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On corporate governance: Lessons from the Australian banks since the GFC

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What's going on here?

- Why has the community (apparently) lost trust in the banks and other institutions of finance?
- Australian banks are sound, profitable and subject to extensive governmental regulation. They have signed up to many self-regulatory codes, guidelines and voluntary commitments on a range of matters, including ESGC
- But in April 2016, two-thirds of Australian voters were in favour of a Royal Commission
- Is it a failure of spin, the politics of envy, or something deeper?

After all...



Maybe...

- We just live in a 'post trust' world (the Turner view)
- Financial institutions behave in a way that doesn't warrant trust (the Ferguson premise)
- Financial institutions are selling a lot of products that no-one really needs, and that no-one profits from but them (the John Kay theory) and that for some retail customers are simply unsuitable or unsafe (the Murray Inquiry unease)
- 'Too big to fail' has turned into 'too big to gaol' or even worse, 'too big to nail'



So there is talk of a 'social licence'



But my issue is this...

- We have an elaborate and extensive (legal and non-legal) framework for corporate governance and corporate accountability, in which we are significantly invested
- Financial institutions, and in particular the D-SIBs, are right at the heart of that framework
- The important question is: what have we learnt, from what has happened with the financial institutions over the last eight years, about that framework, its pressure points and its limitations?



Five lessons

1. Self regulation only works if everyone believes the obligations voluntarily assumed are actually real
2. Boards are well and truly in the frame
3. Shareholders (particularly institutional investors) are important, but 'it's complicated'
4. Yes it is about culture, but not about culture prattle
5. Government needs to invest in legislative and regulatory capacity, resist vested interests, and innovate



A quick reminder



- The double helix of corporate governance – what the company is for, and how it is organised to achieve that
- The legal core and the self-regulatory penumbra
- ‘The framework of rules, relationships, systems and processes within and by which authority is exercised and controlled in corporations’
- Shareholders primacy v stakeholder theory (ho hum). Enlightened shareholder value (ho ho hum)
- Accountable to whom?
- Remember company officers in Australia have public duties, not just private responsibilities

Lesson 1

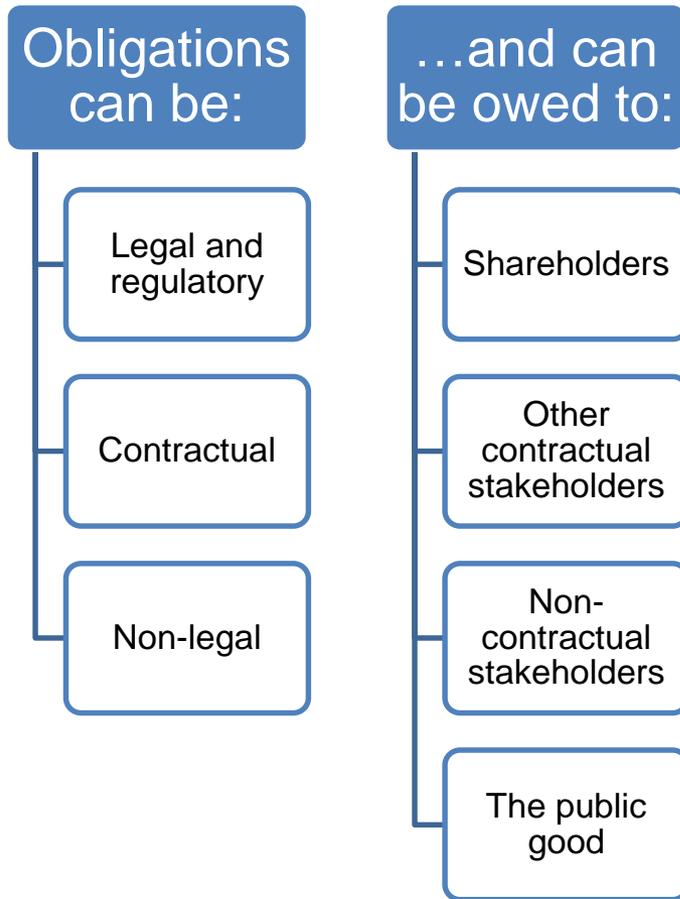
Self-regulation

Self regulation only works if everyone believes the obligations voluntarily assumed are actually real

- The modern appetite for self-regulation reflects a changed understanding of the role of the state
- Industry codes of practice or conduct, governance codes, environmental and social impact, sustainability
- Principle 3 of the ASX Corporate Governance Principles and Recommendations – the corporation must act ethically and responsibly
- The problem of individual v corporate accountability – from Dodgy Don to Wells Fargo



The corporation as 'obligor'



- Where do self-regulatory obligations sit?
- To whom are they owed?
- Can they be 'enforced'? How about through M&DC laws?
- Can corporations (as distinct from individuals) have non-legal obligations to the public good? A question of corporate theory
- The role of the board is to reconcile these obligations
- Not all corporations have (or must have) the same 'values proposition'

Lesson 2

Boards

Boards are well and truly in the frame, and not just for Theresa May

- The nature and purpose of ‘independence’. APRA CPS 510 and the Walker review
- Consider what boards are for, and the importance of diverse perspectives
- Punishing directors for ‘poor culture’ is not the answer (and that is not what CC does)
- Storm Financial and the *Cassimatis* decision – next in a long line of ASIC stepping stone cases. The directors’ duty of care not to expose the company to regulatory or reputational risk, which can be enforced by the State even when the company would have no action in negligence



Lesson 3

Shareholders

Shareholders (particularly institutional investors) are important, but 'it's complicated'

- Shareholders are potentially a much more potent force for change than customers
- Financialisation and the ever-lengthening investment chain creates complex and contrary incentives
- Not all institutional investors have the same objectives
- Voice strategies are increasingly important where institutions cannot exit
- The UK Stewardship Code is a significant initiative, coupled to governance code, but will it survive?
- CBA and executive pay



Lesson 4

Culture

Yes it is about culture, but not about culture prattle

- There is a difference between a company's values proposition and its culture – and not every company's values proposition is the same
- Culture is 'good' when incentives and behaviours throughout the organisation are aligned to the values proposition
- Culture is local and is learned by watching not listening
- Jawboning from regulators doesn't add much
- Culture can (and should) be measured by management
- Not just dealing rooms, think also product design and sales



Lesson 5

Government

Government needs to invest in legislative and regulatory capacity, resist vested interests, and innovate

- It is incredibly difficult to see how effective change can be driven by government, for a range of reasons all of which we should shout from the rooftops
- There is a program of legislative reform proposed, but we will have to see where it goes
- ASIC has not adopted the recommendations from the Capability Review
- Old truths about regulatory design were challenged by the GFC, but replacements are yet to emerge. Behavioural insights might be relevant, but are they a basis for regulating?



Of course, reform is hard



Why it matters

- Trust in institutions matters
- At the moment, our current framework of corporate governance and accountability is the only game in town
- As a pragmatist, I want to understand the lessons to be learnt from what is happening with the banks

