# Values driven innovation or inadequate self-regulation?: The effective regulation of Australian banks as service providers to low income consumers.

Therese Wilson[*]

## *Introduction*

This paper will draw on qualitative interviews recently conducted with three major Australian banks, and will explore the contention by some banks that voluntary initiatives in the area of service provision to low income consumers is likely to be more effective and less tokenistic than externally imposed regulatory regimes. This contention is echoed in findings of the Parliamentary Joint Committee on Corporations and Financial Services ("PJCCFS") in its recent report on "Corporate responsibility: Managing risk and creating value".[1]

Questions of corporate regulation are often concerned with the regulation of corporations as a generic group under the *Corporations Act 2001.* Issues might arise, however, in relation to a specific category of corporation engaged in a particular industry, and in relation to the most effective way to regulate such corporations in order to achieve regulatory goals pertaining to that industry. This paper will be concerned with the effective regulation of banks in Australia, with a view to achieving the provision of just and adequate credit services to low income consumers.

This paper will commence with a general discussion concerning the regulation of corporations. I will outline regulatory perspectives on corporate regulation, including the role that corporate values are said to play in achieving regulatory goals, and will draw on regulatory theory to provide a framework for subsequent discussion as to possible models of regulatory intervention.

I will then move on to a case study concerning Australian banks as corporations within a particular industry; and the provision of safe and affordable credit by banks to people on low incomes, as the regulatory goal. Current voluntary initiatives in this area will be explored, as will the reasons that banks give for undertaking those initiatives on a voluntary basis, and their perspectives on the possibility of more coercive regulation. Such voluntary initiatives might be regarded as examples of the "values driven innovation" referred to in the title to this paper. Whilst these are commendable initiatives and not wholly ineffective, I will argue that they are not examples of entirely effective regulation (in the sense of achieving certain behaviour in the banking industry) in that such initiatives are limited in terms of geography and the demography served. It is unlikely, given the motivations for these activities discussed in part two of this paper, that in the absence of regulatory intervention these

---

[*] Therese Wilson is a Senior Lecturer at Griffith Law School, a member of the Socio-Legal Research Centre, Griffith University, a director of Foresters ANA Mutual Society Ltd, a member of the Australian Microfinance Network and a member of the Queensland Microfinance Working Party. This paper draws on research undertaken for the purposes on Therese Wilson's doctoral thesis.

[1] Parliamentary Joint Committee on Corporations and Financial Services, 'Corporate responsibility: Managing risk and creating value' (2006), p. 35.

initiatives will be expanded sufficiently to adequately address the problem of lack of access to small consumer loans from mainstream financial institutions, discussed below as an example of 'financial exclusion'. Therefore whilst the title suggests "values driven innovation" and "ineffective regulation" are alternatives, I will argue that in the context of the provision of credit services to low income consumers by mainstream financial institutions, we have an example of values driven innovation which is not wholly effective.

In the final part of this paper, on the basis of the limitations of purely voluntary, self-regulatory initiatives, I will explore two alternative models of regulation. The first is model of 'enforced self-regulation'[2] or 'meta-regulation'[3] using the existing *Code of Banking Practice 2003*, and the second is a model of regulation based on the *Community Reinvestment Act 1977* (U.S.).

This paper will be premised on the legitimacy of the concept of corporate social responsibility which arises due to the power and resources held by corporations in modern society[4]. I will not be engaging here in the debate concerning shareholder versus stakeholder theory, but will assume an acceptance of the position that mainstream financial institutions are a form of corporation in which members of the community other than shareholders clearly have a 'stake', who should be regarded as 'stakeholders' and whose interests should be taken into account by corporations in the conduct of their activities.[5] In this regard, it is interesting to note that most large listed companies, at least those that require consumer approval to operate successfully[6], now willingly accept the idea of corporate social responsibility and refer to it regularly in annual reports and media releases.[7] The recent Corporations and Markets Advisory Committee ("CAMAC") report into the "Social Responsibility of Corporations"[8] referred to corporate social responsibility ("CSR") as 'part and parcel of the way a company's affairs are conducted'[9], and in attempting to define CSR stated that:-

> a company will be seen to be socially responsible if it operates in an open and accountable manner, uses its resources for productive ends, complies with relevant regulatory requirements and acknowledges and takes responsibility for the consequences of its actions.

Particularly pertinent to this paper is the statement that followed, that:-

---

[2] Robert Baldwin and Martin Cave, *Understanding Regulation: Theory Strategy and Practice* (1999), p 133.

[3] Christine Parker, *The Open Corporation: Effective Self-Regulation and Democracy* (2002), p. 246.

[4] See discussion in John Parkinson, *Corporate Power and Responsibility* (1993), pp 30-32.

[5] See discussion in Frederick Post, 'A response to the "social responsibility of corporate management: A classical critique"' (2003) 18(1) *Mid-American Journal of Business* 25

[6] For the significance of the need for consumer approval on a corporation's exercise of CSR, see discussion in Stephen Brammer and Andrew Millington, 'The Development of Corporate Charitable Contributions in the UK: A Stakeholder Analysis' (2004) 41(8) *Journal of Management Studies* 1411

[7] See for example Westpac, 'Stakeholder Impact Report' (2005); National Australia Bank, 'Corporate Social Responsibility Report' (2006); ANZ, 'Corporate Responsibility Report' (2006).

[8] Corporations and Markets Advisory Committee, 'The Social Responsibility of Corporations' (2006).

[9] Corporations and Markets Advisory Committee, 'The Social Responsibility of Corporations' (2006), p iv.

> For some companies, this will require them to engage with particular social and environmental issues.[10]

Also pertinent is CAMAC's finding that whilst corporations have incentives to be socially responsible on a voluntary basis under a 'business case' , a motivation for CSR that will be explored further in Part Two, thereby minimising any need for regulation,

> If market failure is judged to occur in a particular area, governments are able to intervene with regulation tailored to the problem.[11]

I argue that the problem that is the focus of the paper, namely the lack of safe and affordable credit to people on low incomes to enable them to purchase essential household items or pay emergency bills for example, is the result of failure in the consumer credit market. As Chris Field noted recently, low income consumers tend to be the 'losers' of competition, given the distributional effects of markets.[12] The consumer credit market in Australia provides an example of a failure of a competitive market to benefit low income consumers. An inability to access small, short-term loans on reasonable terms by people on low incomes is one aspect of the phenomenon described as 'financial exclusion', defined more broadly in the Australian context as

> The lack of access by certain consumers to appropriate low cost, fair and safe financial products and services from mainstream providers.[13]

This is said to have lead to a growth in the high cost fringe credit market whereby the poor really do pay more for credit [14] which has in turn been linked to a failure on the part of mainstream credit providers such as banks to serve the needs of low income consumers.[15] Iain Ramsay's observations in relation to banks in Canada seem equally apt in the Australian context:

> There is evidence that banks, notwithstanding their public relations efforts, are not strongly committed to cultivating lower income clients or branches which serve lower income areas which do not generate sufficient profits in this age of shareholder-driven capitalism.[16]

## *Part One- The regulatory spectrum*

When considering the regulation of corporations in order to achieve certain regulatory goals, there are a spectrum of regulatory models available, ranging from voluntary self-regulation by an industry through to command and control models of regulation

---

[10] Corporations and Markets Advisory Committee, 'The Social Responsibility of Corporations' (2006), p. iv.

[11] Corporations and Markets Advisory Committee, 'The Social Responsibility of Corporations' (2006), p. 7.

[12] Chris Field, 'Competition, Consumer Protection and Social Justice- Providing a Consumer's Voice' (2005) 33(1) *Australian Business Law Review* 51, p. 54.

[13] Chant Link & Associates, 'A Report on Financial Exclusion in Australia' (ANZ, 2004), p. 58.

[14] Consumer Affairs Victoria, 'The Report of the Consumer Credit Review' (2006), p. 37.

[15] Ministerial Council on Consumer Affairs, 'Long Term Regulation of Fringe Credit Providers Discussion Paper' (2003) , p. 5.

[16] Iain Ramsay, 'Access to Credit in the Alternative Consumer Credit Market' (Office of Consumer Affairs, Industry Canada and Ministry of the Attorney General, British Columbia, 2000), p.5.

with sanctions for non-compliance. Regulatory scholarship argues that regulation should not be regarded as limited to externally imposed command and control models, defining regulation broadly as 'the intentional activity of attempting to control, order or influence the behaviour of others'[17]or 'an activity that is aimed at influencing the flow of events'[18]. Law is but one of a number of regulatory measures that can be used to influence behaviour or the flow of events in society.[19]

John Braithwaite wrote in 1993[20] about the regulatory pyramid, where one first approaches regulation with the least coercive and most cooperative approach, self-regulation being an example, encouraging even 'irresponsible actors to put their best self forward'[21], before moving to more coercive models in the event that the cooperative model fails. Similarly, Neil Gunningham wrote that:-

> Choosing regulatory mechanisms is a dynamic rather than a static process, and the appropriate regulatory response, is contingent on a number of factors including the regulatee's own conduct, the availability of alternatives to command and control, and the existences and strength of third parties capable of implementing them.[22]

Taking up Gunningham's point about the availability of strong third parties capable of implementing regulation, there is a sense that at least the possibility of coercion is required to ensure regulatory effectiveness. Braithwaite wrote in this regard that:-

> Regulatory institutions can be designed to nurture rather than destroy civic virtue in the business community. At the same time, we need tough-minded regulatory institutions that can shift to a hard-headed approach when virtue fails, as it often will.[23]

The benefit of legal regulation is no doubt its strength and coercive force, where voluntary and cooperative initiatives fail. Regulation by states through legislation enables the inclusion of 'direct monetary incentive or disincentive effects'[24] which can have powerful regulatory consequences. The question of regulation can become more complicated, however, when considering the regulation of corporations. It has been recognised that law alone is not always an effective regulator when regulating business corporations characterised by a non-compliant corporate culture. It is argued that:-

---

[17] Julia Black, *Critical Reflections on Regulation* (2002), p.1.
[18] Stephen Bottomley and Angus Corbett, "Regulating Corporate Governance" in Christine Parker et al (eds), *Regulating Law* (2004), pp. 60-81 at p.61
[19] See discussion in Christine Parker et al (eds), *Regulating Law* (2004)
[20] John Braithwaite, 'Responsive Business Regulatory Institutions' in CAJ (Tony) Coady and Charles Sampford (eds), *Business Ethics and the Law* (1993)
[21] John Braithwaite, 'Responsive Business Regulatory Institutions' in CAJ (Tony) Coady and Charles Sampford (eds), *Business Ethics and the Law* (1993) , p. 89.
[22] Neil Gunningham, "Beyond Command and Control: Towards Flexible and Cost-Effective Business Regulation", in CAJ (Tony Coady and Charles Samford (ed), *Business Ethics and the Law* (1993), pp. 93-112 at p. 110.
[23] John Braithwaite, 'Responsive Business Regulatory Institutions' in CAJ (Tony) Coady and Charles Sampford (eds), *Business Ethics and the Law* (1993) , p85.
[24] Thomas McInerney, 'Putting Regulation Before Responsibility: The Limits of Voluntary Corporate Social Responsibility' (2004) *The George Washington University Law School Public Law and Legal Theory Working Paper No 123* <http://ssrn.com/abstract=658081>

> Legal sanctions only work well if they are supported by congruent internalised values;

and further that:-

> even the best combination of laws and ethical standards will be defeated by an institutional environment which is not conducive to legal and ethical compliance.[25]

In relation to corporate regulation to achieve corporate social responsibility in particular, Christine Parker refers to the 'disconnection between corporate life and individual integrity and external values', and calls for corporations to become 'open corporations', permeable to external values.[26] Parker asserts that corporations will not become socially responsible until social responsibility has been institutionalised, but that this process is a difficult one.

> Organizations often tend to destroy individuals' integrity by tearing apart their constituent 'selves'- their commitment to the business goals of the organization on the one hand, and, on the other, their personal ethical commitments (e.g. to family) and sense of social responsibility (e.g. environmentalism) …even organizations full of perfectly 'ethical', well-intentioned managers and employees with decent values are unlikely to corporately act with social responsibility all the time.[27]

Parker seems to concur, however, with the view that both internalised values and state regulatory intervention are necessary to achieve social responsibility, suggesting a model of 'meta-regulation' defined as 'regulation of self-regulation', by which the state can

> hold corporate self-regulation accountable, by connecting the private justice of internal management systems to the public justice of legal accountability, regulatory coordination and action, public debate and dialogue.[28]

'Meta-regulation', which gives the law a role in regulating self-regulation, for example through state audit and verification requirements[29], might alternatively be referred to in Robert Baldwin's and Michael Cave's terms as 'enforced self-regulation', described as the public enforcement of privately written rules.[30] The advantages of such a model are said to include an opportunity for the corporation to internalise concepts of corporate social responsibility[31], and for corporate management to be committed to achieving socially responsible management[32], as well

---

[25] Charles Samford and D Wood in Tony Coady and Charles Samford (ed), *Business Ethics and the Law* (1993), p. 11.
[26] Christine Parker, *The Open Corporation: Effective Self-Regulation and Democracy* (2002), p. 31.
[27] Christine Parker, *The Open Corporation: Effective Self-Regulation and Democracy* (2002), p. 32.
[28] Christine Parker, *The Open Corporation: Effective Self-Regulation and Democracy* (2002), p/ 246.
[29] Christine Parker, *The Open Corporation: Effective Self-Regulation and Democracy* (2002), pp 246, 279.
[30] Robert Baldwin and Martin Cave, *Understanding Regulation: Theory Strategy and Practice* (1999), p. 133.
[31] Robert Baldwin and Martin Cave, *Understanding Regulation: Theory Strategy and Practice* (1999), p. 40.
[32] Christine Parker, *The Open Corporation: Effective Self-Regulation and Democracy* (2002), p. 50.

as a likelihood that the rules as written will be well-informed and therefore effective and appropriate.[33]

Such advantages might also be found in performance-based regulation, which is an externally imposed regulatory regime rather than one based on self-regulation, but one which relies on guiding standards rather than strict rules. The key concept is said to be 'regulating for results rather than adherence to prescribed means under prescriptive regulations'.[34] The benefits of such a model, which will facilitate appropriate regulatory responses through the informed responses of the regulatees in addressing the standards, are said to include

> greater effectiveness in reaching specific regulatory objectives, flexibility in means of adhering to the regulation, increased incentives for innovation, and reduced costs of compliance for regulated entities.[35]

The *Community Reinvestment Act 1977* (US) is just such a model, and will be discussed in the context of 'regulatory possibilities' below.

## *Part Two- Australian banks and voluntary CSR*

This part of the paper will describe voluntary initiatives being undertaken by Australian banks in order to address financial exclusion, and will explore why those initiatives might be occurring. The identified motivations for these voluntary initiatives to some extent provide an illustration of 'value-driven innovation' and a 'permeability' of the corporation to external values.[36] It will be argued, however, that these initiatives do not go far enough in addressing the problem, and that regulatory intervention is required. In that regard I will explore in this part banks' responses to proposed regulatory models to require or encourage the expansion of the current initiatives.[37]

In 2006, ANZ Bank commenced a pilot of its 'Progress Loan' offered in partnership with Brotherhood of St Laurence in Victoria. The program offers loans of between $500 and $3000 to low income earners, to assist in the purchase of essential household items. An interest rate of 12.7% applies and the loan repayment term is flexible to suit the borrowers' needs and can range from a 1 year to a 3 year period. To be eligible for a 'Progress loan', borrowers must be Centrelink[38] Health Care

---

[33] Robert Baldwin and Martin Cave, *Understanding Regulation: Theory Strategy and Practice* (1999), p. 40.
[34] Peter May, 'Performance-Based Regulation and regulatory regimes: The Saga of Leaky Buildings' (2003) 25(4) *Law and Policy* 381, p. 384.
[35] Peter May, 'Performance-Based Regulation and regulatory regimes: The Saga of Leaky Buildings' (2003) 25(4) *Law and Policy* 381, p. 388.
[36] Christine Parker, *The Open Corporation: Effective Self-Regulation and Democracy* (2002), p. 31.
[37] This paper draws on the interviews that I conducted with representatives of 3 of the major Australian banks (holding titles of Community Development Finance Manager, Corporate Social Responsibility Manager, and Corporate Responsibility and Sustainability Manager), as part of a series of 12 qualitative interviews with banks, credit unions, community organisations and fringe credit providers conducted in 2006 in the course of my doctoral research. For the purposes of views and opinion information derived from those interviews the banks will be referred to as Major Bank 1, 2 & 3 in no particular order. In relation to descriptive information concerning credit products offered by the banks to people on low incomes, the identities of the banks- ANZ, NAB and Westpac- will be disclosed.
[38] Australian Social Security

cardholders, have lived in the same residence for more than 6 months, and be up to date with rent and utility bills.[39]

National Australia Bank has been offering its 'Step Up Loan' in partnership with Good Shepherd Youth and Family Service since 2004. It is currently offered in select locations in Victoria, NSW, WA and SA. These loans are for amounts between $800 and $3000, with a current applicable interest rate of 6.99% per annum. The loans are, again, for essential household goods as well as second hand cars, medical expenses and training course fees. As with the 'Progress Loans', to be eligible for a 'Step Up Loan' the borrower must be a Centrelink Health Care cardholder. [40]

Westpac has tended to focus its CSR activities in areas other than credit provision to low income consumers, however in terms of credit services to people on low incomes Westpac does participate in an Indigenous Capital Assistance Scheme in partnership with the Federal Department of Employment and Workplace Relations ("DEWR"). Under the scheme, Westpac provides loans of between $50,000 and $500,000 to indigenous people to start up businesses. The scheme includes an overdraft product, a term lending product, and an equipment leasing product. DEWR provides to the borrowers interest rate subsidies, reimbursement of the loan establishment fee and reimbursement of professional fees associated with the loan.

Four main reasons were given by the representatives of the three major banks for offering these products which were described as unprofitable or at best 'break even'. The first two reasons are indications that these banking corporations have been 'open to external values'[41] to some extent, and are 'value driven' in these voluntary initiatives. In terms of the regulatory spectrum discussed in part one, this may increase the likelihood of effective voluntary measures, and may also increase the likelihood that any externally imposed regulatory measures will be more effective. The second two reasons are more strategic in nature, driven at heart I would argue by returning profits to shareholders in accordance with directors' duties.[42] This will of necessity limit the extent of initiatives undertaken on a voluntary basis in that banks will not go beyond what is necessary to achieve those strategic outcomes. This supports an argument in favour of regulatory intervention in order to achieve the regulatory goal of the provision of safe and affordable credit by banks to people on low incomes.

The first reason given was a need to contribute to a successful society, on the basis that 'the more successful society is generally the more successful a business like the

---

[39] ANZ and Brotherhood of St Laurence, *ANZ and Brotherhood of St Laurence team up to offer small loans for people on low-incomes* (2006) <http://www.bsl.org.au/main.asp?PageId=3952> , Therese Wilson, 'Major Bank Interview' (2006)

[40] Therese Wilson, 'Major Bank Interview' (2006), Ross Kendall, 'Our Huge Need for Tiny Loans' (2006) *Ethical Investor*

[41] Christine Parker, *The Open Corporation: Effective Self-Regulation and Democracy* (2002), p. 31.

[42] Section 181 *Corporations Act 2001* (Cth) imposes a duty on directors to act in the best interests of the company which has been defined in case law to mean the best financial interests of the shareholders as a whole. I discuss this at greater length in Therese Wilson, 'The Pursuit of Profit at all Costs: Corporate law as a barrier to corporate social responsibility' (2005) 30(6) *Alternative Law Journal* 278, and in Therese Wilson, 'The limitations of CSR as a regulatory measure: ensuring social responsibility by Australian banks as service providers to low income consumers' (Paper presented at the Governance and Social Responsibility Conference, London, U.K., 2005).

bank is going to be', that there is a 'need for a community licence to operate',[43] as well as a social need to avoid a 'dissatisfied population'.[44]

Secondly, there was a desire to achieve employee satisfaction and pride in the organisation, [45] recognising that:-

> If we can't get the support of our employees and we can't get people to work for us we don't have a business, and our employees tell us time and time again in our annual perspective survey from our staff …that community and supporting the community is such an important thing to them.[46]

This desire to be an 'employer of choice' as a motivation for CSR is also discussed in the PJCCFS report.[47]

A third reason given was regulatory risk management, which was also discussed in the PJCCFS report.[48] Two of the major banks commented along the lines that:-

> It also is I think a good risk management approach for regulation. We'd be forced to do some of this if we didn't proactively get involved[49],

and that:-

> If we don't act now we may find over-onerous regulation and 'one size fits all' regulation…we see this as being pre-emptive, a proactive approach to doing what we think would otherwise happen anyway, but for us to control our destiny and to be informed rather than wait for a big stick to tell us how to do it.[50]

The fourth reason centres on the general 'business case' and competitive advantage of engaging in CSR. One of the bank's representatives commented, in response to a question as to whether it bothered that bank that not every bank was engaging in this 'profit-sacrificing' activity, that:-

> I think at the end of the day it is a competitive space because it is linked to our reputation and brand so if some choose not to link this to their brand I think that's a strategic direction. These programs are I think a considerable investment by the organisation but…I think the benefits they get out of them both in the short term and the long term are such that it's a competitive advantage.[51]

Relevant to this motivation are the findings by CAMAC in its report that voluntary rather than mandatory approaches to CSR based on the 'business approach to social responsibility' were likely to be adequate, on the basis that:-

---

[43] Therese Wilson, 'Major Bank Interview' (2006), Major Bank 1.
[44] Therese Wilson, 'Major Bank Interview' (2006), Major Bank 2.
[45] Therese Wilson, 'Major Bank Interview' (2006), Major Banks 1 & 3.
[46] Therese Wilson, 'Major Bank Interview' (2006), Major Bank 1.
[47] Parliamentary Joint Committee on Corporations and Financial Services, 'Corporate responsibility: Managing risk and creating value' (2006), pp. 26-28.
[48] Parliamentary Joint Committee on Corporations and Financial Services, 'Corporate responsibility: Managing risk and creating value' (2006), p. 32.
[49] Therese Wilson, 'Major Bank Interview' (2006), Major Bank 3.
[50] Therese Wilson, 'Major Bank Interview' (2006), Major Bank 2.
[51] Therese Wilson, 'Major Bank Interview' (2006), Major Bank 3.

> A well-managed company will generally see it as being in its own commercial interests, in terms of enhancing corporate value or opportunity, or managing risks to its business, to assess and, where appropriate, respond to the impact of its activities on the environmental and social context in which it operates. Companies that fail to do that may jeopardise their commercial future.[52]

This leaves open the possibility of a strategic but nonetheless profit-sacrificing, philanthropic approach to CSR where

> Directors may sometimes choose to go further, where they see it as relevant to their business interests, in promoting particular societal values or goals or in seeking solutions to challenges facing their industry and the community.[53]

CAMAC is careful to add however that:-

> This is not to suggest that companies bear some form of obligation to tackle wider problems facing society, regardless of the relevance of those problems to their own business.[54]

Contrary to this position, I argue in relation to banks that there should be recognised an obligation on the part of banks to contribute to addressing the social problem of financial exclusion. This is on the basis that access to small amounts of short-term credit for the purchase of essential items should be regarded as an 'essential service'. It is notable that the Director-General of Fair Trading in the U.K. has listed as *essential* community services provided by financial service providers: cash transmission and banking; insurance; *short-term consumer credit*; and long-term savings.[55] It has been argued that where corporations provide services that 'are considered necessary for a 'decent life' in modern society'[56]it is acceptable to impose social responsibilities on those corporations with respect to those services. This certainly seems to be have been approach taken by the Australian government with respect to Telstra as a provider of telecommunications services[57], and I would argue that a similar approach should be taken with respect to the banks, and their obligations acknowledged by the chair of the Australian Bankers' Association that:-

> Because banking is such a fundamentally important service, pricing and access must meet the needs of every member of the community…The point I want to emphasise is this. We do acknowledge that we have a social responsibility…a responsibility to the communities where we conduct our business that goes beyond providing banking and financial services.[58]

---

[52] Corporations and Markets Advisory Committee, 'The Social Responsibility of Corporations' (2006), p. 78.
[53] Corporations and Markets Advisory Committee, 'The Social Responsibility of Corporations' (2006), p. 78.
[54] Corporations and Markets Advisory Committee, 'The Social Responsibility of Corporations' (2006), p. 78.
[55] Peter Cartwright, *Banks, Consumers and Regulation* (2004), p. 219.
[56] Thomas Wilhelmsson, 'Services of General Interest and European Private Law' in Charles Rickett and Thomas Telfer (eds), *International Perspectives on Consumers' Access to Justice* (2003) , p. 149.
[57] Note Telstra's obligations under the "Universal Service Obligation", section 9 *Telecommunications (Consumer Protection and Service Standards) Act 1999* (Cth).
[58] Frank Cicutto, 'Community Link Speech Notes' (Paper presented at October 2000)

The CAMAC and PJCCFS reports referred to above, and comments by the bank representatives interviewed, point to a number of motivations which will lead to the exercise of CSR on a voluntary basis by banks. I would argue, however, that at least some threat of regulatory intervention might be necessary to ensure the continuation and expansion of the initiatives described. Further, on the basis of arguments that banking corporations have social obligations beyond those described by CAMAC and the PJCCFS, regulatory intervention to mandate certain conduct on the part of banks can be justified.

The bank representatives interviewed expressed concerns over prescriptive regulation which might stifle innovation. One comment was that:-

> We'd be very cautious about regulating this space because we've got several products out there at the moment and they're very different and I think we need that openness to allow innovation and creativity…If we try and curtail it too much I think we run into suffocating some of that innovation…If people feel obliged to do things they'll probably do the very basic and not necessarily explore a whole lot of areas.[59]

Another comment concerned a risk of ineffective regulation where there was:-

> …regulation put together by people who tend to watch over the fence or aren't involved on a day to day basis.[60]

The difficulty with leaving the provision of credit services to people on low incomes to voluntary initiatives by the banks, propelled in part by such motivations as 'the business case' and regulatory risk management, is that, as argued briefly above, those initiatives are unlikely to go far enough in addressing the problem of financial exclusion. This became apparent at a recent seminar held in Brisbane, at which one of the representatives of one of the major banks commented that that bank would have considerable difficulty in expanding its small loans program into a state such as Queensland because of the small size of the community organisations in Queensland with which the bank could potentially partner in offering small loans, and a consequent 'lack of economy of scale' that the bank required. In response to a question by one Queensland organisation already offering microfinance programs to financially excluded Queenslanders, as to why the bank could not simply donate to those programs rather than be involved in a partnership that had to fit certain bank requirements, the bank representative replied "well, we're not a charity".[61] That is undoubtedly true however it does lead one to consider the benefits of a legally mandated obligation to contribute to addressing financial exclusion in order to increase the opportunity for such corporate contributions without them being regarded as charity. As one would expect, the current voluntary bank initiatives are being undertaken very much on the banks' terms, which can be very limiting in the sense of what can be achieved.

In the next part I will explore a model of regulation based on 'enforced self-regulation' more recently referred to as 'meta-regulation'; and the *Community Reinvestment Act 1977* (U.S.) ("CRA") model which is an example of performance-

---

[59] Therese Wilson, 'Major Bank Interview' (2006), Major Bank 3.
[60] Therese Wilson, 'Major Bank Interview' (2006), major Bank 2.
[61] Discussion at Community Partnerships Seminar, Brisbane, 15 November 2006.

based regulation. Both of these models might overcome some of the concerns that the banks have expressed in relation to the potential ineffectiveness and inappropriateness of regulation to mandate CSR in this area. They would also be flexible enough to allow the banks to continue with innovative, self-directed programs.

## *Part Three- Regulatory possibilities*

I argue that voluntary initiatives by banks, whilst commendable, are unlikely to go far enough in making meaningful inroads into the problem of financial exclusion. This part of the paper will consider how best to 'control, order or influence'[62] the banks to expand upon the small loans programs currently offered and perhaps even encourage banks to contribute towards microfinance programs already offered by other organisations without the need for such programs to fit squarely within the partnership models with which the banks currently feel comfortable.

As stated above, I will explore a model of 'enforced self-regulation' or 'meta-regulation' based on the *Code of Banking Practice 2003*; and will then consider a 'performance-based' regulatory model, based on the *Community Reinvestment Act 1977* (U.S.). There is another obvious possibility but one which it is beyond the scope of this paper to explore, and that would be a simple model of offering tax incentives to banks for investing in loans programs for low income consumers. This would bring the issue at hand closer to being one about redistribution of wealth, welfare and the appropriate use of the tax system, whereas I argue that this is not a welfare issue but rather a problem arising out of market failure. Nevertheless, it is a model for exploration at another time.

The meanings given to 'enforced self-regulation' and 'meta-regulation' or the 'regulation of self-regulation' have been discussed in Part One. Such a model could involve the inclusion in the current *Code of Banking Practice 2003* of obligations to meet the credit needs if low income consumers , which would then be approved by a state regulator and be enforceable by that regulator if the provisions of the *Code* were not complied with.[63] Industry members would be required to self-evaluate their compliance and report upon that, and those reports would be subject to state audit and verification requirements.[64] As notes in Part One, the advantages of such a model are said to include an opportunity for banks to internalise concepts of corporate social responsibility and increase the likelihood that the rules as written will be well-informed and therefore effective and appropriate.

The main concern about this model is that it relies on a voluntary code, in the sense that not all banks are required to endorse and therefore become contractually bound by it, or to every aspect of it. This may not necessarily be a negative aspect of the model, in that banks that wish to engage in this 'competitive space' will continue to do so but under an expanded model. However, whether banks will still regard work in this area as giving them a competitive advantage and being strategically beneficial

---

[62] Stephen Bottomley and Angus Corbett, "Regulating Corporate Governance" in Christine Parker et al (eds), *Regulating Law* (2004), p.61.
[63] This would involve more extensive power that the Code Compliance Monitoring Committee's ability to "name" banks in connection with *Code* breaches.
[64] Christine Parker, *The Open Corporation: Effective Self-Regulation and Democracy* (2002), p. 279.

under such an expanded model with the threat of a 'big stick' looming, is questionable. Two of the major bank representatives were in favour of this model when interviewed, one noting that because it is a voluntary code:-

> It still leaves an element of choice because some organisations just wouldn't be able to see their way clear to doing some of the things that might be seen by other groups to be needed so its definitely I think one of the options that the industry would consider going forward…I think it would certainly allow parts of the industry who could so it to step up to it and do it and you wouldn't necessarily always be hung out to dry if you had to change your policy. Whereas legislation, it's serious, if it's part of the *ASIC Act* and the *UCCC* and all that stuff then those are very serious obligations to be in breach of.[65]

This final statement gives one the impression that a *Code* model might be something of a 'toothless tiger', and an effective enforcement mechanism in the event of failure to comply would be critical. As indicated above however, such an enforcement mechanism might operate as a disincentive to banks to adopt this aspect of the *Code.*

If this is an issue that regulators consider should be seriously and effectively addressed, then it may be necessary to 'move up' Braithwaite's regulatory pyramid[66] somewhat to a legislative model based on the CRA. The CRA is not without its critics in the U.S.,[67] however the evidence is that the CRA has helped to overcome market failure in credit markets in the U.S. by enhancing access to credit for low-income borrowers.[68] The purpose of the CRA's enactment is said to have been to require a bank to 'serve the credit needs of its entire community, including low-and moderate-income neighbourhoods'.[69] The four federal agencies that enforce the CRA have focused their attention on residential mortgage lending, but there has been a call for greater focus on the more general provision of banking services to people on low incomes to overcome reliance by those people on fringe credit providers.[70] Under the CRA banks are rated on the extent of their lending to borrowers at different income levels, and the provision by them of community development loans. Large banks (with assets from US$1 billion) are also rated on an investment test, concerned with community development investments and responsiveness to credit and community development needs; and a service test based upon the range of services provided by the bank including technical expertise given to 'not-for-profits'.[71] Therefore the banks

---

[65] Therese Wilson, 'Major Bank Interview' (2006), Major Bank 1.
[66] John Braithwaite, 'Responsive Business Regulatory Institutions' in CAJ (Tony) Coady and Charles Sampford (eds), *Business Ethics and the Law* (1993)
[67] See discussion in Michael Barr, 'Credit Where it Counts: The Community Reinvestment Act and its Critics' (2005) 75(6) *New York University Law Review* 101
[68] Michael Barr, 'Credit Where it Counts: The Community Reinvestment Act and its Critics' (2005) 75(6) *New York University Law Review* 101, p. 101.
[69] William Apgar and Mark Duda, 'The twenty-fifth anniversary of the Community reinvestment Act: Past accomplishments and future regulatory challenges' (2003) 9(2) *Economic Policy Review- Federal Reserve Bank of New York* 169, p. 169.
[70] See discussion in this regard in William Apgar and Mark Duda, 'The twenty-fifth anniversary of the Community reinvestment Act: Past accomplishments and future regulatory challenges' (2003) 9(2) *Economic Policy Review- Federal Reserve Bank of New York* 169
[71] Richard Marsico, 'The 2004-2005 Amendments to the Community Reinvestment Act Regulations: For Communities, One Step Forward and Three Steps Back' (2006) 39 *Clearinghouse Review Journal of Poverty Law and Policy* 534, pp. 535-536.

are not only encouraged to lend to people on low incomes themselves, but also to support the work of not-for-profits already undertaking that work.

A poor CRA rating can affect a bank's application for deposit facilities including applications for mergers with and acquisitions of deposit-taking institutions. CRA ratings are also taken into account in the approval process for opening or closing bank branches,[72]and banks must have a satisfactory CRA rating to be allowed to engage in extended financial activities such as insurance and securities.[73]

As stated above, the CRA is an example of performance-based regulation, relying on standards rather than rules. As Michael Barr explains, under the CRA:-

> standards are structured to encourage involvement in the process of regulatory interpretation by both citizens and the regulated entities themselves;

and that it is particularly beneficial to have standards rather than rules

> when the conduct to be regulated varies significantly by the size, market context, organisational structure and business strategy of the regulated entity.[74]

Such an approach is more likely to be effective, appropriate and less likely to stifle innovation than a more prescriptive, rules- based approach. Regulators do not have a fixed requirement for banks to undertake a certain level of activity, but make a judgment about the institution's performance in the context in which it operates.[75] Barr explains that:-

> CRA standards permit banks to respond to local needs based on their institutional organisation, market assessments and business plans, without being judged on the basis of national norms,

and that this allows

> banks to help shape the content of the standard in CRA's application to them, in their local context, during their CRA evaluation and merger applications…This increases the likelihood that the performance will be analysed according to the regulated entity's view of an appropriate standard for the institution…[76]

It is interesting to note that, according to a Federal Reserve Board survey, default rates on CRA loans have been low, and that those loans have proven to be generally profitable and not particularly risky after all; that 'pushing into low-income markets

[72] Michael Barr, 'Credit Where it Counts: The Community Reinvestment Act and its Critics' (2005) 75(6) *New York University Law Review* 101, p. 105.
[73] Michael Barr, 'Credit Where it Counts: The Community Reinvestment Act and its Critics' (2005) 75(6) *New York University Law Review* 101, p. 115.
[74] Michael Barr, 'Credit Where it Counts: The Community Reinvestment Act and its Critics' (2005) 75(6) *New York University Law Review* 101, p. 108.
[75] Michael Barr, 'Credit Where it Counts: The Community Reinvestment Act and its Critics' (2005) 75(6) *New York University Law Review* 101, p. 180.
[76] Michael Barr, 'Credit Where it Counts: The Community Reinvestment Act and its Critics' (2005) 75(6) *New York University Law Review* 101, pp183-184.

has not weakened banks' profitability and soundness'.[77] Further, by encouraging banks to lend to people on low incomes that market has become 'thicker', thus reducing information asymmetries brought about by a lack of information in relation to lending to that market. Barr notes that:-

> As lenders obtain information about creditworthy low income borrowers and develop expertise in lending to those borrowers, the transaction costs associated with overcoming information asymmetries also decrease…with lower information asymmetries, loan prices can be reduced so that they become commensurate with measurable risk, and thus adverse selection and moral hazard pose less of a problem to reaching further into the market of potential borrowers in low income communities.[78]

The argument is that by mandating lending by banks in the low income market, banks will become more experienced at assessing risk in that market and will expand lending in that market not necessarily relying on CSR motivations, but rather on the market being a profitable one with low default risk. It is interesting that the major Australian banks engaged in small loans programs for low income consumers report a low default rate[79], and report having undergone a process of 'learning' that people on low incomes can repay loans offered at reasonable rates and on reasonable repayment terms.[80] Of course, the likelihood of small amount short-term loans being profitable for lenders is less than would be the case with mortgage loans to which Michael Barr would mainly be referring in relation to the CRA. Nevertheless, it is possible that with greater information becoming available about the low income credit market, small personal loans to low income consumers could be offered and priced profitably and according to risk, without involving the prohibitive interest rates currently imposed by the fringe credit lenders on low income consumers.[81]

## *Conclusion*

This paper has considered the effective regulation of corporations in the context of the banking industry, focusing on the provision of credit services to low income consumers. In employing regulatory theory to give the discussion in this paper a framework, I noted that at least a possibility of external intervention or coercion seems to be required in order to most effectively regulate, in the sense of controlling, ordering or influencing the behaviour of banks- that the threat of the big stick is necessary for when 'virtue fails'.

In regulating corporations, the presence of corporate values, compatible with regulatory goals, is regarded as a necessary element of an effective regulatory strategy. This can be difficult to achieve, but is more likely to occur where corporations are left to some extent to design their own regulatory response and come

[77] Michael Barr, 'Credit Where it Counts: The Community Reinvestment Act and its Critics' (2005) 75(6) *New York University Law Review* 101, p. 167.
[78] Michael Barr, 'Credit Where it Counts: The Community Reinvestment Act and its Critics' (2005) 75(6) *New York University Law Review* 101, p. 128.
[79] Therese Wilson, 'Major Bank Interview' (2006), Major Banks 2 & 3.
[80] Discussion at Community Partnerships seminar, Brisbane, 15 November 2006.
[81] In this regard see discussion in Therese Wilson, 'The inadequacy of the current regulatory response to payday lending' (2004) 32 *Australian Business Law Review* 193

to terms with the standards expected of them. Even in the presence of such values, however, regulatory intervention will often be necessary to achieve regulatory goals.

In the voluntary activities being undertaken by some of the major Australian banks in terms of the provision of small loans to people on low incomes, there is evidence of value-driven innovation. I argue, however, that some form of regulatory intervention is desirable to ensure the continuation and expansion of these initiatives.

The CRA model has been tried and tested in the U.S. for nearly 30 years now, and is one which should be carefully considered by regulators. It is a performance-based, standards-based model which is less likely to stifle innovation than a prescriptive rules-based model. It is also a model that will allow banking corporations to continue or develop their own innovative, values-driven initiatives.

## ***Reference List***


ANZ, 'Corporate Responsibility Report' (2006).

ANZ and Brotherhood of St Laurence, *ANZ and Brotherhood of St Laurence team up to offer small loans for people on low-incomes* (2006) <http://www.bsl.org.au/main.asp?PageId=3952>.

Apgar, William and Duda, Mark, 'The twenty-fifth anniversary of the Community reinvestment Act: Past accomplishments and future regulatory challenges' (2003) 9(2) *Economic Policy Review- Federal Reserve Bank of New York* 169.

Baldwin, Robert and Cave, Martin, *Understanding Regulation: Theory Strategy and Practice* (1999).

Barr, Michael, 'Credit Where it Counts: The Community Reinvestment Act and its Critics' (2005) 75(6) *New York University Law Review* 101.

Black, Julia, *Critical Reflections on Regulation* (2002).

Braithwaite, John, 'Responsive Business Regulatory Institutions' in CAJ (Tony) Coady and Charles Sampford (eds), *Business Ethics and the Law* (1993).

Brammer, Stephen and Millington, Andrew, 'The Development of Corporate Charitable Contributions in the UK: A Stakeholder Analysis' (2004) 41(8) *Journal of Management Studies* 1411.

Cartwright, Peter, *Banks, Consumers and Regulation* (2004).

Chant Link & Associates, 'A Report on Financial Exclusion in Australia' (ANZ, 2004).

Cicutto, Frank, 'Community Link Speech Notes' (Paper presented at October 2000).

Consumer Affairs Victoria, 'The Report of the Consumer Credit Review' (2006).

Corporations and Markets Advisory Committee, 'The Social Responsibility of Corporations' (2006).

Field, Chris, 'Competition, Consumer Protection and Social Justice- Providing a Consumer's Voice' (2005) 33(1) *Australian Business Law Review* 51.

Kendall, Ross, 'Our Huge Need for Tiny Loans' (2006) *Ethical Investor*.

Marsico, Richard, 'The 2004-2005 Amendments to the Community Reinvestment Act Regulations: For Communities, One Step Forward and Three Steps Back' (2006) 39 *Clearinghouse Review Journal of Poverty Law and Policy* 534.

May, Peter, 'Performance-Based Regulation and regulatory regimes: The Saga of Leaky Buildings' (2003) 25(4) *Law and Policy* 381.

McInerney, Thomas, 'Putting Regulation Before Responsibility: The Limits of Voluntary Corporate Social Responsibility' (2004) *The George Washington University Law School Public Law and Legal Theory Working Paper No 123* <http://ssrn.com/abstract=658081>.

Ministerial Council on Consumer Affairs, 'Long Term Regulation of Fringe Credit Providers Discussion Paper' (2003).

National Australia Bank, 'Corporate Social Responsibility Report' (2006).

Parker, Christine, *The Open Corporation: Effective Self-Regulation and Democracy* (2002).

Parker, Christine et al (eds), *Regulating Law* (2004).

Parkinson, John, *Corporate Power and Responsibility* (1993).

Parliamentary Joint Committee on Corporations and Financial Services, 'Corporate responsibility: Managing risk and creating value' (2006).

Post, Frederick, 'A response to the "social responsibility of corporate management: A classical critique"' (2003) 18(1) *Mid-American Journal of Business* 25.

Ramsay, Iain, 'Access to Credit in the Alternative Consumer Credit Market' (Office of Consumer Affairs, Industry Canada and Ministry of the Attorney General, British Columbia, 2000).
Tony Coady and Charles Samford (ed), *Business Ethics and the Law* (1993).
Westpac, 'Stakeholder Impact Report' (2005).
Wilhelmsson, Thomas, 'Services of General Interest and European Private Law' in Charles Rickett and Thomas Telfer (eds), *International Perspectives on Consumers' Access to Justice* (2003).
Wilson, Therese, 'The inadequacy of the current regulatory response to payday lending' (2004) 32 *Australian Business Law Review* 193.
Wilson, Therese, 'The limitations of CSR as a regulatory measure: ensuring social responsibility by Australian banks as service providers to low income consumers' (Paper presented at the Governance and Social Responsibility Conference, London, U.K., 2005).
Wilson, Therese, 'Major Bank Interview' (2006).
Wilson, Therese, 'The Pursuit of Profit at all Costs: Corporate law as a barrier to corporate social responsibility' (2005) 30(6) *Alternative Law Journal* 278.