCommunity	0.05	-0.04	-0.05	0.20*	0.63**	0.62**	.85							
8	MnObediance	-0.04	0.06	0.14	0.05	-0.13	-0.12	-0.09	.80						
9	Mncode	0.04	0.01	-0.02	0.57**	0.47**	0.36**	0.38**	-0.08	.86					
10	MnSelf	-0.24**	-0.06	0.02	-0.03	-0.44**	-0.41**	-0.52**	0.34**	-0.25**	.77				
11	MnEffiency	-0.22*	-0.15	-0.03	0.16	-0.06	0.21**	0.04	0.35**	0.09	0.23**	.72			
12	MnRules	0.28**	0.10	0.09	0.15	0.33**	0.17*	0.27**	0.20*	0.26**	-0.22**	0.04	.89		
13	MnPersonal	0.21*	0.16	0.05	0.09	0.44**	0.40**	0.56**	-0.22**	0.30**	-0.49**	-0.04	0.26**	.74	
14	MnLaw	0.18*	0.12	0.08	0.22**	0.33**	0.24**	0.38**	-0.11	0.33**	-0.27**	0.05	0.48**	0.52**	.83

N=149-116, * < .05, ** < .01

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