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26 October 2018

The Hon Kenneth Hayne AC QC
Commissioner
Royal Commission into Misconduct into the Banking, Superannuation, Insurance and Financial Service Industry
https://royalcommissioninterimreportwebform.lawinorder.com.au/#/

Response to your Interim Report of September 28

Dear Sir

In response to the opportunity to make a "Submission on Policy Issues Indentified in the Interim Report" I have attached as "Appendix II" an article prepared for publication in an academic journal. My article on "Regulating Financial Misconduct" provides an answer to the question raised on page xxii of the Interim Report: "Should the existing law be administered or enforced differently?"

Ten reasons are presented why a different approach is needed. The article also describes how a different way of administering and enforcing the law could be introduced and in what form. The suggested solution of establishing bottom up stakeholder advocates/co-regulators also ameliorates the point raised on page 271 of the Interim Report about the "striking asymmetry of power and information between bank and customer that favours the bank".

My second submission of September 21 contained an earlier "Appendix" that was titled: "Causes and Solutions for Misconduct in the Financial Services Industry". This earlier Appendix is posted, without the text of my earlier submission, in the Social Science Research Network archives at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3262057.

As stated in my September 21 submission it was made in response to Round 5 concerning superannuation services, but "it is also relevant for identifying the causes and solutions for avoiding mismanagement, misconduct and malfeasance in banking, insurance and other financial services including stock exchanges."

My attached Appendix II builds on the content of my submission of September 21 as well points raised in my submission of 28 May 2018. My first submission had the title: "Regulators poisoning corporate culture and performance" with reference number PWF.0001.0001.7989.

The issues raised in my submissions suggest that the Commission should inquire into the following seven questions:

1. Why Australian corporate culture is not aware of "what is right", as noted by The Hon Neville Owen in 2003, and revealed by overseas cultures and firms who have adopted different practices to avoid what is not right in Australia?
2. Do any Australian business education courses presented by tertiary institutions, professional bodies, or financial institutions, consider the counter-productive conflicts of interests identified in my submissions that are promoted as "good governance"?
3. Which business education courses that have identified the current systemic counter-productive conflicts have also suggested systemic ways to avoid and/or creditable manage them? I had included the solutions in 1975 for the very first Directors education course in the world that is now presented without them by the Australian Institute of Company Directors.

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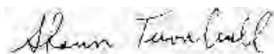
4. Is it appropriate for the Australian Securities Exchange (ASX) and other public exchanges, not to disclose to seller or buyers of securities, the identity of the ultimate beneficial owners and/or controllers of the securities being traded? The identity of traders can be price sensitive information that protects insiders exploiting the public.
5. Is it appropriate for the ASX to trade its own shares with its current rules and governance architecture?
6. Would it be preferable to allow any firm to trade it's own shares publicly if it adopted "sunlight trading" with the "ecological" form of governance described in the Appendices? This would avoid: (a) fourth party agency conflicts, costs and exploitation by current exchanges; (b) firms not being informed as to who are their ultimate owners and controllers to who they are accountable, and (c) anonymity for shareholders not holding directors to account for public harms, risks or other unacceptable outcomes? Even without these conditions the US has twice a many firms trading employee shares then there are publicly traded firms in the US.
7. Is ASIC meeting its: "aim to promote a fair and efficient financial market characterised by integrity and transparency, and to support confident and informed participation by investors and consumers"[1].

In regards to the first three questions it is worthy to note that some overseas firms do not:

1. Allow directors, who have a fiduciary responsibility to manage a business for its corporation, not to be personally conflicted by also possessing powers to govern the corporation. This is achieved by adopting a corporate constitution that introduces a separation of powers as proposed by Australian Senator Andrew Murray in 1998.
2. Allow directors, who are being held to account at an Annual General Meeting, to control directly or indirectly the processes for managing the meeting such as: determining its location, agenda, approving which proxies are valid, approving the allocation of open proxies, counting the votes, who can speak and for how long, etc.
3. Allow directors to nominate, control and remunerate the external auditor who reports only to shareholder/members of the company by having a shareholder audit committee made up of shareholders, not as recommended by the ASX Corporate Governance Principles.

The writer would be pleased to provide additional inform as may be desired.

Yours Faithfully



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https://independent.academia.edu/ShannTurnbull/CurriculumVitae

[1] Refer to p. 7, RG 1223.14 https://download.asic.gov.au/media/3336163/rg121-published-25-august-2015.pdf
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APPENDIX II

Regulating Financial Misconduct: Should the existing law be administered or enforced differently?

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ABSTRACT

This article reviews the efficacy of the Australian government's initiatives to counter misconduct identified by its Royal Commission into misconduct in the banking, superannuation, insurance, and financial services industries. We answer the Commission's Interim report question as to whether existing law should be administered differently. We propose the formation of stakeholder associations for each financial service firm for each of its stakeholder constituencies to appoint an advocate to become a co-regulator. Firm advocates would advise financial firm shareholders on Key Performance Indicators for directors to protect stakeholder interests on who their revenues depend, and for Parliament to evaluate government Regulators.

Key Words:

Contested decision-making, Network governance, Stakeholder regulation, Toxic hierarchies, Watchdog-boards.

JEL Classifications:

D02, D22, D63, D72, 73, 74, D83, G21, G22, G32, K23, L59, M48,

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1. Introduction

This article reviews the efficacy of the Australian governments' initiatives in 2018 to correct widespread misconduct identified by its Royal Commission (RC) into misconduct in the banking, superannuation, insurance, and financial services industry (RC 2018). The RC was established on 14 December 2017.

It is relevant to note that the Government only agreed to establish the inquiry after the Chief Executives Officers (CEOs) of the major banks supported a long standing call from the Australian Parliamentary opposition parties for an inquiry. The CEOs announced that their joint motivation was "to restore public faith" in the banks (Sweeny & Yaxley 2017). The RC quickly revealed that the CEO's had either been unaware of how serious and systemic the misconduct for which they were responsible and/or the degree that the CEO's had lost their moral compass and did not ask the question: "Is this right?" (Owen 2018). Justice Owen had first asked this question when he headed a Royal Commission established in 2001 to inquire into the failure of the HIH Insurance business.

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This review limits its considerations to when the RC published an Interim Report (2018) of its findings on 28 September 2018. The Interim report also raised questions to be answered in the final report to be presented by February 1, 2019.

The misconduct reported by the RC after hearings commenced on March 13 created public out-rage. This resulted in the Australian Treasurer, jointly with the Minister for Revenue and Financial Services, announcing on 7 August that the Australian Government "is injecting a further $70.1 million into the Australian Securities and Investments Commission (ASIC) to ensure the corporate regulator has the resources and powers it needs to combat misconduct" (Press Release 2018).

However, subsequent evidence from the RC revealed that both ASIC and the Australian Prudential Regulatory Authority (APRA) did not act for years on known widespread misconduct, some of which the RC considered could be criminal. The unsatisfactory performance of the regulators led the RC in its Interim Report (2018: xxii) to ask the question: "Should the existing law be administered or enforced differently?"

This article outlines how and why a different approach is required. The different approach would counter what the Interim Report (2018: 271) described as the "striking asymmetry of power and information between bank and customer that favours the bank".

A detailed analysis of why simple centralized command and control hierarchies used by both financial service firms and their regulators cannot reliably deliver either financial services or their regulation is provided in the author's submission to the RC on 21 September 2018 (Turnbull 2018b). The submission on "Causes and Solutions for Misconduct in the Financial Services Industry" was made a week before the Interim Report. It surveyed the literature critical of current governance codes, practices and conduct. It introduced "the natural science of governance" as its framework of analysis (Turnbull 2008a, 2012). This review builds on Turnbull (2018b).

A conclusion of the 21 September submission was that the regulators are irresponsible or lack a moral compass of what is right and what is wrong. This is evidence from the regulators accepting and/or promoting Australian Securities Exchange (ASX) practices and its Corporate Governance Principles (CGPs). The CGPs accept, or promote, unconscionable conflicts of directors' interests. This has supported an Australian business culture that cannot identify conflicts or what is right and what is wrong.

The ASX is conflicted because it trades is own shares on its own exchange and then uses privacy laws to avoid traders of securities being informed of who they are dealing with! The identity of counter parties can be price sensitive information. The non-disclosure practice also protects brokers who deal ahead of their clients as principals and/or for their associates, prospective clients and friends.

What is right and what is wrong is further confused by the CGPs being based mainly on practices rather than outcomes. The CGPs promote the conflicted practice of directors controlling and remunerating the auditor appointed by shareholders to judge the directors' accounts (Bazerman et al. 1997; Moore et al. 2006). Even former audit partners like Hayward (2003) recognize that the narrow self-serving definition of auditor independence, as defined by auditing standards, is not materially true. This explains auditing failures.

Both ASIC, APRA do not recognize the reality of Audit conflicts with APRA requiring licensed prudential institutions to adopt the systemic conflict! Both ASIC and APRA also accept the ASX conflicts of interests embedded in companies with only one board that allows directors to obtain excessive "major inappropriate powers" noted by Monks and Sykes (2002: 11). There is no ethical commercial reason for directors to obtain powers to manage a

business with also the conflicting powers to govern the company. Venture capitalists typically remove these systemic conflicts by entering into an agreement with shareholders. However, Stock Exchanges require that this separation of power to be removed when a company becomes publicly traded. The systemic counterproductive conflict of interest for directors and auditors would be removed if corporate charters created a division of powers by establishing a "Governance Board" as described by Murray (1998). Australian Senator Andrew Murray proposed that these be established for Australian publicly traded firms. Without a governance board, directors can set and mark their own exam papers as noted by Tricker (2011).

Another systemic conflict accepted by regulators, including the ASX, is to allow directors of publicly traded firms to control the processes of AGMs. The purpose of the AGM is to hold directors to account by presenting their accounts. However, the ASX accepts corporations whose constitutions provide directors with excessive and inappropriate powers to control the processes by which directors are being held to account. Directors control the processes of their nomination, election, dismissal and/or remuneration. Directors also control who can speak and for how long, how undirected proxies are voted, which proxies are valid and the counting of votes. These AGM processes exacerbate the asymmetries of power between directors and shareholders; create conflicts of interest, unwitting bias and opportunities for mismanagement, misconduct and malfeasance.

Unless these above-mentioned systemic conflicts become identified in existing professional development courses for directors, bankers or other financial industry professionals these courses will continue to promote a business culture that cannot identify the difference as to what is right and what is wrong. If the ASX, ASIC and APRA do not eliminate the systemic conflicts as described above, then the efficacy any policy options for identifying, avoiding or regulating misconduct will become problematic.

The following Section outlines why existing law should "be administered or enforced differently?" The third Section outlines how the laws and practices of nature provide solutions. Section four outlines how the solutions could be introduced. Concluding remarks are presented in Section five.

2. "Should the existing law be administered or enforced differently?"

There are ten reasons why the existing law should "be administered or enforced differently". These are to:

1 Counter the "striking asymmetry of power and information between bank and customer that favours the bank" as reported by the RC. A situation that facilitates mismanagement, misconduct and malfeasance by suppliers of financial services;

2 Avoid regulators promoting and/or enforcing the Australian Securities Exchange (ASX) Corporate Governance Principles (CGPs) that accept or promote systemic unethical conflicts of interest referred to above and detailed in Turnbull (1975, 2000b: 115, 2018a, b). For example denying shareholders the ability to nominate, remunerate and take control of the auditor who only reports to shareholders, not to directors and investors as occurs in the US (Turnbull 2000a, 2002b, 2008b, 2014a). US audit practice is based on the prospectus provisions of the 1929 UK company law (O'Connor 2004: 17). US audit firms have insinuated US practice inappropriately into Australia.

3 Avoid regulators confusing directors and their executives about the difference between what is right and what is wrong by regulators accepting that the ASX can –

(a) Determine the nature of corporate constitutions that possess systemic unethical practices embedded in them as detailed above. A related example is providing

directors with absolute power to identify and manage their own conflicts of interest to allow them to corrupt themselves, the business and society.

(b) Use privacy rights to deny buyers or sellers of securities trading through the ASX to be informed of the identity of the person(s) they are dealing with (ASX 2015). It not appropriate for shares in public companies to be traded without public disclosure of the participants as their identity can be price sensitive. No trading of publicly company shares should be allowed without the ultimate beneficial owners and/or controllers being made public. The US Securities and Exchange Commission (SEC) requires, disclosure of all the ultimate beneficial owners of even private companies who make tender offers in the US.

(c) Control the trading of the ASXs' own shares on the above conditions;

4 Allow the management of simple centralized command and control hierarchies used by both financial service providers and their regulators to be complemented with information from a variety of stakeholder associations whose boards appoint professional qualified, regulator approved, advocates for each stakeholder constituency. In this way each stakeholder constituency, and so also each financial service provider and regulator obtains a sufficient variety of communication channels to comprehensively and reliably be informed of stakeholder wellbeing or concerns while at the same time obtaining comprehensive and reliable details of any mismanagement, misconduct or malfeasance. These arrangements overcomes the impossibility of *reporting* complexity comprehensively and as accurately as desired by establishing a "requisite variety" of cross checking channels of information (Shannon 1949);

5 Allow stakeholder advocates, as provided for above, to take initiatives to comprehensively and reliably avoid mismanagement, misconduct and/or malfeasance (Ashby 1956: 256). These arrangements overcome the impossibility of directly *controlling* complexity comprehensively as accurately as desired by establishing a "requisite variety" of co-regulators to "amplify" control. In this way stakeholders become co-regulators with a requisite variety to reliably control the complexities of the financial service industry;

6 Allow regulators to become accountable to the citizens that the Government has created the regulator to protect. This could be achieved by a congress of stakeholder advocates from different firms establishing Key Performance Indicators (KPIs) for Parliament to hold regulators to account;

7 Allow regulators to become financially accountable for harms suffered by the people the Government has created the regulator to protect;

8 Allow regulators to take into account the view of the largest investor in the world who stated: "Companies must benefit all of their stakeholders, including shareholders, employees, customers, and the communities in which they operate" (Fink 2018). This outcome would be achieved by the annual report of each stakeholder association being included in the annual reports of each firm;

9 Avoid regulators failing to apply the law comprehensively or as seriously as may be desired and/or appropriate;

10 Introduce "A new model of corporate governance" as proposed by Fink (2018) to produce outcomes such as –
(a)"One that strengthens and deepens communication between shareholders and the companies";
(b) Avoiding "group think" by introducing contestability of views within firms and between firms and their stakeholders;

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(c) Corporations succumbing "to short-term pressures to distribute earnings, and, in the process, sacrifice investments in employee development, innovation, and capital expenditures that are necessary for long-term growth";
(d) Corporations "Lose the license to operate from key stakeholders".

How the laws of nature can be used to protect and further the interest of shareholders as well as stakeholders is outlined in the following section.

3. How the laws and practices of nature provides solutions

This section outlines why "A new model of corporate governance" based on ecological principles overcomes the ten reasons why "the existing law" should be "administered or enforced differently" (Interim Report 2018).

Over the last quarter of century a literature has developed describing a "New way to govern" (Turnbull 2002a). This literature includes writers who may or may not use the term "network governance" (Nohira and Eccles 1992; Craven, Piercy and Shipp 1996; Hock, 2000; Pirson and Turnbull, 2011a, b, 2015, 2016; Podolny and Page 1997; Turnbull 1997, 2013, 2014b; Turnbull and Myers 2017; Turnbull and Pirson 2012, 2014; Van Astyne 1997; Zingales 2017). As will be explained, network governance, is not a new way to govern but a very ancient way. It is the only way used by nature to allow biota to become self-regulating and self-governing.

The Ostroms (1987, 1990, 2012) reported that pre-modern societies used a form of network governance based on "polycentric compound republics". This form of network governance is ubiquitous in nature. It describes the control and communication architecture of the human brain. For this reason it is referred to as an "ecological" form of network governance (Turnbull 2015).

Our brains have no "Chief Executive Officer neuron "(Kurzweil 1999: 84). Instead, our brains possess networks of different decision-making centers competing for relevancy according to external threats and opportunities and internal needs for water, food, comfort and other elements of wellbeing (NIH 2018). Different parts of the brain make different types of decisions. Just like traditional North American Indians, who co-inspired with Montesquieu (1748), the division of powers and checks and balances found in the US constitution. The decision to go to war was not made by the tribal elders nor the warriors. The mothers of the warriors made the decision. An approach that might well be useful in modern societies.

Elinor Ostrom shared the 2009 Nobel Economics prize with Oliver Williamson by making a different contribution to Williamson. Ostrom showed how ecological governance provides a way to avoid the short-term interests of individuals or groups destroying common resources for everyone (Noblelprize.org 2009). This problem is described as the "Tragedy of the commons".

Financial institutions are created to promote the common good for their stakeholders. However, the RC has revealed that this has not been achieved using centralized command and control hierarchies for either delivering financial services or for its regulation. Ecological governance provides a way to overcome the ten reasons identified in the previous section of why command and control hierarchies are not satisfactory.

Simplistic examples of ecological governance that represent "polycentric compound republics" are found in large stakeholder control organisations. Well-known network governed firms located in respectively the jurisdictions of the US, UK and Europe are respectively: VISA International Inc., The John Lewis Partnership, and the Mondragón Corporacion Cooperativa (MCC). Their existence provides evidence that no changes in the

law may be required for them to become established in Australia with "a new way to govern" (Turnbull 2002a).

A theoretical basis for understanding ecological forms of network governance was created earlier in the last century from seemingly unrelated literatures. Smuts coined the word "Holism" to describe how the complexity of the universe was made up of what Simon (1962) referred to as "sub-assemblies" (p. 472) or "stable intermediate forms" (473). Simon used probability analysis to show how this was the most likely way for the complexity of life to evolve. Mathews (1996) documented how different writers had referred to similar concepts using different terms. Mathews adopted the term "Holon" coined by Koester (1967) that describes both a whole system that was in turn a sub-assembly, module or part of a greater system. Koestler described the holonic systems within systems as a "holarchy". A holarchy of social organizations represents what Ostrom described as "polycentric republics".

Turnbull (2000b: 221) showed how the now 200 networked governed stakeholder cooperatives ("republics" or "holons") formed networks of polycentric "relationship groups" to create a four level holarchy around the town of Mondragón in the Basque region of Spain. Holarchies are fundamentally different from hierarchies in a number of important ways such as:

(a) Their constituent parts can exist independently, a division of a hierarchy cannot;
(b) Both the constituent parts and the whole possess contrary characteristics that Kelso (2006) describes as "complementary". These are not found in simple or divisional hierarchies of concentrated top down power;
(c) The combination of complementary~contrary characteristics creates "Tensegrity", a word coined by Fuller (1961) by combining the words "tension" and "integrity";
(d) A defining feature of a holarchy and its component holons, not found in a hierarchy, is that they possesses contrary characteristics like being: top~down, centralised~decentralised, automomous~integrated, order~chaos (Mathews 1996). The founding CEO of the network governed VISA Inc., was apparently not aware of the literature and coined his own word to describe its organizational architecture as "Chaordic" by combing the words "Chaos" and "Order" (Hock 1999).

Polycentric compound republics of the Mondragón Corporacion Cooperativa (MCC) have provided operating and competitive advantages. Thomas and Logan (1982: 126-127) reported their superior resiliency and operating advantages of the MCC. For other network governed firms Nohira and Eccles (1992), Craven et al. (1996), Podolny and Page (1998) and Turnbull (2000a, c; 20001b, 2002b) reported on their competitive and operating advantages to suggest that the benefits of network governance in relation to hierarchies increases with the complexity and dynamism of the environment and/or the activities of the firm. This supports the intuition that the architecture of creating and surviving complexity in nature provides a superior approach for humans to adopt than hierarchical organizations.

Porter (1992) also identified the competitive advantages of including stakeholders in the governance architecture of firms. His conclusions arose from comparing German and Japanese firms with those in the US. He reported that: "Both Japanese and German companies practice a form of decentralization involving much greater information flow among multi units in the company, as well as with customers and suppliers" (p.11). As a result Porter recommended that US companies: "Nominate significant owner, customers, employees, and community representatives to the board of directors" (p. 17). These recommendations were ignored because a board accountable to many constituencies becomes accountable to none.

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Ecological governance solves the problem by introducing competition for corporate control through political and social markets *within* the organizations rather through financial markets of a stock exchange. The theory of a firm developed by Coase and Williamson was limited to firms organized as "an authority system" as found in a hierarchy (Coase 1937). Williamson (1985: 265) was aware of the success of the MCC but did not know how to explain it. He described it as "dilemma". It is ironic that he shared a Noble prize with someone who identified the answer. According to Coase, firms exist because market prices fail to communicate the complex nature of components for make or buy decisions.

Both Hayek (1944) and Popper (1945) promoted decentralization to allow market forces to efficiently allocate resources instead of relying on the dictates of command and control hierarchies. Their arguments based on financial markets can also be used to support ecological governance that introduces political, social and technology markets for allocating resources.

The use of financial markets is totally dependent upon the existence of the human social construct of economic value. Today, no one or more real things can be used to define economic value. Non-human markets require non-price signals as established by ants and bees to efficiently co-ordinate hundreds of their specie with miniscule brains to make collective decisions on deciding when, where and how to locate, design, build and operate their complex dwellings. Pound (1992, 1993) has recognized the contribution of using non-financial markets for corporate control on which ecological governance is dependent.

Ecological governance is dependent upon creating competitive tensions between the various interests of different stakeholder constituencies. Ironically this leads to the need to negotiate cooperative solutions. This creates tensegrity. In this way social organizations can obtain the operating advantages hard-wired by evolution into all social biota including humans.

Humans are hard wired by evolution to possess complementary~contrary behavior like being: competitive~cooperative, trusting~suspicious, altrulistic~ selfish and so on (Kelso and Engstrøm 2006). Tensegrity provides the most efficient way for social biota to survive and thrive in novel dynamic complex environments. Harvard biologist Ingber (1996), described tensegrity as "The architecture of life". Quantum physicist Bohm (1980) described it as "the architecture of the universe". Ecological governance provides social organizations with tensegrity to allow them survive and thrive in novel dynamic complex environments.

Hierarchies inhibit humans using their instincts to apply their complementary~contrary behavior. Ecological governance is dependent upon: (a) allowing humans to use these instincts and (b) reproducing them in the behavior of the organization. This improves the wellbeing and resilience of both humans and their organizations (Turnbull 2018c). How ecological governance might be introduced is next considered.

4. How might ecological governance be introduced?

This section considers how an ecological form of governance could be introduced and in what form.

While ecological forms of governance have evolved in many different jurisdictions in many different ways in many different forms, it has attractive little investigation and scholarship. Bernstein (1978) pioneered the study of economic feedback systems within firms and later published a global survey of the governance architecture of stakeholder-controlled firms (Bernstein 1980). Hock (1994:6), the founding CEO of the credit card organization VISA

International identified five principles to "re-conceive" its organization. These principles are consistent with the nine guiding principles Whyte and Whyte (1998:259) identified for the MCC. An analysis of the architecture of four stakeholder-governed firms in are presented in the authors PhD Thesis (Turnbull 2000a).

The question of how elements of ecological governance could be introduced must be left to practitioners. However, regulators can encourage practitioners to develop elements by exempting licensed financial institutions from regulations as they develop more creditable systemic changes to counter the "striking asymmetry of power and information between bank and customer that favours the bank" (Interim Report 2018: 271).

The author obtained such an exemption from the law by the Australian regulator in 1991 when needing to convene an AGM of a public company to change its auditor (Turnbull 2000a: 150). The exemption was given because the company had already obtained approval from its "Corporate Senate" elected by shareholders on a democratic basis of one vote per investor. The corporate senate carried out the roles of nomination, remuneration and audit committees (Turnbull 2000a: 149). As the founding CEO of the company the author had previously obtained agreement of its shareholders to change its corporate constitution in1988 to remove all such governance powers that should embarrass directors with a systemic conflict of interests. These were transferred to the Corporate Senate. The Corporate Senate provided the role model for Senator Andrew Murray to recommend that all publicly traded corporations in Australia establish a more robust form that he described as a "Governance Board" (Murray 1998).

Establishing a separation of the current excessive powers of directors would be a first step in removing the asymmetry of power between directors and customers. The second step would be to establish customer and other stakeholder advocates who are appointed independently by each of the most relevant stakeholder constituencies of each financial institution.

The interest of stakeholders to participating in firm specific activities to promote their common interests was made evident in a number of US shareholder owned price regulated utilities. To avoid regulator capture Ralph Nader invited customers to donate money to fund Citizen Utility Boards (CUBs) to lobby the regulator to encourage utilities providing water, power, gas and so on to improve their efficiency rather than increase prices. Although only a minority of customers donated money it was sufficient for a number of CUBs being established as reported by Givens (1991).

Stakeholders were activated to donate both money and their time to establish the CUBs. Rather than protecting their wealth CUBs were formed simply to get a better deal on prices. The economic costs suffered by Australian customers of banks, superannuation funds, insurance companies and other financial services would seem to be at least an order of magnitude greater than ameliorating price increases. The incentive for Australians to participate in appointing, and/or acting as stakeholder watchdogs, could likewise be much greater than that in the US. Especially as they would not need to donate funds to hire professional qualified regulated approved stakeholder advocates. It is a cost that the regulators could impose on financial institutions as a condition for them obtaining a license to operate.

In Australia, stakeholder associations could simply and economically be formed under State Legislation as a non-profit incorporated body. Financial institutions could invite their various common interest stakeholders to join free of charge to elect their own directors. Stakeholder boards could then nominate appropriately qualified persons who could meet such standards that ASIC may establish for them to become a part-time or full-time co-regulator. The

regulator could set the pay scale for nominee co-regulators according their experience and professional qualifications. ASIC could recover their costs from the relevant financial institution. In this way institutions would avoid the cost, and the inherent conflicts of employing in house stakeholder ombudsmen, customer care and dispute resolution units.

The UK 1845 Companies Clauses Act provides a precedent for the government to indirectly fund a privately appointed watchdog. Pursuant to the legislation, shareholders appointed one of themselves to be the auditor who was then paid by the government. The government then invoiced the company (O'Connor 2004: 14).

Unlike auditors, or as the Chair of ASIC suggested, for regulators to be embedded in financial institutions, Stakeholder Associations could offer suggestions on how to improve services and efficiencies. Stakeholder advocates could support firms with continuous feedback to improve operations and competitiveness as well as continuously protect their respective stakeholder constituencies as co-regulators from mismanagement, misconduct and malfeasance.

Stakeholder Associations provide a way to counter the asymmetries of power and information that financial institutions possess in way that promotes constructive mutual collaboration to promote the interests of all parties that may possess competing interests. Stakeholder Associations and their Advocates introduce elements of ecological governance to avoid the tragedy of the commons that in this case is the wellbeing of financial institutions. Figure 1, "Network governance with stakeholder co-regulation" illustrates elements of what Ostrom described as "polycentric compound republics". Each Stakeholder Association shown on the left hand side of the Figure represents a self-managing "republic". They are collectively centered on the financial institution as "polycentric" republics that become integrated from a "compound" board described in the Figure as "Stakeholder Congress".

Figure 1 illustrates a generic way to introduce on a step-by-step trial and error basis without necessarily changing any laws to:

1) Answer the question raised in the RC Interim Report (2018: xxii) on how "Should the existing law be administered or enforced differently?"
2) Counter the concern of the RC Interim Report (2018: 271) on the "striking asymmetry of power and information between bank and customer that favours the bank";
3) Introduce "A new model of corporate governance" to achieve the outcomes specified by Fink (2018);
4) Introduce "polycentric compound republics" identified by Ostrom that allows the tragedy of the commons to be avoided and promote the long-term common good of financial institutions.
5) Apply the natural laws of self-regulation and self-governance that requires a "requisite variety" of decision-making centers (Neumann 1947) and channels of communication Shannon (1949) and control (Ashby 1956).

Figure 1 illustrates how the existing law could be administered differently by: (i) introducing stakeholder co-regulators; (ii) making the principal regulators directly accountable to Parliament (not the government), and (iii) allowing the public, who regulators are created to protect, to become accountable to the public through the KPIs established by a Federation of Stakeholder Congresses from regulated financial institutions.

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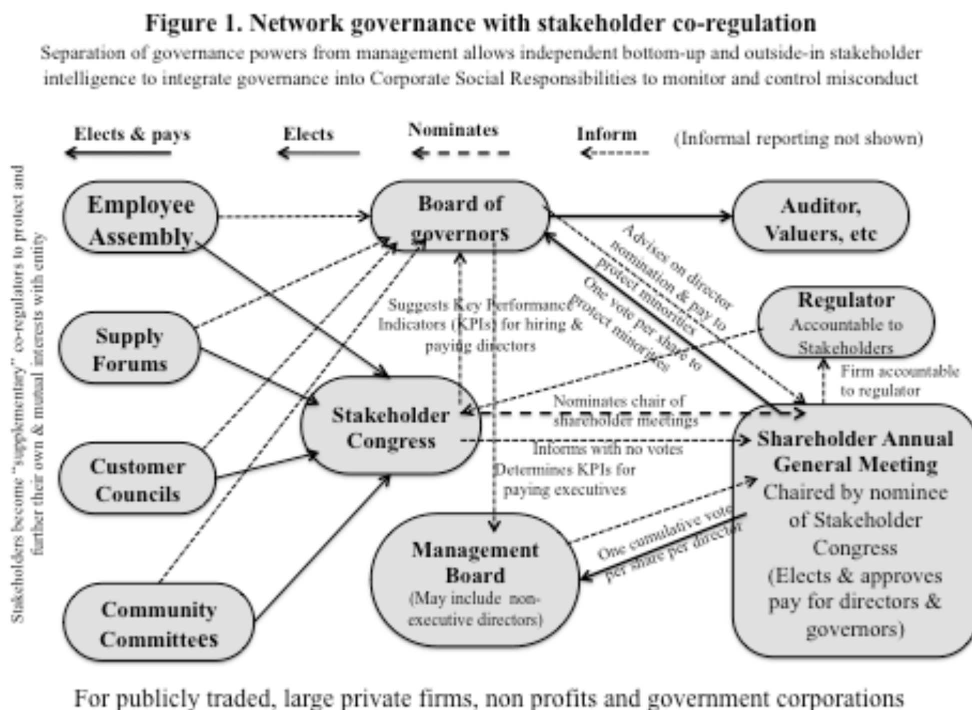

Figure 1. Network governance with stakeholder co-regulation
Separation of governance powers from management allows independent bottom-up and outside-in stakeholder intelligence to integrate governance into Corporate Social Responsibilities to monitor and control misconduct

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

6)

The directors of financial institutions could include the stakeholder KPIs in their annual accounts. This would allow investors like BlackRock to be informed if the company benefits "all of their stakeholders, including shareholders, employees, customers, and the communities in which they operate" (Fink 2018). The stakeholder advocates and their firm specific Congress would counter "Group think" that concerned Fink (2018). Stakeholder reports would create competitive pressures in the markets in which financial institutions operate to improve customer protection, services and value for their money.

The processes for introducing the outcomes detailed above are considered next.

5. Concluding remarks

The previous section referred to the need to introduce change on a "trial and error basis". ASIC (2018) has already established a "Regulatory Sandbox Framework" for fintech firms to trial new financial technology. It provides exemptions from the law as the author achieved as reported above.

A similar but different approach is required to answer the question: "Should the existing law be administered or enforced differently?" As noted in the previous section, innovations in regulation should be practitioner driven. Regulators and/or the private sector could create competition for developing more economic, efficient, efficacious, equitable, ethical reliable and comprehensive control of financial services by introducing annual rewards for the most promising creditable innovation in promoting self-governance.

Self-governance awards need not be limited to publicly traded financial service firms but to any type of firm be it government owned, privately held or a non-profit organization. Private firms and non profit organizations could well lead the way with governance innovations that

could have direct relevance for financial firms of all types. A role model for establishing such awards are the Australasian Reporting Awards (APA 2018) that began in Australia in 1950.

The impossibility of the existing system of simple centralized command and control hierarchies in either the private or public sector to reliably control or regulate complexity is indicated by "Table 1 Hierarchies simplify complexity incompletely".

Table 1. 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)

HIERARCHY	DATA UPWARDS			No. of EMPLOYEES	
Private or public sector	**Volume**	**Correct**	**Missing**	Say span of five	
Legislature	50% loss per level	85% of lower level	or wrong meaning	Per level	Accumulated total
Minister of shareholders	1.6%	1.3%	98.2%		
Board of directors	3.1%	2.7%	96.4%		
Chief Executive Officer	6.3%	5.3%	92.8%	1	1
Senior managers	12.25%	10.6%	85.6%	5	6
Middle management	25.00%	21.3%	71.3%	25	31
Team leaders	50.00%	42.5%	57.5%	125	156
Workers	100.00%	100.00%	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.

The Table assumes that up to half the data available to any member in a hierarchy can be communicated to the next higher level and that only 15% of the data losses meaning. Losses of meaning commonly arise at much higher levels in the party game when competing teams of five or so people try to relay an identical message accurately through their team. In a business each subordinate has an existential incentive to bias, spin or omit bad news for which they may be seen to be responsible. This indicates how optimistic is the accuracy and completeness of data transmitted to CEO's of large organizations as shown in the Table. Network governance with a requisite variety of crosschecking channels can increase the accuracy of data as much as desired.

We may conclude that simply hierarchies can only manage complexity incompletely on an unreliable basis that can introduce existential risks to destroy their existence. Network organizations that represent an ecological form of governance can mange complexity as completely and reliably as desired to identify opportunities to survive and thrive while avoiding and/or managing existential risks. This explains why nature universally uses ecological forms of governance and does not use hierarchies.

Table 1 reveals: (a) how introducing elements of ecological governance counters the ten reasons set out in Section 2 of why the existing law should be administered differently and (b) why more of the same top down business controls or public sector regulation could be expected to fail. Failure in private innovation initiatives that can more reliably identify, avoid and/or creditably manage misconduct on a systemic basis could also arise if regulators do not provide leadership of what is right and what is wrong.

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Specifically regulators would need to require the ASX to adopt "sunlight share trading" (Turnbull 2005) and not trade the shares of any firm, including its own, where directors obtain absolute power to identify and manage their own systemic conflicts of self interest and those that may arise from operations of the business (Turnbull 2001a).

This would mean that corporate constitutions of publicly traded firms would need to be amended to separate the power to manage a business from the powers involved in governing its corporation. This arrangement would result in no director obtaining the power to manage the processes of an AGM. It would also remove the need for directors to form nomination, remuneration, audit committees or any other board sub-committees involving their self-interests. All such powers being taken over by a board of governors as proposed by Murray (1998). The effectiveness of introducing stakeholder associations and advocates, as co-regulators, could very much be dependent upon introducing a separation of director powers that systemically exist in all firms governed by a single board.

Dee Hock, the founding CEO of VISA International, summed up the problems of the existing system of command and control hierarchies to control firms or to regulate them. Hock (1995) noted how hierarchies were against the laws of nature in his statement:

> Industrial Age, hierarchical command and control pyramids of power, whether political, social, educational or commercial, were aberrations of the Industrial Age, antithetical to the human spirit, destructive of the biosphere and structurally contrary to the whole history and methods of biological evolution. They were not only archaic and increasingly irrelevant; there were a public menace.

Nine years before the global financial crisis in 2008 Hock (1999: 6) also noted that:

> We are experiencing a global epidemic of institutional failure that knows no bounds. We must seriously question the concepts underlying the current structures of organization and whether they are suitable to the management of accelerating societal and environmental problems – and, even beyond that, we must seriously consider whether they are the primary source of those problems.

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