Legacy of Hayne Royal Commission into misconduct into the financial services industry

New inquiry needed because **Hayne identified problems** but **no solutions or incentives** for industry to find solutions that require <u>no new laws</u>

Refer to: Turnbull, S. 2019, 'Causes and solutions and solution for misconduct in the financial services industry', ***Law and Financial Markets Review***, April 16, pp. 99-113, <https://doi.org/10.1080/17521440.2019.1602694>.

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Causes and solutions of misconduct:

Outlined in next five slides

Providers of financial services possessing superior power and information than customers permitting their exploitation.

Countering the asymmetry of power and data by corporate constitutions introducing stakeholder boards and advocates

Directors in a cocoon of ignorance of customer exploitation

Directors become accountable to board of governors who obtain KPIs from stakeholders to determine director pay

Poisoned culture in corporations and regulators not knowing what is right and what is wrong in the current system.

Re-introduce professional education knowledge removed from the Company Directors Course I co-founded in 1975

Directors/Regulators/Ministers live in a cocoon of ignorance:

Because hierarchies simplify complexity incompletely

Decision makers lose data, information, knowledge and the wisdom of their stakeholders

Loss and distortion of data in a hierarchy (Downs 1967: 116-118)

HIERACHY	DATA UPWARDS			EMPLOYEES	
Public or private sector	**Volume**	**Correct**	**Missing** or wrong meaning	Say span of five	
Legislature	50% lost per level	85% of lower level		Per level	Accumulated total
Minister/Shareholders			**99%**		
Board of directors	3.1%	1.4%	98.6%		
Chief Executive Officer	6.3%	3.3%	96.7%	1	1
Senior Management	12.25%	7.7%	92.3%	5	6
Middle Management	25.0%	18.1%	81.9%	25	31
Team Leaders	50.0%	42.5%	57.5%	125	156
Workers	100.0%	100,0%	0.0%	625	781

Shannon's law of requisite variety states communications can be made as accurately as desired by introducing a requisite variety of independent cross checking channels in networks introduced by ecological governance

Hierarchies facilitate bad culture & misconduct

Simple command and control hierarchies cannot comprehensively or reliably inform directors on the quality of their managers and/or outcomes for stakeholders because hierarchies:

1. Simplify complexity incompletely by needing to filter data flowing upward to minimise data overload, that can still create data overload;
2. Create incentives for subordinates to bias, overlook and/or omit data to superiors that could reflect on their own performance;
3. Depend on obedience, subservience to create group think to deny the ability of individuals to express contrary behaviour to improve their ability to manage complexity with innovative decisions;
4. Can de-motivate initiatives of subordinates by being alienated and abused without safe recourse;
5. Typically deny contestability in decision-making to achieve "tensional integrity", i.e. "Tensegrity", especially from the bottom up;
6. Allow existential threats, risks, harms and opportunities to be undetected and so nature never uses them in self-regulating living things.

Regulators and directors not knowing right from wrong

Australian business culture has been poisoned by following global unethical **systemic** practices described as “best” so that regulators, directors, managers, academics, professional educators and even some ethicists cannot tell right from wrong.

Six examples of **systemic conflicts** accepted or enforced by regulators arise from:

1. Directors possessing the power to manage a business as well as the power to govern the corporation to allow them “to set and mark their own exams” (Tricker, 2011);

2. Directors possessing absolute power to identify and manage their own conflicts of interests allowing them to corrupt absolutely themselves, the business and society;

3. A director chairing a <u>meeting of shareholders</u> and so controlling the processes for <u>being held to account by shareholders</u> such as: directing open proxies, rejecting proxies, counting the votes, determining who is eligible to attend, speak and for how long, the agenda, time and place of meetings, etc.

4. Directors nominating, controlling and remunerating external auditors appointed by shareholders to report to shareholders on the integrity of director accounts;

5. Australian Securities Exchange (ASX) not allowing investors to know with whom they are buying or selling securities to hide insider and broker trading against a client;

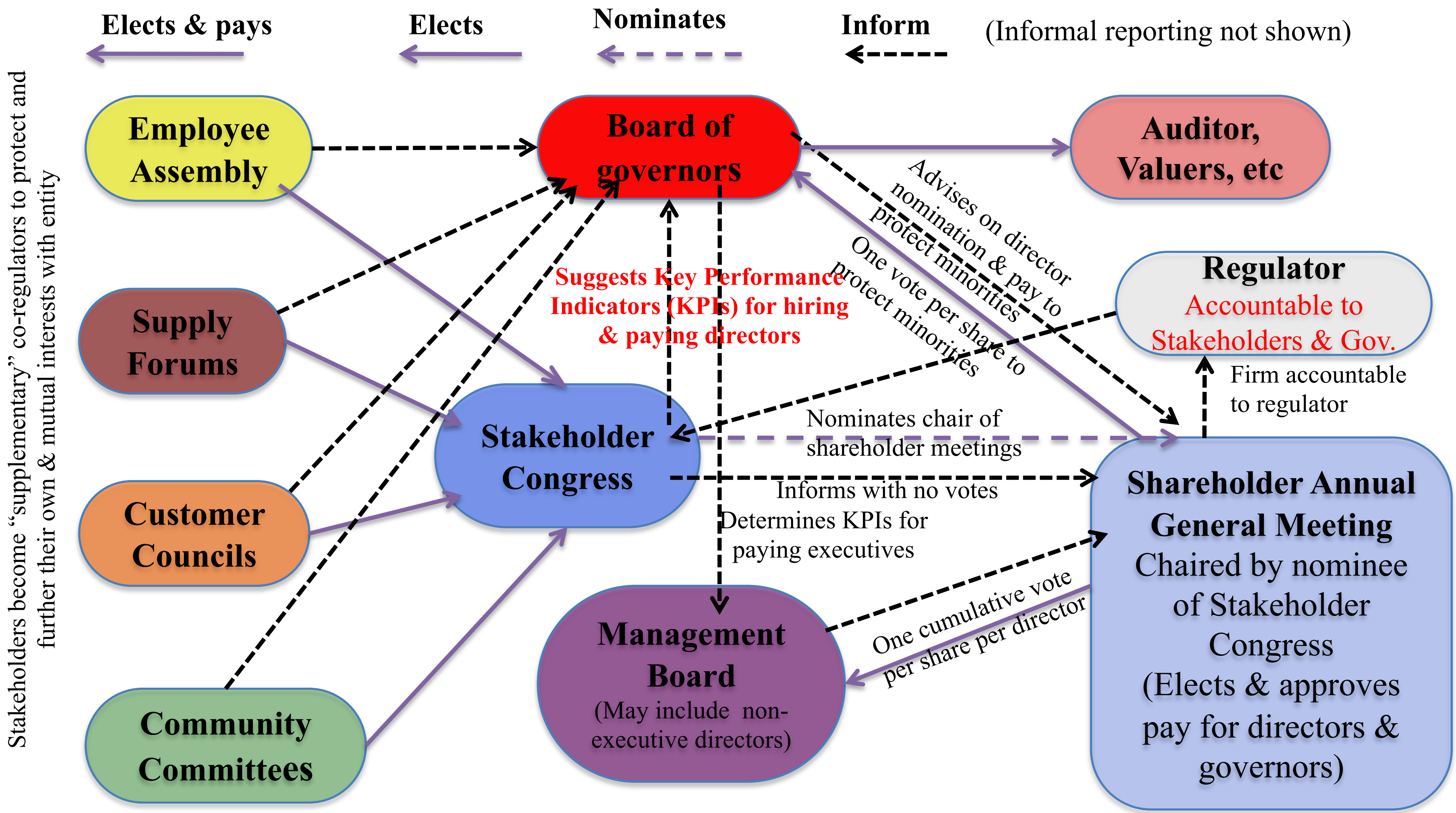
6. ASX as role model facilitating insider trading by covert trading its own shares.

Hierarchies have created **systemic** global problems avoidable with networks

- Misconduct in banks has been experienced in many other jurisdictions to provide global evidence of an intellectual gap in understanding cybernetic laws that show <u>it is impossible for simple hierarchies to directly reliably manage complexity</u> without a "requisite variety of co-regulators".
- Also, the Cadbury inspired governance codes have poisoned the ethics of directors and external auditors globally so they cannot recognise unethical conflicts of interests.
- Ecological governance introduces a "requisite variety of co-regulators" to increase reliability of control as much as desired (Ashby 1957: 268, ***Introduction to cybernetics***). It allows Ostrom (1996) insights to be used to provide benefits for all stakeholders as wanted by BlackRock (Fink 2018).

Ecological governance identified by Ostrom can makes corporations a "common good" benefiting all stakeholders as wanted by worlds biggest investor (Fink 2018)

Separation of governance powers from management allows independent bottom-up and outside-in stakeholder intelligence to integrate governance into Corporate Social Responsibilities to monitor and control misconduct



For publicly traded, large private firms, non profits and government corporations:

To make Shareholders and Regulators accountable for treatment of stakeholders

Thank you for your attention

Questions?

Comments?

Suggestions?