'CORPORATE CULTURE' IS THE 'NEW BLACK' – ITS POSSIBILITIES AND LIMITS AS A REGULATORY MECHANISM FOR CORPORATIONS AND FINANCIAL INSTITUTIONS?

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A common and recurring theme in analyses of the causes of the Global Financial Crisis ('GFC') is the poor culture of corporations and financial institutions. It is unsurprising then, that in its aftermath, arguments that regulatory reform, absent a changed culture, will be ineffective gained momentum. The succession of corporate and banking scandals post-GFC, both globally and locally, suggests that corporations and banks have failed to address their cultural failings. Meanwhile, the perceived failure of regulators to hold to account wrongdoing corporations and directors, by not prosecuting them, has weakened public confidence and trust in the financial sector, regulators and political oversight. Indeed, trust in public institutions in Western liberal democracies is at an all-time low. Australia, up to the beginning of the COVID-19 crisis, has not been immune from this phenomenon as the Hayne Banking Royal Commission hearings have demonstrated. The focus of this article is on the role of 'culture' in corporations and the extent to which corporate culture can be used as a regulatory tool. It will contend that despite a wealth of scholarly work and commentary on 'corporate culture', efforts to use it as a legal mechanism in prosecutions and as a regulatory device to instil a superior culture in corporations remain problematic. This is not to say that recent initiatives that focus on culture as a key item of interest in the regulation of corporations, such as embedding Australian Securities and Investments Commission specialist staff in the major Australian banks are not important; only that it is unlikely that we will see public confidence and trust in corporations and regulators being restored any time soon.

I INTRODUCTION

The Global Financial Crisis ('GFC') moved corporate and financial regulation from the pages of academic journals to the front-page headlines, forcing renewed and sustained attention on corporate integrity and good governance. While the dynamics which caused the GFC are complicated and indeterminate,[1] among the

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1 Wolfgang Streeck, *How Will Capitalism End? Essays on a Failing System* (Verso, 2017) 11.

causes that scholars have identified were serious corporate governance problems (including the failure of boards to identify and curb excessive risk-taking)[2] and what many have described as a 'defective' culture of unrestrained self-interest and 'greed'.[3]

It is, therefore, not surprising that the GFC provided momentum for arguments that regulatory reform will achieve little without a changed culture to gather force.[4] Greg Medcraft, when he was chair of Australia's corporate and financial services regulator, the Australian Securities and Investments Commission ('ASIC'), prosecuted a very public culture agenda[5] and, as Tomasic has observed, has been 'a leading international voice in focusing attention on corporate culture issues'.[6] Similarly, Medcraft's successor, James Shipton, has urged companies to 'work root and branch to change their ways … to rebuild their culture from deep within'.[7] However, the seemingly unending procession of corporate and financial scandals since the GFC, globally (eg, rate-rigging in the London Interbank Offered Rate ('LIBOR'))[8] and locally (eg, most recently, concerning Westpac Banking Corporation ('Westpac'), regarding allegations of serious failures to comply with anti-money laundering and counter-terrorism financing ('AML/CTF') laws linked to child exploitation),[9] suggests that corporations and banks have failed to address their culture issues and wish to return to 'business as usual'.

Additionally, the perceived failure of regulators to hold those corporations and directors, especially directors of banks and other financial institutions that either collapsed or needed bailing out as a consequence of the GFC, to account by failing to prosecute them for wrongdoing, has undermined public confidence in not only banking and financial institutions, but also more broadly in regulators and political oversight.[10] Interestingly, the Edelman Trust Barometer shows that the public's

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2 For a review of the literature on the failings in corporate governance in banks and financial institutions: see Hamid Mehran, Alan Morrison and Joel Shapiro, *Corporate Governance and the Banks: What Have We Learned from the Financial Crisis?* (Federal Reserve Bank of New York Staff Report No 502, June 2011) <http://www.newyorkfed.org/research/staff_reports/sr502.pdf>.

3 See, eg, Dan Awrey, William Blair and David Kershaw, 'Between Law and Markets: Is There a Role for Culture and Ethics in Financial Regulation?' (2013) 38 *Delaware Journal of Corporate Law* 191.

4 See, eg, Hector Sants, 'UK Financial Regulation: After the Crisis' (Speech, London, 12 March 2010), cited in David Campbell and Joan Loughrey, 'The Regulation of Self-Interest in Financial Markets' in Justin O'Brien and George Gilligan (eds), *Integrity, Risk and Accountability in Capital Markets: Regulating Culture* (Hart Publishing, 2013) 65. In 2010, Hector Sants was chief executive of the now defunct UK Financial Services Authority ('FSA').

5 See, eg, Greg Medcraft, 'Corporate Culture and Corporate Regulation' (Speech, Law Council of Australia BLS AGM Seminar, 20 November 2015) 2. Medcraft was chair from 2009–17.

6 Roman Tomasic, 'Exploring the Limits of Corporate Culture as a Regulatory Tool: The Case of Financial Institutions' (2017) 32(2) *Australian Journal of Corporate Law* 196, 208. Medcraft also served as chair of the International Organization of Securities Commissions ('IOSC').

7 See James Shipton, 'The Trust Deficit and Corporate Australia' (Speech, Australian Council of Superannuation Investors Annual Conference, 17 May 2018) 3 ('The Trust Deficit').

8 This scandal in the international banking sector, which came to light in 2012, concerned major banks (eg, UBS, Barclays and the Royal Bank of Scotland) falsely manipulating interest rates to make massive profits from trades.

9 This scandal, which broke in November 2019, was preceded by another high-profile AML/CTF scandal in 2017 involving the Commonwealth Bank of Australia ('CBA'), discussed below nn 96–8.

10 See Tomasic (n 6) 196; Justin O'Brien, 'A Question of Trust: Post-Truth Paradigms and the Challenge to Financial Regulation' (2017) 11(1) *Law and Financial Markets Review* 20, 20.

distrust of the finance sector is evident in countries, such as Australia, that escaped the worst effects of the GFC.[11] The succession of banking scandals since the GFC in which the major Australian banks have been embroiled,[12] however, have no doubt contributed to this distrust or what Shipton calls a 'trust deficit'.[13] This has been highlighted in the evidence of misconduct which emerged at the public hearings of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, established on 14 December 2017 and headed by the Hon Kenneth Hayne AC QC ('Hayne Royal Commission').[14]

Indeed, after seven rounds of hearings, 130 witness examinations and the review of over 10,000 public submissions,[15] the Hayne Royal Commission found that almost all instances of misconduct considered were products of poor culture.[16] Unbridled 'greed' and the pursuit of short-term profit and financial incentives had motivated the actions of both the financial institutions and individuals concerned, trumping respect for the law and for customers.[17]

The focus of this article is to explore the role of 'culture' in corporations/organisations[18] and the degree to which corporate culture can be used as a regulatory mechanism. It will be argued that even though there is a

11 See discussion below n 154.

12 The CBA and Westpac AML/CTF scandals noted above n 9, are not isolated cases. Australia's largest banks – the CBA, Westpac, National Australia Bank ('NAB') and Australia and New Zealand Banking Group ('ANZ') – have all been involved in scandals that have not only been widely publicised in the media, but chronicled in various reports and inquiries: see, eg, Senate Economics References Committee, Parliament of Australia, *Performance of the Australian Securities and Investments Commission* (Report, June 2014) ('*Senate Inquiry into the Performance of ASIC*').

13 See Shipton, 'The Trust Deficit' (n 7).

14 The Hayne Royal Commission was announced on 30 November 2017 by former Australian Prime Minister, Malcolm Turnbull, who later admitted that it had been a 'political mistake' to reject a royal commission into the banks, despite persistent calls for one from as early as 2014, made in the *Senate Inquiry into the Performance of ASIC* (n 12) xxiv: see David Crowe, 'Malcolm Turnbull Admits "Political Mistake" on Bank Royal Commission', *The Sydney Morning Herald* (online, 23 April 2018) <https://www.smh.com.au/politics/federal/malcolm-turnbull-admits-political-mistake-on-bank-royal-commission-20180423-p4zb2x.html>. To manage the huge amount of information it would receive, a case study approach was adopted. The public hearings focussed on a range of issues, including consumer lending practices (Round 1); financial planning and the wealth management industry (Round 2); and superannuation (Round 5). The Interim Report (limited to an examination of the first four Rounds) and Final Report were published in September 2018 and February 2019, respectively.

15 Department of the Treasury (Cth), 'Restoring Trust in Australia's Financial System: The Government Response to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry' (Government Response to Royal Commission, February 2019) 1.

16 *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, (Final Report, 1 February 2019), vol 1, 1–2 ('*Hayne Royal Commission Final Report*'). See also 335.

17 See *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (Interim Report, 28 September 2018) vol 1, xix ('*Hayne Royal Commission Interim Report*'). See also 301. Such findings are reiterated in the Final Report: see, eg, *Hayne Royal Commission Final Report* (n 16) 1–2, 401.

18 This article will use these terms interchangeably, notwithstanding that the emphasis is on financial institutions. Similarly, it will treat the terms 'corporate culture' and 'organisational culture' as synonymous.

considerable body of scholarship and commentary on 'corporate culture',[19] with legal and management consultancies lining up to offer new integrity audits, products and services, the use of corporate culture as a tool to promote regulatory compliance in corporations continues to face challenges. This is so, despite 'culture' also increasingly figuring as a crucial item of interest in some important recent initiatives, such as the adoption of Shipton's plan of embedding ASIC supervisors inside Australia's major banks, now called the Close and Continuous Monitoring Program ('CCM Program').[20] Not least of these challenges is the argument that the nebulous nature of 'corporate culture' and its definitional elusiveness make it difficult to regulate and, also, to use as a legal mechanism, such as in criminal prosecutions. Furthermore, if seeking to use 'corporate culture' as a regulatory tool, regard must be had that regulators and the regulated community (corporations and the individuals within them) may, and often do, have very different ideas of what constitutes a healthy 'corporate culture'. Other problems include the unclear boundaries between 'criminal' and 'normal' business behaviour and what Haines aptly sums up as 'the essential ambiguity of white collar crime',[21] with the result that wrongdoers (organisations and/or the individuals working for them) and the relevant industry of which they are a part, may consider wrongful conduct 'legitimate' and fail to grasp its criminality. The range of corporations in terms of size and the fact that corporate cultures may differ significantly not only between different corporations, but within those corporations themselves, are among other challenges faced in attempts to draw upon culture in enhancing the regulation of corporations.

The biggest problem, however, is the mantra of banks and financial institutions when confronted with the prospect of regulation of the culture of their organisation; that 'their internal organisation should be free from outside interference – that they should be autonomous',[22] a claim which also regularly features in government reports and is acknowledged by regulators.[23]

19 The scholarship is not confined to socio-legal scholars and lawyers, most notably Brent Fisse and John Braithwaite: see Brent Fisse and John Braithwaite, *Corporations, Crime and Accountability* (Cambridge University Press, 1993). It is the subject of significant work in business-related fields, such as in organisational literature: see especially nn 28–9.

20 It is beyond the scope of this article to examine the CCM Program, which commenced in October 2018 and concluded in February 2020, or any other such initiative. However, for a recent survey of them, including the Banking Executive and Accountability Regime ('BEAR') (soon to be replaced by the Financial Accountability Regime ('FAR')), see especially David Wishart and Ann Wardrop, 'What Can the Banking Royal Commission Achieve: Regulating for Good Corporate Culture?' (2018) 43(2) *Alternative Law Journal* 81.

21 See Fiona Haines, 'Crime? What Crime? Tales of the Collapse of HIH' in Henry N Pontell and Gilbert L Geis (eds), *International Handbook of White-Collar and Corporate Crime* (Springer, 2007) 523, 524, 533. See also Tomasic (n 6) 211.

22 See David Wishart, Ann Wardrop and Marilyn McMahon, 'The Internal Autonomy of the Firm' (2018) 27(1) *Griffith Law Review* 131, 131.

23 See discussion below nn 209–12.

II WHAT IS 'CORPORATE CULTURE'?

Often the first challenge faced in regulatory conversations about 'culture' is that it is an inherently vague concept, partly because there is no universally accepted definition of 'culture'.[24] The same is true for 'corporate culture', where there is also a lack of consensus in defining it.[25] For instance, 'corporate culture' has been variously defined as '[t]he collective programming of the mind which distinguishes the members of one organization from another',[26] 'a system of shared values (that define what is important) and norms that define appropriate attitudes and behaviours for organizational members (how to feel and behave)',[27] and, authoritatively by Edgar Schein, as the 'pattern of shared basic assumptions learned by a group as it solved its problems of external adaptation and internal integration, which has worked well enough to be considered valid and, therefore, to be taught to new members as the correct way to perceive, think, and feel in relation to those problems'.[28] In other words, as Schein explains, 'organisational culture' is 'a broad concept capturing shared values and beliefs', though he has also made the point that it is 'not necessarily one that employees can easily articulate or researchers measure'.[29]

Relying on Schein's definition, ASIC has similarly described 'culture' as:

> a set of shared values or assumptions. It reflects the underlying mindset of an organisation. It lies at the heart of how an organisation and its staff think and behave. It shapes and influences people's attitudes and behaviours towards, for example, customers and compliance.[30]

And, also as: 'the internal controls (ie policies, rules, courses of conduct, practices or attitudes) within a firm which shape its behaviour and mindset'.[31]

Nevertheless, ASIC has recognised problems in the way it has sought to define 'culture', which presents difficulties concerning the use of 'corporate culture' to generate a superior culture consistently throughout a formerly wrongdoing organisation or, indeed, a whole industry. It has recognised that cultures can vary between different corporations and that corporations are not monolithic since it is common for sub-cultures to emerge within the same corporation, especially within

24 See Ann Wardrop, David Wishart and Marilyn McMahon, 'Regulating Financial Institutional Culture: Reforming the Regulatory Toolkit' (2016) 27(3) *Journal of Banking and Finance Law and Practice* 171, 173.

25 See John HC Colvin and James Argent, 'Corporate and Personal Liability for "Culture" in Corporations?' (2016) 34(1) *Company and Securities Law Journal* 30, 36.

26 Geert Hofstede, 'Identifying Organizational Subcultures: An Empirical Approach' (1998) 35(1) *Journal of Management Studies* 1, 2.

27 Jesper B Sørensen, 'The Strength of Corporate Culture and the Reliability of Firm Performance' (2002) 47(1) *Administrative Science Quarterly* 70, 72.

28 Edgar H Schein, *Organizational Culture and Leadership* (Jossey-Bass, 4th ed, 2010) 18.

29 Elizabeth A Sheedy, Barbara Griffin and Jennifer P Barbour, 'A Framework and Measure for Examining Risk Climate in Financial Institutions' (2017) 32(1) *Journal of Business and Psychology* 101, 102.

30 This summary of recent statements made by ASIC that shed light on what 'culture' means to it is set out in Colvin and Argent (n 25) 33 (citations omitted).

31 Ibid.

large corporations.[32] Not surprisingly, this challenge of promoting a healthier culture consistently throughout an organisation was raised by Catherine Livingstone, former chair of the scandal-hit Commonwealth Bank of Australia ('CBA'),[33] when commenting on the difficulty of the task facing the new CEO, Matt Comyn, to steer much-needed 'top-down' cultural change at that bank.[34] In this regard, Livingstone's comments about Comyn's role reflect the current thinking that 'tone from the top' sets the culture of an organisation.[35]

It is also noteworthy that the *Criminal Code Act 1995* (Cth) ('*Criminal Code*') for the purposes of establishing criminal liability, contains the following definition of 'corporate culture': 'an attitude, policy, rule, course of conduct or practice existing within the body corporate generally or in the part of the body corporate in which the relevant activities take place'.[36]

Australia (though historically the 'laggard', compared to the United States ('US') and United Kingdom ('UK'), which purport to be leaders of regulatory innovation on the global stage) has been at the forefront of attempts to use 'corporate culture' as a legal mechanism in criminal prosecutions, with a sophisticated 'culture-based' model of corporate fault attribution being embodied in federal law since the mid-1990s.[37] This model is contained in sections 12.1–12.6 (in part 2.5) of the *Criminal Code*.

The model, which draws on the important regulatory work of Fisse and Braithwaite on corporate blameworthiness,[38] is notable in that, unlike earlier common law models, at its heart is the notion that corporate criminal responsibility is not located within a single corporate organ, senior officer or employee, but more widely within the 'culture' of the corporation. This allows criminal liability to be attributed to a corporation without a finding of fault in relation to an individual, overcoming potential difficulties associated with the narrow 'controlling mind'

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32 See Greg Tanzer, 'The Importance of Culture to Improving Conduct within the Financial Industry' (Speech, Thomson Reuters' Third Australian Regulatory Summit, 27 May 2015) 5. This is consistent with some of the organisational sociology and management literature dealing with corporate sub-cultures: see, eg, John P Kotter, 'Leading Change: Why Transformation Efforts Fail' (2007) 85(1) *Harvard Business Review* 96, 97; and specifically regarding Australian banks: Elizabeth Sheedy, 'Risk Culture in Australian Banks: Does Size Matter?' (2016) 4 *Finsia Journal of Applied Finance* 4, 9.

33 The CBA was plagued by a string of scandals. They include the mis-selling of margin loans to retail customers to invest in financial products recommended by Storm Financial (2008); and use of unethical tactics to avoid paying out legitimate insurance claims by its insurance arm, CommInsure (2016).

34 'CBA Media Conference', *ABC News* (ABC Radio National, 29 January 2018). But note concerns below n 145, regarding Comyn as choice of CEO.

35 Regulators, including ASIC and the UK's Financial Conduct Authority ('FCA'), subscribe to this view: see, eg, Jonathan Davidson, 'Getting Culture and Conduct Right: The Role of the Regulator' (Speech, 2nd Annual Culture and Conduct Forum for the Financial Services Industry, 12 July 2016) <https://www.fca.org.uk/news/speeches/getting-culture-and-conduct-right-role-regulator>.

36 *Criminal Code Act 1995* (Cth) s 12.3(6) ('*Criminal Code*'). This definition is consistent with the way ASIC views it: see Colvin and Argent (n 25).

37 Note, however, the UK legislative development in recent years of introducing corporate offences based on 'failure to prevent' particular crimes, such as bribery in *Bribery Act 2010* (UK) s 7; and tax evasion in *Criminal Finances Act 2017* (UK) pt 3.

38 See Fisse and Braithwaite, *Corporations, Crime and Accountability* (n 19).

identification doctrine,[39] established in the famous UK House of Lords decision, *Tesco Supermarkets Ltd v Nattrass* (‘*Tesco*’).[40] The *Tesco* doctrine holds that the requisite conduct and mental elements can only be imputed to the company if they could be traced directly to the upper levels of the corporate hierarchy – to the board of directors, senior management or a person to whom management powers had been delegated to a sufficient degree that the company could fairly be said to think and act through that person.[41] As a consequence of this constraint, the *Tesco* doctrine effectively afforded any large public corporation that had diffused operations and delegated day-to-day functions protection from liability.[42] It resulted, for instance, in the acquittal of all defendants – P & O European Ferries (Dover) Ltd and seven employees – in the criminal case brought against them for manslaughter regarding the Herald of Free Enterprise disaster in March 1987 when a ferry capsized moments after leaving the Belgian port of Zeebrugge, killing 193 passengers and crew.[43] Even though the Court ruled that a corporation may be guilty of manslaughter, it found no evidence that one sufficiently senior member of the company’s management could be said to have been the ‘embodiment’ of the corporation and acting for it in doing the act or omission which caused death.[44]

Section 12.3(1) of the *Criminal Code* provides that the fault element (the requisite mental element – intention, knowledge or recklessness of a criminal offence) will be attributed to a body corporate where it ‘expressly, tacitly or impliedly authorised or permitted the commission of the offence’. Under section 12.3(2), that authorisation or permission may be established inter alia by:

> (c) proving that a corporate culture existed within the body corporate that directed, encouraged, tolerated or led to non-compliance with the relevant provision; or
>
> (d) proving that the body corporate failed to create and maintain a corporate culture that required compliance with the relevant provision.

‘Corporate culture’ is then defined as above.

While the Australian regime has been described as ‘the most progressive model for fixing criminal liability to corporations’ in comparison to other jurisdictions by Bronitt[45] and other scholars,[46] even after 25 years, these provisions have never been tested in the courts. A common argument made for prosecutorial reluctance in relying upon fault and using culture under the corporate culture

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39 See Simon Bronitt, ‘New Regulatory Paradigms for Preventing Institutional Child Sexual Abuse: Lessons from Corporate Crime and White-Collar Criminals’ in Yorick Smaal, Amanda Kaldelfos and Mark Finnane (eds), *The Sexual Abuse of Children: Recognition and Redress* (Monash University Publishing, 2016) 178, 182–3.

40 [1972] AC 153.

41 Ibid 170–5 (Lord Reid).

42 See Jennifer Hill, ‘Corporate Criminal Liability in Australia: An Evolving Corporate Governance Technique?’ [2003] (January) *Journal of Business Law* 1, 12.

43 *R v P & O European Ferris (Dover) Ltd* (1991) 93 Cr App R 72.

44 Ibid, 88–9 (Turner J).

45 Simon Bronitt, ‘Rethinking Corporate Prosecution: Reviving the Soul of the Modern Corporation’ (2018) 42(4) *Criminal Law Journal* 205, 206.

46 See Jonathan Clough and Carmel Mulhern, *The Prosecution of Corporations* (Oxford University Press, 2002) 138; Olivia Dixon, ‘Corporate Criminal Liability: The Influence of Corporate Culture’ in O’Brien and Gilligan (n 4) 252.

provisions of the *Criminal Code* as a basis of liability has been the onerous task of proving that culture.[47]

However, this article contends that such arguments are exaggerated and that there are possibilities for corporate criminal liability to be pursued under the culture provisions of the *Criminal Code*. This is because the definition of 'corporate culture' in section 12.3(6) overcomes some of the uncertainty as to what constitutes culture by focusing on objective criteria that may be relied upon as evidence of cultural deficiency – namely, policies, rules and a course of conduct or practices.[48] This is notwithstanding that the scope for doing so based on written policies and/or rules may be limited, since it is unlikely that corporations will commit evidence of poor culture to writing,[49] in contrast to evidence of corporate culture gleaned from a course of conduct or practices.[50]

In this regard, it is also significant that the definition of 'corporate culture' in section 12.3(6) of the *Criminal Code* is closer to modern organisational scholarship relating to the construct of 'organisational climate', with its focus on observable practices and policies, than to 'organisational culture', with its focus on values and assumptions that are typically very difficult to observe.[51] As the excerpt below from Sheedy, Griffin and Barbour explains:

> Organizational climate is defined as 'the shared meaning organizational members attach to the events, policies, practices, and procedures they experience and the behaviors they see being rewarded, supported, and expected' (Ehrhart et al 2014; p 286). As described by Schneider (1975), employees use cues within their workplace to interpret their environment and learn what behavior is likely to be rewarded. Cues that contribute to an understanding of local climate include the degree of alignment between what is said and done by leaders, the consistency between policies, and how various goals are prioritized (Zohar and Hofmann 2012).[52]

As highlighted in the text above, lack of alignment between what is espoused (by leaders and in an organisation's formal policies) and what is enacted is one of the most important phenomena observed in organisations,[53] and is at the core of

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47 See, eg, Dixon (n 46) 267; Colvin and Argent (n 25) 38.

48 A point which even Colvin and Argent acknowledged: see Colvin and Argent (n 25) 38.

49 Indeed, the opposite is often the case with corporations' written policies and rules espousing compliance with the law, but where the situation on the ground is very different, as noted below n 53. But note *internal* written communications, such as emails and memos, might be useful to prosecutors in providing evidence of poor culture.

50 Admittedly, the cost of investigating culture that is not evidenced in documents but only in behaviour may be a reason for the hesitance in doing so. However, investigation and evidence gathering is a well-known difficulty in criminal cases.

51 As noted above n 29, they are also difficult to articulate and measure.

52 Sheedy, Griffin and Barbour (n 29), 102, citing Mark G Ehrhart, Benjamin Schneider and William H Macey, *Organizational Climate and Culture: An Introduction to Theory, Research, and Practice* (Routledge, 2014) 286; Benjamin Schneider, 'Organizational Climates: An Essay' (1975) 28(4) *Personnel Psychology* 477; Dov M Zohar and David A Hofmann, 'Organizational Culture and Climate' in Steve WJ Kozlowski (ed), *The Oxford Handbook of Organizational Psychology* (Oxford University Press, 2012) vol 1, 643.

53 This phenomenon is known as 'decoupling' in organisational studies and particularly institutional theory: see, eg, the work of Haridimos Tsoukas, a leading organisational theorist: Dionysios D Dionysiou and Haridimos Tsoukas, 'Understanding the (Re)creation of Routines from within: A Symbolic Interactionist Perspective' (2013) 38(2) *Academy of Management Review* 181.

what organisational psychologists seek to measure when performing assessments of climate.[54]

In the context of section 12.3 of the *Criminal Code*, the definition of 'corporate culture' opens the door to including evidence of a corporation's day-to-day business practices, such as remuneration practices that would clearly demonstrate the organisational climate. According to organisational psychologists, what gets rewarded is one of the strongest signals to guide employees.[55] If they observe that top sales performers rarely or never get punished for non-compliance with a corporation's policies, then that would arguably demonstrate that the policies are not to be taken seriously or are irrelevant. It would also be possible to introduce evidence regarding compliance practices. If very few transactions are audited for compliance with policies, and no consequences flow from non-compliance, then this would arguably demonstrate that the corporation has 'failed to create and maintain a corporate culture that required compliance'.[56]

Regrettably, however, the possibility of proving corporate criminal liability based on cultural deficiency offered by part 2.5 are not available to prosecutions in some important areas, most notably to prosecutions of the financial services sector in Australia. This is because some major federal statutes expressly exclude the operation of part 2.5, such as chapter 7 of the *Corporations Act 2001* (Cth) dealing with the regulation of financial services.[57] Nor are there possibilities available to pursue criminal prosecutions against directors and officers who oversee corporations with defective cultures,[58] despite ASIC's efforts in 2015, under Medcraft, to extend part 2.5 to prosecutions in both of these areas.[59] While

54 See also Elizabeth Sheedy and Barbara Griffin, 'Risk Governance, Structures, Culture, and Behavior: A View from the Inside' (2018) 26(1) *Corporate Governance International Review* 4, 4 ('Risk Governance, Structures, Culture, and Behavior').

55 Ibid. See also Elizabeth A Sheedy, Patrick Garcia and Denise Jepsen, 'The Role of Risk Climate and Ethical Self-Interest Climate in Predicting Unethical Pro-Organisational Behaviour' (2020) *Journal of Business Ethics* <https://doi.org/10.1007/s10551-020-04542-0> ('The Role of Risk Climate').

56 Section 12.3(2)(d) *Criminal Code*.

57 See section 769A of the *Corporations Act 2001* (Cth), which provides that part 2.5 of the *Criminal Code* does not apply to chapter 7 of the *Corporations Act 2001* (Cth). See also section 12GH(6) of the *Australian Securities and Investments Act 2001* (Cth) ('*ASIC Act*'), which limits the application of part 2.5 of the *Criminal Code* to the financial services provisions contained in part 2 division 2 subdivision G of the *ASIC Act*. However, in September 2020, the federal government commissioned the Australian Law Reform Commission ('ALRC') to conduct a review into the laws that regulate financial services in Australia and to consider 'what changes to the Corporations Act 2001 … could be made to simplify and rationalise the law': Attorney-General (Cth), Christian Porter, 'Terms of Reference', *Review of the Legislative Framework for Corporate and Financial Services Regulation* (11 September 2020). The ALRC is not due to publish its final report until 30 November 2023.

58 It is worth noting, however, that although such possibilities cannot be realised based on part 2.5 of the *Criminal Code*, directors and officers may be liable for breaches of their statutory duties found in sections 180–3 of the *Corporations Act 2001* (Cth), with the possibility of criminal liability being imposed if criminal cases are made out under section 184 of that Act. The duty of care contained in section 180 of the *Corporations Act 2001* (Cth) is arguably the most relevant in relation to corporate culture, though there is no criminal offence for breach of this duty. Pursuant to *Daniels v Anderson* (1995) 37 NSWLR 438, under section 180 of the *Corporations Act 2001* (Cth) there is the impropriety of being an 'ostrich' as it were, namely keeping one's head in the sand and turning a blind eye to misconduct.

59 See Evidence to Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, Melbourne, 16 October 2015, 15 (Greg Medcraft).

ASIC's proposals were vigorously opposed[60] and were not enacted, there has been renewed interest in the corporate culture provisions of the *Criminal Code*.[61] Most recently, part 2.5 of the *Criminal Code* was examined as part of a comprehensive review of Australia's corporate criminal liability regime that the federal government in April 2019 had authorised the Australian Law Reform Commission ('ALRC') to carry out.[62]

A problem, however, which might help to explain why a legal model of corporate culture has yet to be applied broadly[63] and not at all to prosecutions in the financial services industry in Australia, is the well-recognised turn from criminal prosecution for serious corporate wrongdoing.[64] Regulators in jurisdictions such as the US, UK and Australia have been favouring the use of 'new' regulatory tools, such as deferred prosecution agreements ('DPAs')[65] and enforceable undertakings ('EUs'),[66] to resolve the regulatory dilemmas associated with pursuing complex, costly and time-consuming criminal cases (including satisfying the criminal burden of proof 'beyond a reasonable doubt') against high profile, well-resourced corporate violators. As far as Australia is concerned, however, this may change, with ASIC's fondness for EUs to deal with misconduct

60 See, eg, Colvin and Argent (n 25).

61 See, eg, Elysse Morgan and Melissa Clarke, 'ASIC Considers Criminal Sanctions for Poor Financial Company Culture', *ABC News* (online, 3 June 2015) <https://www.abc.net.au/news/2015-06-03/asic-considers-criminal-sanctions-for-poor-company-culture/6517684>.

62 See Attorney-General (Cth), Christian Porter, 'Terms of Reference', *Review of Australia's Corporate Criminal Responsibility Regime* (Web Page, 10 April 2019) < https://www.alrc.gov.au/inquiry/corporate-crime/terms-of-reference/>. This review has since been completed and a Final Report tabled: see Australian Law Reform Commission, *Final Report: Corporate Criminal Responsibility* (Report No 136, April 2020). Amongst the 20 recommendations made by the ALRC, the model under part 2.5 of the *Criminal Code* (with some minor changes) is one of two models it recommended for attributing criminal responsibility to corporations (Recommendations 5–7). Interestingly, it also recommended applying the new model of 'failure to prevent' offences to misconduct overseas by Australian companies based on that in the UK of having a culture that 'fails to prevent' corporate offences, such as foreign bribery or tax evasion, noted above n 37 (Recommendation 19).

63 While the model advanced by Fisse and Braithwaite (n 19) has been the subject of extensive discussion in international academic and policy circles, it has not been adopted in jurisdictions such as the US and UK.

64 See generally Matt Taibbi, 'Why Isn't Wall Street in Jail?' (3 March 2011) *Rolling Stone* 44.

65 An American innovation, the DPA is an agreement that suspends the prosecution conditional upon specified terms, typically requiring the corporation to pay fines, compensate victims, and implement changes to corporate governance. DPAs have become the regulatory 'tool of choice' for combatting serious corporate crime in the US, and more recently, the UK. For a more detailed discussion of these administrative tools, see, eg, Simon Bronitt, 'Regulatory Bargaining in the Shadows of Preventive Justice: Deferred Prosecution Agreements' in Tamara Tulich et al (eds), *Regulating Preventive Justice: Principle, Policy and Paradox* (Routledge, 2017) 211.

66 EUs, which have been available to ASIC since 1998, are similar to DPAs, though an important difference is that they are an administrative settlement that ASIC may accept as an alternative to *civil* court action, not criminal proceedings. For a more detailed discussion of EUs, see, eg, Vicky Comino, 'The GFC and Beyond: How Do We Deal with Corporate Misconduct?' (2018) 1 *Journal of Business Law* 15, 21–7. Australia has also had an established system of civil penalties in place since 1993, though in regard to tackling misconduct in the financial services industry, Commissioner Hayne roundly criticised ASIC for 'rarely' going to court: see, eg, *Hayne Royal Commission Interim Report* (n 17) 271.

by financial services entities likely to decrease.[67] This is in view of Commissioner Hayne's strident criticisms of EUs,[68] culminating in his recommendation in the Final Report ('*Hayne Royal Commission Final Report*') that ASIC should take as its 'starting point' the question of 'whether a court should determine the consequences of a contravention',[69] and ASIC's response of publicly committing to a new enforcement posture going forward, encapsulated in the phrase, 'Why not litigate?'[70]

III WHY 'CORPORATE CULTURE' MATTERS?

The idea that social control of the corporation,[71] which includes decisions such as whether or not the corporation complies with the law, is largely determined by its ethical culture is not novel.[72] Poor culture figured as a cause of the GFC,[73] just as it had in earlier scandals.[74] Recent scandals post-GFC have yet again placed a public spotlight on the failures of senior executives, corporations and, also, regulators to combat white-collar crime.[75] This attention leads to speculation as to whether responsibility for failure lies at the individual level, 'rogue elements' within corporations, or at the systemic level with corporate cultures, or a combination of several factors. Increasingly, commentators identify 'defective' culture as a prominent cause of corporate and financial misconduct. Certainly, Commissioner Hayne has identified that 'culture' is a key driver of conduct.[76]

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67 Early indications strongly suggest this. From January to June 2019, ASIC accepted only one EU: see Australian Securities and Investments Commission, *ASIC Enforcement Update: January to June 2019* (Report No 625, 18 August 2019) 5.

68 See, eg, *Hayne Royal Commission Interim Report* (n 17) 288; *Hayne Royal Commission Final Report* (n 16) 442, in which his criticisms led him to the conclusion that EUs were being treated by financial entities as a mere 'cost of doing business' or 'cost of placating the regulator'.

69 *Hayne Royal Commission Final Report* (n 16) 446.

70 Australian Securities and Investments Commission, Submission to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *ASIC Response to Interim Report* (2 November 2018) 9. It is beyond the scope of this article to examine this strategy or its implementation, but it should be noted that ASIC leadership has repeatedly said that 'Why not litigate?' is not a 'litigate first' or 'litigate everything' strategy: see, eg, James Shipton, 'The Fairness Imperative' (Speech, AFR Banking and Wealth Summit, 27 March 2019) [4].

71 'Social control' is a concept within the disciplines of the social sciences and is considered one of the foundations of order within society. Sociologists identify two basic forms of social control: informal means – internalisation of norms and values by a process known as socialisation; and formal means – external sanctions enforced by government to prevent the establishment of chaos and anomie in society.

72 See Christopher Stone, *Where the Law Ends: The Social Control of Corporate Behaviour* (Harper & Row, 1975).

73 See Awrey, Blair and Kershaw (n 3).

74 See O'Brien and Gilligan (n 4) xxviii. Among the examples they give are: BCCI, Polly Peck, Enron and HIH.

75 In Australia, eg, it has led to numerous inquiries, including into ASIC's performance and the financial services sector: *Senate Inquiry into the Performance of ASIC* (n 12); *Financial System Inquiry* (Final Report, November 2014) ('*Murray Inquiry*').

76 See *Hayne Royal Commission Final Report* (n 16) 334. See also Shipton, 'The Trust Deficit' (n 7) 3–5; Davidson (n 35).

In hearings before a 2016 US Senate Committee, which investigated the cross-selling and creation of fraudulent accounts scandal in the US by one of its largest banks, Wells Fargo,[77] the bank's 'toxic' culture came under heavy criticism.[78] That culture involved low-paid branch employees being pressured to meet impossible sales quotas to keep their jobs so that they signed up customers for products through aggressive cross-selling without their knowledge.[79] The responsibility of its former CEO, John Stumpf, whose catchcry to employees was 'Eight is Great' (meaning get eight Wells Fargo products into the market),[80] for facilitating or, at the very least, encouraging systemic misconduct, also came under scrutiny. Even though the bank in its defence had claimed that the 5,300 or so employees who had created 2 million unauthorised accounts between 2011 and 2016 (and who had since been dismissed), acted independently,[81] in questioning Stumpf, Republican Senator Patrick Toomey, for example, declared:

> You state unequivocally that there are no orchestrated effort or scheme, as some have called it, by the company … But when thousands of people conduct the same kind of fraudulent activity, it's a stretch to believe that every one of them independently conjured up this idea of how they would commit this fraud.[82]

The following comments, made in answer to a question raised in an article appearing in *Fortune* magazine, speculating about the reasons for Stumpf and his team misreading the severity of the situation, are also thought-provoking:

> Perhaps self-delusion? For years, Wells had cultivated its image as a virtuous 'community banker'. Nobody seemed to buy into that image more than Stumpf himself, who … seemed to embrace every opportunity to extoll the virtues of the company's culture and values. Living in such a self-congratulatory internal bubble during good times tends to make one tin-eared and tone-deaf in the external world when times turn tough.[83]

On one view, these comments might be seen as underscoring the problem of there not being a clear dividing line between 'criminal' and 'normal' business behaviour, such that leading market participants came to regard wrongful conduct 'legitimate'.[84] After all, Wells Fargo, like the other banks that were involved in

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77 Despite earlier media concerns, the scandal only became widely known in September 2016 after the bank came to a settlement with authorities requiring it to pay USD185 million for the illegal activity: see Michael Corkery, 'Wells Fargo Fined $185 Million for Fraudulently Opening Accounts', *The New York Times* (online, 8 September 2016) <https://www.nytimes.com/2016/09/09/business/dealbook/wells-fargo-fined-for-years-of-harm-to-customers.html>.

78 See 'Senator Elizabeth Warren Questions Wells Fargo CEO John Stumpf at Banking Committee Hearing', (YouTube, 20 September 2016) <https://www.youtube.com/watch?v=xJhkD10M>.

79 See Lucinda Shen, 'Former Wells Fargo Employees to CEO John Stumpf: It's Not Our Fault', *Fortune* (online, 19 September 2019) <https://fortune.com/2016/09/19/former-wells-fargo-employyes-to-ceo-john-stumpf-its-not-our-fault/>.

80 'The Wells Fargo Fake Account Scandal: A Timeline – "Eight is Great"', *Forbes* (online, 13 January 2017) <https://www.forbes.com/pictures/fkmm45eegei/eight-is-great#26b586283d6b>.

81 See Part IV(A) of this article further below, '*Bad Apples*'.

82 Bill Chappell, '"You Should Resign": Watch Sen Elizabeth Warren Grill Wells Fargo CEO John Stumpf', *National Public Radio* (online, 20 September 2016) <http://www.npr.org/sections/thetwoway/2016/09/20/494738797/you-should-resign-watch-sen-elizabeth-warren-grill-wells-fargo-ceo-john-stumpf>, quoted in Tomasic (n 6) 198.

83 Paul Pendergrass, 'How Wells Fargo's John Stumpf Crashed Himself' (14 October 2016) *Fortune* (online, 14 October 2016) <https://fortune.com/2016/10/14/wells-fargo-john-stumpf-scandal>.

84 See discussion below nn 198–201.

cross-selling, made huge profits, '[masking] many sins, or [creating] powerful incentives not to dwell on problems when all seemed to be going well'.[85] An alternative interpretation is that these comments suggest that Wells Fargo, under Stumpf, was a master of deception, able to divert scrutiny through the careful maintenance of a squeaky-clean image that deflected attention from what was really going on.

A report by the Treasury Select Committee in the UK into Barclays, one of the banks involved in the LIBOR, similarly found that 'the standards and culture of Barclays, and banking more widely, [were] in a poor state'.[86] Further, the report's criticism of the FSA was damning, accusing it of following a short-sighted approach that was overly focused on ensuring pejorative rule-based compliance and box-ticking that blinded it to the initial and ongoing systemic failure of compliance at Barclays.[87] More recently, Philip Augur's book, *The Bank that Lived a Little: Barclays in the Age of the Very Free Market*,[88] provides a fascinating exposé of the culture of Barclays and its metamorphosis from an old Quaker bank into a hard-charging capitalist risk-taker.

The poor culture of Australian banks has also been implicated in many of the scandals affecting them over the past decade. Two scandals deserve special attention. The first involved the alleged rigging of the Bank Bill Swap Rate ('BBSW') – Australia's key interest rate benchmark that influences the cost of consumer and business loans – by the major Australian banks, highlighting the 'toxic' culture of trading floors. The BBSW scandal led to ASIC launching civil penalty proceedings against those banks for unconscionable conduct and market manipulation in the period spanning 2010 to 2012,[89] although Westpac was the only bank that fought the case in court. In May 2018, the Federal Court found that Westpac employees trading the BBSW acted unconscionably (albeit a less serious finding than market manipulation).[90] The proceedings against the other banks were resolved by way of settlement with ASIC, though being civil penalty settlements, they required court approval,[91] which is not automatic.[92] Tellingly, when Jagot J

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85 To use the words of Rubin, commenting on the financial reporting scandals in the early 2000s, including Enron Corporation ('Enron'): see Robert E Rubin and Jacob Weisberg, *In an Uncertain World: Tough Choices from Wall Street to Washington* (Random House, 2003) 337. However, while confusion over whether behaviour is unacceptable or legitimate profit-seeking may be true in some cases that skirt the boundary of acceptable behaviour, in the case of Wells Fargo where the problem was not simply cross-selling, but bankers creating millions of unauthorised accounts, the view that it was anywhere close to the line is not plausible.

86 House of Commons Treasury Committee (UK), *Fixing LIBOR: Some Preliminary Findings* (Report of Session 2012–13 No 2, 18 August 2012) 19.

87 See also O'Brien and Gilligan (n 4) xxvii.

88 Philip Augur, *The Bank that Lived a Little: Barclays in the Age of the Very Free Market* (Penguin Press, 2019).

89 For example, in the case of the CBA, the period was 31 January to 5 June 2012.

90 See *Australian Securities and Investments Commission v Westpac Banking Corporation [No 2]* (2018) 266 FCR 147.

91 This position is unlike that for other settlements, such as EUs, which are not subject to judicial review.

92 See, eg, *ASIC v Westpac Banking Corporation* (2018) 132 ACSR 230, 237 [31]–[32], where Perram J rejected a proposed settlement between ASIC and Westpac concerning alleged contraventions of

and Beach J approved those settlements,[93] they were concerned to ensure that the penalties were an 'adequate denouncement of and deterrence against the unacceptable trading behaviour of individuals' within those banks,[94] which Jagot J also described as conduct about which the Australian public should be 'shocked, dismayed and indeed disgusted'.[95]

The second scandal concerned the CBA for lax AML/CTF controls in 2017. Even though the depth of this scandal was such that it led to a high-profile announcement by Australia's money laundering watchdog, the Australian Transaction Reports and Analysis Centre ('AUSTRAC'), that it was bringing legal proceedings against the CBA,[96] which in turn precipitated the announcement of the Hayne Royal Commission,[97] it now arguably pales in significance and seriousness when compared to the latest Westpac AML/CTF scandal. The allegations against the CBA included that it failed to give over 53,000 notifications of transactions of $10,000 or more, which resulted in the CBA signing off on a hefty $700 million penalty on 4 June 2018.[98] In contrast, the allegations against Westpac are that it breached AML/CTF laws 23 million times, including that it failed to 'carry out appropriate customer due diligence on transactions to the Philippines and South East Asia that have known financial indicators relating to potential child exploitation risks'.[99] According to AUSTRAC's statement of claim:

> Westpac contravened the Act [*AML/CTF Act 2006*] on over 23 million occasions. These contraventions are the result of systemic failures in its control environment, indifference by senior management and inadequate oversight by the Board.[100]

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responsible lending laws. Ironically, however, when this case went to trial, it was dismissed: *Australian Securities and Investments Commission v Westpac Banking Corporation (Liability Trial)* [2019] FCA 1244. ASIC's subsequent appeal has also been dismissed: *Australian Securities and Investments Commission v Westpac Banking Corporation* (2020) 277 FCR 343.

93 ANZ and NAB agreed to penalties totalling $50 million each: *Australian Securities and Investments Commission v National Australia Bank Ltd* (2017) 123 ACSR 341, 342 (Jagot J). The CBA agreed to penalties totalling $25 million: *Australian Securities and Investment Commission v Commonwealth Bank of Australia* (2018) 128 ACSR 289, 292 [7] (Beach J).

94 *Australian Securities and Investments Commission v Commonwealth Bank of Australia* (2018) 128 ACSR 289, 292 [7] (Beach J).

95 *Australian Securities and Investments Commission v National Australia Bank Ltd* (2017) 123 ACSR 341, 364–5 [112]–[115] (Jagot J).

96 See Australian Transaction Reports and Analysis Centre, 'AUSTRAC Seeks Civil Penalty Orders against CBA' (Media Release, 3 August 2017).

97 Note also that the AUSTRAC announcement precipitated the announcement on 28 August 2017 of a prudential inquiry into the CBA, discussed below nn 103–6.

98 *Chief Executive Officer of the Australian Transaction Reports and Analysis Centre v Commonwealth Bank of Australia Ltd* [2018] FCA 930.

99 See Australian Transaction Reports and Analysis Centre, 'AUSTRAC Applies for Civil Penalty Orders against Westpac' (Media Release, 20 November 2019).

100 See Australian Transaction Reports and Analysis Centre, 'Concise Statement of Claim', Submission in *Chief Executive Officer of Australian Transaction Reports and Analysis Centre v Westpac Banking Corporation*, NSD1914/2019, 21 November 2019, 2 [4] <https://www.austrac.gov.au/sites/default/files/2019-11/20191120%20Westpac%20Concise%20Statement%20FILED%2019008953.pdf>.

It is interesting that Westpac ultimately agreed to a $1.3 billion penalty,[101] though the magnitude of the theoretical maximum penalty outlined by AUSTRAC in its statement of claim was that 'each contravention attract[ed] a civil penalty between $17 million and $21 million'[102] (and assuming 23 million breaches at the lower end of those maxima, that amounted to a potential $391 trillion). But, of more significance is that AUSTRAC's Statement of Claim regarding this scandal mirrors the assessment reached of the governance, culture and accountability frameworks of the CBA in a 2018 report by the Australian Prudential Regulatory Authority ('APRA').[103] After a series of scandals at CBA, including the 2017 money laundering scandal, APRA had launched an inquiry into the CBA group.[104] Its report identified major shortcomings in CBA's culture. It found that the CBA's continued financial success 'dulled the senses' of the institution and its senior management so that it became 'harder to hear' two critical voices: one was 'the voice of risk' (particularly for non-financial risks) and the other was the 'customer voice', with cultural failings at the centre of these deficiencies.[105] For instance, it reported: 'complacency has run through CBA, from the top down'; and becoming insular in '[turning] a tin ear to external voices and community expectations about fair treatment'.[106]

The overly aggressive sales-dominated culture of banks – one that prioritises profit-seeking above all else – and the associated incentive systems that reinforce that culture, was identified by Commissioner Hayne as a critical contributor to the misconduct that was uncovered during the Royal Commission.[107] In the Introduction to the *Hayne Royal Commission Final Report*, he was clear on the ownership of this misconduct, stating emphatically that: 'There can be no doubt that the *primary responsibility* for misconduct in the financial services industry lies with the entities concerned and those who managed and controlled those entities: their boards and senior management'.[108]

And, that: 'Because it is the entities, their boards and senior management who bear primary responsibility for what has happened, close attention must be given to their *culture*, their *governance* and their *remuneration practices*'.[109]

It may seem bewildering that Commissioner Hayne has tasked remedying culture to those responsible for the problem (although as we will see, there have been changes to board composition in some entities).[110] Yet, this approach is typical of that found in other reports and inquiries in both Australia and overseas, underlining what may arguably be the biggest obstacle faced in efforts to use

101 *Chief Executive Officer of the Australian Transaction Reports and Analysis Centre v Westpac Banking Corporation* [2020] FCA 1538.
102 'Concise Statement of Claim' (n 100) 6 [30].
103 Australian Prudential Regulatory Authority, *Prudential Inquiry into the CBA* (Final Report, 30 April 2018) ('*Prudential Inquiry into the CBA*').
104 See above n 97.
105 *Prudential Inquiry into the CBA* (n 103) 3–4.
106 Ibid 4.
107 *Hayne Royal Commission Final Report* (n 16) 1–2. See also 335.
108 Ibid 4 (emphasis added).
109 Ibid (emphasis added).
110 See below nn 138–43, 147, 149.

culture as a regulatory tool, that is, the claim that the internal governance of the organisation should be free from interference.[111] Significantly, however, the Commissioner went on to recognise what he described as the 'important' role regulators play in the supervision of these matters, noting that '[s]upervision must extend beyond financial risk to non-financial risk and that requires attention to culture, governance and remuneration',[112] though other reports also acknowledge this role for regulators.[113]

In considering culture, to which the *Hayne Royal Commission Final Report* makes over 300 references,[114] Commissioner Hayne regarded remuneration policies and practices as the main drivers of culture. In both the *Hayne Royal Commission Interim* and *Final Reports*, he found that almost all of the cases analysed by the Commission that were breaches of the law, delivered financial benefits for not just the entities concerned, but for individuals.[115] He also found that with entities putting the '[pursuit of] profit above all else', this included a culture of nonchalance towards 'compliance with the law'.[116] Such findings are consistent with modern organisational scholarship, particularly in relation to risk climate in financial institutions. Avoidance (the perception that risk issues are ignored, downplayed and excused) has been found to predict and lead to poor behaviour including lack of compliance and misconduct towards customers.[117]

National Australia Bank's ('NAB') 'Introducer Program', is just one example of many entrenched motivations to misconduct arising from remuneration structures present within the Australian financial services sector, which were highlighted in the Hayne Royal Commission hearings.[118] Striking evidence revealed cash bribes stuffed into paper envelopes, fake documents and manipulation of incentives within that program.[119] In particular, revelations that

111 See in particular discussion below nn 206–10.

112 *Hayne Royal Commission Final Report* (n 16) 47.

113 See, eg, Australian Prudential Regulation Authority, *Capability Review* (Report, 28 June 2019) 77–93 ('*Australian Prudential Regulation Authority Capability Review*'), although the report in typical fashion emphasises a limited role for supervision and reluctance for APRA to be seen as prescribing conduct and culture, the 'preserve' of Australian deposit-taking institutions ('ADIs'), which are body corporates authorised under the *Banking Act 1959* (Cth) to carry on a banking business in Australia and their boards: at 78.

114 As noted by Jennifer Hill: see Jennifer G Hill, 'Legal Personhood and Liability for Flawed Corporate Cultures' (Working Paper No 431/2018, European Corporate Governance Institute, December 2018) 8 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3309697>.

115 *Hayne Royal Commission Interim Report* (n 17) xix, 301; *Hayne Royal Commission Final Report* (n 16) 1–2.

116 *Hayne Royal Commission Final Report* (n 16) 1–2, 401.

117 Sheedy and Griffin, 'Risk Governance, Structures, Culture, and Behavior' (n 54) 5, 19; Sheedy, Garcia and Jepsen, 'The Role of Risk Climate' (n 55).

118 Under this program, which generated $24 billion by way of home loans for NAB, introducers were paid between 0.4 to 0.6% of home loan totals.

119 See James Frost, 'Hayne Royal Commission: NAB Staff Took Cash Bribes to "Smash Targets"', *The Australian Financial Review* (online, 13 March 2018) <https://www.afr.com/companies/financial-services/hayne-royal-commission-nab-staff-took-cash-bribes-to-smash-targets-20180312-h0xdfx#>. It has since resulted in ASIC bringing civil penalty proceedings in the Federal Court and NAB ordered to pay a $15 million penalty for contravening section 31(1) of the *National Consumer Credit Protection Act 2009* (Cth): *Australian Securities and Investments Commission v National Australia Bank Limited* [2020] FCA 1494.

NAB's commission structures generated conflicts of interest in the way the bank remunerated mortgage brokers and the failure to manage conflicts occupied central stage.[120]

As observed in an article in *The Conversation* when the Royal Commission was underway, as a consequence of such revelations:

> We have had belated 'apologies' to customers who were treated unfairly or, worse, fell victim to unscrupulous or wrongful behaviour; admissions that the banks breached their own codes of conduct; and assurances that changes in governance systems aimed at improving culture have been made or will be.[121]

In addition, even before the Royal Commission was over, the banks, trying to pre-empt future government and/or regulatory responses, took more concrete action. This included the major Australian banks (the CBA in June 2018, following the lead of Australia and New Zealand Banking Group ('ANZ') and NAB) beginning to separate their wealth management arms in a bid to resolve the conflicts of interest inherent in their vertical integration.[122] Those conflicts of interest include those banks providing financial, insurance and mortgage advice, and selling related products. While these demergers arguably represented 'a step in the right direction', certain aspects were problematic, most importantly, that not all restructures would result in a complete separation of the banks' businesses, raising concerns that conflicts of interest and banks' failure to act in customers' interests would continue.[123] Among the recommendations Commissioner Hayne made in the *Hayne Royal Commission Final Report*, which the government has said it would implement,[124] there are recommendations that would reduce, and in some cases, hopefully stop the fee-gouging opportunities of vertical integration.

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120 Unsurprisingly, Commissioner Hayne has recommended, for instance, that changes in brokers' remuneration be made, by first banning lenders from paying so-called annual trailing commissions to mortgage brokers on new loans, then by prohibiting lenders from paying other commissions to mortgage brokers: *Hayne Royal Commission Final Report* (n 16) 80.

121 See Vicky Comino, 'Restructuring Alone Won't Clean Up the Banks' Act', *The Conversation* (online, 12 July 2018) <https://theconversation.com/restructuring-alone-wont-clean-up-the-banks-act-99142> ('Restructuring Alone Won't Clean Up the Banks' Act'). While these observations were made in the context of the Royal Commission hearings, they also apply to the way many corporations and banks here in Australia and elsewhere have responded to revelations of wrongdoing. See discussion below nn 129–30, regarding, eg, the Wells Fargo cross-selling scandal.

122 Westpac has since floated the idea of demerging its operations, although initially it took a different approach from the other banks. In October 2018, AMP had also announced that it would be selling its life insurance arm to London-based Resolution Life for $3.3 billion, which sale has since been completed: 'Resolution Life Completes Acquisition of AMP Life', *Resolution Life* (Web Page, 1 July 2020) <https://www.resolutionlife.com/news-and-insights/resolution-life-completes-acquisition-of-amp-life/>.

123 See Comino, 'Restructuring Alone Won't Clean Up the Banks' Act' (n 121).

124 The *Hayne Royal Commission Final Report* made 76 recommendations, of which 54 called for government action (the balance 22 recommendations were aimed at regulators and the finance industry): Josh Frydenberg and Scott Morrison, 'Restoring Trust in Australia's Financial System' (Joint Press Release, Department of Treasury (Cth), 4 February 2019). Yet, despite Treasurer Josh Frydenberg since revealing what he has described as a 'full implementation road map' around these 54 recommendations, the government has already back-flipped on the recommended ban on commission payments to mortgage brokers, opting instead for a review of commissions after three years: see Peter Ryan and Jade Macmillan, 'Federal Government Reveals Timeline to Implement Its 54 Banking Royal Commission Recommendations', *ABC News* (online, 18 August 2019) <https://www.abc.net.au/news/2019-08-18/banking-royal-commission-recommendations-implemented-by-2020/11425910>.

One such recommendation relates to banning grandfathered commissions on investment advice.[125] Unfortunately, however, he did not make any recommendation to cut vertical integration altogether, including for legislation to force all financial institutions to sell off their advice subsidiaries and to close any loopholes that bypass the spirit of the legislation, as Allan Fels, former head of the Australian Competition and Consumer Commission ('ACCC'), had called for.[126] Vertical disaggregation helps minimise the risk of an unethical corporate culture by removing the opportunities for fee-gouging. By failing to act on this issue, an important opportunity has been lost.

Recently, however, in response to the Royal Commission's concerns about conflicts of interest and the treatment of customers, a positive development has been the ANZ flagging the removal of performance-related individual bonuses for staff below executive-level from 1 October 2019.[127] This is another means of constraining culture which could go some way in resolving conflicts so that bank personnel are more likely to act in customers' interests in the future. But with the changes not applying to ANZ's executive team, justified presumably because their pay has reportedly fallen after a year of declining profits, a decrease in share price and industry-wide reputational damage in the wake of the Royal Commission,[128] it arguably does not go far enough.

IV CORPORATE RESPONSES TO CORPORATE CULTURE CRITIQUES

A 'Bad Apples'

A common and well-known response of corporations and banks when they have been involved in scandals and inquiries has been to try to lay the blame at the feet of 'bad apples' (invariably employees at the lower and middle levels of the organisational hierarchy). This was clearly the contention of Wells Fargo when confronted with revelations of wrongful practices in the US cross-selling scandal,[129] accompanied by the usual 'apology' and stated commitment to restore the trust of customers and rebuild community goodwill.[130] In the Australian context, there have been many examples of this same argument by organisations seeking to explain away widespread misconduct as 'a few bad apples', or as in the CBA's initial submission to the Hayne Royal Commission, 'pockets of poor

125 See above n 120.

126 See Allan Fels, 'All Eyes on Kenneth Hayne after Shocking Revelations at Banking Inquiry', *The Sydney Morning Herald* (online, 22 April 2018) <https://www.smh.com.au/business/banking-and-finance/all-eyes-on-kenneth-hayne-after-shocking-revelations-at-banking-inquiry-20180422-p4zb0k.html>.

127 See Stuart Condie, 'ANZ Bins Individual Bonuses for Non-execs', *The West Australian* (online, 6 August 2019 <https://the west.com.au/business/banking/anz-bins-individual-bonuses-for-non-execs-ng-s-1959802>.

128 Ibid.

129 See above n 81.

130 See Doreen McCallister, 'Wells Fargo CEO Discusses Secret-Accounts Scandal in Senate Hearing', *National Public Radio* (online, 20 September 2016) <http://www.npr.org/sections/thetwo-way//2016/09/30/494680201/wells-fargo-ceo-to-address-accounts-scandal-before-senate-panel>.

culture'.[131] As we have seen, however, Commissioner Hayne rejected this excuse,[132] and elaborated: 'That characterisation serves to contain allegations of misconduct and distance the entity from responsibility. It ignores the *root causes of conduct, which often lie with the systems, processes and culture cultivated by an entity*'.[133]

Accordingly, firing lower-down or middle level employees in cases where they actually perpetrated the wrongdoing (as happened with Wells Fargo),[134] does not resolve problems as they will be easily replaced with others just as willing to commit wrongdoing unless the culture of the organisation changes.

B Change at the Top

Another typical response has been to have the CEO take responsibility and resign. This is premised on the argument that while it often is these lower-downs or middle management who perpetrate the wrongdoing, 'it is top management which set the expectations, the tone, the corporate culture that determines the incidence of corporate crime' (condoning, or in some cases instigating or even concealing it).[135] This occurred with Stumpf, who was forced to resign in October 2016 amid mounting criticism and reputational damage sustained by Wells Fargo, although his departure was marked by a highly publicised 'golden hand-shake' of USD133 million,[136] which Tomasic has argued means that no real accountability for wrongdoing was assumed by Stumpf (or any member of his senior management team).[137] Termination payments and 'golden parachute' arrangements that appear to inappropriately reward executive failure are not unusual. The same occurred, for example, when Ian Narev, former head of the scandal-ridden CBA, was forced to stand down.[138] More recently, the media was highly critical of Brian Hartzer (Westpac's CEO), who was forced to resign in the fallout from the Westpac AML/CTF scandal, departing with a $2.7 million payment.[139] This outrage was especially in view of his behaviour and statements when the scandal first broke.[140]

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131 See *Hayne Royal Commission Interim Report* (n 17) 86. See also 86–8 for other examples.

132 See especially, discussion above nn 108–9.

133 *Hayne Royal Commission Interim Report* (n 17) 87 (emphasis in original).

134 See above n 81.

135 See John Braithwaite, 'White Collar Crime' (1985) 11(1) *Annual Review of Sociology* 1, 17.

136 But note that Stumpf forfeited USD41 million in unvested equity: see Lucinda Shen, 'Here's How Much Wells Fargo CEO John Stumpf Is Getting to Leave the Bank', *Fortune* (online, 14 October 2016) <https://fortune.com/2016/10/13/wells-fargo-ceo-john-stumpfs-career-ends-with-133-million-payday/>.

137 See Tomasic (n 6) 199. The Wells Fargo head of retail banking retired with about USD125 million in stock and options.

138 Narev announced his departure from the bank in August 2017. While Narev departed with his bonuses intact, his remuneration had been reduced earlier as a result of a 40% protest vote by shareholders voting against his remuneration at the 2016 AGM.

139 See, eg, Ben Butler, 'Westpac's CEO Brian Hartzer Resigns over Money-Laundering Scandal', *The Guardian* (online, 26 November 2019) <https://www.theguardian.com/australia-news/2019/nov/26/westpac-chief-executive-brian-hartzer-resigns-over-money-laundering-scandal>. However, it seems that Hartzer will not be paid a short-term bonus for 2019 and will lose any long-term bonuses that have not already vested.

140 Hartzer reportedly told staff that that the crisis was 'not an Enron or Lehman Brothers' and was not resonating with ordinary Australians, such that 'we don't need to overcook this': ibid.

Hartzer's attitude resembled the behaviour and evidence of Andrew Thorburn (NAB's CEO) and Ken Henry (NAB's chair) in the face of questioning in the final round of the Royal Commission hearings,[141] which Commissioner Hayne considered demonstrated an '[u]nwillingness to recognise and to accept responsibility for misconduct'.[142] Both Thorburn and Henry, under pressure to resign, dramatically announced their departures from NAB.[143] Those departures came swiftly after the release of the *Hayne Royal Commission Final Report*, in which Commissioner Hayne also expressed a fear – that the 'wide gap between the public face that NAB seeks to show and what it does in practice' may remain.[144]

Who will succeed CEOs when there are scandals is an interesting question from the point of view of culture change. In the case of Comyn, a CBA veteran of 20 years, who replaced Narev, the problem was not so much that he was an insider, but that his responsibilities as former head of retail banking included the rollout of the so-called intelligent deposit machines that were central to AUSTRAC's case against the CBA relating to the systematic breakdown of its AML/CTF monitoring and reporting.[145] Likewise, Tim Sloan, who became Wells Fargo CEO, was Chief Operating Officer at the time of the Wells Fargo fraudulent accounts scandal. Such an approach raises crucial questions regarding whether cultural deficits within an organisation will continue, notwithstanding a change at the top.[146]

Subsequent developments at CBA[147] and Wells Fargo[148] resulted in these banks also purging their boards, yet another typical response to scandals[149] that raises other important questions. Does replacing the board and/or high-level

141 See, eg, Liz Main, 'Banking Royal Commission: Four Times NAB Chairman Ken Henry Lost His Cool', *Australian Financial Review* (online, 27 November 2018) <https://www.afr.com/companies/financial-services/banking-royal-commission-four-times-nab-chairman-ken-henry-lost-his-cool-20181127-h18evx#>.

142 *Hayne Royal Commission Final Report* (n 16) 409.

143 See Stephanie Chalmers and Stephen Letts, 'NAB CEO Andrew Thorburn and Chair Ken Henry Resign in the Wake of the Royal Commission', *ABC News* (online, 7 February 2019) <https://www.abc.net.au/news/2019-02-07/nab-ceo-and-chairman-both-resign-after-royal-commission/10790670>.

144 *Hayne Royal Commission Final Report* (n 16) 411.

145 See *Chief Executive Officer of the Australian Transaction Reports and Analysis Centre v Commonwealth Bank of Australia Ltd* [2018] FCA 930.

146 See, eg, Pendergrass (n 83) who expressed such concerns about Sloan.

147 In addition to its CEO being replaced, the chairperson, chair of the board's risk committee and chief risk officer have all been replaced: see Stephen Letts, 'Do the BEAR Banking Reforms Have Bite if APRA Believes It Is Not a Corporate Cop?' *ABC News* (online, 2 May 2018) <https://www.abc.net.au/news/2018-05-02/apra-says-banks-should-go-beyond-bear-necessities/9718582>.

148 In the case of Wells Fargo, it was the Federal Reserve in 2018, which demanded the replacement of four directors in response to widespread consumer abuses and compliance breakdowns at the bank that occurred less than two years after the cross-selling scandal. See below n 150.

149 AMP, Australia's largest wealth provider, in the wake of evidence unearthed at the Royal Commission hearings of serious misconduct in the notorious 'fee-for-no-service' scandal (eg, that it systematically misled ASIC on at least 20 occasions) and which impacted adversely on its share price, saw most of its board replaced after the CEO, chair and several directors decided to resign ahead of the company's AGM in May 2018: see, eg, Stephen Letts, 'AMP Appoints Former CBA Boss David Murray as New Chairman', *ABC News* (online, 4 May 2018) <https://www.abc.net.au/news/2018-05-04/amp-appoints-former-cba-boss-david-murray-as-new-chairman/9728510#>.

executives (not just the CEO) give companies a real opportunity to change business strategy and cultures of wrongdoing, or are they just symbolic 'scalps'? If it is the latter, then other approaches need to be explored. One possibility is regulators putting restrictions on the growth of wrongdoing organisations. This occurred with Wells Fargo when the Federal Reserve took the rare step of restricting Wells Fargo's growth until it sufficiently improved its governance and controls.[150] The consequent fall in its share price[151] provides a powerful incentive for other wrongdoing organisations to change their ways.

Replacing the CEO and the board/top executives may also have some negative implications for companies. Importantly, it can mean the loss of corporate knowledge, so that the same mistakes are repeated. This observation has been made in relation to the banks, which routinely turn over their top executives every few years and was highlighted in NAB's 'Introducer Program'.[152] Even though the scandal regarding this program erupted at the Hayne Royal Commission, the program had its origins in the early 2000s. At various times, senior NAB executives had grappled with problems, such as growing third-party channels and mortgage brokers keen to earn quick commissions on questionable loans. But as one commentator notes, when those executives were later 'let go, restructured or left, their corporate knowledge of the problems went with them'.[153]

V THE 'TRUST DEFICIT' AND ITS SIGNIFICANCE FOR CORPORATE GOVERNANCE

The responses of regulators to the GFC and post-GFC scandals have done little to restore trust. Instead, they have exacerbated the 'trust deficit', including in Australia where it mirrors that in many other Western nations.[154] In terms of

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150 The bank was restricted from growing any larger than its total asset size as at the end of 2017, but was not required to cease its then current activities, including accepting customer deposits or making consumer loans: Board of Governors of the Federal Reserve System (US), 'Responding to Widespread Consumer Abuses and Compliance Breakdowns by Wells Fargo, Federal Reserve Restricts Wells' Growth until Firm Improves Governance and Controls. Concurrent with Fed Action, Wells to Replace Three Directors by April, One by Year End' (Press Release, 2 February 2018) <https://www.federalreserve.gov/newsevents/pressreleases/enforcement20180202a.htm>.

151 Tae Kim, 'Wells Fargo Shares Are Tanking as Wall Street Is Stunned over the Fed's "Harsh" Action; Multiple Firms Downgrade Bank', *CNBC* (online, 5 February 2018) <https://www.cnbc.com/2018/02/05/wells-fargo-shares-are-tanking-on-feds-harsh-action.html>.

152 This program was discussed above nn 118–19.

153 Patrick Durkin, 'NAB's Internal Power Struggle over the Dark Underbelly of $1.6trn Home Loan Industry', *Australian Financial Review* (online, 16 March 2018) <https://www.afr.com/companies/financial-services/nabs-internal-power-struggle-over-the-dark-underbelly-of-16trn-home-loan-industry-20180315-h0xii0>.

154 See above nn 10–11. The 2017 Edelman Trust Barometer revealed that trust is in crisis around the world, most notably in public institutions in Western liberal democracies: see Richard Edelman, *2017 Edelman Trust Barometer: Executive Summary* (Report, 15 January 2017). It found that the general population's trust in all four key institutions – government, business, the media and non-government organisations – declined broadly, a phenomenon not reported since Edelman, a global corporate communications and advisory firm, began canvassing trust across these institutions in 2012. More recently, the Edelman Trust

corporate governance, the implications of the 'trust deficit' are significant, with rebuilding trust being a key issue facing Western governments.

O'Brien has contended that 'the foundational strength of the associational governance paradigm, pioneered by Streeck (and his co-author Phillipe Schmitter)', has eroded.[155] That paradigm implies that co-regulation will secure substantive compliance rather than regulatory gaming and arbitrage.[156] In making this argument, O'Brien relies not only on Streeck, who is debunking his original ideas,[157] but also Braithwaite, who has expressed similar misgivings,[158] where both are advocating starting a more substantive normative dialogue informed by a common commitment to a social contract.[159]

This has led to renewed examination of broader and more fundamental issues, such as how to mediate the relationship between state and market and the role that the corporation (which, as the chief generator of wealth and taxable income, is critical to economic and social development) should play.[160] Arguably, however,

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Barometer found that the percentage of those surveyed who mistrust business remains significant, particularly in Australia: see Deidre Campbell, *2019 Edelman Trust Barometer: Financial Services* (Report, 24 April 2019) <https://www.edelman.com/research/trust-in-financial-services-2019>. However, since the COVID-19 pandemic, findings suggest that Australians have a newfound trust in government, the media and business: see Malcolm Farr, 'Australians' Trust in Government and Media Soars as Coronavirus Escalates', *The Guardian* (online, 7 April 2020) <https://www.theguardian.com/australia-news/2020/apr/07/australians-trust-in-government-and-media-soars-as-coronavirus-crisis-escalates>, reporting the findings of a survey conducted by that newspaper; Peter Lewis, 'Trust in the Government Is Rising: But Will Australians Accept the Coronavirus Tracing App?', *The Guardian* (online, 21 April 2020) <https://www.theguardian.com/australia-news/commentisfree/2020/apr/20/trust-in-the-government-is-rising-but-will-australians-accept-the-coronavirus-tracing-app>. The better than expected take up by Australians of the TraceTogether app is a further indication of higher levels of trust in government than was the case previously.

155 O'Brien (n 10) 20, referring to Wolfgang Streeck and Phillipe C Schmitter, 'Community, Market, State – and Associations: The Prospective Contribution of Interest Governance to Social Order' in Wolfgang Streeck and Phillipe C Schmitter (eds), *Private Interest Government: Beyond Market and State* (Sage Publications, 1985) 1.

156 See O'Brien (n 10) 24. Here, O'Brien is referring to the 'responsive' regulatory model of an enforcement pyramid as formulated in Ian Ayres and John Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford University Press, 1992). This model has become the model of regulatory enforcement in many jurisdictions and of many regulators, including ASIC. In short, it posits that regulators are best able to secure compliance by displaying an explicit enforcement pyramid. Most regulatory activity takes place at the base (eg, education and persuasion) escalating to more serious sanctions as contraventions become more serious, with criminal liability at the apex (eg, jail and licence revocation for individuals and corporations respectively) as a last resort only for the most serious offending.

157 See Streeck, *How Will Capitalism End?* (n 1) 17. ('I interpret the coexistence of a shared sense of crisis with diverging concepts of the nature of that crisis as an indication that traditional economic and sociological theories have today lost much of their predictive power'.)

158 See John Braithwaite, 'Cultures of Redemptive Finance' in O'Brien and Gilligan (n 4) 267. Braithwaite has argued that pyramidal enforcement ignores the normative dimension between the base and below in terms of there being no capacity for regulators to intervene when corporations are technically not breaking any legal rules, notwithstanding the lack of commitment to good governance and ethics.

159 See O'Brien (n 10) 26.

160 See ibid 24, although O'Brien is one voice in a chorus of many recognising this. See also, eg, David Millon, 'Communitarianism in Corporate Law: Foundations and Law Reform Strategies' in Lawrence E Mitchell (ed), *Progressive Corporate Law* (Westview Press, 1995) 1; Paddy Ireland, 'Is Corporate Law

while the magnitude of the challenge has been recognised, this has merely been at the rhetorical level. In 2016, then British Prime Minister, Theresa May had rationalised a Green Paper on corporate governance reform, for instance, warning that: '[F]or people to retain faith in capitalism and free markets, big business must earn and keep the trust and confidence of their customers, employees and the wider public … It is clear that something has to change'.[161]

In a similar vein, Mark Carney, Governor of the Bank of England, made statements acknowledging the requirement of the consent of society – a 'social licence' – as well as a legal licence for banks and corporations to be allowed to operate, observing that '[r]epeated episodes of misconduct [such as LIBOR] have called that social licence into question'.[162] In Australia, in the wake of local scandals, Malcolm Turnbull, when he was Prime Minister,[163] business leaders, including Elizabeth Proust, chair of the Australian Institute of Company Directors ('AICD'),[164] and bank executives, such as high profile ANZ chair, David Gonski AC,[165] made similar statements.

O'Brien has opined that such statements, for example, by Carney, represent an abandonment of the shareholder primacy model, and put, if only at the level of rhetoric, societal obligation at the centre of corporate and regulatory decision-making.[166] O'Brien also noted that Carney 'has placed commitment to a "social licence to operate" at the normative core of the Fair and Effective Market Review in the UK and, by extension, international regulatory reform'.[167]

However, the Fair and Effective Markets Review ('FEMR') (led by the Bank of England, and co-chaired by the Financial Conduct Authority ('FCA') and HM Treasury), which was a comprehensive assessment of the way Fixed Income,

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Really about Enterprise and Its Functional Needs, as Traditional Presentations of the Discipline Suggest?' (Speech, Corporate Law Teachers Association Annual Conference, February 2018).

161 Theresa May, 'Introduction from the Prime Minister' in Department for Business, Energy & Industrial Strategy (UK) *Corporate Governance Reform: Green Paper* (November 2016) 2 <www.gov.uk/government/uploads/system/uploads/attachment_data/file/584013/corporate-governance-reform-green-paper.pdf>.

162 See Mark Carney, 'Building Real Markets for the Good of the People' (Speech, Lord Mayor's Banquet for Bankers and Merchants of the City of London, 10 June 2015) 3–4.

163 See James Massola, Sarah Danckert and Clancy Yeates, 'Malcolm Turnbull Lashes Banks over Trust and Standards following ASIC Allegations', *The Sydney Morning Herald* (online, 6 April 2016) <https://www.smh.com.au/politics/federal/malcolm-turnbull-lashes-banks-over-trust-and-standards-following-asic-allegations-20160406-gnzjyh.html>.

164 The AICD holds itself out as the peak membership body for company directors in Australia. See Proust's opening remarks at the 2018 AICD annual Governance Summit, themed 'Trust, Sustainability and Innovation': Elizabeth Proust, 'Opening Address' (Speech, Australian Governance Summit, March 2018) <https://aicd.companydirectors.com.au/events/australian-governance-summit/latest-news/opening-address-ags-2018>.

165 See Patrick Durkin, 'Is David Murray or David Gonski Right on Governance?' *Australian Financial Review* (online, 2 August 2018) <https://www.afr.com/work-and-careers/management/is-david-murray-or-david-gonski-right-on-governance-20180802-h13gfe>. Durkin reported Gonski urging the banks, including ANZ, to 'step outside our traditional role as solely shareholder-focused organisations, and work in new ways that also put our customers and our communities at the centre of everything we do'.

166 O'Brien (n 10) 24.

167 Ibid.

Currency and Commodities ('FICC') markets[168] operate, held in the aftermath of such scandals as LIBOR, is an ongoing process. This process has been held to inform on the implementation of the recommendations made by the Review.[169] On 28 July 2016, the chairs of FEMR published an implementation report, and on 24 May 2018, a second Progress Report was published.[170] The 2018 Report emphasises issues, such as strengthening individual accountability, which led to the extension of the Senior Managers and Certification Regime ('SM&CR') in the UK to a wider set of financial institutions.[171] It also emphasised other issues, including embedding a forward-looking approach to FICC markets. The latter has involved initiatives that focus on identifying and mitigating risks, and ensuring that the FCA, as the conduct regulator, is being more pre-emptive in its supervisory approach, which includes looking at the conduct of individual firms and how markets are evolving.[172]

These developments and the fading of the 'social licence to operate' rhetoric have clearly impacted on what is occurring in Australia,[173] and influenced the way regulators have responded in the wake of the Hayne Royal Commission. This includes ASIC, which for all its posturing about its new 'Why not litigate?' strategy,[174] is also paying closer attention to the culture and conduct of firms through its surveillance work and a more intensive supervisory approach, including its new Close and Continuous Monitoring ('CCM') Program.[175] However, it is debatable whether these developments have also resulted in the final version of the 2019 Australian Securities Exchange Corporate Governance Principles and Recommendations ('2019 ASX CG Principles and

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168 These markets have a real impact on individuals, households and businesses. They underpin borrowing costs, exchange rates, and the cost of food and raw materials, and they help firms and households manage financial risks and investments.

169 On 10 June 2015, the three organisations published a Final Report of the Review, including findings and recommendations, which is available on the Bank of England website: *Fair and Effective Markets Review* (Final Report, 10 June 2015) <https://www.bankofengland.co.uk/report/2015/fair-and-effective-markets-review---final-report>.

170 These reports are also available on the Bank of England website: *Fair and Effective Markets Review* (Implementation Report, 28 July 2016) <https://www.bankofengland.co.uk/report/2016/fair-and-effective-markets-review-implementation-report>; *Fair and Effective Markets Review Progress Report* (24 May 2018) <https://www.bankofengland.co.uk/report/2018/fair-and-effective-markets-review-progress-report>.

171 See Financial Conduct Authority (UK), *Fair and Effective Markets Review* (Progress Report, May 2018) 3. For example, the government legislated to extend the regime to insurance firms from 10 December 2018.

172 Ibid.

173 But note developments in corporate governance codes, discussed below nn 179–86. The COVID-19 'systemic shock' in 2020 has also amplified the debate about whether corporations have a broader purpose (or even obligation) beyond profit maximisation for shareholders: see, eg, Jean du Plessis and Andrea Anastasi, '2020 Vision: Current Reflections and Stakeholder Governance in a Post-COVID-19 World' (2020) 37 *Company and Securities Law Journal* 495, 495.

174 See above n 70.

175 ASIC has explained that new supervisory approaches are also part of the wider 'strategic change program', which commenced in 2018 that it is undergoing in response to the Royal Commission: see Australian Securities and Investments Commission, 'ASIC Update on Implementation of Royal Commission Recommendations' (Media Release 19-035MR, 19 February 2019) 4.

Recommendations'),[176] not adopting the proposed revision to Principle 3, which had recognised the importance of a listed entity's 'social licence to operate'.[177] More likely, the exclusion of the phrase 'social licence to operate' was due to strong local opposition from the Australian business community, evident from a review of submissions made when the Consultation Draft was released in 2018, including by the high profile AICD.[178]

Indeed, the final version of the 2019 ASX CG Principles and Recommendations reflects trends involving an enhanced focus on culture and 'societal purpose' found in corporate governance codes and reform proposals in not only the UK, most notably in the 2018 UK Corporate Governance Code ('2018 UK CG Code'), but also in other jurisdictions,[179] demonstrating continuing and growing attention to the social role and responsibilities of public corporations. In addition to the 2018 UK CG Code[180] stating, for example, that the role of a successful company is not simply to create value for shareholders, but also to contribute to 'wider society',[181] it has an elevated emphasis on 'culture',[182] as well as on stakeholder interests as part of that vision of culture.[183] Similarly, stakeholder interests have also become an increasingly important component of the 2019 ASX CG Principles and Recommendations. This is borne out by them, for example, anticipating 'meaningful dialogue' between the company and its shareholders and

176 ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations* (Report, 4th ed, February 2019) ('*Corporate Governance Principles and Recommendations*'). An important mechanism for encouraging good corporate governance practices in Australian listed entities is the 'if not, why not' disclosure requirement introduced by the ASX in 2003: see ASX, *Listing Rules* (as at 1 December 2019) r 4.10.3. It requires listed entities to report against a number of recommendations relating to governance set out in the 2019 ASX CG Principles and Recommendations as formulated by the ASX CG Council. The Council was established in August 2002 and periodically updates its Principles and Recommendations, now in its fourth edition.

177 See ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations* (Consultation Draft, 4th ed, May 2018) 25.

178 See Australian Institute of Company Directors, Submission to ASX Corporate Governance Council, *Review of the ASX Corporate Governance Principles and Recommendations* (27 July 2018) 5–8.

179 For a fuller discussion of these codes and reform proposals: see Hill, 'Legal Personhood and Liability for Flawed Corporate Cultures' (n 114) 4–6.

180 Like the ASX CG Principles and Recommendations, they are non-binding and operate on an analogous 'comply or explain' basis, with the 2018 UK CG Code expanding upon recommendations made in Financial Reporting Council, *Corporate Culture and the Role of Boards: Report of Observations* (Report, July 2016).

181 Financial Reporting Council, *The UK Corporate Governance Code* (July 2018) 4.

182 See, eg, ibid 1, 4 (Principle B). It provides that directors should lead by example to establish a culture of integrity, which supports the organisation's 'purpose, values and strategy': at 4.

183 Provisions include that the board should set out in the company's annual report how the interests of stakeholders have been taken into account in board decision-making: see ibid 1, 5. Such provisions in the Code are, of course, in addition to the statutory duty of directors under section 172(1) of the *Companies Act 2006* (UK) to 'promote the success of the company for the benefit of its members as a whole', which requires directors to consider the interests of a non-exhaustive list of stakeholders and the effect of corporate actions on the community and environment. This has become known as the 'enlightened shareholder value approach' to corporate governance, explored at length by leading scholars, such as Andrew Keay: see, eg, Andrew Keay, 'Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom's "Enlightened Shareholder Value Approach"' (2007) 29(4) *Sydney Law Review* 577.

other stakeholders[184] and highlighting that 'the broader community' expects that listed companies will act 'lawfully, ethically and responsibly'.[185] Moreover, with a focus on 'reputation' and 'standing in the community', principle 3 now recommends that a listed entity should 'articulate and disclose its values' and 'instill and continually reinforce a culture across the organisation of acting lawfully, ethically and responsibly'.[186]

Instilling a culture of acting 'lawfully, ethically and responsibly', however, will not be easy, especially for Australian banks whose cultural problems were laid bare at the Hayne Royal Commission. Furthermore, with behaviour and culture being deep-rooted, recognition that the process of changing them will take many years is inescapable,[187] a fact Henry recently acknowledged on Australian Broadcasting Corporation's *7.30 Report* regarding NAB's future, saying the bank has 'got an absolute mountain to climb'.[188]

VI DIFFICULTIES FACING THE USE OF 'CORPORATE CULTURE' AS A REGULATORY TOOL TO PROMOTE A HEALTHY CULTURE IN ORGANISATIONS

As this article has noted, difficulties facing the use of 'corporate culture' as a regulatory tool to promote a healthy culture in organisations include the phenomenon known as 'decoupling', a term employed by organisational studies, which defines when an organisations' practices diverge from their formal systems and espoused policies.[189] This article has contended that there are possibilities for legal enforcement and corporate criminal liability based on the corporate culture provisions of the *Criminal Code*.[190] In making this argument, it canvassed the types of evidence that can be relied upon by prosecutors as evidence of defective culture. This includes evidence regarding compliance practices that do not align with the organisation's formal policies.[191]

However, as this article has also noted, the possibilities for proving corporate criminal liability based on cultural deficiency offered by part 2.5 of the *Criminal Code* are not available to prosecutions in the financial services sector in

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184 See *Corporate Governance Principles and Recommendations* (n 176) 2, though as Hill rightly notes, the final version does not go as far as the earlier ASX Consultation Draft, which made specific mention of the expectation that directors and managers consider the views and interests of, and engage with, a wide range of stakeholders, and furthermore, that listed companies were expected to act as 'good corporate citizens', principally due to objections that the list of stakeholder interests were inconsistent with Australian law, with no counterpart to section 172(1) of the *Companies Act 2006* (UK): Hill, 'Legal Personhood and Liability for Flawed Corporate Cultures' (n 114) 5–6.

185 See *Corporate Governance Principles and Recommendations* (n 176) 16.

186 See ibid (citations omitted).

187 See Thomas Kell and Gregory T Carrott, 'Culture Matters Most' (2005) 83(5) *Harvard Business Review* 22, 24, describing changing the culture of an organisation as a huge task.

188 Interview with Ken Henry (Leigh Sales, Australian Broadcasting Corporation 7.30 Report, 7 February 2019).

189 See above n 53.

190 See above nn 48–50.

191 See especially nn 48, 50, 56.

Australia,[192] which is regrettable. This is especially given indications of how common the phenomenon of 'decoupling' was at the Hayne Royal Commission. There were many instances of evidence heard from banks saying one thing publicly – that they adhere to the law, and have systems and policies in place to ensure regulatory compliance – 'but then [they] do something entirely different as a matter of standard practice'.[193] A clear example was their alleged focus on responsible lending.[194] In the case of ANZ, evidence was heard about the bank's practices failing to take steps to verify the living expenses declared by mortgage applicants.[195] When William Ranken, ANZ's general manager of home loans and retail lending, was questioned about mortgage brokers submitting home loan applications with inconsistent financial information, he admitted: 'Our processes are we do nothing',[196] thus providing evidence of ANZ substituting legal and regulatory requirements for responsible lending in favour of less burdensome internal practices.

As such, 'decoupling' and the possibility of disjuncture between a corporation's actual culture and that conveyed in its formal governance structures may mean that there is box-ticking of regulatory requirements, but substantive compliance is lacking.[197] This scenario remains one of the main difficulties faced generally by regulators in seeking to use 'corporate culture' as a regulatory mechanism.

Another problem that makes use of 'corporate culture' as a regulatory tool particularly challenging, includes the blurred line between 'criminal' and 'normal' business behaviour. A stark example is provided in the case of *R v Hayes*.[198] Tom Hayes, a former trader of the Yen version of LIBOR, was charged with eight counts of conspiracy to defraud, having attempted to manipulate foreign currency rates over a four-year period between 2006 and 2010. Even though Hayes admitted

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192 As noted above n 57, since part 2.5 is expressly excluded by chapter 7 of the *Corporations Act 2001* (Cth) dealing with the regulation of financial services.

193 Andrew Linden and Warren Staples, 'The Way Banks Are Organised Makes It Hard to Hold Directors and Executives Criminally Responsible', *The Conversation* (online, 23 March 2018) <https://theconversation.com/the-way-banks-are-organised-makes-it-hard-to-hold-directors-and-executives-criminally-responsible-93638>.

194 See Elizabeth Knight, 'Are Banks Irresponsible about Responsible Lending?' *The Sydney Morning Herald* (online, 21 March 2018) <https://www.smh.com.au/business/banking-and-finance/are-banks-irresponsible-about-responsible-lending-20180320-p4z5bh.html>. This article reported on the CBA and ANZ, but the problem was more widespread.

195 Under chapter 3 of the *National Consumer Credit Protection Act 2009* (Cth), lenders are required to take reasonable steps to establish the ability of borrowers to service loans.

196 Michael Janda and David Chau, 'CBA Wasn't Honest with ASIC, While ANZ at Risk of Breaching Responsible Lending Laws, Royal Commission Hears', *ABC News* (online, 19 March 2018) <https://www.abc.net.au/news/2018-03-19/banking-royal-commission-anz--evidence-mortages-will-ranken-hem/9562136>.

197 In other words, there is a disconnect between 'stated' and 'lived' values. While many corporate and financial scandals over the years have demonstrated this problem, a notable example concerns shortcomings in compliance from its formal model by HIH Insurance Ltd ('HIH'), once Australia's second largest insurance company, that Royal Commissioner Justice Owen who inquired into its collapse identified: see *Royal Commission into the Failure of HIH Insurance: A Corporate Collapse and Its Lessons* (Report, April 2003) vol 1, 133.

198 [2015] EWCA Crim 1944.

to engaging in rate-rigging and was ultimately convicted and sentenced to 11 years' imprisonment,[199] he pleaded not guilty on the ground that he had not acted dishonestly. The defence submitted that not only were others in the market engaging in the same practices, but, also, that his employers were aware of his actions. Hayes argued that his actions were 'standard market practice'. He sought to admit evidence that 'he was never trained in the LIBOR process and, in particular, as to what was a legitimate consideration for a submitter to take into account'; given that 'his actions were not only condoned, but also encouraged by his employers and he was instructed to act in the way which he did'.[200] As Bronitt and Brereton, commenting on this case, point out:

> The routine practice of banks at the time 'repeatedly attempt[ing] to manipulate and ma[k]e false, misleading or knowingly inaccurate submissions concerning … global benchmark interest rates' demonstrates how deviant behaviours can become entrenched and even encouraged within an industry's culture and operational practices.[201]

In their discussion of the limits of regulatory intervention regarding the GFC, O'Brien and Gilligan set out the following account by Claudio Borio, then chief economist at the Bank for International Settlements, which he gave at a G20 forum in Mumbai, that demonstrates the level of 'groupthink' and proffers an explanation for the inability of policymakers to have exercised *ex-ante* restraint:

> To varying degrees, policymakers, just like everyone else, underestimated the threat. They were caught up in what, in retrospect, has partly turned out to be a Great Illusion. And even had the threat been fully recognised – and some no doubt did – the political economy pressures not to change policies would have been enormous. On the face of it, the regimes in place had proved to be extremely successful. A lot of reputational capital was at stake. And not even the often more critical academic community provided any support for change. Indeed, as regards macroeconomic policy, that community turned out to be part of the problem, not of the solution.[202]

Commenting on the statement by Goldman Sachs chief executive Lloyd Blankfein in a 2009 interview that the bank was doing 'God's work',[203] O'Brien

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199 The original sentence of 14 years' jail was reduced on appeal to 11 years: *R v Hayes* [2016] 1 Cr App R (S) 63. However, it remains one of the harshest penalties for a white-collar defendant in the UK.

200 *R v Hayes* [2015] EWCA Crim 1944, [8] (Lord Thomas Cwmgiedd CJ, Sir Brian Leveson P and Gloster LJ). See also David Enrich, *The Spider Network: The Wild Story of a Math Genius, a Gang of Backstabbing Bankers, and One of the Greatest Scams in Financial History* (Custom House, 2017), that gives a shocking account of the reckless greed of bankers involved in LIBOR, with insights into the conduct of Hayes.

201 See Simon Bronitt and Zoe Brereton, Submission to the Attorney-General's Department, *Combatting Bribery of Public Officials: Proposed Amendments to the Foreign Bribery Offence in the Criminal Code Act 1995* (Cth) (10 May 2017) 4 (citations omitted).

202 O'Brien and Gilligan (n 4) xxiv, citing Claudio Borio, 'The Financial Crisis of 2007-?: Macroeconomic Origins and Policy Lessons' (Speech, G20 Workshop on the Global Economy, 24–6 May 2009) 13. They also cited another account by Rajan: see below n 205.

203 John Arlidge, '"I'm Doing God's Work." Meet Mr Goldman Sachs', *The Sunday Times* (online, 8 November 2009) <https://www.thetimes.co.uk/article/im-doing-gods-work-meet-mr-goldman-sachs-zflqc78gqs8>. Goldman Sachs had marketed and sold tens of billions of dollars in risky residential mortgage-backed securities. The failure of these loans contributed to the sub-prime crisis in the US, which led to the global economic slowdown. Goldman Sachs' role in the financial crisis is highlighted in the Hollywood film: *The Big Short* (Paramount Pictures, 2015).

and Gilligan point out that short-term efficiency factors (eg, lower transaction costs and higher profits) were the criteria against which 'success' was gauged and that these retrospectively justified and endowed legitimacy on the innovation. The potential adverse impacts were glossed over or ignored.[204] As Rajan has observed, '[t]he problem was not that no one warned about the dangers; it was that those who benefited from an overheated economy – which included a lot of people – had little incentive to listen'.[205]

Returning to the use of culture as a regulatory tool, however, arguably the biggest impediment is the normative claim that 'firms should be free to determine how their internal affairs are organised and governed – that they should be internally autonomous'.[206] In an article published in 2018, Wishart, Wardrop and McMahon probe this claim and identify that it rests on two assumptions: first, liberalism as freedom and, second, the need for competition, which is critical to economic welfare. They also consider that the normative claim is buttressed by an important descriptive claim in the debate as to what should be done to stop corporations and their employees or agents from breaching norms of conduct – that organisational culture is impossible to regulate and cannot be prescribed.[207] They go on to convincingly argue, however, that on analysis, neither of the assumptions nor the descriptive claim are inviolable, despite having 'seized' the policy debate.[208] In this regard, it is revealing that many government reports in Australia and elsewhere[209] echo these assumptions and descriptive claim. For instance, the *Financial System Inquiry* report plainly stated:

> Culture is a set of beliefs and values that should not be prescribed … To expect regulators to create the 'right' culture within firms by using prescriptive rules is likely to lead to over-regulation, unnecessary compliance cost and a lessening of competition. The responsibility for setting organisational culture rightly rests with its leadership.[210]

We have already seen that the *Hayne Royal Commission Final Report* adopted a similar approach by locating primary responsibility for culture setting and repair of financial services entities in those entities themselves and their leadership, though it also proceeded to recognise regulators having an important supervisory role,[211] a role which has clearly now been enhanced by initiatives, such as ASIC's new CCM Program. Nevertheless, regulators also have generally shied away from asserting rights of control over the culture of organisations, notwithstanding

204 See O'Brien and Gilligan (n 4) xxv.

205 Raghuram G Rajan, *Fault Lines: How Hidden Fractures Still Threaten the World Economy* (Princeton University Press, 2010) 1, cited in O'Brien and Gilligan (n 4) xxv.

206 Wishart, Wardrop and McMahon (n 22) 133 (citations omitted).

207 But Commissioner Hayne said that 'culture' can be described: see *Hayne Royal Commission Final Report* (n 16) 334, which is an avenue to regulation. See further below n 211.

208 Wishart, Wardrop and McMahon (n 22) 133.

209 See, eg, Group of Thirty, *Banking Conduct and Culture: A Call for Sustained and Comprehensive Reform* (Report, July 2015) 23, 55 ('*Banking Conduct and Culture*'), discussed in Wishart, Wardrop and McMahon (n 22) 137–8; and more recently, Group of Thirty, *Banking Conduct and Culture: A Permanent Mindset Change* (Report, November 2018) xiii.

210 *Murray Inquiry* (n 75) 7–8.

211 See above nn 108–9, 112.

attempts to do so.[212] Recent examples include APRA's risk culture pilot program in mid-2017,[213] and its 2017–18 investigation and report into the CBA group. That report, which lambasted the CBA's culture,[214] rejected that it was possible to regulate the culture of the bank, stating that '[s]upervisors and regulators cannot determine culture'.[215] Yet, in the EU that APRA negotiated from the CBA,[216] the effect has been to set up a process to regulate that bank's culture.[217]

VII CONCLUSION

Although the causes of the GFC are complex and unsettled, a common theme in these analyses is the poor culture of corporations and financial institutions. It is little wonder then, that in the aftermath of the GFC, those charged with regulation argued that regulatory reform, absent a changed culture, will be ineffective. The succession of corporate and banking scandals since the GFC, both globally and locally, suggest that corporations and banks have failed to overcome these cultural failings. Meanwhile, the perceived failure of regulators to hold to account wrongdoing corporations and directors by not prosecuting them for what they had or had not done, has weakened trust in the financial sector, regulators and political oversight. Indeed, trust in public institutions in Western liberal democracies is at an all-time low. Australia, up to the beginning of the COVID-19 crisis, has not been immune from this phenomenon as the Hayne Royal Commission hearings have shown.

This article has concentrated on the role of 'culture' in corporations and the extent to which corporate culture can be used as a regulatory tool, as well as efforts to use 'corporate culture' as a legal mechanism, such as in prosecutions under the *Criminal Code*. It has argued that despite extensive scholarship and commentary on 'corporate culture', its use as a regulatory device to instil a superior culture in corporations is especially challenging, and highlighted what those challenges are. They include the mantra of the banks when faced with the prospect of regulation of the culture of their organisation that they should be free from external control, and the blurred lines between 'criminal' and what are often regarded as the 'routine' and 'legitimate' ways of doing business, namely the operational culture of an industry, exemplified in the LIBOR case of *R v Hayes*.[218]

This is not to diminish the importance of recent developments that focus on culture as a key item of interest in the regulation of corporations, such as ASIC's

212 See Wishart, Wardrop and McMahon (n 22) 136.

213 See *Australian Prudential Regulation Authority Capability Review* (n 113) 85 for a discussion of this risk program.

214 See above nn 105–6.

215 See *Prudential Inquiry into the CBA* (n 103) 92, quoting *Banking Conduct and Culture* (n 209) 15.

216 APRA's power to accept EUs is contained in section 18A of the *Banking Act 1959* (Cth).

217 This EU has required the CBA to formulate a 'remedial action plan' to rectify the problems that had been identified, submit it to APRA and then to periodic reviews by an independent reviewer to ensure its implementation: see EU, CBA and APRA (30 April 2018). It is available on the APRA website: <https://www.apra.gov.au/sites/default/files/20180430-CBA-EU-Executed.pdf>.

218 [2015] EWCA Crim 1944.

CCM Program, which unsurprisingly was introduced when the Royal Commission was still underway or the increasingly significant role that ‘culture’ is assuming in corporate governance codes; only that it is unlikely that we will see public confidence and trust in corporations and regulators being restored any time soon.