Professional Obligation, Ethical Awareness and Capital Market Regulation: An Achievable Goal or Contradiction in Terms?

A Report Prepared for the Professional Standards Council

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The Global Financial Crisis has revealed significant limitations with the capacity of internal or industry codes of conduct to address ethical deficiencies, prompting a professionalization agenda. The capacity of the traditional professions to embed restraint, however, has been brought into question, in part because of a conflation between market norms and professional obligation. This paper serves three functions: (a) it assesses the role of codes of conduct as a mechanism to embed higher professional standards; (b) it evaluates the tension between the articulation of standards and the process of standard setting; and (c) it explores the relationship between industry-based and formal regulatory oversight. The paper provides evidence drawn from a comparison of approaches to financial regulation in the United States, the United Kingdom and Australia. It finds an emasculated conception of responsibility has done much to tarnish reputation and legitimacy. It concludes that attempts to enhance market integrity will fail unless the deleterious effect of the inculcation of market norms on the traditional professions is addressed.

I INTRODUCTION

In May 2013 the major New York investment bank Goldman Sachs published the results of its *Business Standards Committee Impact Report*.[1] Goldman Sachs' intention was to present to the markets a reframed conception of business ethics and accountability. The gravity of the task was set by the prodigious workload. The report, it was claimed, derived from 'tens of thousands of hours of discussion, analysis, planning and execution, and importantly training and development, which alone totaled approximately 100,000 hours.'[2] Drawing upon the scarifying experience of the Global Financial Crisis (GFC), the paper begins with a stated recalibration of the firm's strategy. It emphasizes the need to put the interests of clients first. Two additional drivers are also referenced, namely 'reputational sensitivity and awareness and the individual and collective accountability of our people.'[3] Curiously, there is no mention of the fact that the stated commitment to reform derives from a settlement agreement with the Securities and Exchange Commission. The settlement dealt with allegations that the pre-existing standards and practices at the bank in relation to the design, marketing and sale of complex financial products violated each of these noble objectives.[4] Goldman Sachs was far from being the

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1 Goldman Sachs, *Business Standards Committee Impact Report* (New York, May 2013), http://www.goldmansachs.com/a/pgs/bsc/files/GS-BSC-Impact-Report-May-2013.pdf.

2 Ibid, 3.

3 Ibid, 3.

4 *Securities and Exchange Commission v Goldman Sachs & Co and Fabrice Tourre* 10 Civ. 3329 (SDNY, 15 April 2010); Securities and Exchange Commission, 'Goldman Sachs to Pay Record $550 million to Settle SEC Charges Related to Subprime Mortgage CDO' (Litigation Release 21592, Washington D.C., 15 July 2010); for discussion of the case and the rationale for settlement, see Justin O'Brien, 'The Façade of Enforcement: Goldman Sachs, Negotiated Prosecutions and the Politics of Blame,' in S. Handelman, S. Will and D. Brotherton (eds.), *How They Got Away With It: White Collar Criminals and the Financial Meltdown* (Columbia University Press, 2013), 178-204.

only offender. The GFC demonstrated in startling detail the externalities caused by emasculated or compartmentalized conceptions of responsibility and accountability.

Corporate executives and their professional advisors conspired to push through deals and strategies informed by legal technicalities and accounting conventions as well as market norms. If not, arguably, in direct violation of the letter of the law, these strategies led to sub-optimal results for both the sustainability of specific corporate models and the professional standing of their advisors.[5] This was as evident in the United Kingdom as in the United States.[6] Existing codes of conduct at corporate, industry or professional level proved incapable of addressing hubris, myopia and the decoupling of ethical considerations from core business. The failure to articulate and integrate purpose, values and principles within a functioning ethical framework created or exacerbated toxic and socially harmful corporate cultures.

From catastrophic collapses such as Lehman Brothers and the implosion of once storied brands such as Merrill Lynch through forced de facto nationalizations in the United Kingdom of major banks such as RBS and HBOS, these cultures elevated technical compliance over substance. Ethical obligation was stated but unwarranted. Deterrence was defective and ineffective. There was little or no accountability and no credible mechanisms to reduce either institutional or systemic risk from the effects of corporate misjudgment. The fact that the statute of limitations has run in most jurisdictions without the bringing of criminal charges for willful blindness poses a series of fundamental and unresolved questions. Has the panoply of reform initiatives at national, regional and global level addressed the core normative problem? Alternatively, have we privileged the politics of symbolism, creating the illusion of a robust architecture incapable of withstanding a crisis of similar magnitude?

It is this context that the revitalized Goldman Sachs Business Standards initiative, linked directly to a strengthening of its code of conduct, is so interesting. The critical

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[5] See *Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States* (Public Affairs, 2011) xxii-xxiii (noting 'a systemic breakdown of accountability and ethics…to pin this crisis on mortal flaws like greed and hubris would be simplistic. It was the failure to account for human weakness that is relevant to this crisis…Collectively, but certainly not unanimously, we acquiesced to or embraced a system, a set of policies and actions, that gave rise to our present predicament.'); for failure of codes of conduct, see Parliamentary Commission on Banking Standards, *Changing Banking for Good* (HM Parliament, 18 June 2013) 298-310 (suggesting that the transfer of responsibility to ensure market conduct to a professional body would be mistaken); see also David Kershaw and Richard Moorhead, 'Consequential Responsibility for Client Wrongs: Lehman Brothers and the Regulation of the Legal Profession' (2013) 76 *Modern Law Review* 26 at 27 (noting that 'the idea that the lawyer's primary function is to zealously advance their clients' interests has acted as an ideological justification for the alignment of the profession's commercial interests with their clients' interests and as a barrier to close investigation of the role and responsibilities of transactional lawyers').

[6] See, for example, Parliamentary Commission on Banking Standards, *HBOS: An Accident Waiting to Happen* (HM Parliament, London, 4 April 2013), 52 ('In the view of this Commission, it is right and proper that the primary responsibility for the downfall of HBOS should rest with Sir James Crosby, architect of the strategy that set the course for disaster, with Andy Hornby [his successor as Chief Executive Officer], who proved unable or unwilling to change course, and Lord Stevenson [the Chairman], who presided over the bank's board from its birth to its death. Lord Stevenson, in particular, has shown himself incapable of facing the realities of what placed the bank in jeopardy from that time until now.'); see also Financial Services Authority, *The Failure of RBS* (Financial Services Authority, London, 2011), 7 (noting many will be 'startled' to read the RBS board voted to proceed with acquisition of ABN-Amro, which is described as an 'extremely risky deal' based on information provided by the target within 'two-lever arch files and a CD' but also noting that incomplete due diligence however, could not form the basis of a credible prosecution. This is attributed to the fact that 'there are no codes or standards against which to judge whether due diligence is adequate, and given that the limited due diligence, which RBS conducted, was typical of contested takeovers': at 8).

question, therefore, is whether the revised approach, which covers client relationships, conflicts of interest, structured products, transparency and disclosure, broader governance, and training and development, is a robust improvement or a cynical privileging of symbolism? On this front, the evidence is decidedly mixed.

In sharp contrast to earlier reliance on *caveat emptor*, the bank now claims that its suitability framework has been enhanced. This, it is claimed, will 'help us [i.e. Goldman Sachs] better assess whether our clients have the background, experience and capacity to understand the range of outcomes from transactions they execute with us, particularly those transactions that are strategic or complex.'[7] Secondly, the firm has introduced what it claimed to be a 'systematic, integrated and comprehensive firm-wide framework for reputational risk monitoring and management.'[8] Thirdly, there is an explicit emphasis on culture. 'We know that while formal processes and rules are important, they cannot alone substitute for sound judgment and experience and an environment in which every person in the firm feels equally accountable for the firm's reputation,' the report concludes.[9] So far so good one might say. Reputation, however, is determined by risk. In this regard the report reads much more defensively.

The defensive tone rings–or should ring–alarm bells. It suggests the commitment to enhanced disclosure and transparency reflects external imposition rather than internalized reflection. Indeed, the report is explicit on this point. Goldman Sachs notes that 'the uncertain impact of regulatory reform on both our clients and the firm currently is a consistent theme across our businesses.'[10] Simultaneously it seeks refuge in its storied past. It notes that 'suitability will always be an important focus for us as will conflicts and business selection.'[11] The failure to provide effective mechanisms to deal with these foundational problems within a functioning ethical framework, however, is what got Goldman Sachs into such trouble in the first place. Moreover, presenting enhanced levels of disclosure and transparency as voluntary initiatives when in fact they are mandated through legislative change and regulatory settlement negotiations is dissembling of the first order. It takes much away from the authenticity of the report.

Paradoxically, the report itself goes on to spell out the forced nature of change. 'Our Investment Management Division has been concentrating on new regulations and requirements related to suitability, many of which impact a broader range of clients than in the past and call for enhancements to disclosure, documentation and controls,' it notes rather plaintively.[12] At the same time, Goldman Sachs remains sanguine that 'professional investors generally have the background, experience and risk profile to make their own investment decisions.'[13] It has, nonetheless, established vetting procedures related to the design and purpose of specific instruments offered by the firm. These are designed to ensure 'the instrument is appropriate for the markets and that the relevant risk factors associated with the instrument are adequately addressed and disclosed.'[14] The unmistakable message is that Goldman will design, market and sell the product if it thinks it can get away with it, not on whether it is appropriate or socially useful. *Plus ça change, plus c'est la même chose* – the more things change, the more they stay the same.

This extended vignette tells us much about the corporate and regulatory response

[7] Goldman Sachs, above n1, 3.
[8] Ibid, 13. Moreover this is deemed to be 'one of the main achievements of the BSC.'
[9] Ibid, 5.
[10] Ibid, 7.
[11] Ibid, 7.
[12] Ibid, 7.
[13] Ibid, 14. For how this defence was framed, see O'Brien, above n4.
[14] Ibid, 15.

to the GFC. Six years on from the August 2007 onset with the vaporization of the securitization market, regulatory authorities across the globe remain mired in crisis rather than strategic management. Within that timeframe, we have moved progressively from a rubric of 'too big to fail' to a dawning recognition that systemically important financial firms are not only too big to manage, to regulate, but also to litigate effectively against and arguably too complex to insure. At the same time, the global investigation into the manipulation of the London Interbank Offered Rate (Libor) suggests the problem is systemic.[15] As the influential United Kingdom Treasury Select Committee reported in August 2012, 'the standards and culture of Barclays [the first bank to agree to a settlement in relation to Libor], and banking more widely, are in a poor state. Urgent reform, by both regulators and banks, is needed to prevent such misconduct flourishing.'[16] The Libor investigation, which remains at an early stage, has exposed systematic and pervasive corruption in the rate-setting process, as most recently noted by the Financial Stability Oversight Council in the United States:

> Recent investigations uncovered *systematic false reporting and manipulations* of reference rate submissions dating back many years. This *misconduct* was designed to either increase the potential profit of the submitting firms or to convey a misleading picture of the relative health of the submitting banks. These actions were *pervasive*, *occurred in multiple bank locations around the world, involved senior bank officials at several banks, and affected multiple benchmark rates and currencies*, including LIBOR, EURIBOR, and the Tokyo Interbank Offered Rate (TIBOR). Each of the banks that faced charges engaged in a *multi-year pattern of misconduct that involved collusion* with other banks. These revelations have undermined the public's confidence in these benchmarks [emphasis added].[17]

The Influential Parliamentary Banking Standards Commission in the United Kingdom has expressed grave concern at the failure of restraining forces. 'Prolonged and blatant misconduct' as evidenced in the Libor and associated scandals, suggest a degree of institutional corruption that is systemic and allied to a 'dismal' and 'striking limitation on the sense of personal responsibility and accountability it concludes.[18] The paucity of institutional memory in leading banks, the fact that such manipulative activities continued even after bailouts and a baleful reality of continued compartmentalized responsibility has made business ethics appear little more than an oxymoron.[19] All of this suggests that much more attention must be placed on those who provide professional advice. If much that occurred in the GFC was technically legal or compliant with accounting standards or the models provided by rating agencies, it seems essential to evaluate the connection between professional obligation, ethical awareness and accountability. Moreover this investigation necessitates evaluating whether

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[15] For overview of the scandal and its impact, see Justin O'Brien and George Gilligan (eds.), *Integrity, Risk and Accountability in Capital Markets: Regulating Culture* (Hart Publishing, 2013).

[16] Treasury Select Committee, *Fixing Libor: Some Preliminary Findings*, (HM Parliament, Westminster, 22 August 2012).

[17] Financial Stability Oversight Council, *Annual Report* (Department of Treasury, Washington, D.C., 25 April 2013), 137.

[18] Parliamentary Commission on Banking Standards, *Changing Banking for Good*, above n5, 16.

[19] Alasdair MacIntyre, 'Why Are the Problems of Business Ethics Insoluble,' in B. Baumin and B. Friedman (eds.), *Moral Responsibility and the Professions* (Haven Publishing, 1982), 358 ('Effectiveness in organizations is often both the product and the producer of an intense focus on a narrow range of specialized tasks which has as its counterpart blindness to other aspects of one's activity.'); see also Alasdair MacIntyre, 'Social Structures and their Threats to Moral Agency' (1999) 74 *Philosophy* 311 ('Compartmentalization occurs when a 'distinct sphere of social activity comes to have its own role structure governed by its own specific norms in relative independence of other such spheres. Within each sphere those norms dictate which kinds of consideration are to be treated as relevant to decision-making and which are to be excluded': at 322).

compartmentalized conceptions of responsibility contribute to sub-optimal outcomes.[20] Why, for example, were the professions so close to the executive suites and trading floors, unwilling or incapable of exercising scepticism, the hallmark of expertise?[21] This is an existential question for both the established professions and those who would like to see the establishment of a professional standards board for banking, an idea canvassed but viewed with extreme caution by the British Parliamentary Banking Standards Commission.

Common to each profession is the acquisition of expertise or competence. Its standing within the community is predicated on a latent trust that this expertise will be applied responsibly through the exercise of professional judgment. The profession itself acts as the gatekeeper for the competence and judgment of its members (if not, necessarily although arguably performing a similar role for the market in which the profession operates). There is a symbiotic relationship between the individual practitioner, the individual firm or partnership in which she operates and the professional association. At both individual level and for the profession as a whole, professional obligation is predicated on the capacity and, indeed, the necessity to uphold the stated values of the profession. This, after all, is where the utility of the profession derives. It is also where its reputation derives from. The specific duties that bind a professional are, therefore, defined by the expectations that the profession has itself created in the public mind. Necessarily, these extend beyond putting the interests of clients first. These expectations, however, become exceptionally problematic in environments such as capital markets, which are governed by specific cultural norms and mores and separated from broader society through (potentially) unbridgeable income disparities. Although lucrative for those providing professional advice, it is, nonetheless, neither fair nor reasonable that the externalities caused by the sector's misjudgments should be borne by those excluded from its governance.[22] Nor is it fair or reasonable for the established professions to retain unwarranted status in the event that actual practice consciously undermines the integrity of either the market or the wider justice system.

The task of ascertaining the parameters of professional obligation is as critical here in Australia as it is internationally. Although no major bank collapsed, Australia has not escaped an incremental but pronounced erosion of confidence because of market failure. From the collapse of boutique financial engineering outfits such as Alco Finance and Babcock & Brown, the mis-selling of complex financial products to investors, including local councils, churches and charities deemed to be sophisticated to the stinging criticism by the Australian Securities and Investments Commission of a general deterioration in audit quality, fundamental questions here too are raised about the

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[20] See, for example, Steven Schwarcz, 'The Role of Lawyers in the Global Financial Crisis' (2010) 24 *Australian Journal of Corporate Law* 214; Doreen McBarnet, 'Financial Engineering or Legal Engineering: Legal Work, Legal Integrity and the Banking Crisis' in I MacNeil and J O'Brien (eds.), *The Future of Financial Regulation* (Hart Publishing, 2010). For rare specific inquiry looking at complicity of London-based Linklaters in a series of transactions for Lehman Brothers, which while correct facilitated the misleading of regulators and capital markets, see Kershaw and Moorehead, above n5. For discussion linking failure to prioritize the public interest to a lost broader obligation to society, see Joan Loughrey, *Corporate Lawyers and Corporate Governance* (Cambridge University Press, 2012), 70-81.

[21] This occurred despite a legislative mandate in the United States for lawyers to report risk internally, see *Public Company Accounting Reform and Investor Protection Act of 2002* (Sarbanes-Oxley), s.307, a provision that mirrored the obligation of auditors to attest to the quality of internal control (s.404). Neither proved effective.

[22] See Steven Schwarcz, 'Systemic Risk' (2008) 97 *Georgetown Law Journal* 193; for application to the legal profession, see Schwarz, above n20 at 217 (noting that complacency, conflicts, complexity as well as a type of tragedy of the commons combined to blind market participants of the risks, which legal professionals were incapable of either identifying or responding to).

complicity of professionals. These questions have, in turn, raised the (sporadic) interest and scepticism of the political establishment about the quality and utility of professional norms and mores.[23]

This paper, therefore, assesses a critical question. What is the nature of professional obligations in the context of capital market regulation? Particular reference is made to the legal and audit communities. Both play pivotal if contested gatekeeper roles in upholding market integrity. Exploring how this role is conceived is of acute interest not only to the professions involved or those seeking to advance a professionalization agenda for the financial services arena. It is also critical to understanding what constitutes broader societal obligation. As such it fits directly with the rationale of the Professional Standards Council (PSC). As the statutory authority responsible for encouraging regulated professional communities to improve standards, it is well placed to evaluate how the conflict between commercial imperatives and the public interest is navigated. It is essential that those standards are effective if the efficacy of self-regulation or the meta-regulatory framework underpinning the PSC is to be demonstrated and legitimated. It is in this context that the announcement by the Institute of Chartered Accountants Australia (ICAA) that the PSC has revoked caps on professional liability must be understood. As will become clear from the case study failure to close the gap between perceived obligation and actual practice risks undermining the authority of the professional model itself.

The investigation is advanced through a three stage process: (a) it assesses the role of codes of conduct as a mechanism to embed higher professional standards; (b) it evaluates the tension between the articulation of standards and the process of standard setting; and (c) it explores the relationship between industry-based and formal regulatory oversight. First, however, it is essential to excavate the intellectual and conceptual underpinnings of the disclosure paradigm that governs market conduct regulation. This paradigm was self-consciously built on an explicit ethical and normative foundation. Reclaiming this lost heritage is essential if we are to ensure that professional obligation meshes with rather than erodes societal welfare.

II RECLAIMING DISCLOSURE'S NORMATIVE UNDERPINNINGS

Political intervention in financial regulation debates tends to be most effective when anchored to sources of legitimacy and authority. Notwithstanding the corrosive and deeply disturbing abuse scandals that have weakened, with cause, the standing of the Catholic Church, the reputation of Pope Francis remains untarnished. An advocate for the poor and the dispossessed, every step of his reign to date has been marked by the astute exercise of the power of symbolic voice. His intervention in the debate on the regulation of global finance is no different. In May 2013 he warned that 'certain pathologies are increasing, with their psychological consequences; fear and desperation grip the hearts of many people, even in the so-called rich countries; the joy of life is diminishing; indecency and violence are on rise; poverty is becoming more and more

[23] See, for example, Parliamentary Joint Committee on Corporations and Financial Services, *Statutory Oversight of the Australian Securities and Investments Commission* (Commonwealth of Australia, Canberra, May 2013), 23 (noting a pronounced gap between audit practice and the public perception of professional obligation); for example of failure of the audit in the British banking scandals, see Philip Aldrick and James Kirkup, 'KPMG Faces Possible Audit Inquiry Over HBOS Failure,' *Daily Telegraph* (London), 8 April 2013, http://www.telegraph.co.uk/finance/economics/9979995/KPMG-faces-possible-audit-inquiry-over-HBOS-failure.html

evident.'[24]

In identifying as a causal mechanism 'our relationship with money, and our acceptance of its power over ourselves and society' the speech had clear echoes of Franklin Delano Roosevelt's inaugural address in March 1933. Although separated by eighty years, the danger of the elevation of 'false idols' remains an exceptionally potent and eerily apposite message for the regulation of capital markets. Roosevelt anchored the New Deal architecture that underpins the disclosure paradigm on the need to put 'an end to a conduct in banking and in business, which too often has given to a sacred trust the likeness of callous and selfish wrongdoing…Restoration calls, however, not for changes in ethics alone. This Nation asks for action, and action now.'[25] Pope Francis elevated the pitch to a global level, noting that the 'worship of the golden calf of old (cf. *Exodus* 32:15-34) has found a new and heartless image in the cult of money and the dictatorship of an economy which is faceless and lacking any truly humane goal.' This did not happen by accident. It is the result of conscious ordering.

For the pontiff this state of affairs has practical ideational roots. It derives from corruption, fiscal tax evasion and 'ideologies which uphold the absolute autonomy of markets and financial speculation, and thus deny the right of control to States, which are themselves charged with providing for the common good. A new, invisible and at times virtual, tyranny is established, one which unilaterally and irremediably imposes its own laws and rules.'[26] The situation is rendered unsustainable if those responsible are not held to account and the systems put in place in the aftermath of crisis paper over the cracks rather than address the structural dynamics that inform the operation of a given regulatory regime. These include which institutional actors have voice, authority and legitimacy and how given preferences are mediated, evaluated and made manifest. Critically, these battles tend to be mostly at the crucial implementation stage, which is largely but erroneously conducted on a technical basis and largely outside sustained public gaze. The effect can be to hollow out legislative intention. Nowhere is this more apparent than in the United States, a point made with great erudition by Paul Volcker, the legendary former chairman of the Federal Reserve in May 2013. Volcker was speaking at the Economic Club of New York where he received a lifetime achievement award, only the second recipient to be so recognized. For Volcker, the regulatory architecture in the United States is a 'recipe for indecision, neglect and stalemate, adding up to ineffectiveness. The time has come for change.'[27]

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[24] Pope Francis, 'Address of Pope Francis to the New Non-Resident Ambassadors to the Holy See' (Speech delivered at Clementine Hall, The Vatican, Vatican City, 16 May 2013), http://www.vatican.va/holy_father/francesco/speeches/2013/may/documents/papa-francesco_20130516_nuovi-ambasciatori_en.html. Similar unease has been expressed by the Anglican community, see 'Statement By Archbishops and Bishops Ahead of G8 Summit in County Fermanagh' (Press Release, Dublin, 6 June 2013), noting 'The equitable management of economic affairs has the potential to bring many benefits to a de–moralised world…It is perhaps one of the strangest and saddest aspects of the world post 2008 that governments, especially governments of wealthy countries, have not promoted serious discussion of alternative economic models beyond those of a particular form of financial capitalism. The levels of youth unemployment in wealthy countries is not only an economic disaster, it is also a moral tragedy,' http://ireland.anglican.org/news/4618.

[25] Franklin D. Roosevelt, 'Inaugural Address' (Speech delivered at Capitol Hill, Washington, D.C., 7 March 1933).

[26] Pope Francis, above n24. For positive political reaction to the speech, see Deutsche Welle, 'Pope Francis Gets Merkle's Ear on Financial Reforms,' *Deutsche Welle*, 18 May 2013, quoting the German Chancellor after meeting with the Pope as saying that 'it is true that economies are there to serve the people and that has by no means the case in recent years,' see http://www.dw.de/pope-francis-gets-merkels-ear-on-financial-reforms/a-16822799.

[27] See Paul Volcker, 'Central Banking at a Crossroads' (Speech delivered at the Economic Club of New

What unifies these approaches is the need to render subservient means to ends through a process of ethical and political renewal. Both Pope Francis and Paul Volcker suggest in their different ways fundamental flaws, which must be addressed if warranted confidence in capital market conduct is to be returned. This necessitates conceptual as well as practical reform. As could be expected, the Pope stressed the normative dimension.

> There is a need for financial reform along ethical lines that would produce in its turn an economic reform to benefit everyone. This would nevertheless require a courageous change of attitude on the part of political leaders. I urge them to face this challenge with determination and farsightedness, taking account, naturally, of their particular situations. Money has to serve, not to rule... In this way, a new political and economic mindset would arise that would help to transform the absolute dichotomy between the economic and social spheres into a healthy symbiosis.[28]

This is far from an exercise in handwringing. It is a deliberate and cautious attempt to change the narrative governing the purpose of regulation. Pope Francis is rescuing from history Karl Polanyi's claim that 'the principle of freedom to contract…is…merely the expression of an ingrained prejudice in favor of a definite kind of interference, namely such as would destroy non-contractual relations'[29] To be successful as an agent of change, however, necessitates a commitment from the financial services sector itself that the bifurcation between the economic and the political and social spheres has been disastrous to societal cohesion and indeed its own self-interest. Crucially it cannot do so on self-referential terms. Hence, the importance of Volcker's admonition that credible reform must balance private and public expectations.[30] Not for

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York, 29 May 2013), 8-9 (According to Volcker, 'the regulatory landscape has been little changed. The result is that we are left with a half dozen distinct regulatory agencies involved in banking and finance, each with their own mandate, their own institutional loyalties and support networks in the Congress, along with a an ever growing cadre of lobbyists equipped with the capacity to provide for campaign financing…[T]he present overlaps and loopholes provide a wonderful obstacle course that plays into the hands of lobbyists resisting change. The end result is to undercut the market need for clarity and the broader interest of citizens and taxpayers.'), http://econclubny.com/events/Transcript_VolckerMay2013.pdf. Critical in this process is the cost of campaign finance, see Martin Gilens, *Affluence and Influence: Economic Inequality and Political Power in America* (Princeton University Press, 2012), for broader discussion of regulatory decline in the United States, see Christopher Carrigan and Cary Coglianese, 'Oversight and Hindsight: Assessing the US Regulatory System in the Wake of Calamity' in in C Coglianese (ed.), *Regulatory Breakdown: The Crisis of Confidence in US Regulation* (University of Pennsylvania Press, 2012), 1-20 (suggesting 'the anemic pace of economic recovery following the Great Recession has generally made regulation a matter of great political contestation:' at 3).

[28] Volcker, above 27.

[29] Karl Polyani, *The Great Transformation* (Beacon Press, 1944), 171; see also Joseph Schumpeter, *Capitalism, Socialism and Democracy* (Allen & Unwin, 1943), 137 ('No social system can work in which everyone is supposed to be guided by nothing except his short-term utilitarian ends...the stock market is a poor substitute for the Holy Grail'); for discussion of the rise of materialism and loss of values, see Charles Taylor, *A Secular Age* (Harvard University Press, 2007); Herman Daly and John Cobb, *For the Common Good* (Beacon Press, 1994). For application of this thinking to the legal profession, see Michael Kirby, 'Legal Professional Ethics in Times of Change' (1996) 14 *Australian Bar Review* 170 at 183 (noting that 'it is easier to adopt a purely economic or mercantile view of the law if you have no concept of the nobility of the search for individual justice, of the essential dignity of each human being and the vital necessity of providing the law's protection, particularly to minorities, those who are hated, even demonized and reviled. Without some kind of spiritual foundation for our society we can do little less than to reach back into the collective memory of our religious past or to rely on consensus declarations as to contemporary human values').

[30] Paul Volcker argues for a bipartisan commission that brings together 'the President, Congressional leaders, interested and responsible business and academic experts [to] support something constructive, a well-coordinated, adequately financed financial inquiry bringing together the legitimate public and private interests,' see Volcker, above n27, 10. This is not to suggest that risk is avoided totally. As Carrigan and Coglianese have pointed out, 'in a world governed by probabilities, harms will still occur whenever a

the first time understanding what could be the future of financial regulation necessitates reclaiming its rationale, a fact recognized by its initial framers.[31] None speaks more directly to the problems facing the industry and society today than James M Landis its key architect.

An inaugural member of the Securities and Exchange Commission who became its chairman in 1935, Landis was an outstanding practitioner and theoretician of regulatory design. Extending far beyond the narrow realm of banking and securities regulation, the New Deal was designed to recalibrate society itself through the guidance of neutral experts. Experience, experiment and avowed faith in the rule of experts to solve the complexity of modern society underpinned a powerful inter-disciplinary intellectual movement. Given the opportunity to simultaneously translate theory into practice and generate theory from practice, the crisis also revealed significant conceptual shortcomings in prior policy design, the power of which was exponentially increased by the temporary fracturing of previously powerful electoral and ideational coalitions. From the beginning he stressed purpose over regulatory form, cooperation over coercion and, critically, the need to guide industry to understand and provide socially beneficial outcomes.[32] Within this framework, disclosure was designed to inform the investing public of actual practice, thereby incrementally changing the boundaries of what could be constituted as acceptable.

As with the current crisis afflicting the Anglo-American model of capitalism,[33] the debate in the 1930s on whether and how the government should intervene was based on a response to a social as well as economic catastrophe. The result was a profound recalibration. Private interests were rendered subservient—if only temporarily—to societal obligation. Moreover, it was to be the progressive erosion of that compact, with the explicit support of political agency, which has, in large part, brought us to the current crisis. Seen in this context, the GFC is a result not of a failure of culture but what happens when the needs and cultural framing of specific communities of practice gain ideational support for what purports to be communal virtues but more accurately reflects unsustainable (and ultimately failed) commercial virtues.

The previous elevation of the ideational as rational is anything but.[34] The cult of

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regulator is asked to balance risk,' see Carrigan and Coglianese, above n27, 10. The critical point is how to determine what risks are acceptable in the trade-off calculus; a process that Volcker suggests–and I concur–cannot be made in a self-referential vacuum.

31 James M Landis, *The Administrative Process* (Yale University Press, 1938), 51 (citing the rise of the administrative state as a necessary response to the complexity of modern society). For importance of history, see James M Landis, 'Address Before the Third Annual Eastern Law Students Conference' (Speech delivered at the School of Law, The Catholic University of America, Washington, DC, 20 March 1937), 1 ('One grasps for shadows, the better to comprehend sunlight. One reaches into the past, more clearly to know today and tomorrow. It is the privilege of all who care about education to test the depth and quality of that shadow for there, perhaps more than anywhere, one must try to pierce the brilliance of continuing dawns').

32 See Justin O'Brien, 'Back to the Future: James M Landis and the Rationale for Intervention in Capital Markets' in O'Brien and Gilligan, above n15.

33 Barack Obama, 'Remarks on Financial Regulatory Reform' (Press Conference, White House, Washington DC, 17 June 2009), 2 ('In many ways, our financial system reflects us. In the aggregate of countless independent decisions, we see the potential for creativity—and the potential for abuse. We see the capacity for innovations that make our economy stronger—and for innovations that exploit our economy's weaknesses. We are called upon to put in place those reforms that allow our best qualities to flourish— while keeping those worst traits in check. We're called upon to recognize that the free market is the most powerful generative force for our prosperity—but it is not a free license to ignore the consequences of our actions').

34 For dynamics of this process in financial market regulation, see Lawrence Brown and Lawrence Jacobs, *The Private Abuse of the Public Interest: Market Myths and Policy Muddles* (University of Chicago Press, 2008);

money has, it appears, many acolytes. Credible reform necessitates that the ethos of responsibility percolates much deeper than bankers and their regulators. It must also inform the self-regard and self-referential framing of discourse by the professions. Through ideological privileging, neglect or willful blindness they failed to either identify or safeguard market integrity and societal welfare.[35] In so doing they have brought into doubt both the utility and legitimacy of their function.

III PARADIGMS AND PARADIGM SHIFTS

As we have seen, the GFC has provoked an acute legitimacy crisis that five years on remains unresolved. It is particularly apparent in the United States and Europe. This is precisely because the effects of the imposition of the austerity agenda are so pronounced. While dysfunctional regulatory apparatuses are unquestionably at play, as evidenced in Paul Volcker's speech to the Economic Club of New York referenced above,[36] a broader malaise is also apparent. If capital markets are to restore the faded lustre of respectability, attention must focus on the moral principles of the professions. These are the 'gatekeepers' of market integrity.[37] They derive prestige and standing from identification with professional obligation. They appear, however, to have misunderstood its true meaning. The placing of legal permissibility over ethical judgment necessitated professional guidance from audit and legal communities. They did so because that responsibility was conceived on a narrow technical rather than normative basis. It is this broader question of potential complicity that remains the least developed in the aftermath of the global financial crisis.[38] Before ascertaining how that process can be

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Bernard Harcourt, *The Illusion of Free Markets: Punishment and the Myth of Natural Order* (Harvard University Press, 2011).

35 See Kershaw and Moorhead, above n5 at 45-46 (noting the conflation of libertarian and pluralist rationales); see also W Simon, 'After Confidentiality: Rethinking the Professional Responsibilities of the Business Lawyer' (2006) 75 *Fordham Law Review* 1543 (noting reliance on formalism privileges technicalities and eviscerates obligation to uphold the spirit of the law); for analogy to American Wild West, see Jeremy Carver, 'The Role of Lawyers' in J. O'Brien (ed.), *Governing the Corporation* (John Wiley & Sons, 2005), 223 ('If the price was right, the man would do what he had to do, i.e. what he was hired to do. He could be Shane – quintessentially noble or decent; or he could be Jesse James – a cool and ruthless killer; or a range of characters in-‑-between': at 224).

36 See Volcker, above n27.

37 See Loughrey, above n20, 80 (noting that 'allowing corporate lawyers to abandon a public service role and accepting that they can be guided by market norms alone, rather than broader professional values, has costs…Lawyers should balance their commitment to the client with an obligation to serve broader public interests such as preserving the integrity of the markets and market confidence, and promoting good corporate governance and respect for the law.'). Here in Australia, the emphasis on the professions as gatekeepers animates the manner in which the Australian Securities and Exchange Commission advances its agenda, see Greg Medcraft, 'News From the Regulator' (Speech delivered at the Financial Ombudsman Service Annual Conference, Melbourne 2 May 2011, http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/News-from-the-regulator-FOS-speech-2-June-2011.pdf/$file/News-from-the-regulator-FOS-speech-2-June-2011.pdf. This expansive view has been challenged, see for example, Andrew Lumsden, 'The Oxford Project: A View From the Trenches, UNSW Centre for Law Markets and Regulation (noting, 'It's too easy to suggest an "indisputable duty of corporate lawyers to act as officers of the legal system" as a reason for corporate lawyers to be characterised as gatekeepers. To characterise corporate lawyers as gatekeepers is to impose upon them and by analogy financial advisers an inappropriate standard that does not address the matrix of relationships in which they operate…Unlike auditors or security analysts (who have independent duties as objective providers of external assurance) corporate lawyers do not and can not have imposed on them duties to the wider market beyond their general ethical duties.'), http://clmr.unsw.edu.au/article/ethics/the-oxford-project/oxford-project-view-trenches.

38 See Kershaw and Moorhead, above n5 at 60 ('In the absence of an effective constraint resulting from professional identity and culture, lawyers may become not a means of upholding the rule of law but a

reversed, it is essential to evaluate how it occurred. It is in this context that evaluation of the Australian experience of the GFC is of acute relevance.[39] As noted above, Australia escaped the calamity of a major institutional collapse. Malpractice was, however, evident. Two cases studies detailed below raise very real concerns about the manner in which the professions operated: (a) the marketing and sale of complex financial products; and (b) a gradual but pronounced deterioration in audit quality, which has resulted in the revocation of professional liability caps for the Institute of Chartered Accountants of Australia.

Complex Financial Products

'How was it that relatively unsophisticated Council officers came to invest many millions of ratepayers' funds in these specialized financial instruments? That is the fundamental question at the heart of these proceedings,' reflected Rares J, before pronouncing judgment in a case that has far-reaching implications for the regulation of financial services.[40] *Wingecarribee Shire Council v Lehman Brothers Australia* addresses directly a critical issue: what specific duty of care does a financial services provider owe to its clients and can these be voided by contractual terms or legislative exceptions? The Rares judgment provides the first definitive affirmative answer to the former and a negative to the latter.

It holds that a critical bifurcation in the Australian financial services legislation between sophisticated or professional and unsophisticated investors cannot be used to evade responsibility of financial services providers to act in the best interest of clients. It finds that Grange Securities, a wholly owned subsidiary of Lehman Brothers Australia, breached its fiduciary duty in facilitating individual transactions for complex products to

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means of undermining it where they can facilitate wrongdoing but deny responsibility for it.'); for a US perspective, see Sandra Day O'Connor, Commencement Address, Georgetown Law Center, May 1986 ('Lawyers must do more than know the law and the art of practicing it. They need as well to develop a consciousness of their moral and social responsibilities.... Merely learning and studying the Code of Professional Responsibility is insufficient to satisfy ethical duties as a lawyer'); see also Deborah Rhode and Paul Paton, 'Lawyers, Ethics and Enron' in N. Rapoport, J. Van Niel and B. Dharan (eds.) *Enron and Other Corporate Fiascos: The Corporate Scandal Reader* (Foundation Press, 2009), 625-657, 629 (noting 'a disturbing gap between professional interests and societal values' in the American Bar Association's opposition to strengthened obligation to report malfeasance internally as a consequence of Sarbanes-Oxley).

[39] For review of professional legal obligations in Australia and the pressures of market ordering, see Steve Mark and Tahlia Gordon, 'Regulating the Legal Profession: A Prototype for Change,' in O'Brien and Gilligan, above n15 (emphasizing the interaction between ethical practice, organizational culture and regulatory compliance and the need to construct what the authors terms an 'ethical infrastructure'); for roots of this framing based on empirical evaluation of the dynamics of practice, see Christine Parker, Adrian Evans, Linda Haller, Suzanne Le Mire and Reid Mortensen, 'The Ethical Infrastructure of Legal Practice in Larger Law Firms: Values, Policy and Behaviour' (2008) 31 *University of New South Wales Law Journal* 158 see also Christine Parker, Tahlia Gordon and Steve Mark, 'Regulating Law Firm Ethics Management: An Empirical Asses of an Innovation in Regulation of the Legal Profession in New South Wales' (2010 37 *Journal of Law and Society* 466. This is far from an Australian preoccupation, see Anthony Kromman, *The Lost Lawyer: The Failing Ideals of the Legal Profession* (Harvard University Press, 1993), 1 ('The profession stands in danger of losing its soul'). Notwithstanding the crisis, some senior commentators remain sanguine; see Bjorn Fasterling, 'The Managerial Law Firm and the Globalization of Legal Ethics' (2009) 88 *Journal of Business Ethics* 21 at 25-27 (outlining how the conflation of external and internal pressures combine to potentially weaken individual judgment.). Fasterling concludes, however, somewhat optimistically, that globalization and consolidation can strengthen legal obligation and that 'a a change in these core values could only occur if the individual interests of clients and lawyers were to prevail over the common interest in the rule of law': at 31. This, however, is precisely the suspicion, see Kershaw and Moorhead, above n5 at 60-61. This critique animates the writing of the leading British scholar on legal ethics, see Loughrey, above n20, 81 (noting 'unless dedication to the client's interests is counterbalanced by a commitment to broader social concerns, there is a real risk that the professions ethics will be eroded, which could pose a threat both to clients and to the broader community.').

[40] *Wingecarribee Shire Council v Lehman Brothers Australia (in liq)* [2012] FCA 1028, Para 14.

sophisticated clients without explaining the risks. Of potentially greater significance, in what is a robust indictment of financial engineering and the methods used by its leading practitioners, it holds that the placing of highly complex collateralized debt obligations in the investment portfolios of councils represented misleading and deceptive conduct.

The litigation's significance focuses on the interplay between three factors. First, the judgment revealed a serious and unresolved conflict over policy implementation of legislative intention in determining how complex securities instruments can and should be marketed. As will be explored more fully below, this has been only partially addressed by the Future of Financial Advice reform agenda, precisely because the Department of Treasury has not released the outcome of a consultation process on whether the bifurcation between sophisticated and retail investors should be repealed. Second, the litigation derives from rather than spawns a class action. The testing of obligation was left to commercial funders, listed on the Australian Stock Exchange for profit, rather than the regulator funded by the taxpayer to uphold the public interest. This is rendered even more surprising given that the entities represented in that action are themselves an arm of government. This opens the question of why the market conduct regulator, the Australian Securities and Investments Commission did not risk litigating a case that Rares J found of acute public importance. In part the answer lies on a policy decision not to intervene when a class action has been initiated, a de facto recruitment of the class action as a private attorney general. In part, it also raises the possibility that an industry has developed without adequate regulatory oversight that seeks advantage not in the merits of a case but the propensity of major corporate's to settle. Third, as Lehman Brothers Australia is in liquidation it is unlikely to appeal. The legal advisers to the litigation funders, IMF, have already signaled intention to file suit against other solvent providers of complex financial products. The ruling is, therefore, likely to herald future litigation.

The United States investment bank Lehman Brothers had entered the Australian market through its acquisition of Grange Securities and Grange Asset Management in March 2007.[41] In so doing, it took responsibility for the management of ongoing and prior relationships. These included the provision of transactional services and asset management for a number of local councils, each governed by a specific Individual Management Protocol (IMP). The Australian Federal Court found that 'the improvidence, and commercial naivety, of Grange's Council clients in entering into these transactions that were highly advantageous to Grange'[42] could only have occurred because the financial services firm was dealing with individual officials variously described as 'financially quite unsophisticated and completely out of his depth',[43] 'uninformed'[44] and 'careless'.[45] Notwithstanding the carelessness, the Federal Court did not find grounds to reduce liability through contributory negligence. It did so because Rares J held that the financial services firm had used a deliberate strategy to take advantage of its asymmetrical knowledge of product and regulatory complexity.[46] That it could do so necessitated capacity to circumvent the legal rules and failure of the audit

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[41] In December 2007, four months after the problems in the US securitization market became apparent, the business was rebranded as Lehman Brothers Australia and Lehman Brothers Asset Management, respectively.

[42] *Wingecarribee Shire Council v Lehman Brothers Australia (in liq)* [2012] FCA 1028 at Para 266.

[43] Ibid, 483.

[44] Ibid, 491.

[45] Ibid, 462.

[46] *Wingecarribee Shire Council v Lehman Brothers Australia (in liq)* [2012] FCA 1028 ('Grange was a person who, unlike each of the Council officers had the necessary financial acumen and expertise to be categorized as a "sophisticated investor" in the English ordinary usage of that expression. That is the capacity in which each Council engaged Grange to act on its behalf:' at 913.)

process to ascertain the material risks of such a strategy.[47]

'The contrast between the actual, and patent, lack of financial acumen of the various Council officers at each of Swan, Parkes and Wingecarribee [the local councils representing the class action] and the intelligent, shrewd and financially astute persons at Grange was striking', noted Rares J.[48] 'Generally, risk-averse people do not take bets with substantial assets held for public purposes', he concluded.[49] That they did so could be rendered explainable by the fact that they were victims of an elaborate deception. 'Grange financed itself when it required cash by borrowing from its Council clients at a rate of interest or on terms as to security that Grange was not likely to achieve in an informed, arms length transaction with a commercial financier'.[50] The clients had no 'real appreciation of the true risks of SCDOS [Synthetic Collateralized Debt Obligations] or the financial wisdom of its [i.e. Grange's] recommendation'.[51] Rares J is disarmingly forthright as to how and why this could happen:

> The nature and risks of a SCDO are concepts that are beyond the grasp of most people. Indeed, after the benefit of expert reports, concurrent expert evidence and the addresses of counsel, I am not sure that I understand fully how SCDOs work or their risks. Nonetheless, Grange portrayed itself as an expert in these investments. Most certainly, none of the seven Council officers who gave evidence had any expertise in these financial products. And, Grange knew and preyed on that lack of expertise and the trust the Councils placed in its expert advice.[52]

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[47] This approach has come under significant attention both here in Australia and in the United Kingdom, see, for example, Lateline Business, 'ASIC's Medcraft Outlines His Vision,' *Australian Broadcasting Corporation*, 9 June 2011 (in which the chairman of ASIC noted that 'we're focused on with particularly, say, investment bankers, the investment banks, we're really focused on them as product manufacturers. And in fact, when we undertake surveillance on the investment banks, we really focus on their new product approval procedures in terms of how they're bringing a product to market to make sure that they are focused on making sure that the products they're actually bringing to market are not inappropriate.' http://www.abc.net.au/lateline/business/items/201106/s3240343.htm. In the United Kingdom the Financial Services Authority (FSA) initially privileged a similar approach, see Hector Sants, 'Annual Lubbock Lecture in Management Studies,' (Speech delivered at the Said Business School, University of Oxford, 12 March 2010) in which he noted the need for early intervention rather than relying on disclosure: 'My personal view is that if we really do wish to learn lessons from the past, we need to change not just the regulatory rules and supervisory approach, but also the culture and attitudes of both society as a whole, and the management of major financial firms. This will not be easy. A cultural trend can be very widespread and resilient – as has been seen by a return to a 'business as usual' mentality. Nevertheless, no culture is inevitable. But changing it is a task that cannot be achieved by policymakers alone - we need to collectively address these issues. From the regulators' perspective it is probably the case that seeking to set ourselves up as a judge of ethics and culture would not be feasible or acceptable. More realistic would be to relate the consequences of culture to regulatory outcomes. However, developing this line of thinking requires much further debate, which I would welcome.' Unfortunately the debate did not continue until relatively recently, see Clive Adamson, 'Journey Towards a Conduct Regulator' (Speech delivered at Westminster Forum, London, 5 March 2013; Spelling out these themes Mr Adamson noted that 'firms have designed, manufactured and sold products not always with the needs and interests of their customers in mind but instead, seeing the customer as somebody to maximise profit from. This has been accentuated by a view, and it has to be said encouraged by the FSA, that disclosure at the point of sale absolves the seller from a real responsibly of ensuring that the product or service represents a good outcome for the customer. This, in turn, has led in many cases to a tick-box and overly legalistic compliance culture within firms, encouraged by what has been seen as a tick-box regulatory approach….Where we believe cultural measures exposure the firm to a high level of risk in the context of our objectives, we will expect the firm to take account of it.' See also Chris Adamson, 'Regulation and Professionalism: The Importance of Culture in Driving Behaviours of Firms and How the FCA Will Assess This' (Speech delivered at UK Professionalism Conference, London, 19 April 2013).

[48] *Wingecarribee Shire Council v Lehman Brothers Australia (in liq)* [2012] FCA 1028 at Para. 752.

[49] Ibid, 895.

[50] Ibid, 264.

[51] Ibid, 265.

[52] Ibid, 410.

The 445-page judgment highlights again and again how Grange actively circumvented the stated objection of its clients to investing in illiquid instruments through a combination of deception and obfuscation. This is made manifest in the evaluation of specific dealings with Wingecarribee Council, a rural shire in New South Wales. 'Grange tested the water' and when the official 'bit' he was 'reeled in' by 'words of comfort'.[53] According to the Court, the council believed that it 'had the best of both worlds: principal protection and increased interest. For Grange, this manner of allaying risk averse, financially unsophisticated council officers' fears of CDOs, was as easy as shooting fish in a barrel.'[54]

There can be no doubting the level of judicial disquiet at corporate interpretation of the bifurcation between sophisticated and unsophisticated investors 'given the subject matter involved, the prudent investment of public money'.[55] The severity of the misconduct and the robustness of the judgment calls into question the sufficiency of a range of options currently canvassed by the Australian Department of Treasury on how complex financial products are systematically sold to mid-market participants (i.e. those that were deemed sophisticated or professional in legal terms but were, arguably, nothing of the sort).[56] The unresolved policy question focuses on whether the conduct complained of in relation to Grange derived solely from a suboptimal culture within an individual firm. Although a significant actor in the Australian marketplace, Grange was not the sole facilitator of the placing of complex instruments in investor portfolios, a process that appeared not to raise any concerns with the audit profession. In this crucial respect the judgment in *Wingecarribee Shire Council v Lehman Brothers Australia* raises more questions than it answers.

The ability to contract out of investor protection mechanisms is central to the rationale behind the bifurcation between sophisticated (i.e. wholesale or professional) and unsophisticated (i.e. retail) investors. In many developed markets much greater disclosure is required when products or financial advice are offered to retail clients.[57] Traditionally, the restraints on the retail side are designed to protect the naïve and the unwary from unscrupulous action by those with asymmetrical advantage. Sophisticated or professional investors, by contrast, have traditionally been assumed to have the resources to make informed decisions.[58] Given the propensity for pension funds to

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[53] Ibid, 662.
[54] Ibid.
[55] Ibid, 790.
[56] See Department of Treasury, *Wholesale and Retail Clients: The Future of Financial Advice* (Commonwealth of Australia, Canberra, January 2011), 8-10.
[57] See Dimity Kingsford Smith, 'Regulating Investment Risk: Individuals and the Global Financial Crisis' (2009) 32 *UNSW Law Journal* 514 (questioning whether retail investors have the capacity or capability to evaluate risk and calling for a recalibration 'between market efficiency and market protection': at 515); see also Joanna Grey and Jenny Hamilton, *Implementing Financial Regulation* (John Wiley & Sons, 2006), 224 (noting that increased participation by retail investors, through self-investment and through defined contribution superannuation schemes leave unanswered questions of responsibility).
[58] See *Securities and Exchange Commission v Capital Gains Research Bureau* 375 US 180 (Goldberg J) (1963) ('A fundamental purpose common to these statues, was to substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry': at 186). This necessitates, however, balancing valid and spurious claims, see Justin O'Brien, *Redesigning Financial Regulation: The Politics of Enforcement* (John Wiley & Sons, 2007), 66-67 (citing Judge Milton Pollack's argument that the federal securities laws are not meant 'to underwrite, subsidize and encourage…rash speculation in joining a free-wheeling casino that lured thousands obsessed with the fantasy of Olympian riches but which delivered such riches to only a scant handful of lucky winners'). Increasingly, however, there are suggestions that the SEC should be given the power to ban either specific products or limit access to them, see Saule Omarova, 'From Reaction to Prevention: Product Approval as a Model of Derivatives Regulation (2013) 3 *Harvard Business Law Review* 98; 'License to Deal: Mandatory

include a proportion of alternative assets within their portfolios, it is essential that asset managers given authority to invest mandatory defined contributions understand the risk. While Australia has an exceptionally permissive market and the extent of compulsory superannuation further blurs the dividing line between investor classes,[59] it does differentiate between levels of mandatory disclosure on the basis of financial literacy, measured in crude financial terms, which have now been rendered questionable by the Federal Court. This suggests that much greater emphasis needs to be placed on articulating and delineating more precisely where responsibility and accountability lies in financial product design.[60]

It is in this context that the lawyer, in particular, has the capacity to play an important role. If the lawyer's obligation is to the institution rather than the individual executive involved in the design and authorization of a specific project, there is a necessity to take into account the broader risk externalities and report, where necessary those risks to the board of directors.[61] As with the litany of scandals in the United States, no evidence was provided in the Lehman case here in Australia that this was done. This emphasis on the transactional over the relational has done much to undermine public confidence.

This normative point was underscored by the chairman of ASIC, Greg Medcraft, in a March 2013 speech in Sydney to mark Australia's tenure stewarding the agenda of the International Organization of Securities Commissions (IOSCO).[62] It is now incoherent from a legal perspective to limit the demand for greater integrity to one component of the marketplace. Can we seriously suggest that *product A, when offered to customer B is ethical, unethical when offered to customer C but that entity D, if offering both simultaneously, has a cohesive integrated operating framework and a warranted (as opposed to stated) reputation for integrity*? As with pregnancy, it is impossible to be semi-ethical. Removing the distinction and reliance on disclosure alone is not, however, going to change practice unless cultural change is also effected, a point recently underscored by ASIC itself.[63] Such

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Approval of Complex Financial Products' (2012) 90 *Washington University Law Review* 63. For comparative review of how this is achieved with pharmaceutical products, see Daniel Carpenter, *Reputation and Power: Organizational Image and Pharmaceutical Regulation at the FDA* (Princeton University Press, 2010). For theoretical and practical opposition within the highest echelons of the Australian regulatory regime to this course of action, see Belinda Gibson, 'Opening Remarks at Australian Regulatory Summit' (Speech delivered at Thomson Reuters Regulatory Summit, Sydney 1 May 2013), noting a personal preference not to impose bans on retail access to complex products, citing concern that it would lead to imposition of 'a nanny state'. This mindset also underpins the thinking of the Goldman Sachs Business Standards Committee, above n13 and accompanying text.

[59] Kingsford Smith, above n57, at 519.

[60] The debate is as important in the United Kingdom as here in Australia, see references above n45.

[61] See Schwarz, above n20 at 225.

[62] Greg Medcraft, 'Opening Address' (Speech delivered at the ASIC Annual Forum, Sydney, 25 March 2013), 5 (in which the ASIC chairman noted: 'My position on this is clear – those selling complex products to unsuspecting investors need to wise up and do the right thing. They might get away with it for a while, but government and courts will inevitably rule in favour of investors.'); for updated legislative framework in Australia, which imposes a specific duty to put the interests of retails act first see Corporations Act (2001) s 961J (as amended by the *Corporations Amendment (Further Future of Financial Advice Measures) Act* (2012). Crucially, however, this applies only to products offered to retail investors. Notwithstanding the Rare J judgment, the Corporations Act still contains a bifurcation between investor classes as we await the outcome of Treasury consultation process, see above n51. In the United Kingdom a much broader conception of responsibility is now mooted, see Adamson, above n42 ('we view culture through the lens of what matters to us as a conduct regulator. This means an effective culture is one that supports a business model and business practices that have at their core, the fair treatment of customers and behaviours that do not harm market integrity').

[63] See Greg Medcraft, 'Fresh Thinking Needed to Tackle Hi-Tech Challenges,' *The Australian*, 9 October 2012, 28; see also Belinda Gibson, 'Response to Judge Jed Rakoff,' (Speech delivered at Roundtable on

emasculated conceptions of responsibility have not, however, been solely the preserve of the transactional lawyer. Similar lack of judgment has also informed the operation of the audit.

Deterioration in Audit Quality

On 4 December 2012 the Australian Securities and Investments Commission released a review of audit performance that raised distinctly uncomfortable questions for the profession. The ASIC Chairman described the results, which showed an increase in failure to provide reasonable assurance that financial reports were not materially misstated from 14% to 18% over an eighteen month period, as 'disappointing.'[64] This was mild compared to oral evidence the previous day at the Joint Parliamentary Committee investigating the governance and operation of ASIC. Then he was characteristically blunt: 'I consider what we are seeing now as [a] second strike for the audit sector and it is clearly one I think the profession should consider itself on notice: it needs to lift its game.'[65] While it is very much open to question whether the severity of the criticism was designed to offset broader criticism of the agency before parliament, there was no doubting its effectiveness.

The ASIC review found three critical areas that highlighted dissonance between public expectations and actual practice: the sufficiency and appropriateness of the evidence on which judgment was exercised; the level, or more accurately the lack of, professional skepticism; and, concomitantly, the unwarranted reliance on the work of others, in particular in the compliance programs of managed investment schemes[66] The evidence produced in the report is somewhat alarming. It is rendered more so because the deficiencies correspond to what the regulator sees as a global trend.[67] For ASIC the importance of the evaluation lies not in whether the results were, in fact, misleading. The concern is more fundamental. Has the profession even the competence to gather the evidence on which to make a considered judgment?[68] ASIC believes not. Crucially the lack of sufficient control occurred across the spectrum of audit firms. Size is not a

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Regulatory Enforcement and the Judiciary, Allens-Linklaters, Sydney 15 May 2013) in which the outgoing Deputy Chairman of ASIC criticized a decline in commitment to societal values among corporate lawyers. She suggested however that these ethical considerations are not, however, primarily a matter for market conduct regulators to resolve.) <http://clmr.unsw.edu.au/resource/accountability/berle-v/video-version-judge-jed-rakoff-address-and-roundtable>. In the absence of federal oversight, this leaves unanswered the extent to which ASIC has indicated potential ethical breaches to state-based Offices of the Legal Services Commissioner. Absent the exchange of information between regulators, Legal Services Commissioners are operating at a distinct asymmetrical disadvantage. In New South Wales, for example, the OLSC is mandated to resolve disputes and investigate complaints but in the absence of notification or determination by the Law Society (representing solicitors) or the NSW Bar Association it lacks the intelligence on which to act, see Mark and Gordon, above n39. The absence of proof does not, however, mean that there is not a problem, see Kershaw and Moorhead, above n5 (discussing the issues raised by the provision of legal advice by Linklaters to Lehman Brothers, which allowed it to misstate financial health in the months prior to its collapse. Critically the authors do not assign blame to Linklaters, citing incomplete evidence: at 27).

[64] See ASIC, 'Audit Inspection Findings for 2011-2012' (Press Release, Sydney, 4 December 2012).

[65] Oral evidence to the Parliamentary Joint Committee on Corporations and Financial Services, 3 December 2012 cited in *Statutory Oversight of the Australian Securities and Investments Commission*, above n23, 9.

[66] Australian Securities and Investments Commission, *Audit Inspection Program Report for 2011-2012* (ASIC, Report 137, 4 December 2012), http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rep317-published-4-December-2012.pdf/$file/rep317-published-4-December-2012.pdf.

[67] Ibid, 5.

[68] Ibid, 5.

precondition of quality.[69]

The review process generated what ASIC termed 'a high level of concerns about the sufficiency and appropriateness of evidence obtained by auditors to support their conclusions on significant areas of the audit.'[70] These included basic criteria such as external evaluation of impairment testing and fair value measurement and assessment of the capacity of the audited entity to establish its viability as a going concern. Unquestioning use of data when deploying substantive analytical procedures as well as the failure to ascertain directly from executives the material risk of fraud compromised audit quality. The unquestioning use of data was most pronounced in the audit of financial institutions, arguably the most systemically important in a domestic, regional and global context.[71] The specific findings for financial institutions are worth detailing.

> (a) insufficient and inappropriate audit evidence obtained to support the valuation of significant financial assets, such as trading derivatives, trading securities and available-for-sale securities. In particular, we found instances where the auditor's substantive procedures were inadequate and the auditor placed inappropriate reliance on controls and external confirmations to validate the valuation assertion;
> (b) insufficient testing to assess the adequacy of provisions for loan losses. In designing a disaggregated substantive analytical procedure, one auditor used an aggregated threshold for testing, and did not clearly identify a threshold for investigating differences or sufficiently corroborate variations identified; and
> (c) insufficient testing of the reported net interest margin, including the inappropriate application of substantive analytical procedures or reliance on the audited entity's controls without detailed substantive testing where the balance was material.[72]

Each area identified is critical to professional standing, expertise and judgment. The deliberate flagging to the market of such fundamental flaws in the audit process is significant. ASIC accepts that 'leaders remain committed to an appropriate "tone at the top" that emphasizes the importance of audit independence.'[73] It simply finds that reliance on such pronouncements alone as a guarantee of probity implausible. This is not surprising. The material failures are substantive. They include contravention of the mandatory auditor rotation requirements of the Corporations Act. Just as significantly, ASIC reports an unidentified instance in which the senior audit partner of a large audit practice was rotated out of sequence because of a direct challenge to the client's usage of a particular accounting treatment.[74] It is far from a ringing endorsement of expertise and judgment, the cornerstone of audit profession, that ASIC feels obliged to spell out what constitutes professional scepticism:

> Professional scepticism must be maintained and exercised throughout the planning and performance of an audit. Engagement partners and staff should have questioning minds, obtain a full understanding of all relevant facts, not be over reliant on management's explanations and representations, and not just seek to obtain audit evidence that corroborates rather than challenges management's judgment. Partners and staff must have a sound knowledge of the accounting standards and framework to conduct an effective audit. When considering accounting treatments, partners and staff should consider the substance of arrangements, alternative views and the principles and intent of accounting standards in

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[69] Ibid, 6 (noting a 3 per cent increase in both larger firms (13 per cent v 10 percent in previous audit quality review) and other national and network firms (21 per cent v 18 per cent).
[70] Ibid, 9.
[71] Ibid, 11.
[72] Ibid, 14.
[73] Ibid, 17.
[74] Ibid, 18 (Further noting its belief that 'more extensive and complete consultations, outlining all relevant circumstances, should have taken place within the firm in question and with those charged with governance of the clients. The assessment of threats and safeguards to independence should have been more thoroughly considered and documented by the firm.').

making their judgments.[75]

Not surprisingly, the content and tone of the report prompted an ongoing public relations battle, waged both through the parliament and subsequently the media. The industry referred back to a 2010 Treasury strategy paper that commented on the robustness of the audit framework in Australia. It repeated a defence from that period that there remains as yet, no unified definition of what constitutes audit quality.[76] The head of the CPA, Alex Malley, in particular, condemned what he termed a persistent 'propensity [on the part of ASIC] to make statements in a range of public forums that are sensationalised and driven by a media grab mentality rather than seeking constructive outcomes and working collaboratively with the profession.'[77] Rather than awaiting the outcome of the parliamentary inquiry, Mr Malley then repeated his concerns to *The Australian*. In so doing he engaged in exactly the same kind of megaphone diplomacy he accused the regulator of.[78]

If the approach was to influence the final findings of the Joint Committee, he was to be mistaken. In adjudicating on this debate, the Committee did little more than note but then disregard industry concern, largely and ironically enough, on the basis of scepticism.[79] Critical in this regard is the overarching conclusion of the investigation: 'The committee acknowledges the evidence provided by industry and professional bodies

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[75] Ibid, 21.

[76] See for example, Joint Accounting Bodies Submission to the Treasury Strategic Review on Audit Quality, 7 May 2010 (representing CPA Australia, Institute of Public Accountants and National Institute of Accountants),http://www.charteredaccountants.com.au/Industry-Topics/Audit-and-assurance/Exposure-drafts-and-submissions/Submissions/Government/14-05-10-Joint-Submission-Treasury-Audit-Quality-in-Australia.aspx. Although the Treasury review found no systemic problem in the Australian context, a recent parliamentary investigation, endorsed ASIC's combative approach, see *Statutory Oversight of the Australian Securities and Investments Commission*, above n23, 22.

[77] Letter to the Committee Secretary of Parliamentary Joint Committee, 20 March 2013, cited in *Statutory Oversight of the Australian Securities and Investments Commission*, above n32, 13.

[78] Alex Malley, 'Watchdog Out of touch with Investors,' *The Australian*, 17 April 2013, http://www.theaustralian.com.au/business/opinion/watchdog-out-of-touch-with-investors-needs/story-e6frg9if-1226622014203 ('The Australian Securities & Investments Commission seems firmly attached to an insular, blame-shifting approach -- scrambling for headlines to cast doubt anywhere but home. A constant growling indignation that gives Australians the impression of activity and action, the feeling that they're covered, while real issues may be missed. ASIC's audit inspection program should provide real value as a catalyst for constructive work and constant improvement. Yet the regulator's sensationalised communication since the release of its most recent report has badly distracted from this, and taken its findings out of context.'); for response see John Price, 'ASIC Spell it Out in Audit Quality Report,' *The Australian*, 23 April 2013, http://www.theaustralian.com.au/business/opinion/asic-spells-it-out-in-audit-quality-report/story-e6frg9if-1226626209323 (Price, an ASIC Commissioner makes no apology for using the media to telegraph its message: 'We need the firms to work with us to improve audit quality. We need to get the message through, so sometimes that leaves little room for polite nuance or weasel words. If there were another collapse where audit quality was poor, questions naturally would be asked about what the audit partner, the firm, the profession and ASIC were doing to tackle these problems. One needs only to look back a little more than a decade to the collapse of Arthur Andersen to recall the potential problems an audit failure can have for the profession, the broader market and investor confidence.').

[79] *Statutory Oversight of the Australian Securities and Investments Commission*, above n23, 14 ('The committee is reassured, at least to some degree, that there is a commitment to improving the audit process among the key stakeholders. However, it draws attention to high profile cases, such as Trio Capital and Banksia Securities, where auditors failed to undertake an adequate inspection of financial statements. To the committee's mind, there remains a need for ASIC to continue to carefully scrutinise the quality of auditing in Australia and the framework and standards within which the audit profession operates.' The Committee goes on to offer a ringing endorsement of ASIC's approach. 'The committee shares ASIC's concern about audit quality in Australia and is pleased that ASIC has a policy of constructive engagement with the audit firms and professional bodies. The committee looks forward to an update from ASIC on how it has worked with the large audit firms on their action plans to improve audit quality and whether there has been constructive engagement with all the relevant firms:' at 22).

about what an audit actually encompasses, but it remains concerned about the gap that exists between what the public expects and what the public gets with regard to an audit.'[80]

The unexpected decision by the Professional Standards Councils to revoke the limited liability of the Institute of Chartered Accountants Australia (ICAA) has brought into sharp relief ongoing concern about the behavior of the accounting profession. The decision is a major blow to the chartered accountants and, by extension, the other associations representing the profession. As late as February this year the ICAA was highlighting the fact that 'it is in the enviable position of being the first professional body in Australia to have schemes approved in all states (aside from Tasmania). This is an acknowledgement of our commitment to addressing the concern of our members and to the public policy principles underlying the liability capping mechanism in this country.'[81] It is now the first to have lost the protection. This raises the inevitable question: what went wrong and on what basis could the PSC have made such a momentous decision? In part it is a question of timing. The PSC operates its licensing arrangement on a five-year basis, with the possibility of one-year extensions. Put simply, the framework governing the accountancy profession is now up for complete review. Secondly, that review is conducted by the PSC, which has the power not to recommend the renewal or approval of a scheme if it believes it deficient.[82] The question for the PSC is whether the ICAA has accounted for the deleterious decline in audit standards and quality identified by ASIC and endorsed by the Joint Parliamentary Committee. The PSC, to its credit, believes not.

In an update to its members on 21 June 2013, ICAA noted that the revocation is the result of the PSC raising 'a broad range of new issues relating to the fundamental structure and design of the current schemes which the Institute has worked hard to resolve in a timely manner. Ultimately, however, the PSC decided that they do not believe it is appropriate to approve the adoption of new capping schemes in line with the existing framework.'[83] As of 30 June in the ACT and then on a rolling basis the cap on professional liability will be revoked across all states and territories. With remarkable understatement the ICAA advises that 'members may wish to consider their risk profile in relation to the structure of their existing professional indemnity insurance levels.'

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[80] Ibid, 23. The audit community has responded to the 'nudging' of ASIC by setting up action plans to improve the quality of audit, see ASIC, 'ASIC Welcomes Audit Firm Plans to Improve Quality' (Press Release, Sydney, 13 June 2013). ASIC notes that the 'firms responded to encouragement from ASIC for the action plans to particularly focus on: the culture of the firm, including messages from firm leadership focusing on audit quality and consultation on complex audit issues' and that the plans should be regarded as 'living documents.'

[81] Institute of Chartered Accountants Australia Website, 'The Institute's Role,' 14 February 2013, http://www.charteredaccountants.com.au/Industry-Topics/Practice-management/Professional-indemnity-insurance/The-Institute-Role. Its counterpart, CPA Australia is more fulsome in its praise for the scheme. It notes that 'an Occupational Scheme, such as the CPA Australia Scheme, is only approved following rigorous, independent assessment of risk management strategies,' see 'You Can Trust a CPA Practitioner,' CPA Australia, February 2008, http://www.cpaaustralia.com.au/cps/rde/xbcr/cpa-site/You-can-trust-a-CPA.pdf.

[82] The criteria are set out in the enabling state legislation, see, for example, *Professional Standards Act 1994* (NSW), which mandates the PSC to take into account the nature and level of claims (s10 (1) (c)); the risk management strategies of the association concerned (s10 (1) (d)) and the means by which these strategies are to be implemented (s10 (1) (e). The mechanism is further informed by regulatory guidelines, see http://www.psc.gov.au/agdbasev7wr/psc/documents/pdf/application_guidelines_2010.pdf.

[83] Institute of Chartered Accountants Australia, 'Schemes Limiting Liability of Members, 21 June 2013, http://www.charteredaccountants.com.au/Industry-Topics/Practice-management/Limitation-of-liability-schemes/Schemes-limiting-liability-of-members.aspx.

The ICAA proposes maintaining the current limits for the professional liability of individual participants involved in the audit process to ten times the fee for professional services up to a maximum of $75m. Caps in relation to liquidations, receivership and bankruptcy are also proposed to stay below the $20m threshold. At the same time it mandates insurance cover to that level.[84] As such it reflects no change to the current regime. The renewal also requires adherence to codes of conduct, 40 hours of continuous professional development per annum. Holders of a Certificate of Public Practice have a requirement that 40 per cent of this should be related to a specific area of practice. Again there is no proposed change in current practice. The only new dimension is the fact that the provision of audit to the self-managed superfund sector requires additional training (although the ICAA submits in its application that this has been in place since 2008).

The documents provided by the ICAA to the PSC highlight the implementation of a new five-year risk management system. It links the setting of benchmarks for 'the highest ethical and educational standards for accountants' on admission and an ongoing basis to multi-media dissemination of best-practice conduct; commits to ongoing dialogue with government and regulators; and to the development of dispute resolution services. This is more granular than the 2008-2013 framework, which had committed the ICAA 'to preserve at all times the professional independence of accountants in whatever capacity they may be serving' and 'to advance the profession of accountancy' through the provision of high quality training in the theory and practice of the discipline.[85]

The new framework proposes monitoring 'member adherence to their legal/professional/ethical and practice obligations through the Training & Development audit, Quality Control Reviews, Professional Conduct and PSC Compliance programs.'[86] It does not, however, specify the consequences of breach, unlike the prior framework, which promised to 'prescribe disciplinary procedures and sanction, to exercise disciplinary powers and to impose sanctions for the better observance of the standards of practice and professional conduct of the Institute by members, non-member practice entities and candidates.'[87] In the context of a marked rise in claims against auditors, the ICAA commits to the establishment of 'processes to monitor and review liability claims with the objective of identifying those areas where further attention is required to reduce the frequency and value of claims.'[88] This too represents a partial advance on the 2008-2013 framework but appears to the PSC to be too little too late. There has been no formal announcement from the PSC on whether the revocation applies to all accounting professional bodies or to what extent its review will apply to all occupation groupings covered by the scheme. What is clear, however, is that the ICAA announcement, albeit coded, signals a seismic shift in the self-regulatory architecture.

IV CODES OF CONDUCT: DESIGN, EFFICACY AND EVALUATION

Any successful proposal to extend responsibility and accountability to those involved in product design rather than clarifying the enabling conditions governing marketing and

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[84] Institute of Chartered Accountants Proposed Professional Standards Scheme Summary Document, Scheme Documents lodged at Professional Standards Council (NSW), 21 February 2013, http://www.psc.gov.au/agdbasev7wr/psc/documents/pdf/scheme_icaa_summary_2013.pdf

[85] ICA Summary of Scheme 2008-2013, Professional Standards Council, http://www.psc.gov.au/agdbasev7wr/psc/documents/pdf/scheme_icaa_act_summary_20082013.pdf

[86] Ibid, 3.

[87] Ibid, 3.

[88] Ibid, 4.

sale would, however, constitute a major shift in the structure of the financial services industry. The integration of more interventionist normative objectives with enabling ones may also significantly change the ethical boundaries of global finance. What consitutes or should constitute optimal cultural traits necessitates extending beyond *efficiency* criteria (i.e. lower transaction costs). Three additional distinct but overlapping subjective normative dimensions must be applied. First, *permissibility* (i.e. whether a particular product can be sold and if so to whom and on what basis); second, *responsibility* (i.e. who carries the risk if the investment sours and on what terms); and third, *legitimacy* (i.e. does the product serve a legitimate purpose). This, in turn, suggests the need for the dynamic integration of rules, principles and social norms within an interlocking responsive framework. As John Kay has persuasively argued, sustainable reform must be predicated on capability to 'restore relationships of trust and confidence in the investment chain, underpinned by the application of fiduciary standards of care by all those who manage or advise on the investments of others.'[89]

The Kay formulation builds on an insight first advanced in 2009 by the then managing director of the United Kingdom Financial Services Authority, Hector Sants. Sants had famously complained that it was impossible for principles-based regulation to work when those charged with informal authority to maintain the integrity of the system had no principles.[90] This was not simply a particularly memorable aside. It reflected cognizance of the importance of what Oliver Williamson has termed the 'non-calculative social contract'.[91] Sustainable reform must also be consistent with principles of good regulation. It must be proportionate, consistent in application, transparent and targeted. The danger is that an ill thought-out structure will exacerbate rather than resolve conflicts within the industry.[92] It risks creating another layer of formal restraint that does little to change either corporate practice or facilitate voluntary progression towards higher ethical standards. It is also clear, however, that the construction of accountability mechanisms cannot rely on self-certification alone.

Past inefficiencies can be–and often are–redressed by the passage of further ostensibly more stringent rules or more detailed articulation of overarching principles. This dynamic is particularly apparent in corporate governance and financial regulation reform, where these initiatives are often presented as evidence of increased

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[89] See John Kay, *The Kay Review of Equity Markets* (HM Government, London, July 2012), 9. According to Professor Kay, this necessitates a move away from short-termism, as 'trust and confidence are the product of long-term commercial and personal relationships: trust and confidence are not generally created by trading between anonymous agents attempting to make short term gains at each other's expense': at 5, http://bis.gov.uk/assets/biscore/business-law/docs/k/12-917-kay-review-of-equity-markets-final-report.pdf.

[90] Hector Sants, 'Delivering Intensive Supervision and Credible Deterrence' (Speech delivered at the Reuters Newsmaker Event, London, 12 March 2009), 2 ('The limitation of a pure principles-based regime have to be recognized. I continue to believe the majority of market participants are decent people; however a principles-based approach does not work with people who have no principles.').

[91] Oliver Williamson, 'The New Institutional Economics: Taking Stock, Looking Ahead' (2000) 38 *Journal of Economic Literature* 595 at 597. Williamson notes that analysis of this 'level one' component of social theory is conspicuous by its absence with regulatory studies. The other three levels comprise institutional arrangements viewed primarily through property rights and positive political theory, governance mechanisms through transaction cost economics and resource allocation frameworks generally examined through agency theory.

[92] Critically, it must also be based on a re-conceptualization of the regulatory architecture, see Kay, above n89 ('Bad policy and bad decisions often have their origins in bad ideas…Regulatory philosophy influenced by the efficient market hypothesis has placed undue reliance on information disclosure as a response to divergences in knowledge and incentives across the equity investment chain. This approach has led to the provision of large quantities of data, much of which is of little value to users': at 10).

accountability.[93] More often than not, however, these same initiatives tend to privilege the politics of symbolism.[94] This is no longer sustainable.[95]

The policy question is how to render an alternative framework operational in a systematic, dynamic and responsive way. To be successful, it needs to balance specific economic efficiency (i.e. benefits to business) and professional rights to self-governance with explicit requirements that society should not be held responsible (or liable) for the failures of the former.[96] At corporate, professional and regulatory levels the framework needs to be mutually reinforcing. It needs to be capable of evaluating the calculative, social and normative reasons for behaving in a more (or less) ethically responsible manner.[97] It also requires reciprocal obligation from each institutional actor to maintaining (and certainly not contributing through omission or commission to the erosion of) the integrity of the governance arrangements. These must articulate common understandings of what constitutes the ethical problem. Moreover, it must generate a framework in which disputes over interpretation can and should be resolved in a manner that is proportionate, targeted, and, ultimately, conducive to the building of warranted trust in the operation of the financial sector. As John Kay has astutely noted, 'the most powerful mechanism for establishing a culture of trust and respect is for intermediaries and market participants to impose it on each other. Conversely, the contagious effect of failure to observe these standards at any point in the investment chain undermines them at every point in the market chain'.[98] It is in this context that the professions play a pivotal role.

What is also apparent, however, is that those rules and procedures cannot be vouchsafed by allowing the communities of practice themselves to set what constitutes best-practice and monitor effectiveness; a point critical in Adam Smith's (lost) essential

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93 For application to the politics of corporate governance, see Peter Gourevitch and James Shinn, *Political Power and Corporate Control* (Princeton University Press, 2005) 57-94.

94 See Murray Edelman, 'Symbols and Political Quiescence' (1960) 54 *American Political Science Review* 695.

95 See Lawrence Seabrooke, 'The Everyday Social Sources of Economic Crises: From "Great Frustrations" to "Great Revelations" in Interwar Britain' (2007) 51 *International Studies Quarterly* 795 (noting that 'ongoing processes of legitimation as two-way relationships between claims made by those who seek to govern by the rightfulness and fairness of their actions, and the conferral or rejection of such claims by those being governed': at 796); for most recent (and failed) attempt to suggest common cause between regulator and regulated, see Mary Shapiro, 'Address to the Practising Law Institute' (Speech delivered at PLI Securities Regulation Seminar, New York, 4 November 2009): 'We might sit on opposite sides of the table in any given matter, but I believe that all of us — regulators, attorneys, and business people alike — all share the common goal of ensuring that our capital markets work — and work fairly and effectively.' For ongoing rationale of scepticism and the negative consequences, see Volcker, above n27; for reflection of religious leaders, see above n24-26 and accompanying text.

96 For application to business as an intangible asset, see Joseph Petrick and John Quinn, 'The Challenge of Leadership Accountability for Integrity Capacity as a Strategic Asset' (2001) 34 *Journal of Business Ethics* 331; for original formulation of the model, see Joseph Petrick and John Quinn, 'The Integrity Capacity Construct and Moral Progress in Business' (2000) 23 *Journal of Business Ethics* 3.

97 Soren Winter and Peter May, 'Motivation for Compliance with Environmental Regulations' (2001) 20 *Journal of Policy Analysis and Management* 675; see more generally Ian Ayres and John Braithwaite, *Responsive Regulation* (Oxford University Press, 1992); for study suggesting the power of outsiders to frame the emphasis on effective internal controls only if there is a perception within the company that performance is being monitored, see Christine Parker and Vibeke Nielsen, 'To What Extent Do Third Parties Influence Business Behaviour' (2008) 35 *Journal of Law and Society* 309 (reporting survey evidence from 999 large Australian companies); for broader theoretical issues, see Melvin Dubnick and Justin O'Brien, 'Retrieving the Meaning of Accountability in Capital Market Regulation' in M. Dubnick and G. Fredrickson, *Accountable Governance* (ME Sharpe, 2011), 282-301.

98 Kay, above n89, 47.

reasoning.[99] It also informs the demands by figures as disparate as Pope Francis and Paul Volcker for a reimagined conception of responsibility.

The failure of professional obligation in established professions should, in this context, provide a warning that zealously protecting the interests of the client can turn into ideational zealotry. Much more holistic assessment of the efficacy of existing trust boundaries is required as is evaluation of how codes of practice police deviance from agreed institutional commitments and reinforce stated adherence to integrity. In the aftermath of the GFC public trust in technical expertise is understandably unforthcoming. What is, therefore, required for regulator and regulated alike is an articulation of a renewed non-calculative social contract capable of embedding ethical restraint.[100] As the leading British philosopher Derek Parfit has pointed out, it is essential to integrate utilitarian and categorical imperatives: 'An act is wrong just when such acts are disallowed by the principles that are optimific, uniquely universally willable, and not reasonably rejectable.'[101] Paradoxically it is this very imperative that underpinned the initial (but lost) normative basis of the disclosure paradigm. As one of its key architects, Baldwin Bane, pointed out eighty years ago the disclosure paradigm was:

> informed by a moral idea, a realization that our ills have been due also to the weakening of our moral fibre, leading to easy temporizing with traditional and tried standards of right and wrong The only act that is founded upon a moral background, that has been passed in the past twenty years, is the Securities Act. The permeating character of such forces was slow to be comprehended, but with its discovery came a grim determination to restore to a numbed national conscience some semblance of sensitivity. It was of a spirit such as this that the Securities Act was born, free of vindictiveness that might easily have been attached to it, reasonable in its demands and built upon tried experience in their formulation. It would be idle to pretend that it does not ask something of the security world, but it also promises much in return-the opportunity of creating a true and honorable profession by the assumption and adequate discharge of public responsibilities.[102]

What also becomes clear from the recently released archive at Harvard Law School is that across a whole swathe of industries, there was early recognition at the Federal Trade Commission (FTC) that far from weakening power, the early reliance of the Roosevelt Administration on the development of codes of conduct provided industry with an opportunity to retain it, a factor that must be taken into consideration given the fact that the British Banking Association has canvassed the idea of developing a code of conduct underpinned with statutory authority. An example is the promulgation of the Code of Fair Competition for Investment Bankers, which was endorsed on 27 November 1933. It

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[99] Adam Smith, *The Theory of Moral Sentiments* (Penguin, 1759, 2009 edition), 133 (arguing that 'we can never survey our own motives, we can never form any judgment concerning them, unless we remove ourselves, as it were, from our own natural station, and endeavour to view them as at a certain distance from us').

[100] Williamson, above n91; see also Dimity Kingsford Smith, 'A Harder Nut to Crack: Responsive Regulation in the Financial Services Sector' (2011) 44 *University of British Columbia Law Review* 695 at 696 (noting the reputational damage associated with licencing as is 'gives an imprimatur of approval to the operating standards that the firm adopts…When it becomes clear that this is not the case (as with the global financial crisis) the regulator and the regulated lose legitimacy and the investing public loses confidence in the safety and security of the market'); Henry Hu, 'Too Complex to Depict? Innovation, Pure Information and the SEC Disclosure Paradigm' (2012) 90 *Texas Law Review* 1601 ('to remain vital, the SEC disclosure paradigm must be able to encompass in a meaningful and systematic way the vast complexities of modern markets and institutions:' at 1715).

[101] Derek Parfit, *On What Matters* (Oxford University Press, 2007), 25. This approach takes cognizance of the objection by Alaisdair MacIntyre that the 'elevation of the values of the market to a central social place' risks creating the circumstances in which 'the concept of the virtues might suffer at first attrition and then perhaps something near total effacement,' see Alaisdair MacIntyre, *After Virtue* (University of Notre Dame Press, 1994), 196.

[102] Baldwin B. Bane, 'The Securities Act of 1933' (1933) 1 *The Certified Public Accountant* 587, 592 (reprinting an address to the Annual Meeting of the American Society, Milwaukee, Wisconsin, September 19, 1933).

had ensured that power to determine the extent of compliance would remain with the banks themselves. It mandated that the management committee administering the code would contain 21 voting members, 15 appointed by the president of the Investment Banking Association of America, 6 through a 'fair method to represent employers not members of the IBA and a representative appointed without vote by the President of the United States of America.'[103]

James M Landis, by then heavily embroiled in disputes over the operation of the Securities Act, was horrified by the way in which industry was behaving. 'How truly despicable some of their tactics are. I really thought they were essentially decent though somewhat misguided people, but I have my doubts now,' he wrote Frankfurter on 13 December 1933. Those doubts were in part informed by unease about the willingness of industry to engage in meaningful partnership. This unease was captured by an internal report prepared for Landis and the other members of the FTC on the workings of the National Recovery Administration (NRA), which was charged with oversight of the codes.

Assigned to be the chief legal liaison to the NRA, Millard Hudson was flabbergasted by what he termed the 'chaotic conditions' at the agency. 'There is hardly an important form of monopolistic practices which the Federal Trade Commission and the courts have endeavored to prevent in the past, that is not authorized and more or less explicitly provided for in these codes; not of course by individuals, but what is a great deal worse, by the cooperative activities of whole industries. It would be an exaggeration to say that any remonstrances against these things have resulted in any substantial improvement,' he reported on 6 December 1933.[104]

Two weeks later, Hudson provided a more in-depth account of regulatory failure. 'The industries, having got the bit in their teeth, are running amok, and are bent upon destroying the good work accomplished by the Commission in the past and to prevent its doing any more in the future,' he reported on 22 December.[105] Four principal reasons were attributed. No representative of the Commission had power to draw up and enforce a model code. Second, legal representatives were 'practically all young, inexperienced men, many of whom knew nothing whatever about the Commission's work. It was easy for the industries to put things over on them.' Third, 'having given the industries in the early codes practically everything they asked for, it was difficult to refuse those which came later. But the most alarming development is the unwillingness of the Administrator to set up any effective form of control over the administration of the codes. He is leaving it, by his own statement, as far as possible to the boards set up within the industries themselves. This means that matters in which they are interested will receive attention and probably little else will.'[106] The internal report was forwarded to Roosevelt who, in turn, turned over responsibility for evaluation of code operation to the FTC, effectively limiting the power of the NRA long before the Supreme Court deemed it unconstitutional the following year.

The release of the new material suggests that the administration had come to the conclusion that the partnership approach was a failure long before then, although for very different reasons. Critically, notwithstanding this failure, the initial success of the

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[103] Investment Banking Association of America, 'Code of Fair Competition for Investment Bankers,' 1933, Papers of J.M. Landis, Harvard Law School, Box 18-8.
[104] Millard E. Hudson, 'Memorandum for the Commission: Work at the NRA,' December 6, 1933, Papers of J.M. Landis, Harvard Law School, Box 18-8.
[105] Millard E. Hudson, 'Memorandum for the Federal Trade Commission,' December 22, 1933, Papers of J.M. Landis, Harvard Law School, Box 18-8.
[106] Ibid.

New Deal experiment can be traced to the combination of five ideational and political economy factors. First, the policy imperatives of the initial Roosevelt administration (1932–36) advanced the necessity and legitimacy of state intervention. Second, the policy imperatives were predicated on a rebalancing of private rights and public duties, a strategy that was subsequently overwhelmingly endorsed at the ballot box in 1936. Third, initial judicial skepticism that rendered legislative action unconstitutional was overcome by a progressive whittling away of the influential freedom of contract model, the growing institutionalization of judicial restraint and, in part, through an unconsummated but nevertheless real threat in 1937 following Roosevelt's comprehensive electoral victory to 'pack the court' unless the judiciary accepted political will. Fourth, the nascent administrative agencies, in particular the SEC, placed a 'cop on the beat' doing much to restore public confidence. Fifth, however, the initial emphasis was not on direct enforcement but changing industry practice through an associational model of governance. It clearly specified purpose and sought to enroll market actors within a regulatory paradigm that replaced caveat emptor with a disclosure philosophy. At its core was a belief that sustainable reform could only be achieved at an industry-wide level, with the administrative agency operating at one stage removed from the sector it regulated, rather than having a role to secure its survival and growth.

For Landis, 'the art of regulating an industry requires knowledge of the details of its operations [and the] ability to shift requirements as the condition of the industry may dictate.'[107] Landis' early faith in governance by experts had already eroded by the time of the election of John F Kennedy in 1960. In part this derived from what he saw as the failure of the agencies to remain focused on narrow regulatory purpose, a process that intensified because of patronage appointments at the level of the commission and declining commitments to the public service as a career. For Landis, the power of the disclosure model, first set out in the Securities Act (1933) and reinforced by the Securities Exchange Act the following year, was the capacity to set, evolve and frame broader discourse. The aim was not to mandate organizational change as some early commentators—including William O. Douglas—advocated,[108] but to present disclosure as a necessary response to societal obligation. In 1937 Landis told the *New York Times*, somewhat optimistically, that brokers 'are beginning to realize more clearly that their interest is tied up with the public interest. They are beginning more often to subordinate their own interest to the larger interest. People are beginning also to look upon the

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[107] Quoted in Joel Seligman, *The Transformation of Wall Street* (2002), 62.

[108] WO Douglas and G Bates, 'The Federal Securities Act of 1933' (1933) 43 *Yale Law Journal* 171. Douglas viewed the disclosure paradigm as insufficient. What was required, he argued, was a much more substantive reordering of relations between market participants. This essentially corporatist approach, advocated mainly by the Columbia-based members of the original Roosevelt 'brains trust' was always regarded as suspect by Landis and his colleagues at Harvard, most notably Felix Frankfurter. The personal nature of these disputes becomes clear with the release in January 2013 by Harvard Law School of additional personal papers of James M Landis, the driving force behind the creation and management of the Securities and Exchange Commission. The papers include correspondence between Landis and Frankfurter, arguably the most influential academic advisor to the Roosevelt administration. The correspondence reflects a growing frustration by both men towards industry opposition to and academic misunderstanding of the paradigm shift associated with the passage of the Securities Act and its corollary, the Securities Exchange Act (1934). Most notably, this derision is directed towards Douglas himself, whom, it is clear, neither man entirely trusted from the very beginning. On 6 March 1934, Landis noted to Frankfurter that 'Douglas seems to me to lack a tremendous sense of the realities that are involved in this problem and how the relentless drive for profits leads men to do things and then defend them.' On 17 March 1934, Frankfurter replied that 'Douglas is trying to reflect too much the people in the big offices and the business schools, among whom he likes to appear as a sound and knowing fellow.' Frankfurter goes on to comment that Douglas had privately opined to him that 'his public articles against us are a form of high strategy. Well its [sic] too high for my eyes to scale.'

exchanges not so much as private institutions as public utilities.'[109] The real tragedy here is not the misplaced optimism of Landis but the misplaced trust in financial services sector statements that through their disclosures they had recognized their obligations. The banking industry proved incapable of rising to the level of a profession, within the financial services arena professional obligation has weakened, in large part through self-identification with those who are paying for services. The result is a mutual draining of legitimacy and authority, which has now reached crisis proportions for both. An exceptionally critical report by the Parliamentary Banking Standards Commission in the United Kingdom has laid bare the extent of that legitimacy crisis.

V Potemkin Facades and Westminster's Wrecking Ball

The Approved Person regime that lies at the heart of the Wheatley Review on Libor has been dismissed by the United Kingdom Parliamentary Commission on Banking Standards as a mechanism that created 'a largely illusory impression of regulatory control over individuals, while meaningful responsibilities were not in practice attributed to anyone.'[110] The lack of accountability for past failings is seen as critical in bringing the banking sector into disrepute. Incremental change, it concludes in its final report, 'will no longer suffice.'[111] In a damning assessment of prior regulatory design, compliance is dismissed as the key architectural innovation in the building of Potemkin villages that give 'the appearance of effective control and oversight without the reality.'[112] The fact that 'prolonged and blatant misconduct' as evidenced in the Libor and associated scandals occurred without comment, suggest to the Commission a degree of systemic institutional corruption, allied to a 'dismal' and 'striking limitation on the sense of personal responsibility and accountability' of banking leaders.[113] The Commission advocates scrapping the Approved Person framework and introducing instead a Senior Persons Regime. This is designed to assign specific roles to specific individuals. It is proposed to combine this with a licensing regime and replace general principles and codes of conduct with 'a single set of rules to be drawn up by the regulators.'[114] Breach of these formal rules would provide grounds for enforcement action. The Commission maintains that while the existing principles are not

> intrinsically wrong…they do not constitute a sufficiently robust foundation for improving banking standards…The rules should explicitly encapsulate expectations about behavior which are currently absent from the statements of principle for individuals, such as treating customers fairly and managing conflicts of interest and a requirement to draw to the attention of senior management and regulators conduct which falls below the standards set out.[115]

This will, argues the Commission, deal with a critical failure of the current regime, the fact that 'regulators have rarely been able to penetrate the accountability firewall of collective responsibility in firms that prevents actions against individuals.'[116] The approach is also designed to simultaneously provide enforcement action against staff senior enough to satisfy public outrage and broad enough to capture those not currently

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[109] 'Landis Retiring, Reviews SEC Acts,' *New York Times*, 10 September 1937, 1.
[110] Parliamentary Banking Standards Commission, above n5, 9
[111] Parliamentary Banking Standards Commission, *Changing Banking for Good* (HM Parliament, Westminster, June 2013), Vol 2, Para 566.
[112] Ibid, Para 684.
[113] Ibid, Para 105.
[114] Parliamentary Banking Standards Commission, above n5, 9.
[115] Parliamentary Banking Standards Commission, above n111, Para 634.
[116] Parliamentary Banking Standards Commission, above n5, 10.

on the Approved Person register. The introduction of a criminal offence for reckless behaviour adds significant teeth to the proposals. Jail or the prospect of it is, as the Commission acknowledges, a critical deterrent. Whether the regulatory authorities have the stomach for such enforcement strategies is however another matter entirely. But for the fact that the United Kingdom has already gone through a radical redesign of its regulatory architecture, the Commission would advocate creating a specific statutory enforcement agency.[117]

Throughout the report there is evidence of continued suspicion of both banks and their regulators. The emphasis on better governance and the lack of confidence in the ability of boards of directors to recognise their responsibilities is manifest in the suggestion that the Companies Act should be amended 'to prioritise financial safety over shareholder interests in the case of banks.'[118] As the Commission makes clear 'it is essential that the risks posed by having a large financial centre do not mean that taxpayers or the wider economy are held to ransom.'[119] Unless the lessons of history are learnt, however, banks will inevitably fail, hence the need for stringent oversight as 'many banks remain too big and too complex to manage effectively.'[120] By extension, it infers, they are too complex to regulate. In a critical passage, the Commission warns against the myth that the problem in British banking is the result of individual failure or that banking has indeed learnt from its mistakes, thus requiring no further action. Specifically, it rejects any suggestion that robust intervention could threaten the future of the industry. 'If the arguments for complacency and inaction are heeded now, when the crisis in banking standards has been laid bare, they are yet more certain to be heeded when memories have faded. If politicians allow the necessary reforms to fall at one of the first hurdles, then the next crisis in banking standards and culture may come sooner, and be more severe,' it warns.[121] It is this fear that animates the Commission's discussion of professional standards in the industry and whether codes of conduct can have any restraining value.

The Commission is exceptionally cautious about the stated ambition of the banking industry to develop a professional standards body. While seeing potential value, it is exceptionally concerned that this too could become an exercise in regulatory gaming. 'There are also very substantial risks of duplication between the powers and role of a professional standards body and those of regulators as well as risk that the creation of such a body could become a focus of public policy, diverting attention from the changes that are urgently needed within the existing regulatory framework,' it warns.[122] The proposals for a professional body run the additional risk that power is stripped away from regulators at the very point it is most needed. It is a risk that the Commission is not prepared to countenance. 'On the basis of our assessment of the nature of the banking industry, we believe that the creation of an effective professional body is a long way off and may take at least a generation,' it concludes.[123] The reform of British banking remains, therefore a work in progress. The Potemkin facade has been pierced not yet demolished.

Building a sustainable framework necessitates warranted belief in the underpinning rationale. For the process to be effective necessitates commitment in the

[117] Parliamentary Banking Standards Commission, above n111, Para 1200.
[118] Parliamentary Banking Standards Commission, above n5, 11.
[119] Parliamentary Banking Standards Commission, above n111, Para 8.
[120] Ibid, Para 86.
[121] Ibid, Para 273.
[122] Ibid, Para 598.
[123] Ibid, Para 601.

end goal itself rather than a mechanism to forestall external oversight. Critically, there is a need to separate 'purpose' from 'ends.'[124] No practice can lead to the sustainable achievements of desired 'ends' if the 'purpose' for holding the beliefs that animates practice differs in substance from the primary goal. The ultimate end of the physician, for example, is to heal. If, however, the purpose of believing in or seeking to achieve that goal is to make money, for example, risks subverting that end. Unnecessary tests or procedures may be prescribed that increase the financial burden on the patient, insurance company or taxpayer. The patient may not necessarily be harmed; she may in fact be healed. The conduct, however, if replicated across a given market, is undesirable. It can impose additional costs, financial and emotional. It also threatens the corruption of the primary end: the protection of life through the application of the do no harm thesis. The imposition of unnecessary costs clearly violates the individual. It also risks bringing the wider institutional system into disrepute.

This critical distinction between ultimate 'ends' and 'purpose' has deep resonance for participants involved in the governance of financial markets. How this can be addressed is the subject of a companion paper, to be published later this year and sketched out here. At the core of the design is the development of a capability model to measure and evaluate regulatory and meta-regulatory effectiveness. Although designed for application in the capital markets, it has broader application, particularly for the Professional Standards Council itself, given its capacity to provide assurance professional groupings or those aspiring to professional status embed and monitor a public-interest function.

Five key performance criteria are measured and evaluated – Compliance, Ethics, Deterrence, Accountability and Risk (CEDAR). These are then evaluated according to mandate, process and use of discretion. The model differentiates between four levels of performance – world leading (i.e. setting new boundaries of excellence), exceeding sector best-practice, achieving best-practice and lagging global standards. The proposed design involves scoping and applying 30 Key Performance Indicator (KPI) measurements for each dimension (10 against mandate, 10 against process and 10 measuring agency or use of discretion for each component part of the CEDAR matrix giving 150 indicators in total). This integrated approach aligns performance across each dimension to the furtherance of an overarching objective (e.g. demonstrable and verifiable commitment to market integrity). As such it places and evaluates integrity within an overarching framework rather than within the confines of ethics alone. As such it provides diagnostic and evaluative functions.

The indicators within each dimension take into account the operating environment and the dynamics of the regulatory regime.[125] Any assessment of the dynamics of a given regime must take into account the ideational factors.[126] Built into the

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124 Alaisdair MacIntyre, 'Ends and Endings' (Speech delivered at the Catholic University of America, Washington, DC, 25 September 2009); see also David Rose, *The Moral Foundations of Economic Behaviour* (Oxford University Press, 2011), 188 ('There is no escaping the fact that why one holds the required moral tastes matters as much as having the right kind of moral tastes.').

125 Christopher Hood, Henry Rothstein and Robert Baldwin, *The Government of Risk* (Oxford University Press, 2001), 8 (describing a regulatory regime as a 'complex of institutional [physical and social] geography, rules, practice and animating ideas that are associated with the regulation of a particular risk or hazard'); see, more generally, Pierre Bourdieu, *The Logic of Practice* (1990). Bourdieu refers to the importance of mapping the *habitus*–the complex social and physical institutional geography in which communities of practice assimilate and constantly adjust practice.

126 See John Ruggie, 'What Makes the World Hang Together? Neo-Utilitarianism and the Social Constructivist Challenge' (1998) 52 *International Organization* 855 ('The building blocks of international reality are ideational as well as material' at 879); Ricardo Gutierrez, 'When Experts Do Politics: Introducing

design, therefore, is the guidance from the Australian Productivity Commission that *regulator practice and performance must be evaluated against both the structural environment and the processes and practices within that environment.*[127] These factors include 'the number of regulators and scope of the regulation for which each is responsible; extent of independence and policymaking responsibilities; and resources, enforcement tools and discretion with which they are provided.'[128] Comprehensive mapping is, therefore, required to ascertain whether obstacles have structural or managerial roots. In line with the recommendations of the Productivity Commission the model integrates a review of the overarching institutional framework – legislative requirements, regulators powers, oversight arrangements – and the processes and practices the regulators themselves adopt within it.

The CEDAR approach offers an opportunity to build organically from principles of self-regulation and embed them within a much more clearly defined conception of integrity.[129] The emphasis is on how to ascertain the extent to which the stated values of the entity under investigation inform actual practice. This approach produces two additional practical and conceptual advantages in regulatory design. First, by providing an integrated approach it reduces contestation between actors in the regulatory regime over purpose. Second, it provides the conceptual framework to transcend the limitations of narrow cost-benefit analysis, linking effectiveness to five core outcomes: substantive compliance, warranted commitment to ethical standards, effective deterrence, enhanced accountability and reduced financial, regulatory and reputational risk. All of which are means to secure a common end (i.e. socially beneficial outcomes from warranted market integrity). The first step to recovery, however, is acceptance that there is a problem with current frameworks. The evidence provided in this paper should leave little doubt that reform is not only desirable. It is an imperative.

VI CONCLUSION

The enormity of the global financial crisis has demonstrated just how misplaced confidence in market ordering was. As such, it represents a fin de siècle moment. The material and ideational certainties associated with the privileging of financial capitalism have evaporated. The *Wingecarribee Shire Council v Lehman Brothers Australia* decision highlights the sub-optimal effect of a prior retreat to technicalities in dealing with substantive ethical considerations (i.e. the bifurcated protection offered to sophisticated or professional investors and their retail counterparts that remains embedded in the legislative framework). In this regard the granular articulation of what constitutes a duty to put the interests of a retail client first in the Future of Financial Advice reform agenda is a positive step. But it is only a step, an uncertain one at best not least because the bifurcation between investor classes still informs legislative framework and industry norms. Moreover, as we have seen, structural problems in the audit process along with

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Water Policy Reform in Brazil' (2010) 23 *Governance* 59 (noting how in 'highly specialized areas, such as water resources, experts "do politics" when they use expertise as a political resource and broker political, bureaucratic, and social relationships in order to get their proposals approved and implemented': at 60); see, more generally, Martha Finnemore and Kathryn Sikkink, 'International Norm Dynamics and Political Change' (1998) 52 *International Organization* 887 (referring to actors capacity to effect 'strategic social construction': at 888); for application to financial regulation, see Tony Prosser, 'Regulation and Social Solidarity' (2006) 33 *Journal of Law and Society* 364 (noting that most conflicts in regulation are about fundamental values: at 372).

127 Productivity Commission, *Identifying and Evaluating Regulatory Reform* (Melbourne, 2011), Appendix H1.

128 Ibid, 1.

129 For discussion, see Justin O'Brien, The Future of Financial Regulation: Enhancing Integrity Through Design (2010) 34 *Sydney Law Review* 65.

emasculated conceptions of responsibility to society have done much to weaken trust in the professions. In this context, the decision by the PSC to demand a higher standard of accountability from the audit community sends an unmistakable message that failure to act threatens not just the credibility of the professions but also the oversight mechanism itself.

As the Goldman Sachs Business Standards Committee Impact Report has revealed, these norms remain exceptionally powerful. To address them necessitates challenging the discourse and its underpinning assumptions. In short it necessitates fashioning a different narrative in an agonistic dialogue and partnership and holding institutional actors as well as the professions accountable to it.[130] As we have seen, however, a command and control approach to regulation without internalisation of its rationale and purpose has profound limitations. Rules are too easily transacted around. Likewise, the articulation of principles without ongoing external validation and oversight is difficult to enforce. Tackling ethical deficiencies requires we pay much more attention to the moral dimension of market conduct, which I have argued is core rather than incidental to the disclosure paradigm. It is essential to once again stress the ethical component of corporate and professional obligation. In so doing we can rejuvenate the paradigm and provide a meaningful basis for trust. Without it we are destined to repeat past mistakes at precisely the point that society literally cannot afford to pay for them. As Roosevelt warned in 1933, it is not enough to rely on exhortation. It is time for action.

[130] See John Braithwaite, 'Cultures of Redemptive Finance,' in O'Brien and Gilligan, above n15.