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Directors' Duties, Corporate Culture and Corporate Governance

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Corporate Governance: Regulators and ASX



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Corporate Governance: Regulators and ASX

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While the views expressed in this paper owe much to many discussions and lively debates with my colleagues at King & Wood Mallesons and on the Corporations Committee, they remain my own (as are any errors, typos and mixed metaphors) and do not purport to represent the views of either organisation.

As some of you may know, I am a passionate fan of Bell Shakespeare, and as I was gathering my thoughts for this paper, I had attended the opening night of Julius Caesar. Today, perhaps, I fear I come to bury Caesar, not to praise him...

It does seem to me that there is some balance to be brought to current discussions about our key corporate regulators and their proper roles, including their role in relation to matters of corporate governance.

1 Regulators and ambition

1.1 Valuable period of review and reflection

There can be no question that is an interesting time to be a regulator, and that the role of various regulatory bodies involved in the oversight of corporate Australia been under intense review and scrutiny over the past 5 years – whether directly or incidentally.

That is not to suggest that this scrutiny or reflection on the appropriate roles and performance of our regulators only commenced with the 2013 Senate Inquiry¹ into the performance of the Australian Securities & Investments Commission – simply that it has been unrelenting in one form or another since that time.

It has been a valuable and timely period of reflection.

1.2 The various inquiries

The Senate Inquiry into ASIC's performance was undertaken in close proximity to the Financial System Inquiry² (FSI) (which in turn reflected on the earlier work of the Wallis Inquiry and the Campbell Inquiry), and was followed by the ASIC Enforcement Review (Enforcement Review)³ with the contemporaneous House Review of the Four Major

¹ Senate Economics References Committee Inquiry into the Performance of the Australian Securities and Investments Commission 2013-2014.

² Financial System Inquiry 2013-2014.

³ ASIC Enforcement Review, by a Treasury Taskforce, 2016-2017.

Banks⁴. Then most recently, of course, the Interim Report of the Royal Commission (**Royal Commission**)⁵, combined with the release of APRA's CBA Prudential Inquiry Final Report (**APRA Report**).⁶

1.3 Reforms as a result of, or anticipating, these inquiries

In the midst of this – important reforms have been proposed and are in the course of being implemented:

- reforms to introduce Design and Distribution Obligations and Product Intervention Powers (**the Product Design and Intervention reforms**);
- the introduction of the Banking Executive Accountability Regime (tellingly known as the **BEAR reforms**);
 - substantial reforms to corporate penalties and sanctions, following the ASIC Enforcement review; and
- revisions to the Corporate Governance Principles and Recommendations of the ASX Corporate Governance Council proposed for the 4th edition (**Corporate Governance Principles**).⁷

1.4 Regulatory themes

Out of those various inquiries, reviews and reports emerge some consistent, and not terribly surprising themes:

- Firstly, that for law to be effective, it must be seen to be enforced
- That enforcement is not simply about consequences for the entity or person who has contravened the law, but an important deterrent and motivator of corporate conduct;
- That enforcement will not be an effective deterrent if the sanctions are not meaningful.

These are not new observations – but their examination has raised questions as to whether the various regulators have been doing enough of the right kinds of things, in the right way.

Further themes emerged that have captivated the legal community:

- That where sanctions have not been meaningful and where regulators have been too 'comfortable' with or close to the entities they regulate, compliance with the law (or lack thereof) may be treated as a 'cost of doing business';
- Sometimes controversially, the relevance (or otherwise) from a regulatory and governance perspective of the "social licence" and values or culture of regulated entities; and

⁴ House of Representatives Standing Committee on Economics Review of the Four Major Banks 2016-2017.

⁵ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 2017-2018.

⁶ APRA's Prudential Inquiry into the Commonwealth Bank of Australia, 2018.

⁷ The 4th Edition is scheduled to be released in the near future, but unlikely to be before the conference date.

- Finally – the roles of core corporate regulators appear to be shifting and changing – including an expanded role for APRA, suites of new powers and increased sanctions for ASIC, but a looming threat to the scope of ASIC’s remit.

1.5 Themes to explore in this paper

These themes have offered too generous a supply of material, so for today’s purposes – I propose to explore only a couple of aspects, in particular:

- **Regulating culture?**
To reflect on the proposal to incorporate “social licence” and cultural issues in the draft Governance Principles in light of the APRA Report and the Royal Commission’s Interim Report, and the effectiveness of different regulatory strategies for engaging on culture; and
- **Enforcement strategies and regulatory engagement**
To consider the comments in the Interim Report on enforcement strategies by regulators, and the way that this may impact governance and compliance.

2 The ‘social licence’ and regulation of culture

2.1 ASIC protests that it does not mean to regulate culture

In 2016, the then Chairman of ASIC waxed lyrical on a few occasions on the importance of corporate culture and companies’ awareness of their need for a social licence to operate, to maintain the trust and confidence of the community, over and above their legal licence.

Greg Medcraft was careful, however, to emphasise that ASIC was examining culture to identify early warning signs of misconduct, not seeking to regulate culture.

2.2 The Royal Commission considers matters beyond breach of law?

There was an echo of this concept of the social licence in the articulated focus of the Royal Commission, being not only on conduct that breached the law, but also on conduct that had ‘fallen below community standards and expectations’.

It was initially unclear whether this suggested that the Royal Commission would seek to hold financial institutions to community standards that went beyond black letter law.

2.3 Culture as an element of governance and accountability?

Against this backdrop, and amid the media frenzy surrounding the daily commentary of case studies being examined by the Royal Commission, there were two fascinating developments:

- the release of the APRA Report on 1 May 2018; and
- the release of the consultation draft of revised Governance Principles by the ASX Corporate Governance Council on 2 May 2018.

Each of these connected cultural factors with governance and accountability.

2.4 APRA links culture with its prudential mandate

The APRA Report highlighted concerns with culture in a number of respects:

- a certain complacency and over-confidence, buoyed by financial success;

- a reactive attitude to risks (particularly non-financial risks), and a slow, legalistic and at times dismissive culture in dealings with regulators;
- insularity, and a failure to listen to external voices and community expectations of fair treatment; and
- a degree of collegiality and trust in the good intent of peers that impeded accountability and healthy challenge within the organisation.

The APRA Report made a range of recommendations to “strengthen governance, accountability and culture”, which included cultivation of a DNA-deep culture of asking “should we” rather than “can we” in its dealings with customers. So the APRA Report did, in effect, touch on social licence issues, but connected them strongly with traditional governance obligations and compliance with law.

2.5 Effect of the APRA Report

At the risk of leaping ahead to my next theme, I believe the APRA Report is an interesting demonstration of how a regulator can have a profound effect on the conduct of those who believe themselves to be good (or at the very least, well-intentioned) actors, without resorting to prosecution.

This report did not purport to be a set of guidelines for all companies, yet it contained simple messages that appear to have resonated strongly with Boards. It has been discussed and debated in boardrooms both within, and far beyond, the financial sector, often with Board’s asking “what can we learn from this”?

Part of the value of the report, in my opinion, is that it examines cultural factors as they connect with governance and compliance issues in the specific context of a large, *complex* business, and acknowledging both strengths and weaknesses. As a result – it provides flashpoints of recognition for other entities.

2.6 The draft Corporate Governance Principles

The release of the consultation draft of the Corporate Governance Principles at around the same time provided an interesting contrast to the APRA Report.

It too, was a thoughtful document that sought to engage with the links between culture and governance. It too was released against a backdrop of stories from the Royal Commission that were highlighting cultural, governance and compliance concerns.

Amongst a range of other changes, the draft proposed that Principle 3 (currently - *to act responsibly and ethically*) be substantially revised as follows:

“to instil and continually reinforce a culture across the organisation of acting lawfully, ethically and in a socially responsible manner”.

This Principle was then voiced in a number of Recommendations. Listed entities must report the extent to which they have chosen to follow Recommendations, on an ‘if not, why not’ basis. As members of the ASX Corporate Governance Council are at pains to point out – it is not a binding code (other than in a few respect for larger listed entities).

The additions to the Recommendations include:

- **Reporting on values**
That the entity should articulate and disclose its core values.

There is also a *suggestion* (which entities need not strictly respond to) that this could be included in its code of conduct, and that this should include a requirement not to act in an unethical or socially irresponsible manner;

- **Reporting to the board on values and culture matters**
That the board should be informed of material breaches of the code of conduct (presumably including core values) by directors or senior executives; and any other material breaches of the code that call into question the culture of the organisation;
- **Whistleblowing extended to ‘socially (ir)responsible’ conduct**
That the entity’s whistleblower policy should encourage reporting of concerns that the entity is not acting lawfully, ethically or in a socially responsible manner;
- **Reporting to the board on whistleblowing concerns regarding culture**
That the board should be informed of material concerns raised under that policy that call into question the culture of the organisation.

2.7 Reactions to Principle 3

While many submissions acknowledged the importance of values and the culture of organisations, this formulation encountered significant resistance from the industry and legal community.⁸

Objections included comments to the effect that:

- that it went beyond the obligations of black letter law to act in the best interests of the company and comply with the law;
- it could expand the scope for potential liability for companies and their directors;
- the Recommendations, whilst generally not ‘binding’, operate as a soft code that has the potential to creep into hard law;
- the concepts of “*values*”, “*culture*” and more particularly “*acting in a socially responsible manner*” were nebulous and problematic; and
- it represents an attempt to *regulate culture*, which is not the proper role of regulators.

The final 4th edition of the Governance Principles is expected to be released in the near future, and there is speculation that some aspects of these recommendations may be reconsidered.

2.8 Why are these reactions so different?

I found the vehemence of some of the reactions to the proposed Principle 3 and its Recommendations curious, when contrasted to the reaction to the APRA Report.

⁸ There were 100 submissions made – accessible at <https://www.asx.com.au/regulation/corporate-governance-council/review-and-submissions.htm>.

Selecting a few (but encouraging more to be considered) – see those from the Law Council of Australia, the Australian Institute of Company Directors, King & Wood Mallesons, Business Council of Australia, Governance Institute of Australia.

For a contrary point of view, see submissions by CGI Glass Lewis, Australian Shareholders Association amongst others.

See also Professor Pamela Hanrahan, *Companies, corporate officers, and public interests: Are we at a legal tipping point?* (August 2018)

It struck me that the APRA Report could be said, without any great stretch of the imagination, to be seeking to influence and engage on matters of *culture and values* more directly. Effectively, regulating culture?

APRA provided a simple but effective answer to why a prudential regulator commissioned the report in the first place, and why these matters fall within its remit. Culture, governance and accountability go to risk, which is fundamental to stability.

Nonetheless, the commissioning and publication of a report of this kind was a new approach for APRA.

Perhaps the difference in reactions to the two documents lies, in part, in the way that people respond to, and derive significance from, more specific narratives – i.e. storytelling.

The Governance Principles necessarily are expressed at a general level, and it is acknowledged that governance practices can be adapted to different organisations, in light of the scale and complexity of different businesses. However, while they are not a code, they do purport to articulate a ‘contemporary view of appropriate corporate governance standards’ and reflect reasonable expectations of investors, which suggests they have the potential to influence interpretation of directors’ duties and *could* expand those duties. That may also go some way to explaining the reaction.

The APRA Report is obviously a very different kind of document. It grounds the specific cultural issues that it identified in compliance, oversight and accountability outcomes, and matters that have had demonstrated relevance to the existing law and to shareholder value. It acknowledges strengths but explains how weaknesses have arisen from those strengths. It is vivid, and relatable.

2.9 The behavioural impact of vivid, recent examples

There may be some scientific backing for the difference in the reaction. The APRA Report has both a sense of *immediacy* and *salience* – it has been produced swiftly, it is contemporary to events, and its observations compelling.

That struck a chord with an early piece of work by behavioural scientists Professors Cass Sunstein, Christine Jolls and Richard Thaler⁹ – who as you might recall, won the Nobel Prize last year for his work in the field, that examines the ways that laws influence the behaviour of individuals and in particular the ways in which individuals’ behaviour will be likely not to conform to economically rational behaviour.

While I am dramatically oversimplifying – part of the gist of their thesis relates to the **availability heuristic**, which they say seems to shape regulation. That is, troubling conduct that is both *salient* (vivid, noticeable) and *recent*, influences perceptions of the probability that it will recur (and therefore the importance of addressing it). It is more likely to provoke both a community reaction and a regulatory reaction. It also means that this heuristic can be used by regulators to influence people’s behaviour.

Could that help explain why the APRA Report has had such an influence beyond the entity it concerned? And perhaps there is powerful lesson here as to how culture can be shaped.

The later work of Professor Thaler and Sunstein, in their acclaimed (and accessible) work ‘Nudge’,¹⁰ also highlights some of the successes of public disclosure and transparency by

⁹ Cass R. Sunstein, Christine Jolls & Richard H. Thaler, "A Behavioral Approach to Law and Economics," 50 Stanford Law Review 1471 (1998).

¹⁰ Richard H. Thaler, Cass R. Sunstein, (2008) *Nudge: improving decisions about health, wealth, and happiness*

regulators in motivating improved behaviour on the part of regulated entities – even if consumers themselves do not always read it.

2.10 Pre-empting the Royal Commission...

Both the APRA Report and the draft Governance Principles could be said to have pre-empted matters that were within the remit of the Royal Commission. After all – the Royal Commission had specifically inquired into conduct that fell below ‘community expectations’.

To my mind the Interim Report grounds matters of social licence and cultural concerns firmly within compliance with the law – often, in a failure of to meet a standard of “honestly, efficiently and fairly” that is required of (legally) licensed entities, and failures in oversight.

The Commission’s observations regarding the role of the regulators do not suggest that it believes that regulators need more powers to regulate “culture”. Rather, it asserts that they should have responded more firmly to breach reports, and should have made more use of traditional forms of enforcement.

2.11 Regulatory engagement on culture

The Interim Report may have quieted some concerns that the Royal Commission will call for the law on director’s duties to be dramatically re-written, and we will wait to see what emerges from the ASX Corporate Governance Council in the final version of the 4th edition of the Governance Principles.

However, in the meantime, we should not forget the powerful *nudge* that came from the APRA Report, and the impact that it has had. Regulating culture by any other name...

3 The proper role of the regulators

Which brings me to my second theme – that of the examination of the role of regulators, some of the critique by the Royal Commission in its Interim Report, and the impact that this could have on the way that regulators interact with regulated entities.

3.1 The observations in the Interim Report

The Interim Report seeks submissions as to whether ASIC and APRA, in particular, need greater powers, and whether their enforcement strategies are effective.

However, the Commissions’ interim views with respect to ASIC in particular, do tend to leap off the page. The Interim Report suggests that ASIC:

- has responded to misconduct in the banking sector by focussing on infringement notices (made on a no-admissions basis) and negotiated enforceable undertakings which set relatively low financial payments;
- does have a track record of successful prosecutions, but that on closer scrutiny these reveal an apparent emphasis on prosecutions in the small business compliance and deterrence team (in many cases, prosecuting strict liability offences);
- has a risk averse approach to litigation.

The Royal Commission does recognise that ASIC will be delivered an additional suite of powers and that Corporations Act contraventions will carry significantly increased sanctions, and broader ability to seek civil penalties and infringement notices, under the Enforcement Review bill and the Product Design and Intervention reforms.

However, the Interim Report remains highly critical of ASIC’s attitude to enforcement, and appears to advocate for more of a “litigate first, negotiate later” approach.¹¹ It gives the example (presumably intended as a favourable comparison) of the ACCC conducting unsuccessful litigation in order to demonstrate that regulatory reform was needed.

But how does that stack up against theories of effective regulation?

3.2 Braithwaite pyramids

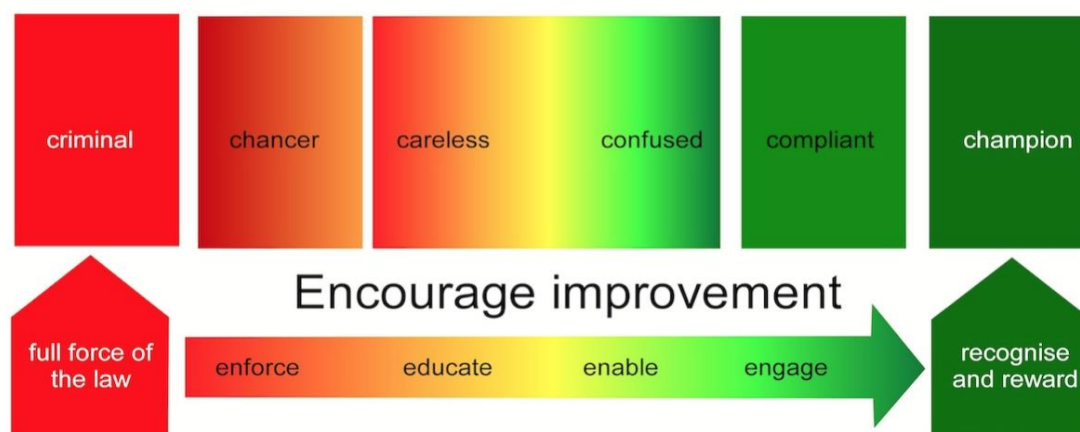
The Interim Report makes reference to the Enforcement Pyramid, from the work done on responsive regulation by Professors John Braithwaite and Ian Ayres.

The Enforcement Pyramid is often presented, in a corporate law context, in a relatively simple form drawn from Braithwaite and Ayres 1992 work¹² (and this is the text referred to in the Interim Report), with regulatory responses starting at persuasion, escalating to warning letters, then civil penalty, criminal penalty, licence suspension, and ultimately licence revocation. They indicate that the vast majority enforcement of enforcement activity should be concentrated in the lower three levels of the pyramid.

More recent versions show the now familiar tiers of regulatory responses, with some variations noting that different tiers are suited to different categories of ‘actors’, and to complement pyramids of enforcement with corresponding pyramids of supports and rewards (see Fig 1 below, and Fig 2 over page).

Braithwaite indicates that strategies at the lower orders of the pyramid should be tried first, but signalling an intention to escalate.

Fig 1:¹³ A reconfigured pyramid tailored to different categories of ‘actors’

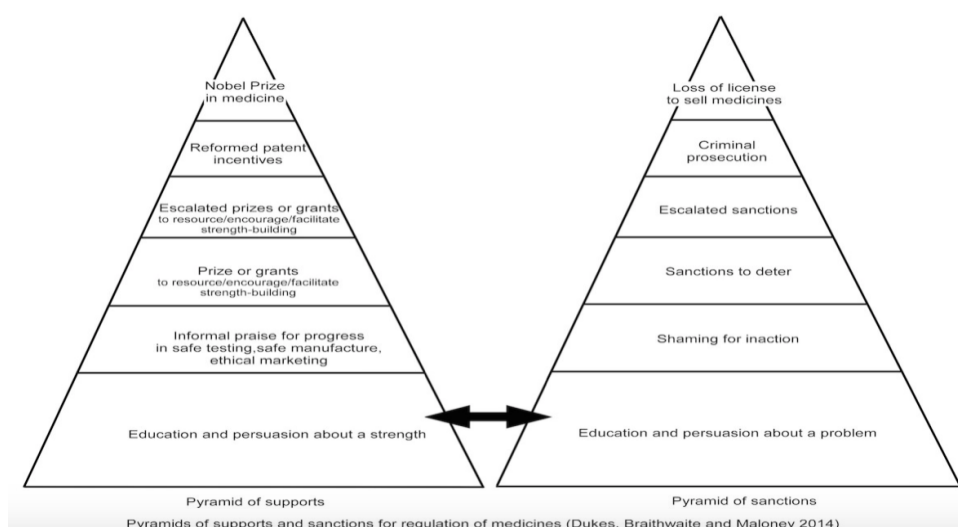


¹¹ The temptation to suggest that this recommends “a little less conversation, a little more action” is very strong – but it may be some kind of heresy to quote Elvis when I started with Shakespeare...

¹² This is text referred to in the Interim Report – Ian Ayres, John Braithwaite (1992) *Responsive Regulation, Transcending the Deregulation Debate*.

¹³ Source: <http://johnbraithwaite.com/responsive-regulation/> - an example from the South Australian Environmental Protection Agency.

Fig 2:¹⁴ Pyramids of support and enforcement



The Interim Report accurately observes that the Braithwaite thesis is that enforcement strategies should start at the lower levels of the pyramid, and escalate from there – then goes on to observe that ASIC should be more inclined to pursue litigation, and negotiate with regulated entities in the context of that litigation.

The Interim Report cautions that “A regulator ‘speaking softly’ will rarely be effective unless the regulator also carries a big stick”.

It suggests that persuasion cannot be the starting point for a conduct regulator, and that ASIC must always ask “why it would not be in the public interest to bring proceedings to penalise the breach”. Hasn’t that turned Braithwaite’s Pyramid on its head?

Surely the course that ASIC has pursued is consistent with the Braithwaite model – even though it may be criticised for agreeing to financial payments at too low a level. Is there not a valid case to be made that court-enforced undertakings, with outcomes made publicly known, are not capable of being highly effective regulatory tools if set at levels that are perceived to properly reflect the severity of the contravention?

It is also interesting that the example from another industry includes in the pyramid a stage between education / persuasion and sanctions to deter, namely ‘shaming for inaction’.¹⁵ We typically refer to the Brandeis quote that “sunlight is the best disinfectant” in the context of disclosure regulation – but perhaps it is also apt in this context. The impact of the APRA Report on not only its subject, but on other companies across the market being a case in point.

3.3 Other insights from behavioural science

That brings me back to behavioural science.

¹⁴ Source: <http://johnbraithwaite.com/responsive-regulation/> - an example from a medical context – from a publication noted in the diagram.

¹⁵ This is consistent with Thaler and Sunstein, in *Nudge*, as above.

In addition to the “**availability heuristic**” (i.e. the effect of vivid, recent examples on the assessment of the significance of a risk, and the need to respond), Professors Sunstein, Jolls and Thaler identified other behavioural biases and heuristics:¹⁶

- **Perceptions of fairness** powerfully influence the way that people respond, but they are impacted by self-interest.

In particular – people tend to be concerned for others and they are inclined to be co-operative against their own material self-interest (i.e. economically-speaking, irrationally) in the interests of fairness; conversely they may act spitefully (even against their own interests) where there is perceived unfairness.

- **Over-optimism** affects both perceptions of relativities of conduct, and individual responses to regulation.

People tend to be overly optimistic about their own standards of behaviour, relative to others – in effect, they tend to believe that they are ‘good actors’.¹⁷ They believe that their own risk of a negative outcome is lower than other people’s.

- **Hindsight bias** has a striking effect on the assessment of past conduct – namely that the outcomes of actions that would have been fundamentally uncertain or unpredictable at the time, look far more predictable after the outcomes are known.
- **Hyperbolic discounting** is the tendency of people (other than economists and perhaps lawyers) to ‘discount’ costs or consequences that occur over time, at an inconsistent rate.

As a result – impatience for near term rewards, and aversion to immediate sanctions, tends to be very high, however this sharply declines over time.

For some time, many regulators (including ASIC) have acknowledged the importance of behavioural science to understanding how consumers and investors make decisions, and also to understanding how to procure better compliance by companies.

Later work by Professors Thaler and Sunstein continues to be influential in regulatory design, particularly where there is a need to *change* people’s minds or behaviour (or both).¹⁸

3.4 How does the “litigate first, negotiate later” proposition fit with the behavioural science?

Behavioural science tends to suggest that increasing the size of the “big stick” that regulators carry does not always have a corresponding influence on behaviour.

¹⁶ As above, Cass R. Sunstein, Christine Jolls & Richard H. Thaler, *A Behavioral Approach to Law and Economics*, 50 *Stanford Law Review* 1471 (1998).

¹⁷ The example Sunstein, Jolls and Thaler give is that people tend to be optimistic about their own driving skills and behaviours, but readily believe that other drivers are bad – so road safety campaigns that warn them to drive cautiously because they must watch out for other drivers tend to be more effective than simply warning them about speeding fines.

¹⁸ In particular – see Professors Thaler and Sunstein (2008) in *Nudge* (as above); R.H Thaler (2015) *Misbehaving: The making of behavioral economics*. There is widespread commentary – but see for example Tim Harford, *Financial Times* (13 October 2017) *Richard Thaler: how to change minds and influence people*; Sergey V. Popov, *The Conversation* (10 October 2017) *Why Richard Thaler won the 2017 economics Nobel Prize*.

For instance:

- people who are generally well-intentioned (albeit perhaps not effective) will tend to see themselves as ‘good actors’ (so can’t imagine that the stick would be applied to them); and
- people who are not-well intentioned may either be delusional about their compliance or overly optimistic that they will be able to avoid detection.

Moving straight to litigation more often, by itself, may not necessarily be effective to persuade the mainstream business community that their conduct or attitudes need to change.

In addition, while increasing applicable penalties is important so that there is an appropriate sanction available in the worst of circumstances, if those penalties can only be obtained through traditional litigation proceedings – then the delay in securing an outcome may cause the regulated community to ‘discount’ the effect of it as a deterrent, and reduce the impact of it on the community as a vivid and proximate response (i.e. it does not take advantage of the availability heuristic).

3.5 The fairness issue

If Braithwaite’s model is valid – then responsive regulation can justify dialogue with the regulated community, and seeking to secure their co-operation, before escalating to more severe sanctions. If examples of regulatory responses are heavily weighted towards litigation and formal sanctions, then will that in fact deter co-operation that is valuable for enforcement outcomes?

If there is not perceived proportionality in regulatory responses and applicable sanctions – both for wilful and serious misconduct, and lower order compliance failures, then that can impact on perceived fairness, which behavioural science suggests will impact on willingness to co-operate in those lower order cases.

In addition – if laws are so torturous, or broad and uncertain that perfect compliance is virtually impossible or seems meaningless – does that not also have an impact on perceived fairness?

3.6 ASIC’s response to criticism

Understandably, ASIC has responded to the anticipated (and received) criticism:

- It has announced a greater emphasis on civil and criminal litigation;
- It appointed an experienced Senior Counsel as its new Deputy Chairman;
- It proposes to put ‘supervisors’ into the major banks and use public denunciation of the banks to drive change; and
- It has secured increased funding for these purposes.

However, I would urge that these responses be tempered and applied with proportionality, and an appreciation of the way that human behaviour can be shaped.

ASIC has also demonstrated many strengths as a regulator. For instance, ASIC has been effective in improving standards and conduct in the securities markets. It has followed a process of well-publicised scrutiny and information gathering, followed by the publication of

reports and detailed guidance that shines a light on problematic conduct, with a warning of enforcement following publication of the report, has guided changes in behaviours and market practices in a way that has been effective. It has engaged in well-promoted public education programmes that appear, anecdotally, to be accessible and helpful.

3.7 In defence of regulatory discretion, and innovation

There is something to be said for recognising our regulators' strengths. While regulators must face candid scrutiny, to build trust and confidence in our regulatory frameworks, it must also be *balanced* scrutiny.

Regulators are required to make judgment calls, exercise discretions and can play a significant role in permitting flexibility that supports innovation and the reduction of red-tape. Regulators must also be conscious that they are funded by public money and that regulatory intervention imposes costs on companies that can impact, ultimately, shareholders.

Regulators have to choose their battles, try out some strategies, take some risks – and we should want them to do that. Sometimes their choices will not work out as well as they hoped. Those actions all get judged with hindsight, and regulators can fall victim to hindsight bias as much as anyone else.

In my view, it is important for trust and confidence in, and effectiveness of, our regulatory systems and our regulators that they both act fairly, and are treated fairly.

3.8 Limitations of an inquiry into 'misconduct'

It is worth bearing in mind that the Royal Commission is an inquiry into misconduct, and as part of that it is examining where there may have been failings in the regulatory systems or on the part of regulators that have contributed.

It has not been tasked with providing affirmation or support for the good work that companies or regulators do, nor the many strategies that regulators employ that have in fact improved corporate conduct, improved the standard of communication to consumers and investors, and increased public access to educative information. Its job has been to highlight the failings.

That does not mean that those engaging in the debate over "what next" should lose sight of the ultimate goal of improving outcomes.

3.9 The link between proportionate regulation and good governance

We should not over-emphasise regulatory strategies, or regulatory structures, that deter the regulated community from coming forward and seeking help, and receiving education and support.

We want Board's to supervise actively and constructively; we want executives to escalate concerns as they identify them for the abundance of caution, and not to look for reasons why they do not have to. We want them to exercise judgement and to be recognised for identifying and dealing with problems well, and to expect that they will be treated fairly.

There is no question that maximum Corporations Act penalties needed to be increased to be meaningful. However, there should not be a presumption that the maximum penalty should always be pursued, nor that complex cases that pivot on technicalities are necessarily the right cases to pursue.

While the deterrence effect of the law suffers if enforcement of serious breaches are not seen to be pursued, there is also harm done if proceedings are pursued and penalties are

imposed where the conduct is not perceived to be sufficiently culpable; if regulators take highly technical or pedantic interpretations of ambiguous laws; if they refuse to give guidance; or if they engage in “ambush” litigation.

There is as much risk that the law will be disregarded if it is seen to be unfair or impossible to comply with, or if regulators take unreasonable positions, as if it is not seen to be enforced in instances of serious breach.

This is not to attempt to shift responsibility for the conduct highlighted to date in the Royal Commission, or to suggest what the response should be – far from it.

Rather it is to acknowledge that regulatory discretion, engagement and judgement is important and that sanctions are not the only solution.

Sometimes the *nudge* may achieve more than the stick,