How exceptional is Australian financial sector misconduct? The Hayne Royal Commission revisited

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How Exceptional is Australian Financial Sector Misconduct?

The Hayne Royal Commission Revisited

Abstract

By failing to consider that the types of financial misconduct witnessed in Australia in recent years are relatively commonplace in other countries, the Hayne Royal Commission exaggerates the level of miscreance within the local financial sector. This paper seeks to rectify this neglect by offering an explicit comparison of misconduct in Australian and major British and American banks. It also suggests that the Commission's work and findings inadvertently provide support for the populist view that Australian financial institutions are exceptionally unethical in their treatment of customers and clients. Given the emergence of Fintech and the potential for Big Tech firms to penetrate financial services markets, large incumbent Australian firms are already facing a serious challenge. If the net effect of the Royal Commission is to deepen mistrust of large Australian banks and insurers, their capacity to resist this challenge will be diminished with potentially far-reaching consequences.

I Introduction

Australia has a strong and distinctive populist tradition, stretching back to the 1890s, in which bankers are portrayed as rapacious villains who exploit and ruin households, small businesses and communities. Though important, the work and findings of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (hereafter RCM), chaired by Kenneth Hayne, unintentionally provide fuel for that tradition by depicting the Australian financial services industry in a more negative light than is merited when its misbehaviour is compared with that of its counterparts in, for example, the United States and the United Kingdom.[1] The penultimate (ninth) clause of the Letters Patent permitted the RCM to examine international experience.[2] Yet Hayne was given little over a year (from November 2017 until 1 February 2019) to complete his investigations and publish a final report, which may explain why he gave so little attention to comparing financial misconduct in Australia with that overseas. Although worthy of strong condemnation, the misconduct committed by Australian financial institutions appears unremarkable, one might almost say routine, when placed in international context. This paper not only provides that context, it identifies the potential pitfalls of setting up a strictly time-limited inquiry within the environing conditions of a populism-inflected national culture.

To a considerable extent, the RCM's reform proposals are off-the-peg solutions produced by the G30 and the Financial Stability Board.[3] Chapter 6 of the first volume of the Final Report gives considerable attention to the framework offered by those international bodies. If an international dimension had pervaded the work of the RCM, the present paper argues, there would have been less risk of stoking anti-bank populist sentiment. Indeed, if the principal effect of the RCM is to intensify public mistrust of major incumbents such as ANZ, CBA, NAB, Westpac and AMP, then it could promote greater competition within the financial services industry by providing encouragement to a new wave of entrants including Fintech and Big Tech firms such as Amazon and Google. For the incumbents to avoid this outcome – and to limit its potentially destabilising effects – it is now more important than ever that they execute genuine, and not merely cosmetic, reforms to their values and conduct.

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[1] The financial services industry, as investigated by the RCM, encompasses banks and other deposit takers, insurance companies, pension funds, and a range of intermediaries, such as mortgage and insurance brokers and independent financial advisors, which sometimes enjoy close relations with the larger firms.

[2] RCM, *Interim Report*, vol. 1 (Commonwealth of Australia 2018), 4-5.

[3] The Group of Thirty (G30) is a think tank of international bankers, central bankers and academics based in Washington DC, and possessing close links to the international financial establishment. The Financial Stability Board was established at the London Summit of the G20 in 2009, and is hosted by the influential Bank for International Settlements at Basel.

In this sense, the RCM's unintended consequences may be more significant than its official purpose and goals.

The paper's argument is developed in several sections. Section two discusses the reasons for the establishment of the RCM and places it within the historical and cultural context of a recurring public debate over the relationship between financial institutions, especially large banks, and the Australian people. The third section provides an explicit comparison of the type of misconduct that has been prevalent in financial services firms in Australia, the US, and the UK. The causes of financial misconduct, as conjectured by the RCM, are outlined in the fourth section, and shown to be consistent with the findings of overseas authorities. The fourth section maintains that Hayne's decision to opt for 'off-the-shelf' cultural remedies to Australian financial misconduct suggests precisely that this misconduct is not exceptional by international standards. Yet absent explicit recognition of this fact by the RCM itself, the penultimate section argues, the potential of its deliberations and findings to worsen reputational damage to Australian financial institutions creates an opportunity for tech-driven new entrants. A brief conclusion rounds out the discussion.

II Historico-cultural backdrop to the Royal Commission

Between 2014 and 2017 the Liberal-led government faced mounting pressure to intervene in response to a spate of alarming press revelations about misconduct by large Australian financial institutions. Liberal leaders rejected calls by opposition parties for a Royal Commission into financial misconduct, arguing that it would be an overreaction, but, in late November 2017, Prime Minister Malcolm Turnbull and Treasurer Scott Morrison folded and announced the formation of a Royal Commission.[4] Chaired by Kenneth Hayne, the RCM was tasked to investigate misconduct and conduct falling short of community standards and

[4] George Gilligan, "The Hayne royal commission and trust issues in the regulation of the Australian financial sector" (2018) 12(4) *Law and Financial Markets Review* 176.

expectations (hereinafter bracketed as 'misconduct') in the financial services industry, and was invited to make recommendations for reforms to the law, the internal practices of firms, and the regulatory system.

The clamour for a Royal Commission on banking had an important precedent in the 1930s. In the aftermath of the depression, the banking system in Australia was deeply unpopular. Joseph Lyons's fiscally conservative UAP government feared losing support at the 1934 general election in the face of the anti-banking rhetoric of Labor on the left and the Country Party (the forerunner of National) on the right. Lyons agreed to set up a Royal Commission on Banking, with a view to containing electoral damage.[5] That Labor and the Country Party shared at least some common ground shows that, just as today, anti-bank populism had left and right wing variants.[6]

There is a singular leitmotif: Turnbull, Morrison, and Lyons were confronted by the power of a distinctively Australian strand of populism with its origins in the late nineteenth century. Pinnington and Lafferty link hostility to the big banks to the "bush myth" of independent and hard-working, yet at the same time egalitarian and community-minded, Australians. Trading banks, by contrast, were villains who exploited Australian battlers for the benefit of management, distant shareholders and shady overseas interests.[7] A severe banking crisis in 1893 brought a credit crunch and ruin for many rural and urban Australian businesses.[8] In the wake of this disaster, the privately-owned banking system, with its close ties to the City of London and domestic political influence, was branded as incompetent,

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[5] Warwick Eather and Drew Cottle, "'Keep government out of business': bank nationalisation, financial reform and the private trading banks in the 1930s" (2013) 59(2) *Australian Journal of Politics and History* 172.

[6] Dick Bryan, "Australian populism and the global financial crisis: finding a place for labour" (2010) 20(3) *Labour and Industry* 252.

[7] Ashly Pinnington and George Lafferty, "The Bush Myth: internationalisation, tradition and community in the Australian context" (2004) 6(3) *Philosophy of Management* 5-13.

[8] Christopher John Kent, "Two depressions, one banking collapse: lessons from Australia" (2011) 7 *Journal of Financial Stability* 126-137.

corrupt, cruel and, essentially, “un-Australian”. Critics of the banks drew on the rhetoric of US populism, remoulding it for an Australian audience. The Commonwealth Bank of Australia (CBA) was established by a Labor government in 1912 to create a publicly owned, and supposedly more responsible, alternative to the private trading banks. Although the depression of the early 1930s left the Australian banking system relatively unscathed, radical politicians of the left and right, most notably Jack Lang, the Labor premier of New South Wales, argued that the economy was being sacrificed by the Money Power to meet the demands of creditors in the City of London. The CBA and the private trading banks were denounced for vetoing reflation, and for playing a part in the fall of the Scullin government. Nationalisation was proposed as a solution to the power of the banks.[9] Regaining power in 1941, Labor was determined to retain tight controls over the banking system after the war, and to subordinate the CBA to the government. When, in 1947, the High Court ruled section 48 of the new Banking Act invalid, Chifley began a campaign for nationalisation of trading banks, arguing that they were obstructing an elected government. Chifley and Labor were defeated at the polls in 1949, but the threat of nationalisation had been tangible.[10]

Hostility to the banks surged again during the recession of the early 1990s, with the Treasurer, Paul Keating, fanning the flames by accusing trading banks of exacerbating the downturn by delaying cuts in interest rates on loans to businesses and households.[11] Senator Paul McLean (Australian Democrats) launched an attack on the conduct of banks at around the same time.[12] In short, a strong undercurrent of opinion has, since the 1890s, maintained that financial institutions are exploiting ordinary Australians. Arguably, the RCM would not have happened without that undercurrent of opinion.

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[9] Peter Love, *Labour and the Money Power* (Melbourne University Press 1984).

[10] A.L. May, *The Battle for the Banks* (Sydney University Press 1968).

[11] Christopher Richard Berg, “Safety and soundness: an economic history of prudential bank regulation in Australia, 1893-2008” PhD thesis, RMIT University (2016) 247-252.

[12] Paul McLean and James Renton, *Bankers and Bastards* (Hawthorn Vic 1992).

Set against the backdrop of populism, the RCM has served conflicting purposes: on the one hand, allowing critics of the financial system to vent their complaints and stock up on ammunition, but on the other hand generating rational proposals for reform. Which of those purposes will dominate is an open question. If Hegel is correct that people and governments learn nothing from history, then the preceding demonstration of the recurrence of anti-bank populism lends weight to O'Brien's contention that, absent urgent action to deal with misconduct, "anxiety, resentment, alienation and rage" against the banks could provide further ammunition for "the politics of populism".[13] Indeed, by attributing financial misconduct ultimately to "dishonesty and greed", the language of the RCM overlapped with that of populism.[14] Those terms were perhaps unavoidable, since dishonesty and greed were proven, but they definitely were consistent with the populist narrative. Populist attacks could also be renewed if, as Wishart and Wardrop fear, the financial institutions use their political influence to deflect and dilute any substantive reforms recommended by the RCM.[15] Moreover, though the RCM's failure to place financial misconduct in Australia in an international context may be understandable on one level, such an approach reinforces the popular conception of Australian banks and financial institutions as lacking a moral compass. In short, the RCM's tendency to stress the distinctiveness of Australian financial sector misdeeds risks a populist backlash.

III Australian financial misconduct in comparative perspective

[13] Justin O'Brien, "'Because they could': trust, integrity and purpose in the regulation of corporate governance in the aftermath of the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*" (2019) 13(2-3) *Law and Financial Markets Review* 141-156.

[14] RCM, *Interim Report*, vol. 1 (Commonwealth of Australia 2018), 73; Bryan, op cit, 253.

[15] David Wishart and Ann Wardrop, "What can the Banking Royal Commission achieve: regulating for good corporate culture?" (2018) 43(2) *Alternative Law Journal* 81-88.

This section compares the recent record of misconduct in the Australian, American and British financial services industries. Many of the same varieties of misconduct occurred in each country. For that reason, the Australian case is not especially egregious. This is not to say that public outrage lacks justification, but rather that emotion-driven responses must be tempered by consideration of facts derived from comparative analysis. For example, Australian financial institutions were not heavily involved in some of the types of misconduct that contributed to the Global Financial Crisis (GFC), suggesting that they were not as badly regulated or supervised as the RCM claims, or that their relative isolation from the world's financial centres limited their exposure to temptation.

Evidence of widespread financial misconduct was presented to, and catalogued by, the RCM, and was given rapt attention by the media. The RCM focussed primarily on misconduct by Australian financial entities in their dealings with small customers and clients (whether individuals or businesses including farms). Such behaviour, whether illegal or merely unethical, had caused "substantial loss to many customers" whilst bringing "substantial profit to the entities concerned."[16] The "asymmetry of knowledge and power between consumers and financial services entities" had been exploited.[17] Aggressive sales techniques were used by staff working under pressure to meet sales targets for various products including housing and farm loans. Little effort was made to determine whether a loan was, as required by law, suitable for the applicant. Statements offered by customers about their income and outgoings were taken at face value, and a rule of thumb procedure based on the Household Expenditure Measure was used to assess their capacity to service housing debt. Some customers were overcharged for loans and financial advice. Fees for financial advice were hidden from clients, or charged when no advice was given, and clients were pushed into selecting expensive or poorly performing funds when doing so was to the

[16] RCM, *Final Report*, vol. 1 (Commonwealth of Australia 2019), 1.

[17] RCM, *Final Report*, vol. 1 (Commonwealth of Australia 2019), 490.

benefit of the adviser or their firm. Conflicts of interest were settled furtively in favour of advisers and their firms. Complaints were often fobbed off, and when errors were admitted the process of remediation was slow and inadequate.[18] To take but one example, both CBA and Westpac admitted misconduct in relation to add-on insurance products, known in the UK as Payment Protection Insurance (PPI). CBA estimated that 20,000 customers had been sold loan protection insurance in relation to a home or personal loan, despite being ineligible to claim any benefits on account of their employment status.[19]

Undoubtedly the RCM provided grist to the mill of populist critics of the banking system. Hearings in Brisbane were accompanied by protests from farmers outside the venue, and interruptions from Bob Katter, the leader of Katter's Australian Party, within the venue. Their goal was to draw attention to the suffering of farmers at the hands of the big banks.[20] Pauline Hanson, leader of the One Nation Party, also found much of interest in the work of the RCM and wanted its scope to be extended: her party had "fought long and hard for the Banks to be held accountable and we won't give up until all those affected receive the justice they deserve."[21] By resisting calls for a Royal Commission in 2017, the government had hoped to circumvent such reactions.

A key point, which the RCM failed to emphasise, is that similar or even worse cases of financial misconduct have occurred overseas. Brannan shows how staff members at a UK call centre selling insurance against credit card and identity fraud were compelled to cut

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[18] The evidence collected by the RCM is extensive. RCM, *Interim Report*, vol. 1 (Commonwealth of Australia 2018), 19-266. Detailed case studies of misconduct by a selection of banks and other financial service providers are set out in RCM, *Final Report*, vol. 2 (Commonwealth of Australia 2019).

[19] RCM, *Interim Report*, vol. 1 (Commonwealth of Australia 2018), 48-50; RCM, *Interim Report*, vol. 2 (Commonwealth of Australia 2018), 51-64.

[20] James Frost, "Cyclone Katter disrupts Hayne inquiry", *AFR Online*, 26 June 2018

[21] "Pauline calls for banking Royal Commission to be extended", 27 July 2018 https://www.onenation.org.au/pauline-calls-for-banking-royal-commission-to-be-extended/ (accessed 6 April 2020)

regulatory corners and mislead customers in order to meet sales targets, placate their bullying managers, and retain their jobs.[22] The PPI scandal in the UK involved systemic and sustained misconduct by banks and other financial organisations over many years. Over 20 million PPI policies were held by British consumers in 2006. Numerous PPI policies were mis-sold, not least to vulnerable and desperate customers, who were sometimes given the impression that PPI was compulsory rather than optional when taking out a loan or signing up for a credit card; the policies were poorly explained. As in Australia, customers were sold PPI even when they were ineligible to make a claim. PPI, however, was highly profitable for the banks. A large compensation programme was instituted to recompense customers who had been misled, but the damage to the reputation of British lenders was not easily undone.[23] Having come under intense pressure to record higher sales, employees at Wells Fargo, a large US bank, opened over two million deposit and credit card accounts in the name of existing customers, usually without their knowledge or approval, and shifted customers' funds temporarily into those accounts. As well as resulting in unexpected fees for Wells Fargo customers, such practices were deemed unfair, deceptive and abusive under the Dodd-Frank Wall Street Reform and Consumer Protection Act, and the bank was fined heavily.[24]

Given the RCM's preoccupation with services provided to consumers and small business clients, it by and large steered clear of misconduct in investment banking, and in consequence some types of misconduct that were committed on a larger scale by international than by Australian financial institutions. Misconduct in investment banking may affect

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[22] Matthew J. Brannan, "Power, corruption and lies: mis-selling and the production of culture in financial services" (2017) 70(6) *Human Relations* 641-667.

[23] Patrick McConnell and Keith Blacker, "Systemic risk: the UK payment protection insurance scandal" (2012) 7(1) *Journal of Operational Risk* 79-139.

[24] Consumer Financial Protection Bureau, Consumer Financial Protection Bureau fines Wells Fargo $100 for widespread illegal practice of secretly opening unauthorized accounts, September 8 2016 https://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-fines-wells-fargo-100-million-widespread-illegal-practice-secretly-opening-unauthorized-accounts/ (accessed 19 February 2020)

customers indirectly by weakening the balance sheets of banks and therefore their capacity to lend, and by influencing interest rates. Here, once again, the record of Australian banks is not unblemished, but neither is it as patchy as that of global players. In the early 2000s, inadequately managed foreign exchange dealers cost NAB dearly when they got into difficulties and then tried to cover up large losses.[25] Westpac and other banks operating in Australia were found in 2017-18 to have engaged in the manipulation of the local bank bill swap reference rate (BBSW).[26] But to put these transgressions into perspective, consider the fact that Barclays' staff played a leading part in the efforts of a group of large international banks to manipulate the London Inter Bank Offered Rate (LIBOR), either to increase profits or – during the GFC - to give the impression that Barclays could borrow more easily, and was in less trouble, than in reality was the case. LIBOR is a benchmark used in the setting of interest rates on US$ trillions worth of lending across the world, including Australia. Although the tweaks to LIBOR were small, their impact was substantial given the volume of lending that was affected. Heavy penalties ensued for Barclays and other offenders.[27]

The involvement of banks in money laundering constitutes another serious form of misconduct. In Australia, CBA was investigated by the Australian Transaction Reports and Analysis Centre (AUSTRAC) over the use of its facilities for money laundering, and in 2018 it agreed to pay a $700m penalty.[28] Since the publication of the final report of the RCM, the

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[25] Steven Dellaportas, Barry J. Cooper and Peter Braica, "Leadership, culture and employee deceit: the case of the National Australia Bank" (2017) 15(6) *Corporate Governance* 1442-1452.

[26] ASIC, 18-151MR Federal Court finds Westpac trade to affect the BBSW and engaged in unconscionable conduct, 24 May 2018 https://asic.gov.au/about-asic/news-centre/find-a-media-release/2018-releases/18-151mr-federal-court-finds-westpac-traded-to-affect-the-bbsw-and-engaged-in-unconscionable-conduct/ (accessed 16 March 2020)

[27] Philip Ashton and Brett Christophers, "On arbitration, arbitrage and arbitrariness in financial markets and their governance: unpacking LIBOR and the LIBOR scandal" (2015) 44(2) *Economy and Society* 188-217.

[28] RCM, *Interim Report*, vol. 1 (Commonwealth of Australia 2018), 87; AUSTRAC, AUSTRAC and CBA agree $700m penalty, 4 June 2018 https://www.austrac.gov.au/austrac-and-cba-agree-700m-penalty (accessed 16 March 2020)

involvement of Westpac in a large international money laundering and child exploitation scandal has been alleged by AUSTRAC.[29] Although the laxity of specifically Australian banks in relation to money laundering is deplorable, it is not unprecedented. For example, lax internal controls allowed drug dealers and terrorists to use HSBC and its subsidiaries to launder money over a number of years in breach of the law in the United States and other jurisdictions.[30] HSBC was by no means the only culprit among large global banks.

Finally, and perhaps most tellingly, Australian banks and other mortgage providers managed to avoid the worst excesses of the sub-prime mortgage crisis that in the United States was instrumental in triggering the GFC. Although the RCM identified several types of misconduct in the granting of housing loans, especially to households on low incomes, the aggregate amount of sub-prime mortgage lending in Australia was very low.[31] Even on the eve of the GFC, sub-prime lending in Australia was comparatively modest, with higher standards applied than in the United States. Arguably, legal differences between Australia and many US states led Australian *borrowers* to be more cautious. Whereas Americans who were unable to repay their housing loans could simply hand back their keys and depart with no further liability, Australians could not rid themselves of mortgage debt so easily.[32] In 2012 the five largest mortgage servicers in the US reached a settlement with the federal

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[29] Jamie Smyth, "Westpac accused of Australia's biggest money laundering breach", *Financial Times*, 20 November 2019 https://www.ft.com/content/3598cb7a-0b27-11ea-bb52-34c8d9dc6d84 (accessed 20 February 2020)

[30] United States Senate, Permanent Subcommittee on Investigations, HSBC exposed U.S. financial system to money laundering, drug, terrorist financing risks, July 16 2012 https://www.hsgac.senate.gov/subcommittees/investigations/media/hsbc-exposed-us-finacial-system-to-money-laundering-drug-terrorist-financing-risks (accessed 19 February 2020); Aidan Carlin and Mark Eshwar Lokanan, "Ritualisation and money laundering in the Swiss banking sector" (2018) 21(1) *Journal of Money Laundering Control* 89-103.

[31] RCM, *Interim Report*, vol. 1 (Commonwealth of Australia 2018), 31-32.

[32] Pelma Rajapakse and Jodi Gardner, "The unconscionable conduct and consumer protection in subprime lending in Australia" (2014) 29 *Banking & Finance Law Review* 485-515.

government and forty-nine state attorneys general over abuses in mortgage lending and foreclosure. As well as agreeing to implement new loan servicing standards, the five miscreants undertook to "commit $25 billion to resolve violations of state and federal law."[33] Banks and other mortgage originators had engaged in deception and even forgery when signing some borrowers up for mortgage loans; they had also resorted to illegal methods when foreclosing on some loans. Lorraine Brown, the CEO of a firm called LPS, admitted to committing mail and wire fraud in relation to a "scheme to prepare and file more than 1 million fraudulently signed and notarized mortgage-related documents".[34]

By not participating fully in the sub-prime lending spree of the early 2000s, Australia avoided the exaggerated boom and bust that afflicted the United States. Major Australian banks and insurers did not require bailouts during 2007-09, unlike some of their overseas counterparts. Australia, moreover, did not descend into recession. According to one estimate, real GDP in the United States in the final quarter of 2016 was 15% (or US$4.6 trillion) less than it would have been if the pre-crash growth rate had persisted.[35] The cost of lost growth was borne by consumers, workers, taxpayers and business owners. The conclusion is inescapable: however morally reprehensible it was, the nature and extent of misconduct in the Australian financial services industry was unremarkable by international standards.

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[33] United States Department of Justice, Federal government and state attorneys general reach $25 billion agreement with five largest mortgage servicers to address mortgage loan servicing and foreclosure abuses, February 9 2012 https://www.justice.gov/opa/pr/federal-government-and-state-attorneys-general-reach-25-billion-agreement-five-largest (accessed 19 February 2020)

[34] Don Mayer, Anita Cava and Catharyn Baird, "Crime and punishment (or the lack thereof) for financial fraud in the subprime mortgage meltdown: reasons and remedies for legal and ethical lapses" (2014) 51(3) *American Business Law Journal* 517.

[35] J.W. Mason, *What Recovery? The Case for Continued Expansionary Policy at the Fed* (Roosevelt Institute 2017), 20, 22.

IV Off-the-shelf remedies – implications and concerns

The RCM called for the tougher enforcement of conduct regulations, and for some changes – or simplifications – in the law relating to financial services, not least in relation to the resolution of conflicts of interest between service providers and their customers and clients. Above all else, however, the RCM demanded that banks and other financial institutions remodel their culture, governance and remuneration structures in order to deter misconduct and ensure that staff and agents serve the best interests of customers and clients. External regulation would not be enough to change the values and conduct of the financial services industry. The accent on cultural remedies represented a deliberate choice amongst alternative recipes.

Hayne's recommendations were closely related to those of the G30's report on *Banking Conduct and Culture* in 2015.[36] Culture is defined by the RCM as the "shared values and norms" of the organisation, or, to put it more crudely, how staff behave when no-one is watching.[37] Values and norms are strongly influenced by the behaviour of leaders within the organisation, by the content and intensity of staff training programmes, and by remuneration and promotion practices. If employees were rewarded overwhelmingly in relation to meeting sales or other financial targets, they would be in no doubt as to the actual – as distinct from espoused – values of the business. The RCM acknowledged that its take on the causes of financial misconduct owed much to recent research by the G30 and FSB.[38] The similarities in approach are striking. "Poor cultural foundations and significant cultural failures", argued the G30, "were major drivers of the recent financial crisis, and continue to be factors in the

[36] Gail Kelly, a former CEO of Westpac, was a member of this team.

[37] RCM, *Final Report*, vol. 1 (Commonwealth of Australia 2019), 334.

[38] RCM, *Final Report*, vol. 1 (Commonwealth of Australia 2019), 375-388.

scandals since then”.[39] In order to restore the community’s trust in banks, continued the G30, there must be a radical change in banking culture, so as to embed values and conduct appropriate to businesses serving the public. Better governance was essential, for boards and senior managers must drive cultural change, not least by setting the right tone in their own behaviour. The award of promotion and performance-based pay should be made to depend, to a meaningful degree, on the demonstration of the approved values and conduct. Much greater emphasis should be placed on values and conduct in the selection and training of staff, and training should continue until the application of the desired values and conduct becomes automatic.[40] Staff should be required to report wrongdoing. Bank supervisors should monitor the mechanisms introduced by management to form a better culture, discuss them with the board and senior management, and offer advice. As a prerequisite, banks would have to engage in a more open and less defensive dialogue with supervisors than is now the norm.[41] Similar remedies were recommended by the Financial Stability Board, but the G30 is more succinct and uses similar language to that adopted by the RCM.[42]

Why would financial institutions make the investments of time and resources to rearrange their priorities and reform their business culture and practices? The G30 maintained that banks had a strong incentive to reform. A customer-focussed culture was the “bedrock” of a secure and effective financial system, whilst the absence of such a culture had cost banks many US$ billions in fines since the GFC, weakening their financial results and sustainability.[43]

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[39] G30, *Banking Conduct and Culture: A Call for Sustained and Comprehensive Reform* (Group of Thirty 2015), 11

[40] G30, *op cit*, 50-52.

[41] G30, *op cit*, 54-56.

[42] Financial Stability Board, *Reducing Misconduct Risks in the Financial Sector: Progress Report to G20 Leaders* (Basel, 2017).

[43] G30, *op cit*, 18, 20. See also Roger Mccormick and Chris Stears, “Banks: conduct costs, cultural issues and steps towards professionalism” (2014) 8(2) *Law and Financial Markets Review* 134-144.

Hayne's proposed remedies for the financial services industry are generic ones that reflect the prevailing international consensus on how to respond to financial misconduct. The fact that an off-the-shelf solution was deemed appropriate by the RCM offers further confirmation that the types of financial misconduct seen in Australia were commonplace. By accepting the analysis of misconduct provided by the G30, the RCM was in effect admitting that the causes of misconduct in the financial services industry were the same as those in banks across the developed world. Yet the RCM did not offer examples of overseas banks with weak culture and values. The net result is that followers of the RCM, if so inclined, could continue to regard Australian banks as exceptionally disreputable. Insofar as this was not made explicit by the RCM, and in view of the populist reflex, the associated damage to the reputation of incumbent banks opens the door to new entrants.

V Cultural change and the threat of digital disruption

Large Australian financial institutions have expressed fervent commitments to securing drastic change in internal culture in response to the RCM and other investigations, with a view to meeting the expectations of customers and clients. In the 2019 annual report of the CBA, for example, the chairman, Catherine Livingstone, assured stakeholders that the bank was becoming more focussed on the needs of customers. A code of conduct had been introduced to help promote "lasting cultural change" within the bank; more appropriate remuneration practices were in use; and senior managers were "leading the necessary cultural change".[44]

But lasting cultural change will not be easy to achieve at all, let alone in a short space of time. Doubts were expressed in the *Financial Times* early in 2020 over whether the cultural change advocated by Hayne would be sufficiently deep or lasting. Efforts were in

[44] Commonwealth Bank of Australia, *2019 Annual Report*, 4.

train to weaken new regulatory initiatives, and public interest in banking misconduct was waning.[45] The potential for mishaps and backsliding is considerable. In 2017, UK financial regulators fined Jes Staley, the CEO of Barclays, £642,000. Staley was judged to have "breached the standard of care required and expected of a Chief Executive in a way that risked undermining confidence in Barclays' whistleblowing procedures."[46] The same agencies began a further investigation into Staley's relationship with the late Jeffrey Epstein in 2020.[47] Changing the culture of a large organisation is a long slog, and those driving the process may become complacent, or discover that their energy is claimed increasingly by other emergencies. By March 2020, at the time of this writing, the economic and financial impact of coronavirus has become a much more pressing concern. When considering the threat of digital disruption, bankers of a sanguine nature may take comfort from the reluctance of Australians to switch banks.[48] At times of strong uncertainty, however, the past is not a good predictor of the future – especially when radical new alternatives are available.

In this latter regard, digital disruption from Fintech and Big Tech companies poses a significant challenge for the banking sector in many countries including Australia.[49] That challenge will likely grow if mistrust in existing Australian financial services brands is not restored. As measured by the Edelman Trust Barometer, only 40% of the general public in Australia trusted banks in 2019, down from 48% in 2017. Of the 26 countries in that survey

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[45] Jamie Smythe, "Have Australia's scandal-hit banks changed their culture?" *Financial Times* 11 February 2020 https://www.ft.com/content/ef7ac354-4b8c-11ea-95a0-43d18ec715f5 [accessed 11 Feb. 2020]

[46] Financial Conduct Authority, FCA and PRA jointly fine Mr James Staley £642,430 and announce special requirements regarding whistleblowing systems and controls at Barclays https://www.fca.org.uk/print/news/press-releases/fca-and-pra-jointly-fine-mr-james-staley-announce-special-requirements (accessed 30 March 2020)

[47] David Crow and Caroline Bingham, "Barclays' Jes Staley probed by regulators over links to Jeffrey Epstein" *Financial Times* 13 February 2020.

[48] Park Taichon, Sara Quach, Amulya Sai Bavalur, and Meeta Nair, "Managing customer switching behaviour in the banking industry" (2017) 38(3) *Services Marketing Quarterly* 142-154.

[49] Xavier Vives, "Digital disruption in banking" (2019) 11 *Annual Review of Financial Economics* 243-272.

only Italy recorded a lower level of trust in banks than did Australia.[50] The four pillars (ANZ, CBA, NAB, and Westpac), along with the giant insurer AMP, all fell into the lowest (51st to 60th) tier of the 2019 Corporate Reputation Index which graded 60 Australian organisations. Only the relatively small Bendigo and Adelaide Bank attained a respectable ranking (11th). By way of comparison Apple Australia was placed 17th.[51]

Certainly, smaller Fintechs can be acquired if they become troublesome but Big Tech organisations, such as Google and Facebook, represent a more serious potential challenge. They possess vast stores of data gathered from existing customers, the technical skills to squeeze commercially valuable information from that data, and successful online platforms. Moreover, they are already well-known to potential customers, and are not encumbered by large branch networks, and may be able to avoid being drawn into the current regulatory framework.[52] Research on millennials in the United States indicates that they believe banking to be the industry most vulnerable to digital disruption, and that they would be more interested in new financial products supplied by Google, Amazon, Apple or PayPal than in ones offered by traditional banks.[53] If the Fintech and Big Tech challenge intensifies at a time of public mistrust in the big Australian financial institutions, especially the banks, there could be significant changes in market shares. Contraction of the big four banks, if too rapid, could be destabilising for the financial system, exposing Australia to that other *bête noire* of economic populists: foreign control.

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[50] *2019 Edelman Trust Barometer: Financial Services*, p. 35. https://www.edelman.com/sites/g/files/aatuss191/files/2019-04/2019_Edelman_Trust_Barometer_Financial_Services_Report_1.pdf [accessed 3 March 2020]

[51] *Australia RepTrak 2019 Rankings.pdf* https://www.medianet.com.au/releases/174538/ [accessed 3 March 2020]

[52] Augustin Carstens, "Big tech in finance and new challenges for public policy", Keynote address at FT banking summit, 4 December 2018 https://www.bis.org/speeches/sp181205.pdf (accessed 6 April 2020)

[53] Ian Pollari, "The rise of fintech: opportunities and challenges" (2016) 3 *JASSA: The Finsia Journal of Applied Finance* 16.

VI Conclusion

The Hayne Royal Commission on financial misconduct was remiss in failing to emphasise that misconduct in the Australian financial services industry was by no means the exception when viewed from an international perspective. From a utilitarian ethical perspective, British and American banks have behaved as badly, if not worse, precisely because they are at the centre of the global financial system and have imposed far greater damage on ordinary households and businesses, through the reckless actions that led to the Global Financial Crisis. By not making such comparisons, the RCM gave succour to populists who argue that Australia is exceptional and the Australian banks exceptionally bad. This populist narrative has ebbed and flowed in the public consciousness since the late nineteenth century. The opponents of the banks came close to success in the late 1940s when the Chifley government campaigned for bank nationalisation. Today the threat to the major domestic players in the Australian financial services industry is more subtle but no less far-reaching. If detractors of the large incumbent banks succeed in amplifying public mistrust in those businesses, they may become less resilient in the face of digital disruption from Fintech firms as well as the global technology giants. Undoubtedly the banks are mainly to blame for their own poor reputation. Yet, by its failure to make appropriate international comparisons, the Royal Commission has arguably poured fuel on the populist fire. Drawing on the recommendations of the G30 and FSB, the Royal Commission called for the financial services industry to reform itself, essentially on the grounds that that would be in its own best interests. Ironically, this prescription shows that the Royal Commission *was* aware of developments in other parts of the world. Whether or not its reform prescription will be effective in this time of crisis remains to be seen.