6. DISCUSSION

The report examined how two conflicting images of the big four banks can exist side-by-side: that of the banks as lauded sustainable enterprises, and conversely their involvement in a range of financial scandals and unsustainable activities. Furthermore, in the context of the Financial System Inquiry, which failed to address the social and environmental responsibilities of banks, as well as the decade-old parliamentary inquiry into corporate responsibility, which favoured voluntary initiatives over legal amendments and mandatory requirements, the report asked why it is that banks are allowed to continue to self-regulate social and environmental matters, while national and global financial regulation is becoming stricter following financial misconduct and the global financial crisis.

The report then proceeded to examine sustainability in the Australian and global banking sector. Specifically, it assessed self-regulatory and voluntary measures aimed at enabling socially and environmentally responsible banking practices. Extending earlier research into banking and corporate sustainability informed this analysis, while the report also set out to critically assess these indicators to verify whether they form accurate sustainability proxies. The material test was formed by three key challenges: addressing misaligned incentives, information asymmetry, and social and environmental risk levels.

FINDINGS

The research shows that misaligned incentives are not effectively countered. While banks make some efforts to combine profit with environmental and social goals, they do not do enough. Banking products and services have a two-faced nature, while stakeholder engagement, a tool that can align incentives, is often quoted but is accompanied by many examples where stakeholders have been disadvantaged. Moreover, partaking in multistakeholder initiatives and adopting related principles lacks credibility, due to the absence of serious consequences for non-compliance. Non-financial measures are increasingly included in remuneration, but the focus on customer and employee satisfaction suggests self-interested motives, while the implementation of sustainability in governance was inadequate, suggesting that social and environmental matters are of limited concern to leadership in banks. In sum, the report provides a host of examples where banks do not have community interests at heart.

Doubts also arose regarding how banks address information asymmetry. The report established that there are several levels of commitment to voluntary sustainability reporting among banks, concerning the scope and accuracy of disclosed information. Despite an extensive uptake of reporting tools, as well as external assurance by accounting firms, increased disclosures have not prevented environmental, social and governance controversies from occurring. Doubts likewise exist about the effectiveness of stakeholder engagement, as well as responsible and sustainable finance: in many cases, stakeholders only become aware of unsustainable banking activities following action taken by civil society organisations. This simultaneously verifies that sustainability indices are mostly questionable, providing high ratings despite dubious business practices. In all, the report shows a substantial discrepancy between what banks say and what they do.

The management of environmental and social risks by banks falls short. While risk assessment and the screening of high-risk sectors are frequently mentioned, banks nevertheless continue to finance unsustainable activities. The adoption of voluntary codes and involvement in multistakeholder sustainability initiatives is shown to come at little cost, while the lack of enforcement inhibits increased accountability, allowing for business to resume as usual. Responsible products and services cannot be used to compensate for unsustainable activities. Clearly there would be no need to single out a product or service as ‘responsible’ if banks would adopt an overarching sustainable business strategy. The voluntary responsible finance initiatives of banks do not represent a strong commitment to reduce social and environmental risk levels, but instead predominantly denote market rhetoric.

Summarising, this report shows that the self-regulatory social and environmental measures of banks have largely resulted in symbolic outcomes. Although the banks have created an image of responsible corporate citizenship, additional probes reveal contradictions and shortcomings that debunk this portrayal. The question that follows is whether self-regulatory efforts should be seen as entirely symbolic: do banks merely try to adhere to societal expectations without truly changing, or is part of their effort genuinely aimed at social and environmental improvement? A balanced view would be that some efforts are symbolic, while others are substantive. Do the symbolic initiatives merely serve as a legitimacy front for banks, obscuring unsustainable activities, or are they a sign of uneven progress and will they eventually develop into substantial activities? Either way, the governance gap created by the present self-regulatory and voluntary sustainability paradigm will need to be overcome.

BRIDGING THE GOVERNANCE GAP

Business enterprises are subject to three distinct but interrelated governance systems: that of public law and authority; a non-state system revolving around civil society and stakeholders; and the system of corporate governance - where the latter reflects the requirements of the previous two, albeit to varying degrees.[122] The discussed Inquiries demonstrate that the Government foresees a modest role for public law and authority in the governance of social and environmental matters concerning companies, while the system of corporate governance shows promise but has not yet fulfilled its potential. The non-state governance system spurred on by civil society is fulfilling its role as watchdog well, as shown by media and NGO reports on controversies involving banks and other companies.

As mentioned at the beginning of this report, the 2005 Government Inquiry into Corporate Responsibility and Triple Bottom Line Reporting found that legal amendments were undesirable, as it was deemed "[…] not appropriate to mandate the consideration of stakeholder interests into directors' duties", while sustainability reporting was to remain voluntary, as "[…] mandatory reporting would lead to a 'tick-the-box' culture of compliance."[123] Ironically, voluntary sustainability reporting has resulted in a similar box ticking exercise, but rather than complying with the law this exercise is instead aimed at societal expectations. The fact that directors' duties were not reformulated to cover stakeholder interests has, unsurprisingly, resulted in stakeholder issues remaining of relatively minor concern to company boards.

The argument here is not purely to expand the role of public law and authority.

Although additional regulation can potentially decrease risks associated with unsustainable finance, such a measure would also externalise responsibilities to a certain extent: by only embedding social and environmental responsibilities into corporate law, what is required of banks and companies is to be law-abiding. This would embed social and environmental sustainability in legal frameworks, rather than necessarily in business models. Yet, redefining the responsibilities of company directors, to include stakeholder, social and environmental concerns, would anchor responsibilities in the rule of law, while leaving a suitable amount of discretion and incentive on the part of companies to meet this requirement.

Reformulating the duties of company directors is not a new or radical idea: "[…] it may be a breach of **fiduciary duties** to fail to take account of [environmental, social and governance] considerations that are relevant and to give them appropriate weight, bearing in mind that some important economic analysts and leading financial institutions are satisfied that a strong link between good [environmental, social and governance] performance and good financial performance exists."[124] Indeed, the areas of corporate social responsibility and corporate governance are converging [125], which suggests that the legal and moral responsibilities of corporate leadership progressively overlap.[126] Thus, narrow views on corporate governance stressing legal and accounting compliance, with a focus on shareholder returns, are gradually supplemented by views that include a social and environmental focus and concern for wider stakeholder groups.[127]

The nature of corporate social responsibility differs from corporate governance in that it is voluntary, while corporate governance is anchored in corporate law and (coercive) stock exchange listing requirements. Increased integration would help make social and environmental matters more enforceable and thus make companies more accountable, diminish the use of sustainability disclosures as a public relations tool, lead to the development of valid performance indicators, streamline disclosures while increasing comparability, and ultimately improve social and environmental performance. Indeed, research shows that instead of establishing obligatory sustainability disclosures, enhancing corporate governance quality is a more effective way to improve disclosures.[128]

Where corporate governance systems are optimally designed and functioning - meaning that they reflect the requirements of the state governance system of the rule of law and authority, as well as the public governance system of civil society - there will be limited need for mandatory regulatory measures and public shaming by civil society organisations. Yet the current configuration of the governance systems is off-kilter and unjustifiably favours self-regulatory and voluntary efforts. To rebalance the governance structures, public law and authority will need to assume a bigger role. If increased convergence between corporate social responsibility and corporate governance takes the shape of additional self-regulation, the same issues that currently inhibit sustainability issues from becoming a core part of corporate bottom lines will undermine it.

EXTENDED SUPERVISION

The assurance that financial operations are based on sustainable principles requires independent monitoring of compliance and performance, followed by public consultation regarding the findings, as NGOs and the media have been at the forefront of exposing of unethical activities, and naming and shaming is an effective measure.[129] “Publicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants; electric light the most efficient policeman.”[130] Governance, regulation and supervision should thus not be seen as measures that restrain innovation or entrepreneurship, but instead as instruments that can help to restore trust, and ensure that banking activities are conducted openly, fairly and sustainably.

Although the Financial System Inquiry did address the social and environmental responsibilities of banks and the role of corporate governance, regulation and supervision, this does not mean that Australian institutions have no role to play. It should be noted that Australian regulators are not free of controversy. The Australian Securities and Investments Commission (ASIC), which enforces laws to protect consumers, investors and creditors, permitted NAB lawyers into its quarters, and allowed the bank to alter a media release about its failures.[131]

In 2014, a Senate report considering ASIC’s performance recommended a Royal Commission[132], but the Government adopted the dissenting opinion. The report of the Financial System Inquiry put forward a solution for regulatory capture by corporate interests, which entails establishing a body that assesses ASIC’s and APRA’s performance.[133]In other words, the watchers will need to be watched.

Nation-based regulatory action only forms one part of the governance puzzle, as corporate governance is also rooted in frameworks at the international level. Concerning the financial sector, institutions such as the **International Monetary Fund**, the **Financial Stability Board**, and the **Basel Committee on Banking Supervision** regulate the financial system and assure its proper functioning. Although the plethora of international institutions shows growing global efforts to resolve issues in the financial sector, they focus chiefly on sustaining economic growth and avoiding future financial crises. However, as this report argues, misaligned incentives, information asymmetry, and risk-levels constitute flaws where the effects are not limited to financial crises.

As APRA noted, the diffusion of international governance standards for the financial sector has proven to be economically successful in the Australian context, which suggests that there is an institutional basis to repeat this exercise with social and environmental governance tools. An additional argument in favour of formulating corporate governance in an international context is that financial issues are increasingly global in nature. While defining corporate governance in a global context can result in a more sustainable banking sector, it should be noted that reaching consensus among sovereign stakeholders remains a key task, as national governments and regulatory bodies remain responsible for implementation and enforcement. Good governance begins at home.