

# Conceptualizing financial advice in Australia: The impact of business models and external stakeholders on client's best interest practice

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## Abstract

Many individuals entrust financial advisors to navigate through important financial decisions, yet extant research and persistent scandals bring the effectiveness of advice into question. In examining the Australian financial advice sector, we determine when financial advice can be provided in a client's best interest and formulate a model differentiating types of financial advice and their relationship to best interest practice. We extend this model to form an integrated framework considering external stakeholders that encourage, and business models which prevent, best interest practice. Our examination reveals some business models prioritize financial institution interests whilst thwarting external stakeholders encouraging best interest practice. © 2019 Academy of Financial Services. All rights reserved.

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## 1. Introduction

Because of an aging population and increased longevity, the responsibility of being financially stable in retirement has moved from the state to the individual and is illustrated by a decrease in state funded pensions with an increase in mandatory personal retirement accounts (Holzmann, 2013). Creating a sound financial plan is difficult when considering the complexity of ones' life and the myriad of financial products available. Professionals, such as the financial advisor<sup>1</sup>, have a fiduciary duty—or a duty to act in a *client's best interest*—

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when they provide services to navigate through financial decisions and in doing so mitigate or avoid risking conflicts of interest. Yet, the financial advisors providing advice are employed or remunerated by financial institutions that have differing and arguably conflicting interests; and, in particular, financial interests in attaining consumers of the products they create. As such, financial advisors are inherently caught between acting in a client's best interest and their own interests, or the interests of financial institutions.

This research investigates the extent to which financial advice in Australia can be provided in a client's best interest. We address this from a contextual perspective, where we identify the impediments and enablers of financial advisors achieving *client's best interest practice*. This research investigates dimensions that distinguish types of financial advice, the business models used in providing financial advice and external stakeholders in the Australian financial services industry that may induce or mitigate prioritizing a client's best interest. In order to address these topics, we conducted a qualitative study encompassing content analysis, in-depth interviews and triangulation. Firstly, the content analysis included analyzing Australian government inquiries into financial advice (Parliamentary Joint Committee on Corporations and Financial Services (PJCCFS) inquiries). Then in-depth semi-structured qualitative interviews were conducted with financial service professionals to test the validity of our findings emerging from the content analysis. Finally, results were then triangulated with an Australian Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (henceforth referred to as 'Royal Commission'). Using these data, we conceptualize financial advice, and its purported conflict, in relation to acting in a client's best interest.

The contributions of this article are threefold. Firstly, we develop a general model of best interest practice in financial advice, showing the extent to which a client's best interest can be prioritized is due to the *Orientation* of advice (product advice or personal advice) and *Alignment* of the advisor (integrated with or independent from product providers). As such, this model conceptualizes the differing forms of financial advice and clarifies which type of advice can prioritize a client's best interest.

The second contribution addresses the dearth of understanding through the inclusion of the contextual environment that influence financial advisors. Extant research is largely international and shows presence of conflicts (Foerster, Linnainmaa, Melzer, & Previtero, 2017; Hackethal, Haliassos, & Jappelli, 2012; Hoechle, Ruenzi, Schaub, & Schmid, 2018), but simplifies explanation of contextual issues of financial advisors work to remuneration (Angelova & Regner 2013). While remuneration influences how financial advisors operate, this article argues that an understanding of the Australian business models in which financial advisers operate in, as well as external stakeholders that impose numerous levels of regulation and influence upon the financial advisor, are necessary. We find that within the Australian context, business models and external stakeholders can enable or inhibit the ability of a financial advisor to act in a client's best interest.

The third contribution of this article is the articulation of the interaction between the nature of advice provided, the business models and external stakeholders. This is explained through the development of a holistic and integrated framework. The framework illustrates how initiatives by external stakeholders aimed at achieving client's best interest practice are impeded by certain business models. As such, this framework offers more meaningful

insights and implications for policymakers, financial planners, and clients by conceptualizing where initiatives should be targeted to effectively influence changes in the financial advice industry in Australia. Therefore, this article offers timely clarity on current Australian initiatives that are thwarted by structural barriers and, therefore, are at risk of becoming blunt tools of change.

The remainder of the article is structured as follows. Next is a review of the literature on financial advice and client's best interest. After this, the research objectives and methodology are outlined. Next, the findings are outlined in three sections: a general model of a client's best interest in financial advice, three business models in financial advice and the external stakeholders influencing best interest practice. Finally, this analysis is brought together through an integrated framework, followed by concluding comments.

## 2. Literature review

### 2.1. Conceptualizing the “financial advisor” in respect of financial advice

#### 2.1.1. The scope of the “financial advisor”

Our article purposely uses the holistic term of “financial advisor” to encompass the many occupations and professions that offer financial advice. For example, the following occupations and professions have an element of financial advice in their work: financial planner, investment advisor, wealth advisor, tax advisor, stockbroker, financial product sales agent, mortgage broker, real estate agent, accountant, or lawyer. From this perspective, advice can be considered financial advice if “it is intended to influence a person or persons in making a decision about a particular financial product” (Australian Securities & Investment Commission (ASIC) 2016: 5). Our holistic perspective can be contrasted with a narrower focus, such as on the financial planner alone within the international setting. Warschauer (2002: 204), considered financial planning in particular, noting that “one can be a financial adviser or consultant or give financial advice without being a financial planner, but one is not practicing as a financial planner without the elements of the definition and the process intact.” Our perspective focuses on the outcome of the provision of financial advice, rather than the provider process, and as such captures numerous providers of financial advice. In that sense, both a lawyer and a stockbroker are providing financial advice, but the advice they provide may differ greatly. In doing so, we can “capture the diversity and complexity of financial planning engagement” (Heckman, Seay, Kim, & Letkiewicz, 2016: 442) more broadly.

#### 2.1.2. Client's best interest

An overarching element of financial advice is that clients seek advice to aid in making financial decisions because of an inability to undertake these decisions wholly by themselves. Prioritizing a client's best interest is an element of financial advice because the client is entrusting some aspects of decision making to the financial advisor (Inderst & Ottaviani, 2012b). We use the terminology *client's best interest*, but this is akin to fiduciary duty in

financial services (Boatright, 2000), with the terms used interchangeably in academic literature (Angel & McCabe, 2013) and financial advice practice (Maley, 2018). Boatright (2000: 202) states “fiduciary duties are the duties of a fiduciary to act in that other person’s interest without gaining any material benefit except with the knowledge and consent of that person.”

With this in mind, a client’s best interest duty is obliged in financial advice but has some limitations. Firstly, this duty obscures the type of advice being provided and whether a client’s best interest obligation is enacted. Some advice, such as TV commercials of financial products, by their nature, are presenting information. Yet, this information provider cannot aim to be acting in a client’s best interest as the client’s interest is unknown. However, such information is used to influence financial decisions and should be considered financial advice. Secondly, there is a growing amount of research that suggests that a client’s best interest duty is not being met by financial advisors. However, this reflects an international context and because of local regulatory environments poses issues of generalizability.

## *2.2. An international perspective on conflicts of interest*

Examining the international setting, extant research reveals conflicting effectiveness of financial advice. Relevant research shows that many individuals entrust financial advisors (or financial planners) to help navigate through financial decision making (e.g., within the Italian context: Calcagno, Giofre, & Urzi-Brancati, 2017). However, inconsistency can be seen in the effectiveness of financial advisors and their advice. Foerster et al. (2017) find that on-going commission-based fees charged by financial advisors reduce investment performance for investors in Canada. In Germany, Hackethal et al. (2012) find that portfolio performance of investors who use bank financial advisors is inferior to independent financial advisors. Whilst in Switzerland, Hoechle et al. (2018) find that advised clients incur worse returns than independent clients and that advised transactions focus on mutual funds which are more profitable for the advisor’s employer. These findings can be compared with other jurisdictions, where research advocates the benefits of financial advice in creating less bias, improved returns and more diversified portfolios (Kramer, 2012; Shapira & Venezia, 2001; von Gaudecker, 2015).

Further international research reveals that organizational structure (within a firm) and the local regulatory environment are important in considering the effectiveness of financial advice. Within the U.S. setting, Bigel (2000) finds that a longer tenure as a financial planner is positively related to a decrease in ethical reasoning ability, yet individual incentives (compensation via commission v. fee for service) are not. Mazzoli and Nicolini (2010) compare different compensation structures across the financial advice industries in Italy and the United States. They find that more opaque pricing strategies occur when financial advisors are tied to financial institutions and product providers. Independent financial advisors are more likely to have transparent fee structures and adopt a fee for service style of compensation.

An argument presented to explain why a client’s best interest is not being met is that material benefits (commissions) provided to financial advisors negate this obligation. For example, Inderst and Ottaviani (2009, 2012a) use economic models of financial advice to show the inherent conflicts of interest when incentives from product providers are high. Similarly,

Angelova and Regner (2013) show that truth telling decreases in the presence of commissions. However, material benefits encapsulate some, but not all, of the contextual issues which impede financial advice from achieving client's best interest practice. Šindelář and Budinský (2017) find that commissions do not apply homogeneously in the Czech Republic. In particular, they note that organizational structures need to be considered as the relationship between commissions and quality of financial advice only hold in flat-business structure models (Šindelář & Budinský, 2017).

International literature also suggests disclosure is not an effective method for negating conflicts of interest in financial advice (Chater, Huck, & Inderst, 2010; Rubin, 2015), because trust binds clients to their financial advisors (Gennaioli, Shleifer, & Vishny, 2015). That is, the trust that a client has in their advisors will allow clients to use financial advice when conflicts of interest are disclosed. This is consistent with empirical research in Italy, which shows there is a high level of trust reported by clients of advisors and if a client's trust is higher, they are more inclined to delegate decisions to financial advisors (Calcagno et al., 2017). Calcagno et al. (2017) find that 74% of clients that hold risky assets do not attempt to influence their financial advisors. Out of the 26% investors that do influence decisions, they do so by monitoring (19%), obtaining second opinions (3.4%), or both (3.3%). These results indicate that most clients trust their advisor's financial advice and that they will not enforce a strict client's best interest practice on financial advisors.

Within this international setting, there is a variety of regulatory frameworks and contrasting contextual factors. Therefore, this limits the potential generalizability to the Australian context. Moreover, within the Australian context there is minimal empirical research considering the ethical behavior of financial advisors (Cull & Bowyer, 2017).

### 2.3. *The Australian financial advice industry*

The Australian financial advice industry has experienced rapid growth since 2002, driven by social, cultural, institutional, political and economic factors (Cull, 2009). Following a government inquiry in 1996 (called the *Wallis Inquiry*), Australia adopted an authorized representative governance model to regulate this growing industry (McInnes, 2020). Under this model, an Australian financial services licensee (henceforth called a 'licensee') can authorize a financial advisor to give advice on their behalf and also takes responsibility to ensure that their financial advisors comply with relevant legislation. The effectiveness of this model is under question as extreme market conditions, numerous scandals and conflicts of interests have caused havoc in Australia's financial advice industry (North, 2015).

McInnes (2020) researched the legitimacy of the authorized representative governance model and highlights that problems of independence of financial advisors from product providers have persisted since 2009. McInnes surveyed financial advisors in Australia finding that financial advisors did not report having independence as an authorized representative. This is a critical issue given the importance of financial advisors within the Australian context. Clients often trust financial advisors to navigate complexities within the financial environment, especially when many consumers have low levels of financial literacy (Brimble & Murphy, 2012). Hunt, Brimble, and Freudenberg (2011) find that trust in the relationship between clients and financial planners is critical for relationship quality. A lack of

independence can break this trust and, unsurprisingly, Australia has seen an increase in regulation and scrutiny to increase trust in the industry (Cull & Sloan, 2016). Recently, Cull and Bowyer (2017) find that clients rank ethical values as more important than technical competence in a financial advisor.

#### 2.4. *Client's best interest in Australia*

Looking specifically at the regulatory context, at the most basic level, financial advice is governed by the laws of equity as well as common law, imposing duties on a financial advisor creating an obligation to act in a client's best interest. Common law places a duty of care on professionals in contract and tort. Glover (2002) argues that when professionals possess special expertise, they must render services to a client according to 'prevailing community standards' because they are liable in contract or in tort. As the financial advisor is providing expertise to clients, they are liable to ensure advice is provided at community standards. There is also legal precedent of a fiduciary requirement more generally in financial services.<sup>2</sup>

The community standards can be ascertained from professional association's exhortations and legal requirements which stress a client's best interest standard to resolve and avoid conflicts of interests (Glover, 2002; Batten & Pearson, 2013). The two major professional bodies are the Financial Planning Association of Australia (FPA) and the Association of Financial Advisers (AFA) whose code of ethics include principles such as *client first* (FPA, 2013) and *best interests* (AFA, 2018), respectively. In addition, all financial advisors are governed by a new code of ethics, established by the Financial Adviser Standards and Ethics Authority (FASEA), which includes the *Ethical Behaviour*. "You must act with integrity and in the best interests of each of your clients" (FASEA, 2019). Moreover, this code has legislative backing via Section 921E of the *Corporations Act 2001* (Cth) ('*Corporations Act*'), requiring all financial advisors to comply with the code.

A client's best interest obligations was also legislated in Part 7.7A *Corporations Act*, following the Future of Financial Advice (FOFA) reforms in 2012 (North, 2015). The reforms cover best interest obligations (Division 2); charging of ongoing fees (Division 3); conflicted remuneration (Division 4); and banned remuneration (Division 5). For example, Section 961B(1) states that "the provider must act in the best interests of the client in relation to the advice" and s961B(2) details a "safe harboring" process to show satisfaction of this duty. Moreover, s961J specifies that priority must be given to the clients' interest where there is a conflict and the advisor may face civil penalties if this duty is contravened (Batten & Pearson, 2013).

In summary, extant literature suggests that local organizational structures and regulatory environments are important factors influencing whether financial advice is provided in a client's best interest. Within the Australian setting, there is a developed financial advice industry that has undergone significant regulatory reform, yet pervasive misconduct has continued (the Royal Commission offers the most recent summary). Despite this, the Australian setting is infrequently researched or theorized (exceptions being Cull, 2009; McInnes 2020; North, 2015) and relevantly, despite having established client's best interest obligations for financial advisors, impediments in meeting this duty continue to persist. This research, therefore,

investigates this setting holistically by researching when financial advice can be provided in a client's best interest. It also researches the business models and wider environment, including key external stakeholders, that can enable and/or impede the providing of financial advice in a client's best interest. In doing so, the research aims to reveal the stakeholders that encourage, and the business models which prevent, client's best interest practice.

### 3. Methodology

We undertake an exploratory and mixed methodology that utilises both document analysis and interviews to achieve the research aims (Morse, 2003). The exploratory qualitative methodology was adopted so that theory could be generated from data. The research process was carried out in three phases.

The first phase involved content analysis of archival data, including regulatory documents on financial advice, to ascertain how financial advice was regulated and governed in Australia. This data was PJCCFS inquiries into financial advice (see Appendix 1, Table 1). The data were coded using *Nvivo 11* into three broad categories: (1) Professional challenges facing financial advice, (2) State regulation and other control, and (3) the professional community. Using these data, theories on the regulatory factors influencing how financial advice is governed were developed so that they could be explored through the second phase, in-depth semi-structured qualitative interviews.

The interviews were conducted with eight financial advisors and one governance director (refer to Appendix 1, Table 2) to gain insight into the contextual factors of financial advice in practice. As Sandy and Dumay (2011: 255) note, "The benefit of the research interview lies in its unique ability to uncover the private and sometimes incommunicable social world of the interviewee, to gain insight into alternative assumptions and ways of seeing." This allowed us to gather further information outside of the archival data, including interpretations and perceptions of pertinent participants in the financial advice industry. As such, this enabled us to augment the identified business models and influences developed in phase one of the project.

Comparable to Cull and Bowyer (2017), interviewees were selected randomly from financial advisors in Victoria, Australia, verified by ASIC and contactable through public registers of financial advisors, including the Yellow Pages, the FPA and AFA websites.<sup>3</sup> Further participants were then contacted through referrals from other participants. As such, the cohort represents financial advisors currently practicing in the field and excludes advisors not currently authorized by a financial service license holder to practice. The interviews were conducted in person and the average length was 54 minutes (mean), ranging between 33 and 79 minutes. Ethical approval was obtained before interviews being conducted and participant anonymity has been maintained.

In these interviews, open-ended questions on the contextual factors surrounding financial advisors were posed so that respondents could explain how they perceived financial advice was being influenced by various parties (see Appendix 1, Table 3). Business models of financial advice were presented in the interview to verify their accuracy and changes were made iteratively. This process of beginning with open-ended questions, followed by targeted

questions can be described as direct content analysis (Hsieh & Shannon, 2005). Here, the goal of the interview process is centered around validating or extending the theoretical framework or theory proffered (Hsieh & Shannon, 2005). In particular, the findings from the interviews support and extend the theories developed from the document review process. We use this process to verify a general model of a client's best interest in financial advice, business models, and contextual factors that can explain client's best interest practice.

In the final phase of this research, triangulation was undertaken using the Royal Commission conducted in Australia (interim report published in 2018 and final report in 2019). These reports offered new insight into how financial advice is regulated and governed in Australia and, therefore, offered a third source of data for this research project. We reviewed the Royal Commission reports and reconciled their key findings with the findings of this research project. Triangulation strengthens the validity of the research findings and, therefore, enabled the refinement of the models and framework presented in this article.

## 4. Findings

### 4.1. *Two dimensions in a client's best interest in financial advice*

The analysis of the government inquiries into financial advice revealed two dimensions underpinning the giving of financial advice in a client's best interest. These were *Orientation* and *Alignment*.

#### 4.1.1. *Orientation and alignment*

An important distinction made in defining financial advice is between personal advice and general advice. This is summed up succinctly by this quote:

The Corporations Act 2001 defines 'personal advice' in Section 766B(3) as financial product advice given or directed to a person (including by electronic means) in circumstances where: the person giving the advice has considered one or more of the client's objectives, financial situation and needs ... "General advice" is defined in Section 766B(4) as financial product advice that is not "personal advice." (Report 3: 18)

Here the differentiator between personal and general financial advice is the information that the advice is based on. We refer to this as *Orientation* and it is the extent to which a financial advisor is basing their advice on product characteristics or a client's characteristics. Financial advice which focuses on the product is conveying the essential information about that product to possible users of the product. The basis of the information given is on the technical details of the product. Financial advice that focuses on the client's characteristics takes into consideration a client's financial situation, objectives and risk tolerance to formulate the advice given. That is, the basis of the advice provided is taken from the client's situation and it matches products or a strategy to their situation. We conjecture that *Orientation* is considered a continuum, where variability exists between these two positions as financial advice can be more product- or more client-focused.



A second differentiator that came under scrutiny in many government inquiries was whose interests are being served. This can be illustrated by the following quote:

Where an adviser is employed by, or aligned with and acts on behalf of, a principal who manufactures or sells financial products, the adviser's interests (and the principal's) will be advanced by persuading a client to acquire one of the principal's products. (Report 2: 18)

Therefore, in one extreme a financial advisor will serve the interests of product providers and in the other extreme a financial advisor is independent of product providers. We use the term *Alignment* to represent differences in the relationship between a financial advisor and a product provider. An integral aspect, but not the sole aspect, of alignment, is the remuneration model used to conduct financial advice. This perspective is noted in Report 2 (:190):

Although the most obvious conflicts of interest affecting the provision of financial advice are the conflicts between an adviser's duty and his or her financial interests, they are not the only conflicts. Other conflicts can also arise from the associations or relationships between a financial adviser and the issuer of financial products.

At one end of the *Alignment* continuum, the financial advisor is fully aligned with product providers and the product provider is the financial advisors' sole source of income. In this situation, a financial advisor does not charge a client for advice but receives their income from products providers. The other extreme is where the financial advisor is independent of product providers and their income is generated from charging fees to clients, even at a flat rate. Variability exists between these two points where a financial advisor will earn income from both product providers and clients or may charge fees depending on the value of assets under management. Furthermore, another influence on alignment is the business model (reviewed in Section 4.2) used to provide financial advice, as this engenders a close alignment with, or independence from, financial product providers.

#### 4.1.2. A general model of a client's best interest in financial advice

In the government inquiries these two dimensions of financial advice are conflated as being one dimension. For example, Report 3 proposes to rename general financial advice as sales or product information to resolve misleading representation and conflicts of interest. However, our research finds that structural issues run deep, as illustrated by the following quote:

The industry is still structurally broken because . . . the industry was born out of product providers wanting to distribute their product, (and) financial planners were merely just . . . a part of the distribution arm. (Participant 2)

An improved model is needed to conceptualize how financial advice is provided in a client's best interest. We propose the dimensions should be intersected to construct a general model of a client's best interest in financial advice. Fig. 1 presents a graphic form of this model.

These intersecting dimensions lead to four categories of financial advice we term: *Brokers, Agents, Advisors, and Best Interest Advisors* (BIAs). Using this model, it is possible to classify occupations that provide financial advice and the extent to which they can achieve client's best interest practice.

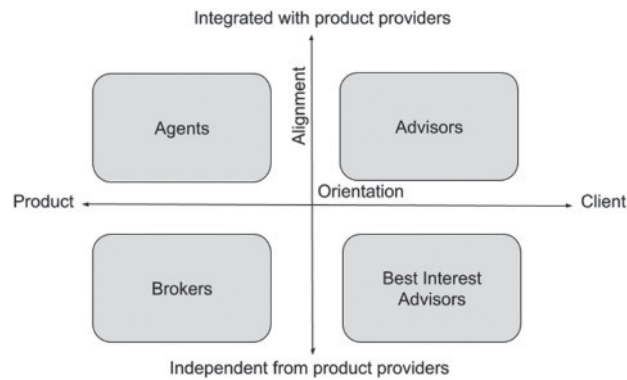


Fig. 1. A general model for providing financial advice in a client's best interest.

*Brokers* refer to those financial professions where alignment is independent of product providers and the information provided is specifically product advice. An example of this is a stockbroker. A stockbroker provides information about stocks to clients; however, is independent of the stocks being recommended. Brokers will have remuneration models that are separate from product providers, such as charging commissions to clients for each transaction. One of the impediments to stockbrokers achieving best interest practices is its orientation towards product (stock) based information.

*Agents* refer to those providing financial advice that is product based and connected to the product provider. An example is a real estate agent selling investment opportunities. These agents give specific information on a product (real estate) that is not based on a client's circumstances. The agent receives remuneration from the product provider, often when a transaction has been completed. A real estate agent is far from achieving client's best interest practice as their alignment is specifically with the product provider (seller of the property) and orientation is focused on the product. An antithesis example in real estate is a buyer's advocate who focuses specifically on their clients' needs and has no orientation towards a product provider, because they will source multiple products.

*Advisors* are those offering personal advice to clients and are aligned with product providers. An example is a financial planner working for a large financial institution. In this position, they offer personal advice to clients as they ascertain a client's situation, objectives, and risk profile to create their advice. However, the financial advisor is being remunerated and is environmentally constrained by the financial institution. Thus, their recommendations will be mostly products within the range of products that their financial institution controls. Advisors have high conflicts of interest as they must serve the product provider's interests and attend to a client's needs.

Lastly, the BIAs, like a broker, is independent of product providers but offers personal advice matched to a client's needs. An example of a BIA would be an independent financial planner. The independent financial planner offers client centered financial advice and is independent of product providers, as they receive no remuneration from, and are not environmentally constrained by, product providers. Instead, the financial planner may charge a fee-for-service model where they charge clients based on the quantity of services rendered or a flat fee for being a client of the advisor.

A limitation worth noting with this model is that it shows when a client's best interest can be prioritized but does not mean they necessarily will achieve best interest practice. This occurs because conflicts of interest still exist for BIAs, who are independent of product providers and provide client-based advice. For example, consider a situation where a financial advisor provides advice using a fee-for-service model. This advisor will gain material benefits by charging fees and providing the smallest amount of service possible, whilst using the time saved to attract new additional clients. This issue was revealed in Report 1 and Report 2 as "fees for no service," where ongoing advice fees are being charged with no advice being given to the client. These reports concluded that poor advice often given to clients has ultimately led to those clients being left worse off than if they had been given proper advice.

#### 4.2. *Business models of financial advice*

International research highlights the importance of organizational structure for financial advice, but a key theme emanating from our research is that the business models of financial advice was important for providing financial advice in a client's best interest. Yet, these models differ from one advisor to the next, because of the arrangement of three major parties involved. These parties are: *the licensee* (the organization or person licensed by ASIC to provide financial advice services to the public); *the financial product provider* (the organization that makes the product a client uses); and *the financial advisor* (the person who recommends the product to the client). As previously indicated, Australia operates an authorized representative model, with the licensee able to authorize a financial advisor to give advice on their behalf whilst taking responsibility to ensure compliance with relevant legislation.

An important aspect of these models is that the work of a financial advisor is largely governed by the licensee because of several factors. Firstly, the licensee sets the terms under which financial advice will be given. That is, they create the contract between the financial advisor and their clients, referred to as the financial services guide (FSG).

An FSG is a general document provided at the commencement of an advice relationship, which must outline the kinds of financial services and products the licensee is authorized to provide, as well as any remuneration, commission and other benefits that may be received by the providing entity as a result of advice being offered and any potential conflicts of interest. (Report 5: 3)

Secondly, a licensee will also issue the financial advisor with an approved product list (APL) that outlines the financial products that a financial advisor can recommend. Participant 6 describes this as:

Again, another subtle way that providers will try to encourage advisors to use their products and their platforms over others will be . . . APLs; (these) can be quite restrictive. (Participant 6)

Finally, the licensee will stipulate professional development requirements, suggest financial services software and conduct audits of the financial advisor practices. Thus, when assessing the extent to which financial advice is provided in a client's best interest, it is important to consider the organizational context of the licensee, financial advisor, and financial product providers.

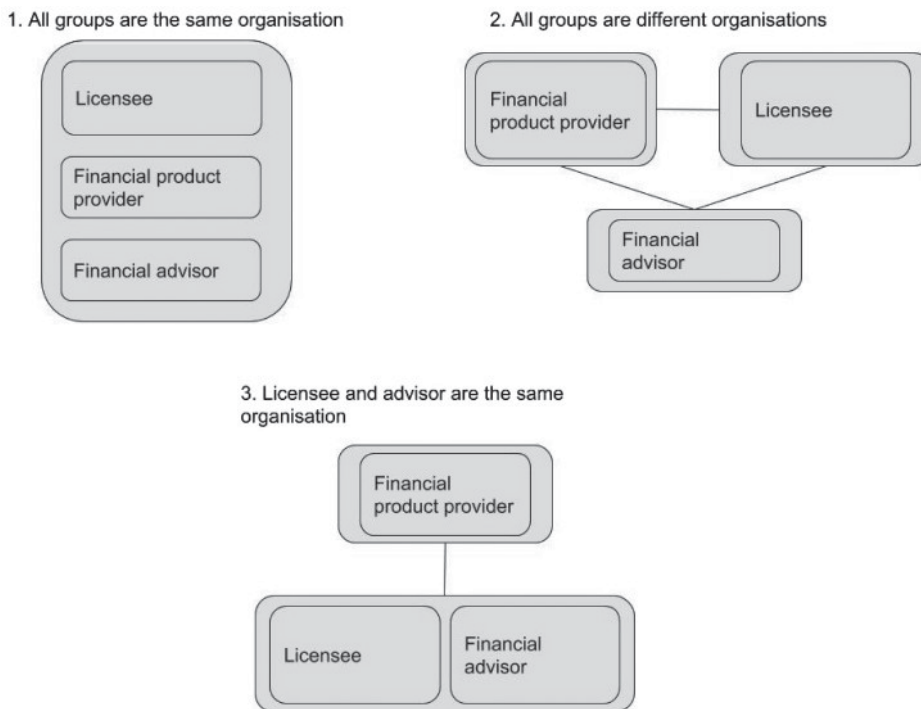


Fig. 2. The three business models of financial advice: Licensees, financial product providers, and financial advisors.

The main three organizations involved with providing financial advisory services can be arranged into three different business models of financial advice, based on the relationship between parties. These models were shown, amended and confirmed in the interviews. Fig. 2 is a graphical illustration of these three models.

#### 4.2.1. Model 1: All groups are the same organization

Model 1 is a business model in which the financial advisor, financial product provider and licensee are the same organization. This occurs when a large financial institution, such as a bank, creates products and obtains a license to give advice and employs financial advisors. In this model, the alignment of financial advisors is close with product providers as the remuneration is being provided by that organization. There is also difficulty in this business model distinguishing between the provision of general (product-orientated) advice and personal (client-orientated) advice. Although a financial advisor will provide personal advice, there may be several other employees (e.g., such as bank tellers) who provide general advice about the products the organization offers.

#### 4.2.2. Model 2: All groups are different organizations

In Model 2 all parties work in separate organizations. In this model, the financial advisor will engage the services of a licensee (often referred to as a dealer group) to obtain authorization to give financial advice. From a legal perspective, the licensee will work as a separate organization to the financial product provider. However, the relationship between the

financial product provider and licensee varies significantly in practice. At one end of the continuum, the licensee is simply a subsidiary of the financial product provider. Consider this quote from a financial planner working in Model 2:

There's two types of product providers. There's, I call them "internal" and "external". So, with my business being licensed through [company name withheld; licensee] any [company name withheld; product provider] product I consider it internal, because [licensee] are owned by [product provider], anything else is external. (Participant 7)

In practical terms, Model 2 resembles Model 1, with independence occurring only in a legal sense and not as separate structures. In contrast, at the other end of the continuum, the relationship between the financial product provider and the licensee is independent. Consider this quote from a financial planner in Model 2:

You might use product A, B, or C, . . . you have a relationship with the product provider, you need to know about it and these types of things, but there's no contractual obligation in any way, shape or form to use that product. (Participant 5)

From a client's point of view, the relationship between the financial product provider and licensee is not obvious and it is difficult to ascertain the alignment of financial advisors with product providers. Clients may not be aware of this structural relationship until the product provider is disclosed in documentation and may not appreciate that nature of this relationship. Nonetheless, business Model 2 is orientated towards providing personal advice rather than product advice.

It is important to note that there are pressures on licensees to align with product providers and not be independent. This is noted by this quote:

It is difficult to run a profitable dealer group (licensee) in financial planning. So you do often need to create some sort of deals, that is where the pressure comes . . . It is very hard for independent dealer groups . . . where the only revenue they would be getting is from advisor only . . . You have to come up with arrangements, that can add to the bottom line or they can pass onto advisors for better fees or whatever. (Participant 2)

#### 4.2.3. *Licensee and advisor are the same organization*

The final model is Model 3, which involves a financial advisor's organization, or the financial advisor themselves, obtaining their own financial services license and then forming a relationship with one or many financial product providers to recommend products. Consider this quote from a financial planner:

I think independence is really important. So we have our own license and we have from the start. . . . I think being independent and not being incentivized to recommend a particular product or strategy to a client is most important. (Participant 1)

Model 3 can be seen as the most independent model of financial advice because the licensee is not aligned with any financial product provider, but the licensee is aligned with the financial advisors. It is common in this model that the financial advisor will operate in a fee-for-service model to remove remuneration from product providers and reduce conflicts of

interest. This model also specializes in giving personal advice rather product advice. However, in contrast with the first two models, Model 3 involves more costs for the financial advisor as they incur the cost of obtaining a license. It also contains the highest amount of upfront expense for a client whose fee will be paying for the financial advisor to comply with regulations.

In summary, of the three business models, Model 3 will most likely enable best interest practice to occur as obtaining an individual license removes the alignment of a financial advisor from a product provider. However, this model is the least common:

Approximately 85% of financial advisers are associated with a product manufacturer, so that many advisers effectively act as a product pipeline. Of the remainder, the vast majority receive commissions from product manufacturers and so have incentives to sell products. (Report 6: 70)

Despite this, calls to individually license financial advisers have not been endorsed by parliamentary enquiries into financial advice.

The organizational context and the licensee in particular can be considered the primary influence over the financial advisor’s financial advice due to having the most power to influence practices. However, in addition to the organizational context, there is a secondary influence stemming from external stakeholders that shape financial advice practices. These stakeholders seek to create or influence a client’s best interest practice in financial advice; however, experience corresponding impediments created by the particular business models.

### *4.3. External stakeholders advocating best interest practice*

Wider contextual influences beyond the employing financial institution and product providers can impact how financial advice is provided. Whilst there will be multiple, cultural and institutional elements which impact financial advice, in this review, we focus the search towards those people, organizations or government that aim to implement client’s best interest practice on financial advisors. Analysis of the interview data narrowed this search down to clients, professional bodies, ombudsman, education providers, and the government (Fig. 3). The stakeholders and their attempts to promote client’s best interest practice are now delineated.

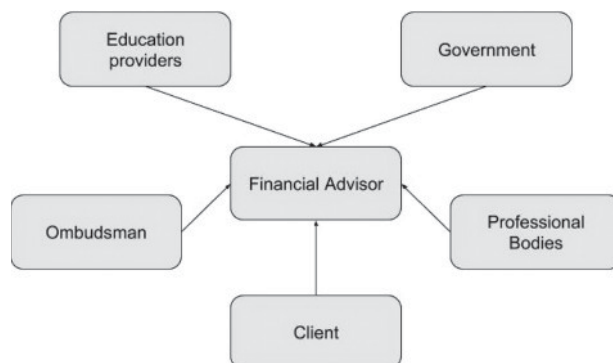


Fig. 3. External stakeholders seeking to influence financial advice.

#### 4.3.1. *The client*

An essential element of financial advice is the relationship that the advisor has with their clients. This relationship is a two-way interaction where advisors will provide services to clients but also clients will have the ability to influence and control their advisor. Thus, the client can be seen as a control mechanism to enforce best interest practice on a financial advisor. Historically, the Australian context of financial advice has placed a large emphasis on the client influencing financial advisors because of the disclosure practices legislated. Some of the disclosure requirements of financial advisors include reporting clients' information about their remuneration (including commissions), conflicts of interest with product providers and, more recently, an opt-in requirement for ongoing fee arrangements. A disclosure practice in financial advice assumes that this process will control the actions of financial advisors and financial institutions.

It could be that clients will choose not to participate in financial advice when conflicts of interest are disclosed and/or the necessity to disclose such practices will stop conflicts from arising in the first place. However, when asked about client's reading of the FSG, a disclosure document provided to clients, one financial planner noted:

I don't know if a client's ever read it. I know well, from myself personally, if you go for a financial product through your insurance and these types of things, I'm sure I've never read them either and I work in the industry. (Participant 5)

Furthermore, government inquiries have found that disclosure practices have not been effective in stopping a persistence of scandals in the financial services industry. Consider these quotes:

... [T]here was a broadly held view that disclosure had been ineffective in managing conflicts of interest, necessitating other more robust measures ... (Report 6: 111)

The reforms recognize that current disclosure requirements are not, on their own, sufficient to fully inform consumers. (Report 2: 105)

This suggests that clients will not enforce a strict client's best interest practice on financial advisors, irrespective of disclosure requirements.

Moreover, the business models create impediments to the control mechanism proffered via the client-advisor relationship. With many clients being unaware of the true nature of the business model, as discussed in Section 4.2, and the majority of business models not positioned optimally for best interest practice (BIAs), clients may inherently face barriers to meaningfully influence their financial advisor. In doing so, client influence can be directed mainly towards perceptions of best interest practice.

#### 4.3.2. *Professional bodies*

Another influence on the practice of financial advisors is the influence of professional bodies. Professional bodies require financial advisors to ascertain certain levels of education and experience before being admitted to the body and, thereafter, undertake training and assessments to become accredited.

Despite the intention of professional bodies to influence financial advisor practices, and enforce client's best interest practice, the ability to achieve this is thwarted. The reason for

this is the organizational context; the business models previously outlined. In this organizational context, direct power over a financial advisor is given to the licensee as they authorize the advisor to give financial advice. In other words, a licensee awards the ability to practice to a financial advisor and sets the conditions under which a financial advisor practice. A professional body's code of conduct is a secondary influence, which can only be invoked once the licensee conditions are met. This order of priority is epitomized by the fact that a financial advisor did not have to be a member of a professional body to practice.

Just as there is no requirement for individual financial advisers to be registered by ASIC, there is also no requirement for advisers to be members of any particular industry association . . . Both the FPA and the AFA seek to advance the cause of financial advisers generally. Each seeks to promote the creation and growth of financial planning and advice as a profession. Both the FPA and AFA now have processes and systems for disciplining members. But the evidence before the Commission did not show that either the FPA or the AFA currently plays any significant role in maintaining or enforcing proper standards of conduct by financial advisers. (Report 1: 208)

Moreover, there are many professional bodies within the financial services industry all competing for membership. Until the shift of authority is moved away from licensees to professional bodies, their ability to enforce best interest practice on financial advisors will remain limited and influence perceptions of best interest practice.

#### 4.3.3. *The ombudsman*

A requirement for licensees in Australia is that they must provide clients with both an internal and external complaint service. The term *ombudsman* is used here to refer to the external services bodies that offer external complaint services. Reports 1 and 2 notes that these bodies amalgamated into a single external dispute resolution service; the Australian Financial Complaints Authority (AFCA). When asked if the ombudsman service influences practices in financial advice one respondent noted:

No I don't think it does. I don't think advisors think too much about what may come of the advice they are giving . . . I think most day to day advisors, they say that the complaint schemes are there. It's part of the industry and I think the advisors don't think on it too much. (Participant 2)

Whilst the ombudsman service could enforce best interest practice on financial advisors, its ability to influence financial advisors is limited because of its reactive nature. Rather than being a proactive influence on advice, they adjudicate on any customer complaints only after the issues are raised. This reduces the effectiveness of an ombudsman service to enforce best interest practice on financial advice. It is possible though, that a decision made by an ombudsman could guide financial advice as they serve as examples of malpractice and the ombudsman could conduct outreach initiatives to influence financial advice. At the moment, such practices do not regularly occur in Australia.

The ombudsman service can also have an indirect influence over financial advisors as the advisors will require professional indemnity insurance, which is typically purchased by the licensee. If a financial advisor is involved with monetary resolutions from an ombudsman service, then the professional indemnity insurers will be involved to cover these costs. As a result, premiums for professional indemnity will increase following resolutions and the



licensee may review practices, including impediments to best interest practice, to reduce professional indemnity insurance premiums. However, this review of practices to increase a client's best interest practice again relies on the licensee enforcing it. If a licensee is closely aligned with financial product providers, then it will not change practices to enforce a prioritization of a client's best interest because of this alignment. Thus, the ability for an ombudsman service to enforce client's best interest practice is impeded by the license business model.

#### *4.3.4. Education providers*

Education providers influence how financial advice is given by providing initial education and also providing ongoing professional development. A strong argument presented in the government enquiry data is that prerequisites to give financial advice, set at a diploma level, are too low and that one factor to improve financial advice should be to raise the qualification level. For example:

Lifting the qualifications of financial advisers and the standards of advice provided to consumers and investors becomes just one important defense mechanism to help reduce the risk of failure in the broader system. (Report 3: 15)

Thus, the education level has been raised with new entrants to financial advice requiring a degree from 2019, whilst existing advisers have until January 1, 2024 to meet the new requirements (FASEA, 2018). Going forward universities will play more of a role in influencing financial advisers by educating future advisers on best practice in the workforce.

Education does present an ability to influence financial advisers towards client's best interest practice. Through rigorous ethics training, education providers could create the framework and discourse for considering a client's best interest in financial advice. The ability to implement has previously been limited for two reasons. Firstly, licensees could stipulate some of the CPD that a financial advisor undertakes and thus may not include courses on ethics and conducting advice in a client's best interest. Secondly, education does not fundamentally change the alignment between a financial advisor and a product provider that causes breaches in a client's best interest practice. This relationship is controlled by the licensee who authorizes the financial advisor and controls the terms under which the financial advisor operates. Thus, whilst education can offer an opportunity to improve client's best interest practice of financial advisers, it has been thwarted by the context in which a financial advisor operates.

#### *4.3.5. Government*

In addition, the Government also has two organizations it uses to enact legislation: ASIC and more recently, FASEA. ASIC controls the financial services environment in Australia and is responsible for enacting legislation by creating regulatory guides that govern financial advice. Thus, it yields substantial influence over both licensee and a direct influence over financial advisers via a register it maintains (ASIC, 2017). The register provides the Australian public with a list of all past and present financial advisers who are or have been allowed to practice in Australia. The information on public display includes the advisor's: name, unique identifier, status (current or ceased), licensee, qualifications, affiliations, products they can advise on, appointments, and any disciplinary actions.

ASIC can change an advisor's status following disciplinary action where their right to provide financial advice is revoked. However, Report 1 finds ASIC has a fragmented and ineffective disciplinary system for financial advisors and explains the reason for this where it states:

ASIC said that, as a regulator, its role is to oversee advisers' compliance with the law and not to supervise or monitor their work. It said that primary responsibility for discipline lies with licensees, who are responsible under the law for the conduct of their advisers. (Report 1: 209)

Report 1 also noted that licensees were not sufficiently sharing information about advisors with ASIC. Some research participants also noted issues with ASIC sharing information with them:

So it's really frustrating when you deal with ASIC. To be honest . . . beyond . . . lodging the required forms I have no involvement. We've not had an ASIC review done. I'd welcome it because . . . you get some great feedback and know when you're on the right path. (Participant 4)

The second control mechanism by which the government directly influences financial advice is FASEA formed in 2017. This authority comprises of members from industry, professional bodies and universities. Its primary role is to implement changes to the Corporations Act in 2017 which raise the education, training, and ethical standards of financial advisers (FASEA, 2018). FASEA will govern via indirect and direct methods. Indirect governance occurs through accreditation of universities financial advisory degrees to ensure financial advisors receive the education needed to improve the professionalism of the financial advice industry. Direct governance occurs through enforcing a national exam, professional year, continuous professional development and a code of ethics to ensure the competency of financial advisors.

Thus, the Government, also can influence financial advice through legislation, ASIC and, more recently, FASEA. Despite legislation being passed, a prevalence of misconduct still occurs in financial services. Why does misconduct persist despite new legislation? We contend that a reason is that the relationship between financial advisors, licensees, and product providers remains unchanged. This relationship ensures that efforts by ASIC and FASEA to control financial advisors come secondary to the relationship between a licensee and financial advisor. That is, even though a register, a degree, a national exam and a code of ethics are enforced on financial advisors, their ability to practice and the conditions under which they practice are set by the licensee. Thus, the ability for government to create best interest practice in financial advice will be thwarted until the mechanism is stopped.

To articulate the interaction between the nature of advice provided and the environmental considerations, this article now extends the broad applicability of the general model of best interest in financial advice to the specific context of Australia, conceptualizing the environmental factors that enable (inhibit) client's best interest practice in financial advice.

## 5. Discussion

### 5.1. *An integrated framework*

The findings of this research are used to create a general model of providing financial advice in a client's best interests using two continuums: *Orientation* and *Alignment*. This

model shows that the conditions under which financial advice is most likely to prioritize a client's best interest practice—and, therefore, more likely to be effective and beneficial to investors—is when *Orientation* is client centered and *Alignment* is independent from product providers. When these dimensions are aligned, they are labelled as *Best Interest Advisors* (BIAs) in Fig. 1. This model offers theoretical clarity to financial advice and policy implications on who should be held to a client's best interest obligation.

A second finding is that an understanding of the business model is required in order to determine the ability of a financial advisor to align with the BIA classification. As described, financial advice in Australia can occur via three different business models due to the licensing structure legislated and are outlined in Fig. 2:

- Model 1 depicts financial advisors as being closely aligned with product providers because the licensee, product provider and financial advisor all work for the same company. As such, this model reduces the capability to prioritize a client's best interest.
- Model 2 depicts all parties as independent and enables financial advisors to have independence from product providers, but the extent to which this happens is dependent on how the licensee operates. In one extreme the licensee could be a subsidiary of the product provider offering no independence for financial advisors and in the other extreme the licensee could be entirely independent of product providers. Importantly, this relationship is difficult for a client to understand, even if disclosed to them.
- Model 3 depicts a business model where a financial advisor or his/her company, obtains its own license and forms relationships with one or more financial product providers. This last business model offers the most opportunity for prioritizing a client's best interest, as obtaining an individual license removes alignment of a financial advisor from a product provider. However, this business model remains the rarest form of business model.

Whilst most of the business models (apart from Model 3) reduce the ability of financial advisors to achieve best interest practice in financial advice, external stakeholders aim to encourage client's best interest practice by financial advisors: Fig. 3. However, despite these influences, the same business models inhibit their influences. These business models often enable licensees to have primary power over financial advisors, creating a barrier for stakeholder efforts to have an effect. Any aims become secondary to the business model and, therefore, any initiatives lead to a perceived client's best interest practice or inherent trust that are not conceptually aligned with BIAs, and as such do not necessarily result in effective financial advice to investors.

Layering these organizational and regulatory factors to create an integrated framework, enables the broad applicability of the general model of best interest in financial advice to be extended to consider factors that are enabling (inhibiting) in achieving clients best interest practice (Fig. 4). Inherent within the financial advice context is a narrowing of opportunity for client's best interest practice to be achieved because of the business models in operation.

## 6. Conclusion

Best interest practice is of manifest importance in financial advice, particularly as personal financial stability is increasingly the responsibility of the individual rather

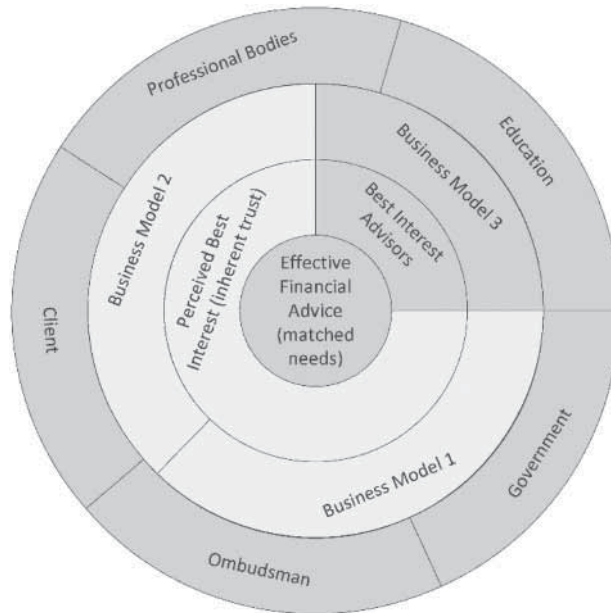


Fig. 4. The integrated framework. Note: The dark grey shaded areas reflect enabled influences working towards the prioritizing a client’s best interest, whilst the light grey areas represent inhibited influences.

than the state. We contend that in considering client’s best interest practice in Australia, it is not only the individual financial advisor that is important, but also the influence of the contextual environment that the advisor operates within. Often, the business models in place are conceptually positioned to prevent or impede financial advisors from becoming BIAs. As per the general model of a client’s best interest in financial advice, these models are less able to enable the *Orientation* (client-centered) and *Alignment* (independent from product providers) that is most likely to prioritize client’s best interest practice. As such, advice is positioned to be less effective and beneficial to investors.

This article offers important implications for policymakers, financial advisors and clients. This integrated framework can enable more targeted initiatives towards the nature of the advice provided in the defined context. Initiatives to promote a client’s best practice should be targeted at advice with an *Orientation* towards clients and *Alignment* independent from product providers (BIA). Other types of advice (Agents, Brokers, and Advisers), should not be expected to achieve client’s best interest practice. Creating clarity in roles identified in this framework would inform on the nature of the advice provided, enable more effective financial advice, and lead to better outcomes for investors. However, in doing so, the related business models need to be considered to ensure financial advisors are enabled to achieve client’s best interest practice rather than the perception of best interest practice. As such, this research continues the conversation towards business models and the risk of stakeholder initiatives functioning as a blunt tool for change. Understanding that initiatives towards BIAs are substantially thwarted by certain business models (Model 1 and Model 2), suggests that for progress to occur, the change should be directed towards overcoming the barriers that business models create.

Future research opportunities should consider how the business structures and the external regulatory context in other jurisdictions interact with the general model of best interest in financial advice, both in terms of determining the existence and pervasiveness of relative barriers. Such examination would offer potential resolutions to impediments identified in Australia or vice versa. Considering the substantial controversy within the Australian context, it is paramount that we further the conversation over best interest practice and progress financial advisors towards the status of BIAs.

### *6.1. International application of findings*

This research focuses on Australia but there is global applicability of our findings because conflicts of interest in financial advice occur in Switzerland (Hoechle et al., 2018), Germany (Hackethal et al., 2012), United States (Egan, Matvos, & Seru, 2019), and Canada (Foerster et al., 2017). The model presented in Fig. 1 can be applied to many contexts and is useful in differentiating types of financial advice that are or are not provided in a client's best interest. The business models outlined in Fig. 2 are Australian specific due to the licensing regime legislated there. The applicability of these business models to other contexts will depend on how financial advisors are authorized to practice in those contexts. Comparing contexts in terms of how financial advice is governed would be a worthwhile pursuit because such research could ascertain strengths and weaknesses of current governance systems. Finally, the various external stakeholders outlined in Fig. 3 will be prevalent in other countries. However, the influence of each stakeholder over financial advisor will vary from context to context depending on their authority and the interplay between the relative organizational context and regulatory framework.

### **Acknowledgment**

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### **Notes**

- 1 Here the term 'financial advisor' encompasses numerous consultant categories (financial advisors, financial planners, brokers etc.). The encapsulation of what a financial advisor is, is detailed in a later section.
- 2 See Justice Jacobsen's interpretation draws from Finn (1989: 46-47, cited in *Australian Securities and Investments Commission v Citigroup Global Markets Australia Pty Limited* (ACN 113 114 832) (No. 4) [2007] FCA 963 at 274).
- 3 These websites are [www.yellowpages.com.au](http://www.yellowpages.com.au), <https://fpa.com.au/>; and [www.afa.asn.au/find-afa-financial-adviser](http://www.afa.asn.au/find-afa-financial-adviser), respectively.

### Appendix 1 Overview of data used for analysis

Table 1 Parliamentary joint committee on corporations and financial services PJCCFS inquiry reports and Royal Commission reports into misconduct in the banking, superannuation and financial services industry reports reviewed for this research

Report number	Citation	Submissions	Pages	Report name
1	Hayne (2019)	10,323	530	Final Report Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Volume 1
2	Hayne (2018)		375	Interim Report Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Volume 1
3	PJCCFS (2014)	39	103	Inquiry into proposals to lift the professional, ethical and education standards in the financial services industry - 2014
4	PJCCFS (2012b)	77	204	Inquiry into the collapse of Trio Capital
5	PJCCFS (2012a)	69	220	Corporations Amendment (Future of Financial Advice) Bill 2011 and Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011
6	PJCCFS (2009)	407	209	Inquiry into financial products and services in Australia
7	PJCCFS (2003)	49	86	Inquiry into the disclosure of commissions on risk products

Table 2 Overview of the in-depth interviews

Interview number	Duration (HH:MM:SS)	Experience in financial services	Position	Company size
1	00:53:24	12 Years	Financial planner	Large corporation 1000+ employees
2	01:12:05	29 Years	Financial ombudsman representative/financial planner	Boutique 0–5 employees
3	00:51:55	17 Years	Financial planner/partner	Medium firm 150+ employees
4	01:09:01	16 Years	Governance director	Medium firm 150+ employees
5	01:03:39	10 Years	Business owner/financial planner	Boutique 0–5 employees
6	01:03:41	5 Years	Financial planner	Large corporation 50,000+ employees
7	00:38:25	17 Years	Business owner/financial planner	Small firm 5–50 employees
8	00:46:36	28 Years	Business owner/financial planner	Boutique 0–5 employees
9	00:33:43	14 Years	Financial planner	Boutique 0–5 employees

Table 3  
Semi structured interview questions

Introduction—Explain purpose of interview	How long have you been working as a financial advisor/planner? What products do you advise on? In your opinion, what are the qualities that make a good financial advisor/planner?
Governance: Organizational level	What do you understand by “governance” of the financial advice industry? How have you or the organization you work for adopted these new governance reforms at the organizational level?
Governance: License (dealer group if separate from the organization)	What mechanisms are there in place to ensure these reforms are complied with? Can you outline your licensing (dealer group) arrangement? What are your views on the current method of licensing for financial planners/advisors? If they are or are not effective, please explain why? What do you believe would improve the license (dealer group) method of governance in financial advice?
Governance: Financial product providers (if separate from the organization)	Is your financial product provider and license holder the same institution? Related? Or independent? In what way do financial product providers influence the way you give financial advice? In what way is the influence of financial product providers positive for the financial advice industry? What about negative impacts?
Governance: Education and professional bodies	What are your views on the current method by which financial product providers are governed? If they are or are not effective, please explain why? What are your views on the requirement for professional qualifications for financial planners/advisors? If they are not effective, please explain why? Are you a member of a professional body? Why or why not? What are your views on the requirements from your professional body? If they are or are not effective, please explain why?
Governance: Clients	What internet/external client complaint services do you have? What are your views on the method for resolving disputes with clients? If they are/are not effective, please explain why?
Overall: Governance effectiveness	Do the client complaint services influence how you give financial advice? What, in your view, are the reforms that have had the most positive impact on your practice? What are the reforms that have had the most negative impact on your practice? Do you believe that the reforms overall are beneficial for the financial advice industry? Why or why not? What are your views on the current penalties for non-compliance of licensing, professional qualifications? If they are not effective, please explain why?
Other topics	Other questions may be asked as a result of the answers given to questions above.

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