Financial ethics must come from within

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The Commonwealth Bank of Australia's financial planning scandal provides the perfect opportunity to explore the enduring question of ethics in financial services.

Thousands of CBA clients have suffering from the actions of a handful of wayward financial advisers. The advisers were encouraged by the combination of aggressive revenue targets and conflict of interest. Overlaid across that volatile mix was the failure of the people involved to have personal ethical standards. They put their own greed and self interest ahead of their clients.

They acted badly and, in some cases, illegally, despite tough provisions in the Corporations Act governing their behaviour. That echoes the systemic problems in the global financial system leading up to the global financial crisis.

Banks in the United States, United Kingdom and Europe were, to a large extent, covered by the same rules and regulations as those covering Australian banks.

They were playing by the same rules but, thanks to good prudential supervision and sound corporate governance, the Australian banks came through the crisis relatively unscathed. The US, UK and European banks went off the rails because of the failure of ethical standards and lax governance at board level.

Nevertheless, governments around the world responded by cranking up regulatory oversight. Thousands of new pages of regulations have been created to deal with ethical failure.

This process-driven and legalistic approach to forcing staff at financial institutions to do the right thing is becoming commonplace in Australia.

You can see it happening with the changes to the Future of Financial Advice.

At the core of the intense debate about FoFA is the assumption that a whole new set of regulations will somehow close every loophole and lead to a new era of business ethics in financial advice.

It is heartening that the chief executive of the CBA, Ian Narev, understands that this is not the way to run an organisation and said as much at a media conference this week.

“I am not going to rely on regulators to try and make this business a highly ethical, high integrity business, that is a fundamental part of my job,” he said.

“Now, I understand why regulators are there to challenge us, to make us think about things we have not thought about, but I certainly do not see them as the substitutes for leading an organisation well and ethically.”

Of course, it will not have escaped those who are familiar with the financial services industry that neither Narev or his predecessor Ralph Norris were willing to be pioneers in removing the barriers to delivering ethical financial advice.

Throughout the period that CBA’s dodgy planners were ripping off clients, the bank’s remuneration revolved around selling products to generate commission.

That business model helps maximise sales of products manufactured by the bank. But it is fundamentally flawed.

CBA recognised long ago that there was little money to be made from leading the industry in reforming commission-driven advice. Its major rival, the National Australia Bank, took a leadership position in 2006 under the then head of its MLC wealth management division, Steve Tucker.

In a seminal speech to a CEDA lunch in May 2006, Tucker revealed that MLC financial advisers would forthwith be paid a fee for advice. They were motivated to provide the best advice and not to maximise commissions on product sales.

At the time he said: “Any system that pays an adviser more for one particular product over another has the potential to influence the advice outcome and may not be in the best interests of the client.

“This practice is wrong and should not be defended.”

However, the decision prompted hundreds of financial advisers to leave MLC. They went to competitors who had no qualms about making the sale of products the priority when advising clients on a financial plan. The exodus of advisers had a negative affect on product sales at MLC.

Its financial performance suffered from Tucker's decision to take the high moral ground. Not surprisingly, no other bank joined the ethical party.

Tucker has since moved on to a second career as a non-executive director. But he maintains a strong interest in financial services and its ethics.

He is a board member of the Banking + Finance Oath (BFO), which allows individuals working in the financial services industry to agree to adopt an oath that includes a set of ethical principles.

It has a range of declarations such as: I will serve all interests in good faith; I will speak out against wrongdoing and support others who do the same and my word is my bond. At an institutional level, banks such as CBA try to capture the ethical obligations through clauses in remuneration systems. Monetary penalties now face CBA financial planners who don't act in the best interests of clients.

However, Chanticleer agrees with BFO board member and Association of Superannuation Funds of Australia CEO Pauline Vamos, who says it is time to switch the conversation away from a rules based approach to lifting standards and talk about what is the required ethical behaviour and how can we hold each other accountable.

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