Market Failure, Regulation and Education of Financial Advisors

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Abstract
This paper explores the recent series of financial scandals in the Australian financial advice industry. It examines the causes, consequences and responses to theses scandals by financial institutions, investors and regulators through the lens of relevant finance theory and extant literature. Although the paper focuses on the recent Australian experience the discussion and findings presented are of relevance to financial market regulation worldwide. It is proposed that a combination of compensation, education, training and structural reforms are required to reduce the undesirable effects of information asymmetry, adverse selection and moral hazard in the finance sector.

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INTRODUCTION

Many retail investors seek the assistance of financial advisors to acquire or confirm information on which to make an informed investment decision. Financial advisors promote a variety of products to their retail clients but their detailed knowledge of those products can vary greatly as can their promotion of certain products over others. Financial advisors may be independent from, work for, or be associated with various product originators. The nature of the relationship between financial advisors and product originators may impact on the extent and quality of information advisors have and their motivation to promote the originators' products. Those who originate financial products have greater knowledge about their products than advisors and advisors in turn have superior knowledge to investors. The difference in information, or Information asymmetry, exists between service and product originators and consumers in all service and product markets to varying degrees but is particularly pronounced in financial markets (Brealey, Leland and Pyle 1977). The asymmetry causes a lack of efficiency in the price and quantity of goods and services and leads to inefficient allocation of resources and adverse selection of products by retail investors (Bebczuk 2003). To reduce information asymmetry in financial markets governments fund financial literacy programs and regulate consumer product information. Governments also address information asymmetry between product originators and advisors by setting educational and training standards of advisors. Despite the best efforts of government, however, cases of financial loss caused by inappropriate advice by financial advisors and product selection by consumers continue to proliferate.

The efficient functioning of financial markets is also affected by moral hazard, where one party creates risk and another party bears the cost of the risk if things go badly (Krugman 2009). The case of Westpoint provides a relevant Australian example of moral hazard in financial markets. Financial advisors received up to ten per cent commission for selling Westpoint's mezannie products, compared with an average commission of two percent in the industry (Westerman, 2006). Those who created and promoted the high risk investment products profited while loses were incurred by investors in the company and its investment products.

This paper analyses the factors underlying recent scandals involving Australian financial service firms including industry structure, culture, regulation and enforcement. Fundamental to such an analysis is an examination of how these factors relate to the principles of information asymmetry, adverse selection and moral hazard. The aim of such an analysis is to propose strategies to better protect consumers.

The paper is divided into six parts. Part 2 of this paper provides a review of relevant literature on regulation of financial advice, financial literacy and compensation. Part 3 describes methodology employed in this paper. Part 4 provides a synopsis of the recent Australian financial advice scandals. Part 5 provides a discussion of the Australian scandals in the light relevant regulation and literature and part 6 provides concluding comments and policy implications.

1. MARKET FAILURE AND FINANCIAL ADVICE

Zitzewitz (2014) discusses the sources of market failure which create an economic rationale for regulation, in particular information imperfections, that give rise to agency conflicts, and potential behavioural limits on investor processing, monitoring and oversight. Zitzewitz (2014) notes a recurring pattern of market and regulatory failures in financial markets, including the 2008 financial crisis. Accordingly regulatory issues involved in market failure in the US finance industry were found to centre on compensation, disclosure, antitrust policy and

agency regulation. The same issues that Zitzewitz notes as present in the US are also present in Australia and other markets as will be discussed below.

One of the frequently raised issues in discussions of regulation of financial advice involves compensation of financial advisors. Robinson (2007) considers the advantages and disadvantages of the three main models of compensation. The traditional commission based compensation model has an inherent conflict of interest between advisors and clients in that advisors receive commission regardless of how investments perform. There is therefore an economic incentive for advisors to direct investors toward products paying the highest commissions, even if they are not the most suited for that investor. Robinson (2007) observes that US financial advisors argue this is not problematic because the US financial services industry is competitive. Faced with losing clients, advisors will forgo short term financial gain. Nevertheless Robinson (2007) notes that there has been substantial criticism of the model.

Robinson (2007) also identifies that the asset fee based model, where advisors' compensation is based on the value of the portfolio, provides some perverse incentives. Under this model there is an incentive to advise clients against reducing assets under management and little incentive to advise against reducing debt, investing in non-managed assets such as property or holding liquid assets.

The third of the three models presented by Robinson (2007), the flat fee model, has been widely discussed in Australia as a panacea for the inherent conflict associated with commission models. The flat fee model allows advisors to be compensated for their advice. Robinson (2007) argues that, while it may be more objective than other models, advisors have no incentive to monitor the performance of investment decisions and may overstate the amount of work done to increase their compensation.

Irrespective of compensation arrangements advisors may still engage in activities which increase their own wealth. Appropriate regulation is needed to reduce the potential for, and impact of, unethical practices and behaviours. McGillivary and Fung (2013) proposed that without proper ethical behaviour a sound financial system is not sustainable and that only a finance industry that does no harm to society can successfully fulfil the profit-maximizing motive.

Standards of ethical and professional conduct have implications for how financial planning is viewed publicly. Murphy and Watts (2009) considered whether financial planning in Australia is an industry or can be considered a profession. They developed a set of attributes of professionalism derived from extant literature, including public / societal responsibility, a systematic body of theory, professional authority and ethical responsibility, and interviewed 78 financial planners to provide attitude statements relating to the attributes. Analysis of the statements failed to show a satisfactory level of professionalism for any attribute indicating that financial planning had not yet developed into a profession. Further, Bruce and Gupta (2011) suggest that minimum training standards set by the Australian regulator have allowed private education providers to capture the training and education agenda away from the profession with the result that financial planning in Australia could be described as an industry rather than a fully fledged profession. The status of the financial planning function has clear implications for attracting professionals and how those working in the sector see and conduct themselves.

Governments regulate the disclosure of product information but also consumers to take greater responsibility for their own financial decisions than ever before. Worthington (2006) amongst others notes low levels of financial literacy exist across the Australian community echoing findings in other countries (Calcagno and Monticone 2015). The low level of financial literacy across households suggests that they are at risk of making suboptimal financial decisions or that they may, in the face of complex or difficult financial

situations, chose to do nothing or use non professional sources of information such as the internet (Bruhn and Miller 2014). The consequences of doing nothing or relying on inappropriate information may be detrimental to their financial health.

International studies find financial literacy is highly correlated with basic literacy and numeracy (Agnew, Bateman, and Thorp 2013) and that the disadvantaged, poorly educated, immigrant and elderly all have low levels of financial literacy (Lusardi and Mitchell 2014). Further, Finke (2005 p.53) argues that most financial mistakes are made by investors who are likely to be less educated and less wealthy and "perceive the highest cost to financial education or the least benefit". The implication of this is that the welfare system may bear the cost (or a major cost) of the lack of effective financial education with the poorest incurring losses and becoming increasingly welfare dependent. As Finke (2005 p.54) notes, the welfare benefit of increased financial education and regulation is "immense".

Governments spend considerable amounts of money on financial literacy or financial education programs. Braunstein and Welch (2002) note that such programs can provide benefits particularly when they have discrete objectives. However, more recent studies have cast doubt on the benefits of financial literacy programs generally. Research by Willis (2008), Cole and Shastry (2009), Hathaway and Khatiwada (2008), Willis (2009) and Gale and Levine (2010) fails to confirm a causal link between financial education, financial literacy, improved financial behaviour and improved financial outcomes. Mandell and Klein (2009) found US school students who completed a personal financial management course were no more financially literate than those who had not. Further, Willis (2008 p.10) notes that firms sometimes use financial education as a vehicle to sell products because they fear other forms of regulation if they can "not point to financial education as the cure for consumer financial woes". Indeed Willis (2008) proposes that pursuing financial education may be based on fallacious arguments and premises. She notes effective financial education is extremely costly due, firstly, to low existing levels of financial literacy, secondly, to complexity of financial decisions and heterogeneity of consumer circumstances, thirdly, to rapidly changing demographics and product offerings and, fourthly, to imbalance of power between industry and consumers. Given the variability of investor preferences, experiences and backgrounds "financial education would need to be extensive, frequent, and personalized for each consumer" (Willis 2008 p.5) and the price to individual consumer time would be enormous. While there are many free programs providing financial education these are often seldom used (Brown and Gartner 2007) and those who participate in such programs are generally better educated and have better financial literacy than those who do not. Hence Willis (2008) notes that to lift financial literacy generally would necessitate making financial education personalised and mandatory which in all likelihood would be politically untenable and financially unviable.

Our brief examination of the literature highlights the role compensation, ethical practice, disclosure and financial literacy play in contributing to consumer loss from market failure. Against this background we identify recent regulatory changes with the aim of examining how they address the underlying causes of failure and consumer loss.

2. METHODOLOGY

To examine the causes and consequences of scandals involving financial advisors in Australia we adopt a content analysis approach. Content analysis involves the systematic identification of themes, images or concepts within a series of media through the use of content categories enabling a more objective evaluation than comparing content based on the impressions of the researcher (Sarantakos 1993).

We searched the Factiva online news archival system using multiple search terms including 'financial advisor', 'financial planning' and 'ASIC' (Australian Securities and Investments Commission) for articles published over the last decade. Factiva incorporates 276 Australian publications covering all States and includes newspapers, industry journals, magazines and industry reports. It incorporates the two dominant media publishers in Australia and accounts for over 90 percent of the daily newspaper sales. The concentrated nature of media ownership in Australia, and common practice of reprinting news items throughout media groups, validates the use of these online sources.

We also searched the media releases on the ASIC website for information concerning the scandals involving financial advice and advisors. This allowed us to confirm details presented in the media and add extra relevant detail.

3. RECENT HISTORY OF AUSTRALIAN FINANCIAL ADVICE SCANDALS

The Australian finance industry is highly concentrated with various estimates suggesting that around 80 per cent of the industry is owned/managed by the "Big 5" institutions the four major banks (ANZ, CBA, Westpac and NAB) and insurance company AMP. Forbes magazine recently put the four largest Australian banks within the largest 25 banks in the world (Chen 2015). Each of these institutions operates numerous financial service businesses including those providing insurance and funds management; for example, NAB's offers financial advice to customers through its NAB Wealth business. NAB Wealth incorporates MLC, which includes the bank's life insurance and superannuation businesses, stockbroker JB Were, financial planning through firms Meritum, Garvan and Godfrey Pembroke, and the NAB-branded financial planning network.

In recent years there have been a number of scandals involving the loss of customer money by improper, unethical and sometimes illegal activities at leading financial service firms, including those controlled by the major Australian banks including CBA, NAB and ANZ. Other smaller but not insignificant businesses have also engaged in activities which resulted in retail investors incurring substantial losses. The names of the companies involved, such as Storm Financial, Westpoint, Opes Prime, Trio/Astarra, and Sonray Capital, have gone into Australian financial service folklore.

Table 1 lists details of several of the more notable scandals. As the information in the table indicates, the number of investors and amounts involved has been substantial.

The ultimate sanction imposed on Australian financial advisors is to receive a ban on providing financial advice from the corporate regulator, ASIC. The ASIC website (www.asic.gov.au) provides details of banned financial advisors including the reasons for the ban and length of ban. During the 5 financial years commencing July 2010 56 advisors were banned from operating by ASIC. Table 2 indicates the major reasons for receiving a ban. The three leading reasons for receiving a ban were: misappropriation or theft of client money (cited on 17 occasions), making false or misleading statements in a material particular (cited on 16 occasions) and inducing clients to invest in certain products by making false or misleading statements (cited on 15 occasions). Often the cases involving theft of client money resulted in the advisor being convicted and jailed. Other reasons for banning include operating without a proper licence, failing to provide a reasonable basis for making a decision and conducting unauthorised transactions. While the length of ban varied, 31 of the 56 banned advisors received a permanent ban. The figure quoted must be interpreted with caution as many financial advisors left their employment when their employer uncovered irregularities in their conduct. In addition several other advisors received enforceable undertakings orders from ASIC (ie to undertake formal approved study). Many of the banned advisors were involved in several of the high profile scandals while others worked independently or worked for smaller firms.

Table 1 Details of notable financial scandals involving Australian financial service firms

Year	Licensee name	Est. no. investors and total amount involved	Issues involved	Resolution
1993 - 2007	Storm Financial[i]	3,000-4,000 investors, $3 billion	Inappropriate advice encouraging clients to make highly geared investments.	$400 million (approx.) settlement with 1,500 clients.
2004-2006	Westpoint[ii]	3,524 investors, $388 million	New investor money used to service existing investments. Planners encouraged clients to make bad investment and promoters kicked back commissions to planners in return	$160-$170 million recovered for investors. CFO convicted and put on a 18 month good behaviour bond.
2003-2008	Opes Prime[iii]	600 investors, $631 million	Investors advised to buy geared share portfolios and assign beneficial ownership of their holdings to Opes. Opes' lent on behalf of ANZ and Merrill Lynch and took ownership of the scrip provided as collateral. Opes then lent that stock for a fee to short sellers, along with stock provided by institutional investors for a fee. Clients thought they owned share ended up losing their investment.	Settlement of $253 million and return of around 40 cents in the dollar to creditors and investors. ANZ has agreed to improve compliance in various areas including reconciliation, compliance processes and risk management. 2 directors jailed.
November 2005 and September 2009	Trio/Astarra[iv]	$180 million	Trio was the trustee of 4 superannuation funds and directed most assets into hedge funds located in the Caribbean. There is little evidence that the purported investments were actually made. Most of the money invested was lost.	11 advisors jailed, banned, disqualified from managing companies or agreed to remove themselves from the industry for a total of more than 50 years.
2003-2010	Sonray Capital[v]	3,000 retail clients, $46 million	Theft, fraud and false accounting.	4,500 affected Investors to received 2/3 of their money back. Founder sentenced to six and a half years in prison.
2006-2010	CBA[vi]	Unclear but reports up to $300 million	Key finding of the senate inquiry include: • Unethical and dishonest conduct and breach of duties of a number of advisers working at CFPL. • CBA's compliance regime failed allowing unscrupulous advisers to continue operating.	1,100 investors received $52m in compensation and CBA agreed to enforceable undertakings.
2003-2013	ANZ[vii]	N/A	ANZ Prime Access wealth package give customers priority access to financial planners, investment	8,500 customers compensated $30m in total and 2 advisors dismissed.

			monitoring alerts, and a documented annual review. ANZ failed to provide review to all customers.	
To 2014	NAB [viii]	Unknown	Inappropriate advice and practices and serious repeat compliance issues as well as cases of forgery of client signatures and file reconstructions.	37 planners sacked (5 reported to ASIC), compensation payments to 700 customers totalling between $10 and $15 million

All monetary figures are in Australian dollars.

Table 2 Financial Advisors Banned by ASIC

Issue	Number of advisors
Misappropriated client money / theft	17
Making statements that were false or misleading in a material particular	16
Inducing clients to deal in financial products by making statements or forecasts that were misleading, false or deceptive.	15
Failing to have a reasonable basis for advice	13
Failing to provide statements of advice	9
Forged client signatures	5
Operated without licence	5
Became bankrupt	5
Failing to provide product disclosure statements	4
Failing to provide additional information when recommending the replacement of one financial product with another	4
Provided false trading and performance reports	4
Falsified documents to earn commissions	4
Used clients' money as collateral for his personal trading account without their authorisation.	3
Failed to maintain adequate records of advice	3
Unauthorised trading	3
Failed to act on client advice	2
Allowing clients early release of superannuation	1
Failed to invest the money as agreed	1
Failed to repay the balance of the proceeds to the investors	1

An examination of the more notable scandals identified in Table 1 highlights the issues involved. For example, Storm Financial promoted highly geared investments to clients even when such a strategy was inappropriate given the circumstances of the client. In late 2008 / early 2009, Storm Financial collapsed costing some 14,000 investors A$3 billion (St John 2011). Macquarie Bank and CBA were involved in the Storm collapse by providing margin loans to Storm customers. In subsequent legal action and ASIC investigation CBA was found to have failed to issue timely margin call notices which ultimately led to many clients passing through their margin call trigger points and ending in negative equity (Storm Financial n.d.). Resulting litigation against CBA by Storm's former clients ended in an estimated $270 million being paid out by CBA in 2013 (ASIC 2013).

While the Storm collapse was playing out, a scandal involving CBAs own financial planning division Commonwealth Financial Planning Limited (CFPL) was developing. ASIC received warnings as early as October 2008 regarding a rogue planner operating within the bank, although the regulator delayed investigating the allegations for the next 16 months (Ferguson and Vedelago 2013). In 2013, the Australian media reported severe misconduct involving financial planners at CFPL, a systematic cover-up by management, and inadequate offers of compensation to complaining customers (Ferguson and Vedelago 2013). CFPL profited over many years from the lucrative commissions earned on risky investment products pushed hard by management and financial planners alike. In reference to the CBA

case Greg Medcraft, the Chairman of ASIC, noted a CFPL culture focused only on short-term gains and profit as underpinning poor conduct (Rose, Eyers and Moullakis 2015). Allegations were bought to light in the media by a former employee and eventually triggered a bipartisan Senate inquiry (Commonwealth of Australia 2014a). The Senate inquiry noted:

> "Advisers deliberately neglected their duties and placed their personal interests far above the interests of their clients. The assets of clients with conservative risk positions, such as retirees, were allocated into high-risk products without their knowledge to the financial benefit of the adviser, who received significant bonuses and recognition within CFPL as a 'high performer'. There was forgery and dishonest concealment of material facts. Clients lost substantial amounts of their savings when the global financial crisis hit; the crisis was also used to explain away the poor performance of portfolios." (Commonwealth of Australia 2014a xviii).

After the scandal involving CFPL became public, the Senate's Economics Legislation Committee questioned ASIC about the CFPL matter and was clearly dissatisfied with ASIC's response. The Senate's economic references committee accused ASIC of missing or ignoring persistent signs of wrongdoing and characterised it as a "timid, hesitant regulator" that was prepared to accept assurances from the bank that there were no grounds for intervention (Hurst and Chan 2014b). In its defence, ASIC CEO Greg Medcraft said that the regulator had just 30 staff available to monitor 40,000 financial planners. It was also noted that the 2014-15 ASIC budget "has been reduced by $120 million" (Kirkland 2014).

> "The emerging revelations about the misconduct of financial advisers in CFPL and ASIC's failure to provide satisfactory answers in relation to this matter to the Economics Legislation Committee was the main catalyst for the (Senate) inquiry" (Commonwealth of Australia 2014b p.6).

The final report of the Senate inquiry accused CBA of deliberately playing down the seriousness and extent of past problems within its financial planning division in an attempt to avoid ASIC scrutiny, contain adverse publicity and minimise compensation payments (Hurst and Chan 2014a). In response, CBA claimed to take the past events "very seriously" and had "worked openly and transparently with the Senate committee and ASIC throughout the inquiry" (Hurst and Chan 2014b). As a result of the publicity surrounding the CBA the CEO of the bank, Ian Narev, issued an apology to CFPL clients and offered them a full and open review of every portfolio.

Both CBA and ASIC investigations of the events discussed in the inquiry revealed numerous issues, however they reached differing conclusions about the scale and seriousness of the issue. When a CBA internal review of the quality of advice given to customers was compared to ASIC's evaluation it appeared that the CBA applied a much lower benchmark for what constituted acceptable quality. Of the 38 advisors whose advice was adversely assessed, only 12 were dismissed by the bank and it was noted that 20 of the 38 had generated over $120 million in gross sales (Ferguson 2014).

Issues involving the ANZ bank revolved around a financial product called "Prime Access" which it offered to around 15,000 customers from 2003. Prime Access was a fee-for-service package that included access to financial planners, investment monitoring alerts and an annual documented review of their financial situation. Many clients received only some of the services but were fully charged regardless of what they received (Ferguson 2015b). Despite ANZ indicating it would pay $30 million in compensation to around 8,500

customers, global wealth chief executive, Joyce Phillips, said the bank did not find any "systemic" problems in its advice function.

The scandal involving NAB came to light when an internal report was published by the media. The report noted "We have suspended, terminated or ensured resignations of 31 NAB financial planners and aligned advisers over the past two years due to conflicts of interest, inappropriate advice, inappropriate practices or serious repeat compliance breaches" (Ferguson and Williams 2015). The report identified that there had been cases where planners had forged clients' signatures and manipulated clients' files in attempts at covering up poor compliance. Rather than being detected by the bank's internal controls, issues had come to light through complaints from clients or queries by regulators (Ferguson and Williams 2015).

4. DISCUSSION

There are several factors common to the scandals that have hit the industry in recent times. These factors include inappropriate remuneration structures driving sales of unsuitable products, poor management, and lack of experience in managing complex people, systems and processes as well as inadequate compliance oversight. Further the culture of the organizations involved has been questioned.

Following several financial scandals involving the financial advice industry, an Inquiry was launched by the Parliamentary Joint Committee on Corporations and Financial Services (PJCI). The findings of the committee were released in November 2009, with recommendations that involved regulation, training, education, professional standards, and adviser remuneration. In July 2012, the then federal labour government introduced regulatory reforms based on these recommendations known as the Future of Financial Advice (FOFA) reforms. The legislation amended the Corporations Act and introduced:

- A prospective ban on conflicted remuneration structures, including commissions and volume based payments, in relation to the distribution of and advice about a range of retail investment products.
- A duty for financial advisers to act in the best interests[4] of their clients, subject to a 'reasonable steps' qualification, and place the best interests of their clients ahead of their own when providing personal advice to retail clients.
- An opt-in obligation that requires advice providers to renew their clients' agreement to ongoing fees every two years.
- An annual fee disclosure statement requirement.
- Enhanced powers for ASIC (ASIC 2015).

FOFA added to and amended existing legislation covering the activities of financial advisors which are regulated by ASIC. Despite the scandals such as that involving CBA, in March 2014 the incoming Coalition government attempted to dilute the FOFA reforms. In response, Labour Senator Dastyari and independent Senator Xenophon organised a "coalition of common sense" which bought together Labour, the Greens and independent Senators Lambie, Madigan and Muir to vote down the Coalition's FOFA wind back.

Current licensing and training requirements of financial collapse in Australia can be traced back to the Financial Services Reform Act (2001) and subsequent release of Policy Statement 146, known as 'Regulatory Guide 146: Licensing: training of financial product advisers' (RG146), by ASIC. In order to provide financial product advice in Australia,

[4] For a detailed discussion and analysis of the 'best interests' duty see Bruhn and Miller (2014).

advisors are required to meet the educational and professional experience requirements specified in RG 146.

RG146 establishes set minimum training requirements in the context of product advice with a basic RG146 course to qualify as a financial planner often taking less than eight days to complete in an open-book, non-supervised environment. and most financial advisers receive their training by private providers in the vocational training sector (Bruce and Gupta 2011). Bruce and Gupta (2011) argue that the lack of higher education qualifications among the majority of the trained financial adviser workforce is an impediment to the development of a financial advice profession in Australia.

The largest professional association representing financial planners and advisors in Australia, the Financial Planning Association (FPA), offers the CFP Certification Program. The program comprises five units; two of which are compulsory (one of which is ethics) while the other units focus on technical and strategy development. Candidates may get exemption from non compulsory units if they have completed accredited studies in an approved post-graduate level program. There are several FPA accredited financial planning courses offered by Australian universities which meet the requirements of RG146. The FPA has set a requirement of a bachelor's degree as the main entry point for its CFP Program. While the FPA is the dominant industry association, a significant proportion of the industry are not FPA members and do not have degree qualifications.

RG146 training as delivered by vocational training organisations has been subjected to criticism particularly in relation to widely reported cheating on exams. For example, in CBA’s West Australian division, two experienced planners were dismissed in 2014 for having junior staff sit tests for them (Ferguson 2015a). More recently, an investigation by ASIC into fund manager IOOF revealed that head of advice research, Peter Hilton, had junior staff complete training modules (online training modules from private vocational training provider, Kaplan) on his behalf as well as compliance training. (Ferguson 2015a).

One issue not addressed by the Senate inquiry or proposed reforms relates to the structure of the Australian financial system. The central feature of the Australian Financial Services Industry is the "vertically integrated" model which allows banks to both create investment products and sell them through their financial advice networks mainly to their customers. ASIC has indicated that there is an "inherent" conflict of interest within this model and the recent Financial System Inquiry report (Commonwealth of Australia 2014a) called for vertical integration to be actively monitored. Industry concentration and vertical integration together raise the spectre of excessive risk taking and moral hazard particularly in the absence of a well resourced and committed regulatory regime.

Following the Senate Inquiry the Australian government initiated an inquiry into the Financial System (Commonwealth of Australia 2014b). The inquiry acknowledged that effective disclosure and financial literacy were necessary but not sufficient to deliver satisfactory consumer outcomes. It also acknowledged the need for improved firm culture. The Chairman of the Inquiry, David Murray (Murray 2014) noted "Our recommendations are not meant to absolve consumers of responsibility for their choices or insulate them from market risk. Rather they are intended to reduce the risk of consumers being sold poor quality or unsuitable products". The problem remains thought that recent financial scandals have involved the theft of client money and even forgery. Court cases and compensation schemes can take considerable resources and time and may only provide partial compensation. Banning advisors may help remove rogue elements and dissuade others from following provided the regulator is adequately resourced and determined.

5. CONCLUSION AND POLICY IMPLICATIONS

While commission based compensation models may work in competitive markets such as the US, the Australian financial services industry is highly concentrated and not as competitive as the US and other markets. Hence the flat fee model is being proposed as better and less conflicted alternative. As Robinson (2007) notes however, all compensation models have limitations.

The cases of fraud and theft of investor money described earlier would in all likelihood not have been stopped by changing compensation models or improving advisor education and training. Despite financial planning training courses incorporating elements of ethical practice, examples of unethical behaviour continue. There is little empirical evidence that ethics training and education can change the behaviour of people. Are improved methods of recruitment and selection of staff needed?

The highly concentrated and vertically integrated Australian financial services industry has developed over time with successive governments allowing (in most cases) the four major banks to acquire smaller banks, fund management companies and insurers over many years. AMP has survived due to its status as the major life insurance provider in Australia. It could be argued that the dominance of the major financial institutions in the market, and the moral hazard this has created, has manifested in a culture of excessive risk taking. Banks can effectively "bet the ranch" and take excessive risks with depositors money in the knowledge that any investigation into potential wrong doing will take years, that the regulator, ASIC, is under resourced, and that penalties for misconduct are perceived by many to be relatively trivial. In the unlikely event an investigation results in a prosecution the question remains whether the size, severity and scope of penalties are sufficient to provide an effective deterrent, particularly considering that the major organisations that dominate the industry have balance sheets in the billions.

A partial solution to the inherent conflict of interest which exists may lay in the introduction of a US style Glass–Steagall Act or antitrust legislation where retail and commercial banking activities are separated. Breaking the connection between product originators may be a necessary step in changing the culture of the financial advice industry. The political reality is that the Australian banks collectively and individually have immense political power and such regulatory change may be difficult. Some time ago Zingales (2004) wrote in relation to the US managed funds industry "it is difficult to see how this ideal regulation could emerge from the political process, which tends to be dominated by incumbent funds" this same argument could be extended to Australia's highly concentrated financial services industry.

Information asymmetry exists in the relationship between the product originators and financial advisors as well as financial advisors and their clients. Advisors need appropriate training and education while consumers of financial services need to be better informed to reduce information asymmetry. Addressing the financial literacy of advisors through higher mandated educational requirements would appear to be an appropriate positive step. While the benefits of financial literacy training have been questioned there appears to be consensus that basic literacy and numeracy are positively correlated with financial literacy. Improving basic literacy and numeracy is particularly important as those with less education have been identified as being more likely to make financial mistakes than highly educated individuals. Improving basic literacy and numeracy at a school level would necessitate increased funding to less advantaged (mainly government / public) schools but this too is a political 'hot potato'. Financial counselling may also have a role in the case of adults with low literacy and numeracy levels who face a financial crisis and need immediate assistance.

The Australian government has now endorsed all but one of the recommendations of the Financial Systems Inquiry report (Commonwealth of Australia 2014b). Financial advisors will now be required to have minimum degree qualifications, membership of a professional association and adherence to a code of conduct along with completion of a professional year prior to registration. The government will also introduce legislation to make the issuers and distributors of financial products more accountable. They have also announced that they will develop legislation to give ASIC the power to ban individuals from managing financial firms, and that they will consult on strengthening ASIC's enforcement tools in relation to the financial services and credit licensing regimes. While these initiatives as well as those under FOFA go some way to addressing the underlying issues causing the enormous losses to consumers in recent years, they do guarantee the will to investigate and prosecute wrongdoing. Neither do they enhance the financial decision making ability of the most vulnerable consumers or address the underlying structural issue of the vertically integrated model at the heart of the industry. Without changes in this respect the risk of information asymmetry, adverse selection and moral hazard and their consequences persist.

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