Written by Kevin Davis, Research Director of Australian Centre for FInancial Studies and Professor of Finance at Melbourne and Monash Universities, Australian Centre for Financial Studies

It does seem anomalous that the major banks have now become supporters of the royal commission into financial services, given they have been the principal targets. But the alternatives are probably less palatable, particularly if the banks think that all past major issues of misconduct and immoral behaviour have already been brought to light. And the broadening of the terms of reference beyond banking may dilute the focus on the banks themselves.

The banks argue that ongoing speculation and uncertainty are creating unnecessary costs and distractions for them, and that is most likely the case. Even if the major banks were to spend A$100 million in dealing with the royal commission that is less than 0.3% of the annual profits of the majors – so it has little impact on shareholder returns.

And with annual interest expenses in the order of A$65 billion , a cost of A$100 million or so could be quickly offset by improvements in bank borrowing costs from resolution of uncertainty. Whether the government spending a similar sum of taxpayer money on a royal commission is worthwhile is another matter.

Terms of reference too broad

The draft terms of reference of the royal commission ask it to focus primarily on three issues involving financial service entities. One is the essentially legal issue of identifying past cases of misconduct in violation of regulations and laws, as well as what might be termed “misbehaviour” (legal but immoral or unethical or unfair activities).

One apparent omission in the draft terms of reference relates to credit – and lending has been a major problem area in the past . While bank lending is covered, the definition of financial services entities to be considered does not appear to include those (such as mortgage brokers and some lenders) who only require an Australian Credit Licence and not an Australian Financial Services Licence (AFSL). Likewise, some financial services entities are exempt from the AFSL requirement and that may prove problematic if the draft terms of reference are not amended.

The boards and senior management of the banks (and other entities) no doubt hope there are no hidden skeletons in the closets which may be uncovered to shock them, and that revisiting the known past problems will be a case of yesterday’s news.

Although the term “misbehaviour” strays into grey areas of defining consistency with “community standards and expectations”, identifying past misconduct is a task suitable for a royal commission. But it shouldn’t be needed. ASIC and other regulators have adequate powers (if not adequate resources) to identify and prosecute misconduct. The adequacy of those powers is also a topic for the commission.

The second major task of the royal commission is to identify whether misconduct and misbehaviour can be attributed to poor culture and governance practices. This is particularly problematic.

What evidence is to be used to show, beyond reasonable doubt, that there is a causal relationship from the amorphous, non-quantifiable, concepts of culture and governance to specific instances of, or general proclivity towards, misconduct? There’s also undoubtedly many positive behaviours and outcomes occurring within these institutions they could point to, which may imply that, on balance, the arrangements are not bad.

So, the third question the commission then faces, is what changes might be made to reduce these problems. Here, the danger is that it involves a step into the unknown – what would be the likely outcomes under any proposed changes.

In its task of making recommendations, the commission faces a number of other difficulties. There is a raft of regulatory changes in progress following on from the 2014 Financial Services Inquiry and other government policy initiatives .

Also relevant is the financial technology or “fintech” revolution creating new business models, products and services, and methods of customer interaction with financial services entities. These create potential for new types of misconduct and misbehaviour. How relevant lessons the royal commission draws from history will be for this new world is unclear.

The banks will no doubt be pleased that the scope of the royal commission encompasses most of the financial services sector rather than focusing primarily upon them. In particular, the refer

ence to superannuation fund trustees

and use of member funds would seem to bring the controversial issue of fund governance right to the fore and will partly distract attention from the banks.

Kevin Davis does not work for, consult, own shares in or receive funding from any company or organisation that would benefit from this article, and has disclosed no relevant affiliations beyond their academic appointment.

Authors: Kevin Davis, Research Director of Australian Centre for FInancial Studies and Professor of Finance at Melbourne and Monash Universities, Australian Centre for Financial Studies

Read more http://theconversation.com/broad-mandate-for-financial-services-royal-commission-takes-the-heat-off-banks-88391