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CPD MONTHLY

ETHICS: WHAT OUGHT ONE DO?

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This article is worth
Ethics 0.5 CPD HOURS

FPA Dimension
Ethics

ASIC Knowledge Requirement
Financial Planning

INCLUDES:

- Ethical theories
- Six stages of moral judgement development
- Codes of ethics
- Framework for ethical decision-making

No doubt there are a range of factors that come to mind when you hear the term 'ethics'. While the term 'ethics' may mean different things to different people, ethics is an important part of how one lives their life and makes decisions, both personally and professionally.

ETHICAL THEORIES

There are two main theories underpinning the study of ethics; deontological ethics and teleological ethics. Deontological ethics is concerned with rules and the sense of duty and is based on a general 'rule', known as the 'categorical imperative'. This 'rule' was proposed by philosopher Immanuel Kant (1724–1804) and views an action as morally right if it is motivated by goodwill that stems from a sense of duty. It focuses on respect of the individual.

Common phrases that espouse the categorical imperative are 'do unto others as you would have them do unto you' and 'the end does not justify the means'. It measures 'good' or 'bad' behaviour according to the action taken. Deontological ethics is also referred to as ethical idealism.

Conversely, teleological ethics is concerned with utilitarianism and the idea that if all individuals maximise their utility, then this will lead to society's utility being maximised also. Utility is measured by happiness.

The measure of right or wrong is the greatest good to the greatest number of people and is based on the outcomes of the decision (rather than the action taken as in deontological ethics). As a result, teleological ethics is also known as consequentialism.

Ethics is defined by the Oxford Dictionary as 'the moral principles that govern a person's behaviour or how an activity is conducted' (Oxford University Press, 2002). In the context of financial planning, ethics relates to both the behaviour of a financial adviser and also how the activity of providing financial advice is conducted.

BEST INTERESTS DUTY

Central to providing financial advice is the fiduciary best interests duty as outlined in the Future of Financial Advice (FOFA) reform in Part 7.7A (Sections 961B-E) of the Corporations Act 2001. This concept of 'best interests' duty requires that the client trusts in the competence and integrity of the adviser in accordance with the highest ethical standards (Lewis and Weigert, 1985) and that the adviser puts the client's interests before their own.

MORAL DEVELOPMENT

Developmental psychology suggests that how a person responds to an ethical situation is linked to their moral development.

According to Kohlberg, there are three main developmental levels: pre-conventional, conventional and principled. Each of these levels is made up of two stages, making a total of six stages of moral development. Kohlberg argues that the moral development of an individual must reach a minimum of Stage 3 in order to be capable of making an ethical decision.

Table 1 provides a summary of the six stages of decision-making when one is faced with a moral dilemma. It is based on Lawrence Kohlberg's (Kohlberg and Hersh, 1977) cognitive development approach to morality, which is based on the premise that the six different stages of moral judgement development are sequential.

An adviser has an obligation to clients to be trustworthy and to do the things they promised. Fulfilling this professional-client obligation begins at Stage 1 of the Kohlberg moral judgement development scale and progresses to Stage 2. The building of the client-adviser relationship would be at Stage 3, which when combined with adherence to financial advice regulations and procedures, would place an adviser at Stage 4.

While Stage 4 appreciates the importance of the law, there is an underlying assumption that following the law means one is morally right (Rest and Narvaez, 1994), or behaving ethically. Stages 5 and 6 go above the law and instead focus on the idealistic principles of co-operative societies where 'what is morally right best furthers the principle' (Ibid, p.7).

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ETHICAL AWARENESS

While most principles of right and wrong are well established prior to high school, ethical behaviour cannot occur until there is first the awareness that an ethical dilemma exists.

At the low stages of moral development (e.g. Stage 1), one may simply do as they are told, without question. This can result in 'blind' unethical behaviour – where one's ethical awareness is limited, or may result in unethical behaviour being 'justified' by simply 'following orders'. Furthermore, one may have a slightly higher level of moral development and follow the law (stage 4) but fail to consider other moral obligations that sit above the law.

Thiel, Bagdasarov, Harkrider, Johnson and Mumford (2012) acknowledge that the first step in making ethical decisions is to first recognise that an ethical dilemma exists. This then allows an individual to seek out additional information, consider the consequences and then contemplate alternative courses of action in order to make an ethical decision that is morally defensible (Rest 1986, Langenderfer and Rockness 1989).

CODES OF ETHICS

Ethical principles and standards included in professional codes of conduct and codes of ethics provide useful guidance about how to handle an ethical situation and provide norms for expected standard of behaviour within a profession. These codes sit above minimum legal and regulatory requirements (Smith, 2009).

Most ethical codes usually include principles relating to serving the public interest, integrity, objectivity, fairness, independence, professional behaviour and competence, all of which are included in the FPA Code of Ethics, which form part of the FPA Code of Professional Practice (FPA, 2013).

Financial advisers who are members of a professional body are expected to follow the relevant codes of conduct and ethical codes of their profession, or risk disciplinary action.

Members of the FPA are expected to abide by the FPA Code of Ethics in the FPA Code of Professional Practice (FPA, 2013), which is enforceable as a member obligation established in FPA Regulations. The code is not necessarily limited to the client-adviser relationship but may extend to dealings with other professionals and third parties.

THE FPA CODE OF ETHICS

The FPA Code of Ethics includes eight core principles that serve as the minimum benchmark for professional behaviour. Members are encouraged to apply these principles while also complying with any legal obligations, such as those imposed under the *Corporations Act 2001* and other relevant laws.

Continued overleaf

Table 1: Six stages of moral judgement development

Stage 1	**The morality of obedience:** Do what you're told or else there will be pain.
Stage 2	**The morality of instrumental egoism and simple exchange:** Let's make a deal.
Stage 3	**The morality of interpersonal concordance:** Be considerate, nice and kind – you'll make friends. Peer groups are the source of values.
Stage 4	**The morality of law and duty to the social order:** Everyone in society is obligated to and protected by the law.
Stage 5	**The morality of consensus-building procedures:** You are obligated by the arrangements that are agreed to by due process procedures. Based on social contracts and utilitarianism.
Stage 6	**The morality of non-arbitrary social co-operation:** Morality is defined by how rational and impartial people would ideally organise co-operation and is rooted in deontological absolutes, such as those of religion and Kant's categorical imperative.

Source: Adapted from Rest and Narvaez, 1994: p.5; Kohlberg and Hersh, 1977.

The eight principles of the FPA Code of Ethics (FPA, 2013) are:

1. Client First: place the client's interest first.

2. Integrity: provide professional services with integrity.

3. Objectivity: provide professional services objectively.

4. Fairness: be fair and reasonable in all professional relationships/disclose and manage conflicts of interest.

5. Professionalism: act in a manner that demonstrates exemplary professional conduct.

6. Competence: maintain the abilities, skills and knowledge necessary to provide professional services competently.

7. Confidentiality: protect the confidentiality of all client information.

8. Diligence: provide professional services diligently.

Further to the eight ethics principles, the FPA may also issue FPA Guidance to its members to elaborate on the application of the Code of Ethics.

FRAMEWORK FOR ETHICAL DECISION-MAKING

It is recognised that a code of ethics on its own is not sufficient in achieving ethical behaviour, as it needs to be "promoted, implemented and enforced ... Ethical rules do not make ethical people" *(Brien, 1998, p. 392).*

Furthermore, some ethical dilemmas can be complex and may not always be readily resolved solely through the use of a code of ethics. In this case, it can be useful to have a framework in which to analyse and make ethical decisions. One such framework is the Langenderfer and Rockness framework (1989), which uses the following seven questions to consider various ethical issues when making a decision.

1. What are the facts of the case?

2. What are the ethical issues in the case and the stakeholders involved?

3. What are the norms, principles and values related to the case? This step may take any relevant professional obligations and codes of ethics into account.

4. What are the alternative courses of action?

5. What is the best course of action that is consistent with the norms, principles and values identified in point 3?

6. What are the consequences of each possible course of action? (A decision tree approach can be used here and consultation with a trusted external source, such as The Ethics Centre, may be helpful for more complex issues.)

7. What is the decision?

Consider how these steps might be applied in a simple financial advising scenario, such as the one provided at the end of this article.

CONCLUSION

Ethics in financial planning is part of a complex system involving regulation, professional bodies, education, financial advice organisations, compliance officers and individual financial advisers.

For financial advisers to consistently demonstrate ethical behaviour, all parts of the system need to complement one another. Financial advisers must be capable of making ethical decisions to protect themselves and their business from legal liability.

Financial advisers make decisions every day that affect the resources and the lives of many people, so it is imperative that those who work in financial planning have an understanding of ethics to help guide their decision-making.

Furthermore, making ethics central to financial advice demonstrates concern for the client's best interests, while building public trust and confidence in seeking professional financial advice.

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QUESTIONS

To answer the following questions, go to the CPD tab at moneyandlife.com.au/professionals

Financial Advising Scenario

Matthew is a CFP® professional and has been a financial adviser for a number of years as an authorised representative of a medium sized financial planning firm, XYZ Financial Planning.

Matthew sees Rick and Jane Smith who need holistic financial advice. As part of this advice, Matthew will be recommending that Rick and Jane update their will and consider a range of other estate planning needs.

Matthew's licensee has asked Matthew to recommend new clients like Rick and Jane to the licensee's cousin, Mr Will Jones, who is a solicitor. Matthew is aware that Will charges a fee of around $3,000 for the services required by Rick and Jane.

However, Rick and Jane have already told Matthew they have a family solicitor who they and Rick's parents always use. This solicitor is also a trusted family friend and offers his services at a heavily discounted rate to Smith family members.

Furthermore, Matthew's colleague has disclosed to Matthew that the licensee receives a $300 referral fee for every referral to Will for estate planning services.

Should Matthew recommend that the clients make an appointment with Mr Will Jones? Use the Langenderfer and Rockness model to arrive at your decision.

1. The Categorical Imperative:

a. Is the imperative for every financial adviser to choose which course of action to take.

b. Is an area of teleological ethics.

c. Arises from a sense of duty.

d. Is a rule proposed by Aristotle.

2. The FPA Code of Ethics:

a. Has seven main principles.

b. Does not include 'Fairness' as one of its main principles.

c. Applies to all financial advisers.

d. Puts the client first.

3. Which of the following statements is true in respect to deontological ethics?

a. Treat others as you would like others to treat you.

b. The measure of right or wrong is the greatest good to the greatest number of people.

c. The end justifies the means.

d. Ethical decisions are outcomes based.

4. Ethical behaviour:

a. Is abiding by the law.

b. Starts at Stage 2 of Kohlberg's moral development scale.

c. Can be achieved solely by having an established code of ethics.

d. Begins with ethical awareness.

5. In regards to the scenario above, which of the following options is the most ethical decision for Matthew?

a. Fully disclose the referral arrangement to the clients and recommend Mr Will Jones as an alternative option to their existing solicitor.

b. Fully disclose the referral arrangement to the clients, while recommending the clients utilise the services of Mr Will Jones.

c. Do not refer the clients to Mr Will Jones at all.

d. Recommend the clients to Mr Will Jones for all their estate planning needs.

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