

What if we expected financial services to be more like health services?

Written by Paul Kofman, Professor of Finance, University of Melbourne

Earlier this year the chief of a financial planning firm [collapsed in the witness stand](#) during Australia's ongoing royal commission into misconduct in the financial services industry. He had to be taken to hospital in an ambulance – some would say a fitting metaphor for the state of the industry.

Fortunately for him the health care system doesn't operate like the financial planning industry. If it did he might have been "treated" according to what was most profitable for the ambulance service rather than what was best for his well-being.

The [Financial Services Royal Commission](#) is exposing abundant evidence of unethical misconduct. Customers are being charged fees for services they never get or ever need, getting inappropriate advice, being offered irresponsible loans and sold worthless insurance contracts. It shows up an industry riddled with conflicts of interest and obsessed with extracting profits from customers in any way conceivable.

Read more: [***Treasury admits corporate governance is broken but baulks at systemic fixes***](#)

Sound familiar? The 2007-09 Global Financial Crisis was in large part caused by the same "profit at all costs" culture. It fuelled high-risk home lending to ordinary people who couldn't afford it. Why haven't things changed?

Despite the lessons of the GFC and a regulatory crackdown, the central problem with the global financial services industry is that, unlike the health industry, it has long stopped caring about its customers' well-being.

Financial services, such as payments and basic forms of credit and insurance, are now essential for the economy and society to function. For this reason, the large financial services

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firms often receive privileges such as market protection and implicit government guarantees worth billions of dollars, underwritten by taxpayers. So how has the bar been allowed to sink so low?

The mindset behind the scandals

At the heart of the problem lies the mental model that the finance industry applies to itself and the world around it.

This thinking is dominated by the neoclassical model of economics in which people are “rational actors” who always do what is best for them. And they supposedly interact with each other through perfect markets, leading to the efficient allocation of resources.

While everyone understands this as an idealised abstraction, the impact of this working assumption is profound. It has led to an “input-oriented” model. Banks and other financial services companies are exclusively concerned with providing whatever inputs – financial products and services – their customers demand.

Bewildering arrays of products are sold using state-of-the-art marketing techniques, irrespective of whether the customers actually need them.

Undesired outcomes are often considered to be the customer’s responsibility. If the customer ends up with too much credit card debt, possibly as a result of aggressive marketing, don’t blame the bank.

Read more: [*Embedding regulators in banks can help change cultures of wrongdoing, despite the risks*](#)

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Regulatory and public policy responses are also premised on this model. The dominant approach in financial regulation focuses on disclosure, requiring firms to provide more and more information about their financial products.

Product disclosure statements are now often hundreds or thousands of pages long. These are littered with legal and financial jargon that is often incomprehensible even to experts. Rather than clarifying the nature of financial products, disclosure requirements have only made them more opaque.

This rationalist approach has led the industry and regulators to promote financial literacy education as a solution to the problem. The idea is to educate consumers about financial products and services to help them navigate the financial system and make good decisions.

The Australian government [spends tens of millions of dollars on financial literacy programs](#) such as its [MoneySmart](#) program. The Bank of England recently launched [econoME](#), a program with very similar aims.

This approach ignores a core aspect of finance. Many financial problems that consumers face are highly complex. For example, determining a person's optimal lifetime saving and investment strategy to provide an adequate income in retirement is a formidable problem, even for a finance expert with a supercomputer.

It is beyond the capability of the average person to work out many financial decisions on their own, and we shouldn't expect people to do so – just as we don't expect the average person to perform brain surgery.

Read more: [**Royal commission scandals are the result of poor financial regulation, not literacy**](#)

Focus needs to shift to financial well-being

If we accept that many aspects of finance are hard, we will need to give up on the rationalist model. Instead we need to switch to an outcome-focused model in which, as with the health care system, the primary concern is for people to reach a set of outcomes or goals – a certain level of financial well-being, for example.

Services offered by banks and regulations imposed by governments would then be evaluated on the extent to which they offer to improve people's financial well-being. Banks would only offer services that have been shown to improve one or more dimensions of their customers' financial well-being, aligning their interests more closely with those of their customers.

Financial services and their regulation would look radically different. For example, fewer decision options and simpler products would be more effective in improving financial well-being. New technologies such as artificial intelligence could likely play an important role in this new world of finance.

Importantly, both the development of services and their regulation should be based on evidence and delivered under a set of professional standards monitored by an independent standards-setting body. This would be similar to the processes and institutions used in the health system. Providers of financial services would then be subject to both a fiduciary duty and product liability.

The future of finance doesn't lie in ever more regulation, or ever more sophisticated technology to squeeze higher margins out of legacy products. The future of finance lies in the rediscovery of what finance is for – to improve the financial and economic well-being of society.

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