After the Deluge: Rebuilding Trust and Confidence in the Financial Planning Industry

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After the Deluge
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Table of Contents
Executive Summary 3
Introduction 5
The Global Financial Crisis as Ethical Failure 7
Business Ethics in Theory and Practice 9
The Interaction Between Rules, Principles and Norms 13
The Search for Accountable Governance 14
Framing the Debate: The United Kingdom Experience 19
In the Eye of the Storm: Evaluating Ripoll 22
Consumer Protection and the Rebuilding of Trust 29
Towards a Sustainable Framework 32
Conclusion 36
Executive Summary

Australia has emerged from the Global Financial Crisis in a much stronger position than most other industrialized countries. At the same time, however, the collapse of Storm Financial and Opes Prime and others have led to significant retail losses. In some cases, individual investor exposure was magnified by unsustainable reliance on excessive margin lending ratios. Thus, although the system as a whole proved resilient, significant stresses within it have become apparent, most notably within the financial planning and advice sector and its relationship with commercial banks. A parliamentary inquiry has recommended specific changes to the legislative framework in an attempt to rebuild confidence. These include the introduction of an explicit fiduciary duty on financial planners to put the interests of their clients first. More controversially, the Ripoll Report called for the establishment of an independent Professional Standards Board.

This independent report, commissioned by the Financial Planning Association, evaluates the recommendations put forward by Ripoll. It assesses whether the proposed changes are likely, on their own, to rebuild public confidence. The report finds that the proposals lack sufficient granularity to form a credible basis for sustainable reform. It places the debate in a global context. This demonstrates that the primary problem facing the financial services sector and financial planning and advice in particular has a dual nature. First, the failure to manage intractable conflicts of interest and, second, the privileging of technical solutions to what essentially are ethical considerations. This dual failure derives, in turn, from emasculated conceptions of what constitutes appropriate levels of accountability in both the Australian and global context. The report posits the need for a radical change in the structure and the substance of the underpinning framework in a manner that encompasses but does not privilege managerial or regulatory solutions. It suggests that sustainable reform requires a formal recognition of the legitimate role that professional obligation can play in securing broader market integrity.

The report does so by demonstrating that reliance on technical solutions risk obfuscating the defining features of the Global Financial Crisis. It argues that the search for accountability will prove elusive unless we recognize not only what went wrong but why. This requires systematic analysis and the first part of the report presents an accountability model. This allows us to identify and rank the severity of the problems. More significantly it provides a guide for evaluating solutions.
The report argues that merely changing the law to impose a fiduciary duty on individual advisers without changing the underpinning regulatory framework would merely add to confusion and exacerbation of conflicts, particularly within institutions that hold an AFSL. Moreover, it argues that the proposal to establish an independent Professional Standards Board within the current framework preordains confusion and conflict. Neither mechanism is likely to build consumer confidence.

The report compares and contrasts the approaches proposed in Australia with the regulatory and professional models used in other jurisdictions, including the United Kingdom, the United States and South Africa. More significantly, it does so within the context of a very global changed conversation about the purpose of regulatory intervention. It argues that sustainable reform requires simultaneously enhancing the power of internal controls, more intensive and invasive supervision and, crucially, leveraging the restraining power of professional norms. It argues that this cannot be left to the regulator alone. Fundamental change requires an iterative dialogue that operates at personal, professional corporate and regulatory levels. Such a change requires each regulatory participant to set and honour personal and professional commitment to stated values. In so doing they creates the basis for much more sustainable reform, which in turn can serve to deepen trust in the financial services sector.

This degree of intervention poses huge challenges and opportunities to each participant. For the individual planer it provides a guide to action. For the industry association it offers a mechanism to demonstrate warranted trust. For the product manufacturer it allows for an articulation of corporate responsibility. For the regulator it offers an opportunity to engage in pro-active regulatory strategies that prevent systemic risk from developing. For government the accountable governance framework provides a route map to differentiate the Australian marketplace on the basis on warranted commitment to business integrity. Ultimately, for the consumer, it provides a basis on which to trust.

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**Introduction**

Australia has emerged from the Global Financial Crisis in a much stronger position than most other industrialized countries. Technical recession was avoided. Although a sovereign deposit guarantee was required to stabilize increasingly febrile markets, no major commercial bank failed. This relatively strong performance in comparison to competitors in northern Europe and the United States has been widely attributed to the strength of the ‘twin peaks’ domestic regulatory regime and corporate restraint within financial institutions. At the same time, however, the collapse of Storm Financial and Opes Prime and others have led to significant retail losses. In some cases, individual investor exposure was magnified by unsustainable reliance on excessive margin lending ratios. This may, in turn, have resulted from inadequate governance and underwriting procedures within major institutions. Thus, although the system as a whole proved resilient, significant stresses within it have become apparent, most notably within the financial planning and advice sector and its relationship with commercial banks.

Concern over poor levels of financial literacy, the capacity of investors to understand the complex risks associated with specific products and governance processes in the Australian context are linked to broader policy questions. The failure of existing systems of oversight to address the deleterious effect of this tri-partite combination led to a joint parliamentary committee investigation, the Ripoll Inquiry.¹ The resulting report focuses on four main areas of contention. First, can disclosure remain the primary regulatory bulwark in an era of increasing complexity in financial product design and execution? If not, what are the limits of disclosure’s efficacy? Is there a risk that demanding more disclosure will lead only to further obfuscation? Second, what could or should constitute the most appropriate governance model for the sector? Third, could the introduction of explicit fiduciary duties and concomitant professionalization of at least components of the financial planning industry contribute to higher ethical standards? If so, how should this process be managed? Fourth, will structural reform necessarily contribute to an increase in public confidence and trust? Conversely, does it risk dismantling a framework that already reaches, in part, global best-practice benchmarks?

Ripoll advocated the phased introduction of a number of potentially far-reaching changes to how financial products are brought to the market and the processes by which those who provide inappropriate advice about those products could be held more

accountable. The report heard ‘sufficiently broad and consistent evidence to justify making a series of carefully considered recommendations which are designed to enhance professionalism within the financial advice sector and enhance consumer confidence and protection.’\(^2\) The final report canvassed the potential need to compensate investors in cases where losses can be attributed to the provision of inappropriate advice. Adequate compensation provisions are an Australian Financial Services condition, however where these are insufficient it is recommended to establish a statutory last resort compensation scheme. The recommendations also contain a pre-emptive dimension. This is designed to delineate more finely the duties and responsibilities as well as the rights of those involved at every stage of the production process from financial product design through marketing to consumption.

Ripoll recognized the critical public interest associated with raising financial literacy. The aim is to ensure retail investors can more accurately assess the risks associated with particular product classes. The complexity of financial products, however, was also seen as problematic in legal and policy terms. Asymmetrical access to information about product design or the management of inherent (if not intractable) conflicts of interest led to the conclusion that responsibility could not be placed solely on the consumption dimension. Rather accountability needed to be embedded across the entire spectrum. Hence the focus on enhancing the competence of individual financial advisors and recalibrating governance models for the sector as a whole.

The report also emphasized the critical role of the corporate regulator, the Australian Securities and Investments Commission (ASIC). It has a statutory responsibility to create and maintain probity through risk-based surveillance of the licensing model. This sets and monitors the performance of individual financial planners. It makes the institutional holders of an Australian Financial Services Licence directly accountable for the advice offered to retail clients by its representatives. At the same time, Ripoll envisages a substantive and, potentially, transformative improvement in the competency of individual financial advisers. It links this to the need to professionalize the sector. This is to be achieved through four specific changes to the underpinning legislative framework.

First, the report recommends amending the Corporations Act to ‘explicitly include a fiduciary duty for financial advisers operating under an Australian Financial Services...\(^2\) Ibid, 149.
Licence requiring them to place their clients’ interests ahead of their own.3 Second, it suggests the need ‘to require advisors to disclose more prominently in marketing material restrictions on the advice they are able to provide consumers and any potential conflict of interests.’4 Third, it recommends giving ASIC formal powers under the Act to ban individuals from the financial services industry or to deny an application or suspend or cancel a licence, where there is a reasonable belief that the licensee may not comply with their obligations.5 Somewhat more controversially, Ripoll charges ASIC to ‘immediately begin consulting with the financial services industry on the establishment of an independent industry-based professional standards board to oversee nomenclature, and competency and conduct standards for financial advisers.’6 The report does not express a preference on whether the proposed Professional Standards Board should have a single common membership. Furthermore, it does not provide guidance on how the proposed body would interact with the corporate regulator, ASIC, nor does it articulate how to adjudicate potential conflicts between ASIC and the proposed body. The implications of each of these factors will and be examined more fully below. First, however, it is necessary to place the Ripoll Inquiry report, with its emphasis on improving ethical practice, in a global context.

The Global Financial Crisis as an Ethical Failure

The Ripoll Inquiry took evidence and reported in the midst of the Global Financial Crisis (GFC), which itself generated enormous material and psychological dislocation across the developed world. It is essential to stress at the outset that the GFC derives essentially from ethical failure. Although there was undoubtedly criminal activity in the margins, it was largely technically legal. As such, it reflects an erosion of restraint. It provides a particularly stark example of past failure to examine the incremental effect of transactional imperatives and compartmentalized conceptions of responsibility on the integrity of the overarching system. This derives, in large part, from misguided confidence in the restraining strength of what Oliver Williamson has termed the underpinning ‘non-calculative social contract’ (see Figure 1 below).7 This was both a

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3 Ibid, 150.
4 Ibid, 150.
5 Ibid, 151.
6 Ibid, 151.
7 Oliver Williamson, ‘The New Institutional Economics: Taking Stock, Looking Ahead’ (2000) 38 Journal of Economic Literature 595 at 597. Williamson notes that analysis of this ‘level one’ component of social theory is conspicuous by its absence with regulatory studies. The other three levels comprise institutional arrangements viewed primarily through property rights and positive political theory, governance
conceptual and practical mistake of enormous import. The practitioner and policy community, including academics primarily associated with the law and economic tradition, focused on reducing transaction costs as the primary (if not sole) indicator of efficiency. The impact of this privileging within and between each level of analysis on market participants *actual* adherence to values (such as reputation, integrity and trust, all key determinants of confidence) was left unexplored.

<table>
<thead>
<tr>
<th>Level</th>
<th>Frequency of intervention</th>
<th>Purpose</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Social Norms</strong></td>
<td>100-1000 years</td>
<td>Non Calculative Social Contract</td>
</tr>
<tr>
<td><strong>Institutional Environment</strong></td>
<td>10-100 years</td>
<td>Overarching legal, political and bureaucratic framework</td>
</tr>
<tr>
<td><strong>Governance Arrangements</strong></td>
<td>1-10 years</td>
<td>Aligning transactions within accepted rules of the game</td>
</tr>
<tr>
<td><strong>Resource Allocation</strong></td>
<td>Continuous</td>
<td>Incentive alignments</td>
</tr>
</tbody>
</table>

*Figure 1: Williamson’s Governance in Action*

Each of these factors, however, is a critical variable in the establishment of reputation and more, specifically, form the cornerstone of professional obligation. It is not that market participants, including the professions, lost sight of fundamental values. It is more accurate to note a disconnection between the operation of the market and those values. The unwillingness to address this deficit, combined with myopia about the consequences because of timeframe compression, meant that the opportunity costs associated with engaging in self-deception lowered substantially. The democratization of finance, through rapid expansion of superannuation in particular, compressed still mechanisms through transaction cost economics and resource allocation frameworks generally examined through agency theory.
further the timeframes for adjudicating and remunerating success.\(^8\) Notwithstanding the efficacy of technical solutions, if we are to re-engineer corporate responsibility to include fealty to underpinning values, it is essential that we understand much better the forces that ‘denatured’ the broader financial system.\(^9\) Moreover, that understanding needs to be rooted within a much more fundamental practical and philosophical conversation. What restraints should be placed on growth to protect society from externalities, conveniently excised from macro-economic models and legal and regulatory policy frameworks? How does one balance competing objectives without compromising either? What specific duties and responsibilities should be demanded? In order to answer the question of how to regulate one must ask for what purpose do we regulate?

**Business Ethics in Theory and Practice**

Business ethics research tends to calcify around one of four main theoretical approaches: deontological, consequential or utilitarian, virtue-ethics and contextual ethics.\(^{10}\) The deontological approach derives from Immanuel Kant’s categorical imperative, namely ‘act only according to that maxim whereby you can at the same time will that it should become a universal law.’\(^{11}\) Reliance on short-term profiteering that if universalized (and condoned by regulatory and political authorities) destroys the credibility of the market is ultimately self-defeating. In deontological terms, therefore, the crisis displays systemic unethical tendencies. Moreover, deceptive or misleading conduct debases moral capacities (indeed it may well also be illegal if the action can be demonstrated to contravene trade practices legislation). The third categorical imperative is to ensure that corporate actions have societal beneficence; a formulation that lies at the centre of Adam Smith’s landmark *Theory of Moral Sentiments* (1759). In Kantian terms this can only be vouchsafed if the organization acts and is seen to act

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\(^9\) The French President, Nicholas Sarkozy described the GFC as a ‘crisis of globalization’ and noted ‘the crisis we are experiencing is not a crisis of capitalism. It is a crisis of the denaturing of capitalism – a crisis linked to loss of the values and references that have always been the foundation of capitalism. Capitalism has always been inseparable from a system of values, a conception of civilization, an idea of mankind. Purely financial capitalism is a distortion, and we have seen the risks it involves for the world economy. But anti-capitalism is a dead end that is even worse. We can only save capitalism by rebuilding it, by restoring its moral dimension. I know that this expression will call forth many questions. What do we need, in the end, if it is not rules, principles, a governance that reflects shared values, a common morality?’ See Nicholas Sarkozy, (Speech delivered at the World Economic Forum, Davos, 27 January, 2010).


within defined ethical parameters. The global financial crisis clearly demonstrates how the search for yield, at any price, trumped prudence and societal obligation not only in the corporate context but also, crucially, within the professions.

Even if one views the GFC from the less demanding utilitarian perspective, the consequential impact – albeit unintended – makes both the activity itself and the underpinning regulatory framework equally ethically fungible. Here it is essential to differentiate between a particular product and the clearly inappropriate uses to which it was put to work. It is now recognized, for example, that the originate-distribute-relocate model of financial engineering significantly emaciated corporate responsibility. This occurred precisely because it distanced institutional actors at every stage of the process from the consequences of their actions. Given the huge social and economic cost of this misallocation of responsibility, it is deficient for policymakers to profess shock at the irresponsibility of banks, insurance companies and the rating agencies or the sector as whole. This is particularly the case when retail investors are themselves inadvertently exposed to risk precisely because these products form a component of superannuation portfolios. The failure to calculate the risks and design or recalibrate restraining mechanisms at the corporate, professional, regulatory and political levels exacerbated the externalities now borne by the wider society.

The third major approach to evaluate the ethical dimension of corporate activity is, perhaps, more demanding. It is also more fruitful in terms of refashioning corporate, professional and regulatory action. While the policy response to scandal has traditionally been to emphasize personal character, much less attention has been placed on how corporate, professional, regulatory and political cultures inform, enhance or restrain particular character traits. This, however, is at the heart of professional obligation (i.e. the requirement to act in the public interest). The focus of virtue-based analysis is not on formal rules (which can be transacted around) or principles (that lack the definitional clarity to be enforceable). Rather, it focuses on how these rules and principles are interpreted in specific corporate, professional or regulatory practice. This ultimately, is a question of individual and collective character, or integrity.

In a narrowly defined context, it could be argued that the corporate form itself is inimical to virtue. There is prescience to Alasdair MacIntyre’s argument that the ‘elevation of the values of the market to a central social place’ risks creating the circumstances in which ‘the concept of the virtues might suffer at first attrition and then
perhaps something near total effacement’. This builds on earlier insight that suggested that ‘effectiveness in organizations is often both the product and the producer of an intense focus on a narrow range of specialized tasks which has as its counterpart blindness to other aspects of one’s activity.’

Compartmentalization occurs when a ‘distinct sphere of social activity comes to have its own role structure governed by its own specific norms in relative independence of other such spheres. Within each sphere those norms dictate which kinds of consideration are to be treated as relevant to decision-making and which are to be excluded.’ For MacIntyre, the combination of compartmentalization and focus on external goods, such as profit maximization, corrode capacity for the developments of internal goods, which should be developed irrespective of the consequences. It has now become incumbent upon regulatory authorities (formal and informal) to identify and break down the compartmentalization imperatives at corporate and professional levels and, if the rhetoric is to translate into policy innovation, to integrate the form and purpose of business ethics into a wider social contract. It is in this context that the fourth key dimension of business ethics theory comes into play: the contextual material and ideational environment in which social norms play out.

As we have seen, it is mistaken to assume that social norms, once accreted remain static, impervious to environmental corrosion. As noted above a critical feature of the global financial crisis was the fact that much of what occurred was legal. The unresolved question is why this occurred and how it can be ameliorated? The search for answers and the putative solutions necessitate we pay much more attention to the normative dimension of financial market regulation. This, in turn, suggests that regulatory effectiveness cannot be vouchsafed merely by reforming the institutional structure.

Articulating the parameters of what constitutes ‘smart regulation’ does little to improve the conceptual underpinnings because it lacks a normative dimension. Equally, enrolling actors into governance arrangements without articulating precisely what is meant by business integrity and accountability within specific contexts is unlikely to resolve the

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15 For the need to bifurcate and map the distinction between the universality of moral sentiment and the particularity of application, see David Smith, *Moral Geographies: Ethics in a World of Difference* (2000) 14.
16 The importance of context now informs the work of prominent behavioral economists, see Robert Schiller and George Akerlof, *Animal Spirits* (2009).
normative questions highlighted above.\textsuperscript{17} In summary, what is needed is a synthesis between an appreciation of context, the need for virtuous behaviour and the importance of deontological rules and consequential principles of best practice within an overarching framework that that is not subverted by compartmentalized responsibilities.\textsuperscript{18}

The policy problem is how to render this framework operational in a systematic, dynamic and responsive way. Moreover the framework needs to balance specific economic efficiency (i.e. benefits to business) and professional rights to self-governance with explicit requirements that society should not be held responsible (or liable) for the failures of the former.\textsuperscript{19}

Accountability is, therefore, a design question at corporate, professional and regulatory levels. It needs to be mutually reinforcing. It needs to be capable of evaluating the calculative, social and normative reasons for behaving in a more (or less) ethically responsible manner.\textsuperscript{20} It also requires reciprocal obligation from each institutional actor to governance arrangements that articulate common understandings of what constitutes the ethical problem, how disputes over interpretation could be resolved in a manner that is proportionate, targeted, and, ultimately, conducive to the building of warranted trust in the operation of the financial services sector.

It is against this background that policy proposals must be judged. Given that the legitimacy and authority crisis facing the sector derives primarily from the widespread perception of ethical failure, creating structures that weaken ethical obligation (or provide opportunities for gaming) are, by definition, self-defeating.


\textsuperscript{18} Micro social contract norms must be compatible with hyper norms (i.e. norms sufficiently fundamental that they can serve as a guide for evaluating authentic but less fundamental norms), see Thomas Donaldson and Thomas Dunfee, Ties that Bind: a Social Contracts Approach to Business Ethics (1999).


\textsuperscript{20} Soren Winter and Peter May, ‘Motivation for Compliance with Environmental Regulations’ (2001) 20 Journal of Policy Analysis and Management 675; see more generally Ian Ayres and John Braithwaite, Responsive Regulation (1992); for study suggesting the power of outsiders to frame the emphasis on effective internal controls only if there is a perception within the company that performance is being monitored, see Christine Parker and Vibeke Nielsen, ‘To What Extent Do Third Parties Influence Business Behaviour’ (2008) 35 Journal of Law and Society 309 (reporting survey evidence from 999 large Australian companies); for broader theoretical issues, see Melvin Dubnick and Justin O’Brien, ‘Retrieving the Meaning of Accountability in Capital Market Regulation’ (Paper presented at the American Political Science Association Annual Meeting, Toronto, 4-6 September 2009).
The Interaction Between Rules, Principles and Norms

It is axiomatic that when a complex trading model disintegrates, the clarion calls for action inevitably target the regulator. The GFC is no exception. It is exceptionally simplistic, however, to place responsibility for ethical failure in the hands of a market conduct regulator with a primary mandate to implement rather than set policy. Moreover, the scale of the credit crisis requires us to transcend the increasingly sterile debate over whether it is preferable to privilege rules over principles. Rules need to work ‘hand in glove’ with principles within an interlocking system of incentives and disincentives. In some areas, compliance with rules might be more important than alignment with principles. On the other hand, for some problems in other areas, for example potential conflicts of interest, the emphasis might need to be on principles in the context of verifiable procedural requirements, such as an internal but independent mechanism for determination of any conflict of interest. In still other areas, such as disclosure requirements, principles and rules might both need to be met. More generally, principles may require ongoing testing to ensure consistency and coherence in terms of application.

How to ensure that rules and principles mutually reinforce one another – rather than compete with one another – is central to regulatory effectiveness. It has long been recognized that strong moral and ethical codes are required to ensure economic viability. Moreover, the partial falsification of the efficient market hypothesis has been accompanied by a belated acceptance that pursuit of (deluded) self-interest is not only corrosive but when taken to its logical conclusion diminishes accountability. Sustainable reform necessitates examining what factors contribute to the reinforcement or degradation of social norms. Unless this dimension is addressed it is highly unlikely that lasting behavioural change can be expected. The unresolved issue is what form those national standards should take and how to enforce compliance with rules and –

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21 The relative weakness of ASIC to set policy in Australia was made explicit by commissioners at the closing session of the ASIC Summer School (Melbourne, 3 March 2010).

22 The debate is a perennial one within regulatory studies, see, for example, Julia Black, Rules and Regulators (1997). It is also deeply unsatisfactory, see Justin O’Brien, ‘Managing Conflicts: The Sisyphean Tragedy (and Absurdity) of Corporate Governance and Financial Regulation Reform’ (2007) 20 Australian Journal of Corporate Law 317.

23 Douglass North, Structure and Change in Economic History (1981) 47 (suggesting that they are the ‘cement of social stability’).

24 See Shiller and Akerloff, above n16, 5-6.

25 See Lynn Stout, ‘Social Norms and Other-Regarding Preferences’ in John Drobak (ed.), Norms and the Law (2006) 13 [reviewing results from social dilemma, ultimatum games and dictator games and postulating ‘taken as a whole, the evidence strongly supports the following proposition: whether or not people behave in an other-regarding fashion is determined largely by social context tempered—but only tempered by considerations of personal cost [emphasis in original]’ at 22].
more importantly – enhance the ambition of aspiration. This is of particular importance when applied to groups that themselves have professional aspirations or to countries that have aspirations of using that aspiration to provide the basis for economic growth.

The relative strength of the regulatory system in Australia provides both an opportunity and a risk. It is an opportunity in that Australia has significant credibility in proffering regulatory and other solutions. It is a risk that the absence of catastrophic collapse may foster complacency. The Government recognized both dynamics in commissioning the ‘Australia as a Financial Centre Report.’ Noting the enormous potential for Australia to capitalize from the GFC, the Australian Financial Centre Forum articulated a vision that cautioned policymakers against ‘racing to the bottom.’ Instead it advocated aspiring towards:

A financial sector which is open, competitive and underpinned by strong, stable and sound institutions. It exhibits the lowest possible barriers to entry consistent with the maintenance of financial stability and integrity, so as to encourage new entrants and foster price competition and innovation. It is a sector with a reputation for transparency, integrity and efficiency. It is a sector where the critical mass of skills, experience and reputation encourages both domestic and international participants to do business. It thus exhibits a high volume of cross-border transactions in a wide variety of financial products, services and currencies.

The vision combines the technical with the normative (i.e. not just what is but what ought to be). It envisages a much higher ethical content in regulatory and corporate practice. Crucially it suggests that successful reform requires the creation of shared understanding of private rights and public duties. Although the report provides substantial detail on the technical obstacles to developing Australia as a financial services hub, significantly less attention is placed on the governance agenda. In part this can be traced to the difficulties associated with determining what accountable governance means in practice. If we are to avoid knee-jerk policy responses that in themselves generate unintended consequences, it is necessary to articulate much more precisely what this concept means in practice.

**The Search for Accountable Governance**

In the aftermath of crisis regulatory theory and practice has often moved progressively through solutions based on the practical and normative advantages of ‘governance,’ ‘responsibility,’ ‘integrity,’ and ‘accountability.’ The problem is that we rarely stop to

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examine what these nebulous cluster concepts actually mean for particular communities. Figure 2 below posits two critical dimensions played by accountability in the discourse surrounding the financial markets crisis.\textsuperscript{27}

<table>
<thead>
<tr>
<th>Perspective:</th>
<th>Cause</th>
<th>Cure</th>
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<tbody>
<tr>
<td>Accountability-as-Mechanism</td>
<td>Failure of instrument</td>
<td>Reform, replace, repair the instrument</td>
</tr>
<tr>
<td>(i.e. control)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accountability-as-Setting</td>
<td>Absence or collapse of norms, mores,</td>
<td>Reestablishing, rebuilding moral</td>
</tr>
<tr>
<td>(i.e., normative infrastructure)</td>
<td>standards</td>
<td>community based on effective</td>
</tr>
<tr>
<td></td>
<td></td>
<td>norms/standards</td>
</tr>
</tbody>
</table>

**Figure 2: Accountability’s Discursive function**

Along one dimension, accountability is presented as either the cause and/or cure. It is the absence or failure of effective accountability that provides the focus of the discourse. In contrast, accountability is also central to many discussions about how to deal with specific failures. These include but are not limited to malfeasance and misfeasance such as deceptive or misleading conduct, unethical conduct linked to defective internal corporate codes of conduct or governance arrangements, and/or the operation of the external regulatory architecture. It can also be deployed as a counter to the overall conditions that caused the crisis, for example the need to respond to the danger posed by technical compliance within specific communities, such as lawyers, auditors, rating agency professionals, investment bankers or other groupings that play or could play a gate-keeping function.

The second dimension highlights another distinction. Here accountability can be conceived in either mechanistic or normative terms. In the former sense, being accountable means being subject to mechanisms designed to impose some form of control or guidance. It means being answerable, liable, legally obligated, etc. Alternatively, accountability is also treated as a manifestation of the normative condition of ‘being accountable’ -- as something an agent is or ought to be. What form could or should this take is enormously controversial. More specifically, it cuts against

the enabling underpinning of corporate and contract law. This creates two interlinked problems. First, can ethical behaviour be evidenced solely through compliance with functionally understood legal obligation? Second, if acting ethically requires transcending legal obligation, who should adjudicate compliance, on what basis and by what specific measure? These are complex questions. The courts have traditionally been loath to intervene in the internal affairs of the corporation (and for good reason). The lack of consensus on the purpose of the corporation has privileged managerial and performative approaches to accountability (see Figure 3 below).

<table>
<thead>
<tr>
<th>Autonomy of accountable agent</th>
<th>Specificity of accountable activity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>Low</td>
</tr>
<tr>
<td>High</td>
<td>High</td>
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</table>

Constitutive
Creation of ‘accountable space’ of internalized norms and standards

Managerial
Establishing ‘what’ agent is accountable for (objective or standard), allow agent to determine ‘how’

Regulative
Creation and externalized oversight of actions of agent within ‘accountable space’

Performative
Establishing ‘what’ agent is accountable for and ‘how’ to proceed

Figure 3: Accountable Strategies

The relative dominance of each is linked to the boom-bust-regulate-deregulate-boom-bust cycle. Moreover, this desultory spin should remind us that the application of ever...
more detailed proscriptive and prescriptive rules through regulative intervention does not necessary lead to the reduction of agency problems or inculcation of higher ethical standards. These rules can be, and indeed often are, transacted around. Likewise principles alone cannot act as a restraining force. The poor performance of the much-vaulted risk-based regulatory framework in the United Kingdom during the GFC shows the dangers of thinking that the absence of prior scandal demonstrates underpinning strength. As has been demonstrated, traditional regulatory solutions, underpinned by performative, managerial and regulative conceptions of accountability, have drawbacks if viewed in narrow terms. Contrary to the assertions of the former chairman of the Federal Reserve (in office and in retirement), it is not only possible but also necessary to engage in ex ante investigation of the factors leading to bouts of irrational exuberance.\(^{31}\) What is required, therefore, is a two-stage process.

First, we need to have a greater understanding of how rules and principles are interpreted within specific communities of practice. Second, we need to measure the extent to which practice correlates to or deviates from commitment to stated values. The advantage of such an approach is that it offers the opportunity to build organically from principles of self-regulation but embed this within a much more clearly defined conception business integrity. This requires a renewed emphasis on how to constitute a truly accountable space that simultaneously empowers and enhances personal, professional and corporate responsibility. This constitutive dimension of accountability rests at the apex of Williamson’s conception of the non-calculative social contract. President Obama has put this exceptionally neatly:

> We know that markets are not an unalloyed force for either good or for ill. In many ways, our financial system reflects us. In the aggregate of countless independent decisions, we see the potential for creativity — and the potential for abuse. We see the capacity for innovations that make our economy stronger — and for innovations that exploit our economy’s weaknesses. We are called upon to put in

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\(^{31}\) Alan Greenspan, ‘The Challenge of Central Banking in a Democratic Society’ (Speech delivered at American Enterprise Institute Dinner, Washington DC, 5 December 1996). Greenspan asked rhetorically, ‘How do we know when irrational exuberance has unduly escalated asset values, which then become subject to unexpected and prolonged contractions as they have in Japan over the past decade?’ The remarks provided the title for a seminal analysis into the dynamics of speculative bubbles, see Robert Shiller, *Irrational Exuberance* (2000). Shiller, along with a Nobel prize winning economist at University of California at Berkeley have applied similar reasoning to the global financial crisis, see Shiller and Akerlof, above n16 (‘The crisis was caused precisely by our changing confidence, temptations, envy, resentment, and illusions—and especially by changing stories about the nature of the economy’: at 4); see also Alan Greenspan, ‘We Will Never Have a Perfect Model of Risk,’ *Financial Times*, 17 March, 2008, 13; Evidence to House Committee on Oversight and Government Reform, ‘Hearing on the Role of Federal Regulators in the Financial Crisis,’ Washington DC 23 October 2008 (A. Greenspan).
place those reforms that allow our best qualities to flourish — while keeping those worst traits in check. We’re called upon to recognize that the free market is the most powerful generative force for our prosperity — but it is not a free license to ignore the consequences of our actions.\textsuperscript{32}

There can be no doubting the rhetorical flaire. Unfortunately, as with the Australian report into the development of the country as a regional financial services hub, it leaves unresolved the question of how to design mechanisms that allow for a more precise calibration of ethical content. If accountability is to have meaning beyond rhetoric, it is essential to parse its multifaceted dimensions as both cause (i.e. its absence) and putative cure for solving endemic market failure in capital market governance from an applied ethics perspective.\textsuperscript{33}

What remains unclear is how to rank competing, potentially incommensurable interpretations of what constitutes appropriate behaviour? Can one say, for example, that acting within the confines of the law evidences integrity? The scale of ethical failure witnessed in the global financial crisis demonstrates the inherent limitations of black-letter law as a sufficient bulwark even within the liberal democratic state. It is equally unsatisfactory to root integrity lexicographically in the application of consistent behaviour. Consistently engaging in deceptive misleading practice may demonstrate ‘wholeness’ or ‘completeness’ but it cannot be a constituent of integrity. Integrity therefore requires of us not only duty (i.e. compliance with the law; consistent and coherent actions) but also principles that contribute to (and do not erode) social welfare (i.e. treating people, suppliers and stakeholders with fairness and respect). Seen in this context, enhancing integrity through higher standards of business ethics is a question of organizational design. The aim, in short, for policy recalibration is to give substance to what constitutes – or should constitute – appropriate principles of aspiration for the professions or those who aspire to professional status. What we must guard against is trying to secure agreement at any cost, a policy that runs the risk of privileging those with mechanistic conceptions of professional obligation or appealing to the lowest common denominator. Before evaluating the Australian approach now advocated, it is worth examining the debate followed in the United Kingdom, not least because the proposal to establish a Professional Standards Board emanated from there.

\textsuperscript{33} Integrity has also long been recognised as an important intangible asset or liability in strategic management studies, see Muel Kaptein and Johan Wempe, \textit{The Balanced Company: A Theory of Corporate Integrity} (2002) 145-152 (noting that organizational structure and culture generate in a reflexive manner the execution of specific corporate practices).
Framing the Debate: The United Kingdom Experience

The Financial Services Authority in the United Kingdom has engaged in a comprehensive review of the retail distribution sector. Significantly, this process predates the GFC. Research commissioned by the FSA found an absence of trust in the sector, which could not be reversed solely by raising financial literacy. In its latest consultation paper, the FSA argues that ‘while we do have ongoing work to improve consumer financial capability, we must also put measures in place to facilitate improved levels of trust.’

These measures are in turn informed by four core principles. Proposals for change must, according to the FSA, ‘enable effective delivery of higher standards and increased individual accountability among investment advisors; deliver a visible change to consumers that makes this a more attractive and trustworthy sector from which to seek advice; involve simple operations to set up and run; and keep costs to a minimum and take into account other costs that would be incurred by individual investment advisors, such as professional body fees.’

The FSA initially indicated that trust would be enhanced through the establishment of a Professional Standards Board. This would be initially housed within the FSA but have the potential to become an independent statutory authority. Traction for the initiative came from an industry-based Professionalism Working Group set up to advise the FSA’s Retail Distribution Review. It had argued that the creation of an Independent Professional Standards Board would fulfill corporate and regulatory objectives. Specifically it would raise educative qualifications and set out minimum standards of behaviour through the creation and monitoring of an invigorated code of ethics, thereby securing public trust and confidence. The PWG argued that to be effective the IPSB must extend to the whole of the sector. It envisaged mandatory membership with barriers to entry set through the development of minimum education standards and ongoing continuous professional development courses.

35 Ibid, 20; see also Philip Mawyer, ‘Public Trust in the Professions’ (Speech delivered at the United Kingdom Inter-Professional Working Group Ethics, Trust and Integrity Conference, London, 10 February 2010), in which it is argued that ‘Trust involves a willingness to place confidence or faith in another person or organization to fulfill a course of action competently and ethically. Trustworthiness is the sum total of the qualities which earn that confidence.’
36 See Financial Services Authority, Retail Distribution Review (FS08/6).
37 Members include the Chartered Institute of Bankers in Scotland, the Chartered Insurance Institute, the Institute of Financial Planning, the IFS School of Finance, the Securities and Investments Institute and the Financial Services Skills Council.
As late as November 2008, the FSA accepted that the creation of such a board would generate significant advantages.\(^{38}\) In December 2009, the FSA modified its position significantly. It now argues that the establishment of such an entity is unnecessary. Moreover, it justifies the change because of industry submissions in the consultation process that argued ‘creating another statutory agency would bring complexity and duplication of responsibilities and risk of double jeopardy, especially when enforcing a code of ethics.’\(^{39}\) Instead, the FSA itself could monitor ‘both initial and ongoing competence, which includes ethical behaviour’ through ‘a more intensive approach to supervision.’\(^{40}\) Although the FSA now advocates retaining control, it also recognizes the critical role industry can and should play in both setting standards and monitoring adherence to those standards in practice through a three-pillar framework (entry standards, complaints and discipline procedures and continuous professional development).

As the discussion paper makes clear, ‘the role of professional bodies would become more significant than at present. We intend to recognize formally professional bodies that meet certain criteria, so that membership will be taken as satisfying the requirement to evidence the new initial and ongoing competence requirements to be set out in our Handbook.’\(^{41}\) These criteria have yet to be formalized but the discussion paper gives a clear indication of the parameters involved in meeting fit and proper recognition. For a professional body to be recognized it must demonstrate that it

- has adequate resources (including financial resources) and systems and controls;
- is controlled by a governing body comprising persons of good repute;
- acts in the public interest so that its activities and those of its members contribute to raising consumer confidence and trust in the investment advice sector;
- provides the FSA with regular independent reports on its activities in respect of investment advisers;
- shares information, including that about individual members, and cooperates with the FSA in an open and transparent manner;
- leads the professional development of the investment advice market;
- has and is effective in promoting standards of professionalism for investment advisers at least equivalent to those of the FSA;
- provides help and guidance in meeting those standards;

\(^{38}\) See presentations made to FSA Retail Distribution Conference, 25 November 2008 by Michael Foot, ‘Steps Towards a True Profession’ and Amanda Bowe, ‘Key Proposals in the RDR Feedback Statement.’ Michael Foot is chair of the Professionalism Working Group and Amanda Bowe is chair of the Retail Distribution Review at the FSA.


\(^{40}\) Ibid, 16.

\(^{41}\) Ibid, 17.
After the Deluge
March 18, 2010

- has effective arrangements for monitoring members’ compliance with standards; and
- has effective arrangements for disciplinary measures against its members as appropriate.42

The FSA suggests that recognition would be for a defined period. Continuation of the relationship would be subject to regular audit to review and test how well the body is raising standards of professionalism, actual adherence of standards in practice, as well as the processes used by the body to monitor deviance. Noting that this is an iterative process, the FSA envisages that a poor audit will not necessarily mean immediate suspension or revocation. Rather ‘we expect the auditors to work closely with the organization to bring about time-bound actions to remedy the position.’43

Although a complete cost-benefit analysis must await formal approval of the internal governance model, initial projections had suggested this internal model would deliver much better value for money and clarify the duties and responsibilities of each actor in the regulatory domain for enhancing competency and adherence to standards. It was based on the calculation that a process of genuine and considered consultation in which the ethical dimension is at the foreground of debate rather than an optional component would deliver better outcomes. Secondly, it recognized the heterogeneous nature of the industry, which made it difficult for the FSA itself to mandate particular approaches. Instead it placed responsibility back on industry itself to design and implement concrete standards, which could then be verified and validated.

More significantly, however, the FSA has recently signaled what it itself has termed a further radically changed approach to regulatory purpose and strategic implementation. This combined change, outlined in a speech on 12 March 2010, is likely to have far-reaching implications across the FSA’s operations.44 In particular, it calls into question the role and function of a Professional Standards Board precisely because of a stated aim to intervene much earlier in the product cycle.

As such it calls into question the limits of disclosure and increased literacy as the primary bulwarks to protect retail investors. It is against this changed context, which will be explored in further detail below, that the recommendations set out in the Ripoll Report must be evaluated.

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In the Eye of the Storm: Evaluating Ripoll

The impetus for establishing the Ripoll Inquiry came primarily from the collapse of Storm Financial. The committee found that ‘the overwhelming characterization of Storm’s operations is that the majority of Storm’s clients were given the same, or substantially similar financial advice.’ Moreover, ‘the committee is firmly of the opinion that, for at least a subset of Storm’s investment clients – namely clients on average incomes or near the end of their working lives – the advice to engage in an aggressive leveraged investment strategy was clearly inappropriate.’ This raised ‘a multifaceted problem to solve...There is a need to improve the standard of advice offered to consumers, whether that be through enhanced legislative requirements about the standard of advice required or enhanced enforcement of existing standards, or both so that consumers can be confident about the advice received. There is a need to better inform consumers about the products signed up for, so that consumers can take a higher degree of responsibility for financial decisions and only buy products that entail a comfortable level of risk. There is a need to ensure that advisers are better informed about the products being sold.’

Legislative changes introduced in the aftermath of the Storm collapse, most notably the conceptualization of margin lending as a financial product, have enhanced the capacity for the corporate regulator, the Australian Securities and Investments Commission (ASIC) to intervene much earlier in the process. Although the Ripoll Inquiry report recognizes that ‘ASIC does not have a role in assessing business models per se,’ it does need to ensure that advice is appropriate to the needs of individual clients (something that clearly was not the case in relation to Storm). The report makes it clear, however, that existing forms of oversight in Australia are far from optimum and reinforces this by quoting extensively from corporate and industry association submissions. The Commonwealth Bank of Australia, for example, accepted that ‘in some cases we have identified shortcomings in how we lent money to our customers involved with Storm Financial. We are not proud of our involvement in some of these issues and we are working towards a fair and equitable outcome for our affected customers.’

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45 Ripoll Report, above n1 at 27.
46 Ibid, 28.
48 Ibid, 44.
49 Statement by Ralph Norris, Chief Executive Officer, Commonwealth Bank of Australia, 17 June 2009, cited in Ripoll Inquiry Report, 45. Ripoll also acknowledges the CBA’s statement that it ‘was the only organization to stand up and comprehensively acknowledge its responsibilities’ and ‘encourages other lenders, who in some cases are still reviewing their internal policies to be similarly candid about errors that they may have
Financial Planning Association noted that ‘as an association we certainly accept responsibility for the fact that Storm Financial was a member of the FPA and we certainly wish that we could have acted earlier and we wish that we could have prevented some of the losses that have occurred.

Ripoll recognized that no matter how wrenching an individual corporate collapse it was not necessarily appropriate to introduce further legislative or regulatory reform. That being said, the collapse of Storm and Opes Prime did raise uncomfortable questions for individual financial planners, licensed institutions and the regulator that could no longer be avoided. These essentially boiled down to the need to manage an existential conflict over whether financial planning was essentially a sales position or a professional one with concomitant responsibilities and if so what role should be ascribed to the professional body as the custodian of the public interest.

**Fiduciary Duty and Professional Obligation**

A critical determinant of what it means to be a member of a profession is to act in the interests of the client. Societal faith in the efficacy of professional models has been severely tested in a range of domains. The capacity of communities of professionals to engage in self-dealing detrimental to the interests of individual clients or, by extension, the integrity of the wider market system, is central to the articulation of fiduciary obligation. In common with compliance, fiduciary obligation is, however, a remarkably elastic proposition. As Finn makes clear, ‘it is meaningless to talk of [generic] fiduciary relationships as such.’ The relationship requires three interlocking determinants: the binding (or perceived binding) obligation to act in the interests of another, without intermediating contractual provisions limiting the fiduciary’s independence to act. The reliance of fiduciary obligations to prevent *institutional* self-dealing is weakened by the

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made and similarly constructive in the manner in which they engage with clients to redress those errors,’ *Ripoll Report*, 48.

50 *Ripoll Report*, 43.

51 For a standard definition of a profession, see United Kingdom Inter-Professional Working Group, *Professional Regulation: A Position Statement* (2002) 6 [A profession is] an occupation in which an individual uses an intellectual skill based on an established body of knowledge and practice to provide a specialized service in a defined area, exercising independent judgment in accordance with a code of ethics and in the public interest.’

52 See Mawyer, above n35.

53 The fiduciary obligation originates in trust, see *Meinhard v Salmon* (1928) 164 N.E. 545, 546 (‘A trustee is held to something stricter than the morals of the marketplace. Not honesty alone, but the punctilio of an honour the most sensitive is the standard of behaviour’). In its most absolutist form, the fiduciary must render her own interests subservient to those of her client unless provided for by informed consent, see *Bristol & West Building Society v Mothew* [1998] Ch. 1, 18 (Millet LJ).


broader policy acceptance of conflicts of interest. These conflicts of interest are exceptionally difficult to resolve in the financial planning and advice sector over both the employment setting and the sales-advice bifurcation.

Ripoll accepts this historical conflict has left ‘a legacy potentially inconsistent with contemporary expectations that financial advisers provide a professional service that meets their clients’ best interest.’\(^{56}\) Although Ripoll acknowledged sections of the financial planning have expressed a desire to move further along the advice continuum – most notably through a phasing out of commission-based payments – this is not mandated by the FSR regime. The committee advocated resolving these issues by introducing an explicit fiduciary duty not only on the provision of the advice, a course of action advocated by ASIC, but also the individual advisor, a position advocated by the Financial Planning Association.^{57}

Left unexplored, however, is how this change will impact on the governance of entities that hold Australian Financial Services Licences (AFSL) or, even more problematically, the relationship between individual advisers within these firms and ASIC, which has delegated primary oversight over the sector. Does an individual adviser owe a primary duty to his or own employer, to a professional body or to the regulator? In the event of conflict, which duty should be privileged and on what basis? The problem is magnified because of a lack of guidance as to what best practice entails and the lack of a framework in which one can rank the efficacy of internal controls.

The lack of prescription gives the illusion that financial planners operate under agreed normative settings. Those operating within large entities holding an AFSL are, in effect, regulated by a control system that limits, or more accurately can limit, freedom to operate or abide by broader professional duties. Unless this structural issue is resolved the introduction of fiduciary duty is unlikely to fundamentally change behaviour in medium sized settings that do not necessarily attract either media or regulatory attention in the absence of crisis. Indeed, the introduction of fiduciary duties in these enterprises is likely to generate even more confusion about where duty is owed. Failing intervention by ASIC on internal business models (a course of action precluded by

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\(^{56}\) Ripoll Report, above n1, 69.

\(^{57}\) Ibid, 104 (citing ASIC submission that ‘an additional legislative requirement to put the interests of clients first where there is a conflict would lead to a higher quality of advice and the emergence of a professional advice industry.’ According to ASIC an explicit fiduciary duty also has the advantage of resolving, definitively, the conflict of interest over remuneration). The FPA argues that ‘attributing a fiduciary responsibility to the function of advice...is going to be quite hard to monitor and enforce. We would prefer that the role of fiduciary were attached to a person, not to a function or interaction. We believe that the person should have that responsibility’ cited in Ripoll Report, above n1, 106.
Ripoll) how to resolve the conflict between revenue generation and professional obligation is highly problematic. As will be explored in greater detail below, this conflict is even more extreme in larger enterprises over the specific issue of the regulation of product design and manufacturing.

Irrespective of where one stands on this question, it has become an imperative to design and implement a framework that makes individual advisers more accountable and raises standards for the industry as a whole. In this regard the most significant structural change suggested by Ripoll centres on the creation of an independent Professional Standards Board. Unfortunately, here too there is a lack of clarity about how such a body could or should function.  

**Creating a Professional Standards Board**

Ripoll advocated the establishment of an independent model on the grounds that ‘such an entity would be more effective at identifying and addressing problems early, receiving better intelligence at industry level and not being constrained by meeting high legislative thresholds before taking action.’ In this it mirrored, in part, some of the submissions made by industry groups, which argued that professional responsibility had to be both embedded and developed as a critical component of effective oversight. The Financial Planning Association, for example, argued that ‘there should be a professional obligation attached to that person through membership of a professional body – in other words they have to meet with requirements over and above the law.’ Another submission from Boutique Financial Planning Principals Group argued that ‘a professional body is not restricted to enforcing the law but can act in advance of problems whether they involve ‘legal’ behaviour or not. A PSB can also receive intelligence form its members, develop meaningful standards, counsel members and use the threat of expulsion if members are in a position where they may bring the profession into disrepute.’ Quantum Financial Services likewise advocated the development and policing of a compulsory code of ethics and that the primary role of the PSB would be to ‘oversee the development of professional standards and act as a guardian of the public interest.’

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58 Ripoll Report, above n1,141.
60 Ibid, 137.
Each submission reflected the debate carried out through the auspices of the FSA, which had initially advocated the creation of an external body. None, however, appeared to anticipate that the FSA would radically change tack. Furthermore, it remains unclear what precise powers a professional standards body would have or how it would interact with existing regulatory and wider political authorities. Significantly, Treasury itself was not dismissive of the principle behind establishing a Professional Standards Board. It did signal, however, that potential governance conflicts needed to be resolved in advance. In its submission to Ripoll, Treasury asked pointedly, ‘do you put it within ASIC or do you have it as a separate body, which means that ASIC and the body have to work closely together to try to avoid duplication.’ Ripoll concluded, rather unhelpfully, that the board would ‘share responsibility with ASIC for establishing, monitoring and enforcing competency and conduct standards for financial advisers.’

As outlined above, the creation of an external body had been proposed but ultimately rejected by the Financial Services Authority in the United Kingdom on efficiency and practical grounds. Instead it advocated a pluralistic model of oversight in which industry bodies would design and implement strategies for increasing professionalism, which would be validated through an accreditation process. There is recognition that this approach requires a recalibration of the regulatory landscape and could involve a redistribution of authority. There are significant risks and opportunities associated with adopting either unitary or competitive oversight models.

Comparing Unitary and Competitive Models of Oversight

As part of its Retail Distribution Review, the FSA conducted comparative research on the regulation of financial planning and advice. The FSA report that ‘if an ideal distribution system is one in which all consumers take educated financial decisions off the back of sound impartial advice, then it is straightforward to conclude that none of the countries considered have achieved this. While other countries have experienced similar problems and investigated solutions, none has yet arrived at a distribution nirvana.’ One jurisdiction, has, however, come closest to delivering the substantive reform agenda envisaged by the creation of an independent Professional Standards Board.

South Africa has streamlined significantly the governance of the financial advice sector through the emergence of the Financial Planning Institute (FPI). As the sole professional

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63 Ibid, 136.
64 See Financial Services Authority, A Review of Retail Distribution (DP 07/01) Annex 3, 2.
body in South Africa, the FPI ‘operates a three-stage hierarchy of designations – Registered Financial Planners (5,400 holders), Associate Financial Planners (2,700) and Certified Financial Planners (3,200). Underpinning the designations are what the FSA describes as ‘tough academic requirements. For instance, an Associate Financial Planner requires a bachelor’s degree and two years minimum experience.’65 Since the FSA completed its research, the South African model has been further refined. As part of the certification process, members of the FPI must also sit regulatory examinations, which are mandated by the Financial Advisory and Intermediary Services Act (2002) and delivered through the FPI, which is accredited by the same act. These examinations cover not only the codes of conduct but also depending on whether the adviser is providing specific advice knowledge of complex products. It places responsibility for honesty and integrity at three levels. First, the individual is required to report to the Financial Services Provider any material information that impacts on integrity. Second, the FSB must conduct its own checks on an ongoing basis. Third, this information must be reported externally.

The South African experience suggests that an independent Professional Standards Board model necessitates compulsion; that it can only be effective if it applies to the whole industry and has formal legal sanction. It is still too early to evaluate the effectiveness of the South African model in practice. What is clear, however, is that the model is predicated on setting and then inculcating a much broader conception of professional responsibility than reliance on technical competency and does so by delegating power to the institution best placed to monitor that, namely the profession itself rather than relying on a regulatory rules setting. What is also significant about the South African model, however, is that it offers a granulated conception of professional responsibility. It necessitates an ongoing partnership in which professional obligation is measured not only through entry requirements or continuous professional development courses that focus merely on technical competency. Instead, it provides an equal emphasis on identifying, evaluating and adjudicating actual commitment of individual advisers and licensed firms to principles of integrity and honesty in their client dealings and does through a triangular prism (that links responsibility of the individual, the firm and the regulating body). In attempting to warrant reputation it provides a critical public service, itself a critical determinant of professional obligation.

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65 Ibid, 11.
After the Deluge
March 18, 2010

The artificial creation of competition generates its own set of risks. The most substantial risk is that competition could merely privilege a race to the bottom. Irrespective of the quality of the accreditation process, variable quality issues could emerge. The very fact that accreditation has been provided may give a degree of assurance that is unwarranted. In the United Kingdom, for example, the FSA has confirmed that it proposes allowing industry bodies that are in breach of obligations under the scheme opportunities to work with auditors to rectify them. Moreover, it does not clarify whether or when the audit will itself be made public. The primary danger of competition, however, lies in conceiving of a Professional Standards Board as primarily a mechanism to advance technical competence.

**Differentiating Technical and Ethical Competence**

The FSA has noted that educational qualifications were an essential step towards improving professionalization, which is defined elsewhere in the document as ‘improving technical knowledge, capabilities and behavioural standards, all differentiated according to the level of service being provided.’66 In the United States, for example, it found that ‘there are around 320 undergraduate degree, graduate degree, and certificate programs...that are directly geared towards the Certified Financial Planner (CFP) designation. As a consequence, many US financial advisers are educated in financial services to degree level. We believe that this is a contributory factor as to why people – both inside and outside of the US – tend to regard financial advisers there as professionals.’67

This is a rather emasculated ambition. It should be noted, for example, that the regulatory framework for educational standards in Australia is of a significantly higher standard than that being proposed in the United Kingdom, at least as far as members of the Financial Planning Association is concerned.68 Of the 7939 practitioner members, 5693 are registered as ‘certified financial planners, ‘which requires five units of study and an underpinning undergraduate degree,’ a significantly higher educational requirement than that proposed in the United Kingdom. Indeed the FPA is itself held out by the FSA as providing a paradigmatic case study of what constitutes a strong

66 Ibid, 36.
67 Ibid, 11.
68 The Association of Financial Advisors, which has 1300 members, has ongoing education requirements and offers a Fellow Chartered Financial Planner Qualification, which is offered through the AFA and consists of 4 units, each taking 12 weeks to complete.
representative body not least because it attaches ‘an air of professionalism’. Establishing a professional standards board model along the lines now advocated by the FSA risks weakening attempts by sections of the industry here in Australia to raise professional standards above and beyond that required by the FSR regime.

The primary danger of allowing pluralism in the Australian context is the privileging of a competition in laxity. Notwithstanding the actions taken by the FPA in developing the professionalization agenda, including its discipline and complaints procedure, any accreditation procedure that leads to the imposition of less onerous obligations is highly unlikely to improve standards. It is likely to lead to a further deterioration, not least because increased scrutiny itself has material costs that must be recouped from membership fees. This, ultimately, is not a competition Australia has any long-term interest in winning. Indeed, such an approach also cuts against the recommendations of the Australian Financial Centre Forum. If the primary argument for establishing a Professional Standards Board is merely to raise educational competence, it is arguable that the Australian framework is already sufficient. If, however, the aim is to embed higher conceptions of professional ambition, neither the FSA model nor the Ripoll blueprint offers sufficient guidance. It is, perhaps, unfortunate that the FSA itself disregarded its own model of an independent board one month after Ripoll reported.

Crucially, the reform agenda must address the substantive issue: the widespread public perception that the sector cannot be trusted. This cannot be resolved with addressing the most substantial conflict (i.e. whether substantive reform requires intervention at a much earlier stage in the product cycle). Unless a credible mechanism is put in place to manage this tension, in which duties (as well as rights) are clearly articulated, the search for accountable governance will remain elusive. Doing so, however, requires fundamentally changing the balance of power within the regulatory landscape. Here evidence from the United Kingdom and (partially) the United States offers a glimpse of potential changes in trajectory.

**Consumer Protection and the Rebuilding of Trust**

On 12 March 2010, the chief executive of the Financial Services Authority, Hector Sants, used an address at the University of Oxford to outline a new consumer protection strategy. The strategy has three interlocking components: (a) to make the retail market

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69 FSA above n 64, 12. The FPA releases information on a quarterly basis on the number of new, ongoing and closed investigations. In addition, information is provided on the number of individuals suspended, expelled or subject to other forms of discipline. For the financial year ending June 2009, 14 members were expelled.
work better for consumers; (b) avoiding systemic problems by preventing what the FSA terms the ‘crystallisation of conduct risks that exceed the FSA’s risk tolerance; and (c) ensuring that credible deterrence systems are put in place within firms and the FSA itself to provide effective redress. Throughout the speech the FSA CEO emphasized that changed societal preferences had altered the risk-security calculation. This necessitated, he argued, a radical shift from principles-based regulation towards an outcomes-based approach. This presents an acceptance that past reliance on disclosure or financial literacy was not only insufficient but also deleterious to consumer welfare.

Essentially, our focus has been too late in the product lifecycle to ensure that we identify potential issues early enough to prevent consumer detriment. Our Treating Customers Fairly (TCF) initiative, a key element of our retail agenda from 2004/05 onwards, did acknowledge that it is preferable to prevent substantial failures occurring. However, its implementation essentially relied upon the ‘old-style’ supervisory approach that focused on senior management equipping themselves with the right systems and controls. This therefore remained a reactive approach. The TCF initiative has yielded some benefits, particularly with regard to raising management awareness of the outcomes the FSA seeks but it has not yet delivered substantial on-the-ground benefits to consumers. Our new conduct model seeks to take a dramatically different approach. We will now seek to proactively intervene earlier in the product chain to anticipate consumer detriment and choke it off before it occurs.

We will do this through using our integrated model of risk analysis and research to identify earlier sources of conduct risk; intervening further up the value chain and scrutinising products at the design stage. We will also use sector-wide intervention where necessary, for example to change incentives in a market....

A successful consumer protection strategy must restore consumer confidence in the financial market place. A key element of restoring that confidence is that the consumer can trust the regulator. This strategy will restore trust in the regulator and will benefit everyone, including consumers and providers. A regulator must be willing to place themselves between consumers and harm. We will only achieve this by taking a proactive stance.70

Mr Sants went on to emphasize the importance of ‘culture, behaviour – dare I say it, ethics?’ It is most unfortunate that one of the most influential regulators in the world remains cautious about framing the debate on ethical terms. He accepts, however, that the FSA’s renewed emphasis the importance of business models necessitates moving inexorably in this direction, crucially, in partnership with industry.

We need to answer the question of whether a regulator has a legitimate focus to intervene on the question of culture. This arguably requires both a view on the right culture and a mechanism for intervention. Answering yes to this question would undoubtedly significantly extend the FSA’s engagement with industry.

My personal view is that if we really do wish to learn lessons from the past, we need to change not just the regulatory rules and supervisory approach, but also the culture and attitudes of both society as a whole, and the management of major financial firms. This will not be easy. A cultural trend can be very widespread and resilient – as has been seen by a return to a ‘business as usual’

70 Ibid.
mentality. Nevertheless, no culture is inevitable. But changing it is a task that cannot be achieved by policymakers alone - we need to collectively address these issues.

From the regulators’ perspective it is probably the case that seeking to set ourselves up as a judge of ethics and culture would not be feasible or acceptable. More realistic would be to relate the consequences of culture to regulatory outcomes. However, developing this line of thinking requires much further debate, which I would welcome.71

A number of critical issues stem from this repositioning. First there is the explicit, if timid, recognition that one of the central problems facing regulators and business and indeed society is the inculcation among market participants of cultural terms of reference that allow for technical compliance with legal obligation but derogation from the underpinning spirit. Second, there is an acknowledgement that reliance on ex post regulation is no longer either appropriate or sustainable. Third, there is recognition that policymakers cannot solve this problem on their own. Fourth, there is an explicit invitation to industry to join the debate. Fifth, a framework is proposed that 'links the consequences of culture to regulatory outcomes.' Nowhere, however, does he give expression on how this can be achieved or the role that professional bodies can or should play in this repositioning.

What is clear, however, is that the emphasis on more intense pro-active supervision is likely to further exacerbate the tension within financial planing sector over the role and purpose of financial products. This raises a series of questions over appropriate domain, degree of interaction and cohesiveness between approaches taken by disparate regulatory agencies and extent to which reliance on greater disclosure or the development of literacy programs is in itself sufficient. Elizabeth Warren, a law professor at Harvard, has neatly summarized the broader argument. She maintains that while toasters are routinely tested, ‘financial products go unmonitored for basic safety. When shopping in the complex and constantly evolving financial market, where actual costs and unfavourable terms are regularly concealed, consumers are on their own.’72

More significantly, perhaps, Warren, who has served since 2008 as chair of the Congressional Oversight Panel, responsible for monitoring the US Department of Treasury’s management of the Troubled Asset Relief Program, has proposed the establishment of a Financial Product Safety Commission. Her proposals have received some traction with the Obama administration. It has proposed the establishment of a

71 Ibid.
Consumer Financial Protection Agency. The distinction is not merely a question of semantics. Its remit is to deal with the question of whether or not certain consumers should be allowed to access certain complex financial instruments. The financial services industry is sanguine about attempts to limit the exposure of ordinary consumers; there is considerable opposition to limit the access of sophisticated investors to these products.\textsuperscript{73} Whether such a distinction is warranted given institutional investor losses in the GFC is another matter entirely.

These global concerns are also reflected within Australia itself. In its latest member survey, FINSIA found that margin lending, securitisation, derivatives auditing, governance arrangements all required greater regulation. Although respondents were in favour of the current twin peaks model of regulatory oversight, 53\% agreed on the need for a greater focus on governance and enforcement and 21\% strongly agreed. Moreover, 72\% either agreed or strongly agreed that Australia’s financial regulatory setting is likely to be significantly influenced by changes in international regulation; the same percentage argued that Australia should take the lead in driving changes in the global financial regulatory system moving forward.\textsuperscript{74} There is therefore clearly a threat and an opportunity for Australia, particularly with regards to the current framework for regulating financial products.

\textbf{Towards a Sustainable Framework}

Sustainable reform must be consistent with principles of good regulation, namely it must be proportionate, consistent in application, transparent and targeted. The danger is that an ill thought out structure will exacerbate rather than resolve conflicts within the industry. It risks creating another layer of regulation that in fact does little to change either corporate practice or facilitate voluntary progression towards higher ethical standards, a situation that is neither desirable nor sustainable. The debate over the establishment of a Professional Standards Board demonstrates all too clearly the risks. Placing power within a regulatory agency (as now advocated by the FSA) risks privileging technical compliance. Furthermore, while a system of accreditation may ensure that all participants are covered by the regime, it may weaken wider conceptions of professional responsibility, particularly in cases where the emphasis of those bodies


\textsuperscript{74} Finsia, \textit{Australia and the Global Financial Crisis Lessons Learned and Opportunities for Reform in the Financial Services Sector} (Survey Report, September, 2009).
is on raising technical competency alone, delivered through educative barriers to entry or continuous professional development. At the same time, placing the body outside of a regulatory agency, without also delegating formal authority to police deviance and ensure effective whole of industry banning orders, risks creating the illusion of robust oversight. In either event, reform is unlikely to be sustainable in the longer term without tackling the intractable conflict between product design and execution on the one hand and professional responsibility on the other.

This suggests that effective regulatory reform must involve a dynamic, responsive interplay between duties and responsibilities of a range of actors in restoring public confidence. Product designers have a responsibility to ensure innovation serves more than short-term corporate profit. Providers of financial advice have a responsibility to manage conflict between their role as an employee and as a professional. Neither can do so effectively without a recalibration of the broader regulatory environment. The move towards more intensive supervision only partially changes this dynamic. The greatest danger is that innovation will be stifled at product design stage and professional responsibility emasculated by reliance on technical competency. Sustainable reform requires enrolling professional bodies into a formal gate-keeping role.

**Meta-Regulation of Financial Advice**

The proposal to create a Professional Standards Board is, at base, a plea to introduce a credible form of meta-regulation, in which Codes of Conduct are both meaningful and are taken seriously. It is an attempt to differentiate between warranted and unwarranted reputation at an individual, professional and corporate level. From a professional perspective, it requires cognizance and willingness to accept their role as gatekeepers of market integrity. It requires a willingness to transcend characterization of his or her role as a 'hired gun'\(^75\) and conceive of it rather as one designed to protect the public interest.\(^76\) Seen in this context, it is essential for individual planners to know one's client and the limitations of duty (to either the ongoing employer or the ad hoc

\(^75\) See Jeremy Carver, ‘The Role of Lawyers’ in Justin O’Brien (ed) Governing the Corporation (2005) 223 (‘If the price was right, the man do what he had to do, i.e. what he was hired to do. He could be Shane – quintessentially noble or decent; or he could be Jesse James – a cool and ruthless killer; or a range of characters in-between’: at 224)

\(^76\) For application of the need to avoid compartmentalization from a practicing law perspective, see Sandra Day O’Connor, Commencement Address, Georgetown Law Center, May 1986 (‘Lawyers must do more than know the law and the art of practicing it. They need as well to develop a consciousness of their moral and social responsibilities…. Merely learning and studying the Code of Professional Responsibility is insufficient to satisfy ethical duties as a lawyer’). See also Anthony Kronman, The Lost Lawyer: Failing Ideals of the Legal Profession (1995) 16 (lamenting a lost-deal in which reputation was defined by who the person was as such as technical mastery).
consumer who is reliant on your professional judgment). As the head of international law at Clifford Chance has put it ‘the lawyer cannot escape the commitments inherent in the lawyer-client relationship. It is a contractual one, placing mutual obligations and expectations on both. But the obligation to serve the interests of the client is not unqualified. It is conditioned by a set of public duties, including the duty not to misinform.’ In this regard, capacity to recognize professional duties can have the potential to act as a restraining force, providing individual finance professionals with a mechanism and justification for embarking on a particular course of action. Indeed this constitutive dimension now underpins the thinking of the Securities and Exchange Commission in the United States.

It is now incumbent on industry associations to demonstrate, conclusively, that they have the necessary resources to improve the governance of the sector and the willingness to apply them to improve the ethical dimension of professional practice. This goes far beyond mere marketing or, indeed, enhancing public awareness of differential industry association approaches to professional obligation. It suggests that the ongoing transmission of cultural values is as important as the dissemination of technical knowledge. As noted above, the South African model achieves this through tripartite reviews. This also underpins the approach to self-regulation being taken by the Actuarial Profession in the United Kingdom, which emphasizes the importance of cultivating professional norms within firms as well as among individual practitioners.

There is considerable merit in such an approach, precisely because it minimizes the risk of conflict between professional obligation and individual corporate practice. Crucially, it recognizes that compliance with responsibility transcends legal obligation. It cannot be vouchsafed by technical considerations or through application of a managerial or regulatory lens alone or in combination. Seen in this context, professional obligation is

77 Carver, above n72, 229.
78 See Mary Shapiro, ‘Address to the Practising Law Institute’ (Speech delivered at PLI Securities Regulation Seminar, New York, 4 November 2009): ‘We might sit on opposite sides of the table in any given matter, but I believe that all of us — regulators, attorneys, and business people alike — all share the common goal of ensuring that our capital markets work — and work fairly and effectively.’
79 The Actuarial Profession has moved to a principles based regime but ‘find ourselves wrestling with how and when to supplement the principles with guidance to members on specifics; we are increasingly seeing the need to emphasize proactive quality assurance mechanisms in the work place as a means of supplementing reactive regulation through codes and discipline schemes; we are looking to define the skill sets or competencies we expect of actuaries, not just at the point of entry but throughout their careers; we are increasingly conscious of the importance, not just of technical skills but of those skill sets which include managerial and presentational skills and are about aspects of professionalism in its widest sense; we are considering moving from inputs-based to outputs-based CPD, and as part of this process we are acutely aware of the need to improve the range and quality of the CPD we offer in professionalism and other skills; we are very much aware of the importance of the working environment to the professional development of actuaries and whilst we have traditionally regulated individuals, our members, we are increasingly looking to work closely with firms in advancing our regulatory agenda,’ see Mawyer above n35, 6.
an essential constitutive component of effective governance. It acts as a further mechanism to assess the efficacy of existing trust boundaries, police deviance from agreed institutional commitments and reinforce stated adherence to values and integrity.

In this regard the Public Company Accounting Oversight Board in the United States provides a much more effective model. Established in the aftermath of the Enron scandal, the PCAOB has fundamentally changed the governance of the audit profession (although it has not displaced professional membership). It is an independent private sector regulator. Although the Securities and Exchange Commission selects its board, it is neither government-sponsored nor taxpayer funded. Operating expenses are collected from public firms with contributions based on market capitalization.\(^3\) The success of the PCAOB comes from the fact that it has monopoly power. No public company can submit a financial report unless the audit firm is registered with the agency. Second, the board conducts regular inspection audits that go well beyond technical peer review to examine audit firm’s systems of compensation, promotion and internal oversight.

According to William MacDonough, ‘we begin by looking at the business context in which audits are performed. We focus on the influences – both good and bad – on firm practices. These include firm culture and the relationship between a firm’s audit practice and its other practices and between engagement personnel in field and affiliate offices and a firm’s national office.’ Specifically, ‘the Board and its Inspectors want to know if the message of doing the right thing is reaching the rank and file in the firms. Our inspectors talk to the managers but they also talk to the least experienced members of the audit teams to find out if the message is reaching them. The inspectors look at how often and how well the message is delivered.’\(^1\) The PCAOB integrates this intensive supervision alongside a broader responsibility for setting and monitoring compliance with industry standards (a process that involves extensive consultation and outreach to individual investors, auditors, regulators, managers and academics), which are then operationalized by specific firms and professional bodies. What really differentiates the PCAOD, however, is its emphasis on actual practice.

\(^3\) For operation of the PCAOB, see William MacDonough, ‘Accountability in the Age of Global Markets’ in Justin O’Brien (ed), Governing the Corporation (2005) 47 (‘Congress carefully prescribed that funding system to keep the PCAOB independent both of financing by accounting firms and of the political pressures that can come to bear on regulatory bodies that rely on federal appropriations’: at 54).

\(^1\) Ibid, 57.
As such it displays many of the features associated with the accountable governance approach to regulation outlined in this report. It provides a concrete example of how to achieve this and, in so doing, helps to restore consumer confidence. It delineates the duties and responsibilities as well as the rights of each participant in the regulatory conversation. It does so within an integrated framework. It focuses less on formal structure and more on how ongoing dialogue can and should be linked to definable agreed objectives and measurable outcomes.

Reform of the magnitude necessitated by the GFC cannot be imposed by administrative fiat. It must be negotiated. Commitments entered into by the industry association(s) and the regulatory authorities must not only be honoured, but also seen to be. This requires, in turn, an emphasis on the constitutive as well as managerial, performative and regulative dimensions of accountability highlighted above (see Figure 3 above). It also requires an acceptance by the regulatory authorities that formal recognition of professional bodies provides an additional supporting pillar rather than a threat of capture.

**Conclusion**

Given the risks associated with the provision of flawed advice, it is questionable whether it is sustainable to devolve authority to voluntary professional self-regulation or employer-led regulatory authority without mandating that accreditation meets the highest standard available. Secondly, the negotiation process should place current standards as the floor of professional obligation, not the ceiling. Thirdly, any credible attempt to set up a professional standards board in the Australian context – inside or ASIC or independent of it – requires cooperation in a manner that deals conclusively with not just the quality of the advice but also the purpose of the product and the degree to which professional bodies themselves provide guidance to their members about what constitutes personal responsibility to clients for recommending those products. How then should Australia move forward? It is essential that the ethical component of professional obligation is stressed and accreditation is based on demonstrated capacity to advance that objective. To do otherwise is to lose momentum at precisely the same time as sections of the industry are prepared to countenance paradigmatic change. It is an opportunity we cannot afford to lose. For that reason this report recommends a partnership model of oversight in which each actor commits to adherence to the spirit as well as the letter of the accountable governance framework.