Westpac Fails To Monitor Suspicious Transactions

Summary:
Westpac needs to show the community it has taken clear accountability. Brian Hartzer's tenure will come under pressure, but the board also has questions to answer.

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The two things Hartzer just couldn't say

There were two things Westpac chief executive Brian Hartzer just couldn’t bring himself to say when he fronted a media call on Wednesday afternoon, hours after the bank was hit with a Federal Court claim from anti money -laundering agency AUSTRAC.

The first was the phrase “child exploitation”.

In the barrage of allegations levelled at the bank by AUSTRAC – millions of transactions not properly

reported on, poor record-keeping, systemic problems with its process and systems – the allegations that Westpac has failed to implement appropriate processes to detect suspicious payments associated with child exploitation stood out like a flashing beacon.

That phrase will haunt Hartzer and Westpac for years. But on Wednesday, the chief executive wouldn't let those words escape his mouth, instead referring to bank's due diligence around payments to the Philippines and south-east Asia.

The second thing Hartzer wouldn't bring himself to say was that he was actually responsible for the systemic problems identified by AUSTRAC, and now accepted by Westpac.

Yes, Hartzer said he was very sorry.

Yes, he promised to personally fix the problems AUSTRAC had exposed.

And yes, he said he was horrified and disgusted by the detail of the AUSTRAC court documents. These showed that one customer Westpac failed to identify made 605 payments worth $136,000 over six years, including payments to a grub in the Philippines who was arrested in November 2015 for child sex trafficking and streaming live child sex shows.

'Not indifferent'

But Hartzer also said he took issue with AUSTRAC's suggestion that Westpac's various contraventions under its case – which also included 23 million transactions it incorrectly reported on over nine years – were "the result of systemic failures in its control environment, indifference by senior management and inadequate oversight by the board".

"I agree and accept the observations made in the statement of claim almost overwhelmingly," Hartzer said. "But I do take issue with the claims that senior executives and the board have been indifferent. We have not been indifferent."

In recent years, the board had continued to ramp up its focus on its anti money-laundering and counterterrorism financing responsibilities and risk and compliance in general.

But as for taking actual responsibility, Hartzer pushed that down the line.

"It is clear that there has not been enough attention at a working level paid to resolving these issues," he said.

This simply isn't good enough.

The AUSTRAC disaster, coming just weeks after Westpac raised capital and admitted it needed to shift its strategy, has raised serious questions about Hartzer's tenure after four years in charge of Australia's second largest bank.

Increased pressure

Hartzer's decision to push responsibility down the chain of command while defending the way the board and management have handled these issues will increase the pressure on the CEO.

There were rumours that recruiters were already in the market taking soundings about possible replacements before Wednesday. That drumbeat will grow louder now.

The question is: Who else on the board might also need to take accountability for what are really two problems?

The first problem: how was this issue allowed to fester?

Westpac knew it had a problem as early as 2013, and its own policies required it to have ways to

pick up suspicious payments linked to child exploitation.

It was briefed on the size and scope of the problem in 2016 by AUSTRAC, which wanted the bank to update what's called its typology around these issues – basically the characteristics of payments it should be looking out for, such as small, frequent payments to certain countries by middle-aged men.

AUSTRAC then told the bank there were automated solutions it could use to help with this. But it wasn't until two years later that the bank got around to actually implementing these automatic solutions and the new typology, and even now some of its payment channels remain exposed.

Serious problems

How many children might have been put at risk by Westpac's alleged failures? The Westpac camp believes the number of transactions is relatively small, and some payments are quite legitimate. But the system problems mean AUSTRAC doesn't really know, and neither does Westpac.

Was the bank's team just too busy to deal with this issue? Or was this just an example of the regulatory burden that the Westpac camp likes to warn against? How on earth has this been allowed to fall down the priority list, such that the problem is still not apparently fixed?

The second question that Hartzer and chairman Lindsay Maxsted must answer is why the board apparently knew so little about this child exploitation issue.

After defending the level of oversight by the board and management, Hartzer then revealed he had heard "high level" reports about the child exploitation matters only about a month ago, and nothing of the detail until Wednesday morning.

This suggests a serious and on-going problem.

If we've learnt one lesson from the royal commission, it's that accountability sits at the top of these banks.

The tone comes from the board and senior management down to the shop floor. Information – particularly bad news – must flow from the bottom right to the very top.

Do Westpac's board and management still have cultural problems that prevent this from happening?

Hartzer dodged questions about his own future on Wednesday, and he is right that the priority is finding out what went wrong and fixing it immediately, such that it doesn't happen again.

But soon enough, he will need to explain why the problems that AUSTRAC alleges were allowed to fester and why he is the right person to lead the bank out of this mire – not to mention through the dramatic changes being forced on bankers by lower interest rates, disruption and regulatory intervention.

Hartzer has been especially vocal on the latter, saying just two weeks ago that the banking sector was being hit by forces that are "all about public sector intervention one way or another".

Investors and the broader community will have no truck with that line after reading the AUSTRAC allegations.

They will want answers and accountability. Quickly.

BRN Comments

For many years bankers have covered up and ignored cases of misconduct. The environment is now very different. In part due to the Royal Commission but also due to victims of misconduct speaking

out and working together to hold bank executives accountable for legacy cases. Every bank is right now seriously investigating cases that can no longer be so easily dismissed.

Westpac is giving some victims a very good hearing right now and we expect positive moves toward a fair remediation. These cases occurred on the watch of previous administrations. As with the other banks - that makes them perfect for repair by the current leaders who can review the cases with clean hands and fresh eyes.

Scott Morrison looks a bit of a dill now. For years he has been saying our banking system is clean, strong and honest. He said the "cop on the beat" was doing a great job. The fact is he's no dill. He knew exactly what was going on. Politicians and their regulators have been protecting bankers for decades. They have known the whole time. Just pathetic .... but wilful blindness is no longer an option. Politicians that don't stand with the people on bank misconduct will be laughed out of office .... if they're lucky.

Director jobs on the line at Westpac AGM

Westpac's AGM next month will be a flashpoint for the bank, which faces a second strike and has five directors up for election.

Westpac isn’t going to receive any respite from its AUSTRAC nightmare.

The bank’s annual general meeting on December 12 looks like a potentially ugly flashpoint, with shareholders to vote on handing it a second strike against its remuneration report, and on the election of no less than five directors, including risk and compliance committee chairman Ewen Crouch.

This will be a test for chief executive Brian Hartzer and chairman Lindsay Maxsted, who are under huge pressure following allegations that the bank failed to put in place adequate measures to identify suspicious payments connected to child exploitation, with a least one customer funnelling money to a man later arrested on child sex trafficking charges.

There are no two people more responsible for the culture of Westpac, and the tone that gets set from the top.

But this is also a huge test for investors.

While shareholders did deliver Westpac a 64 per cent strike against the bank’s pay report in the midst of the Hayne royal commission, the AGM provides them with the chance to draw a real line in the sand and demand cultural change.

Delivering Westpac with a second strike, which would force the company to then hold a vote on whether to spill the board, would be one signal that investors can send, although arguably this AUSTRAC matter will be reflected in the bonus payments made – or more appropriately withheld – in the 2020 financial year.

But voting a director off the board would send an even stronger message. With a 50 per cent vote required to topple a board member, the bar is much higher than for a strike against the pay report, which requires a 25 per cent vote against.

And while we have seen protests against the re-election of directors, and occasionally sizeable ones, voting down the director of a bank is unheard of.

Of course, that’s what would make the message that much louder.

There are five directors facing either election or re-election to the Westpac board next month.

Publishing industry executive and marketing expert Margie Seale only joined the board in the last 12 months, so hers is a formal election to the board. It's the same for Steve Harker, the former boss of Morgan Stanley in Australia.

Former Equifax chief executive Nerida Caesar faces re-election, but given she only joined the board in September 2017 isn't likely to be a target for too much investor angst.

But it's a different story for former ANZ chief financial officer Peter Marriott, who joined the board in June 2013 – the same year that, according to AUSTRAC, Westpac first recognised it had a problem with potential child exploitation issues, even if they weren't properly addressed until June 2018, and are still not completely fixed.

Also facing re-election is former Allens M&A lawyer Ewen Crouch, who must surely face the greatest scrutiny of the quintet.

Like Marriott, he joined the board in 2013 and so has also been a director throughout the period covered by the royal commission and now this AUSTRAC mess.

It is standard practice at Westpac that every director sits on the risk and compliance committee, so arguably every director bears some level of responsibility for the AUSTRAC scandal.

(This membership policy is presumably used as a symbol of the board's deep commitment to this area, which Hartzer was at pains to defend on Wednesday in his first public comments on the AUSTRAC case. Although as bank governance expert Professor Elizabeth Sheedy from Macquarie University's Applied Finance Centre suggests, sometimes having everyone responsible means no one person is completely responsible.)

But Crouch, who is also the chairman at Corporate Travel Management, is the chairman of that committee and so must surely have some specific questions to answer.

Why was this risk around child exploitation allowed to remain unaddressed for so long? And how was it that, according to Hartzer, news of these problems did not reach the upper echelons until about a month ago?

It's interesting too that Westpac's self-assessment of its culture, governance and accountability provided quite an upbeat view of the board's role, saying the bank had a "respected and suitably challenging board, good 'tone from the top', robust committee structures and practices, and a secretariat that facilitates comprehensive reporting and processes of generally high quality".

Perhaps the prudential regulator will be asking Westpac to consider that assessment again in the coming months. Arguing that board and management are strong in their view on risk in the midst of a scandal like this, as Hartzer did on Wednesday, is a bit like losing a footy match by 200 points and claiming you're the better team.

For all that, observers say it is extremely unlikely that any director will be voted down. It's more likely that they fall on their swords before the meeting, in response to the ugly AUSTRAC scandal.

But for all the attention on the Westpac board and management, we should put at least a bit of focus on Westpac's investors, including the big index funds such as BlackRock, State Street and Vanguard, and several large super funds, who love nothing better than to talk about how seriously they take corporate governance.

Will these investors walk the talk on governance? Here is a bank where cultural change and accountability is clearly needed.

Investors can and should drive this change and accountability by being as open and transparent about their voting intentions as they expect the banks to be about everything in their organisations.

Sheedy says she has been constantly shocked at how many large financial institutions around the world have struggled to get anti-money laundering (AML) systems and processes right and argues that partly these banks are reacting to pressure from investors to keep costs down.

"Fixing it is big, and it's ugly and it's expensive," she says.

But this makes AML a perfect issue for long-term investors to campaign on. They can effect change by making it clear to the banks that they should spend the money and the time getting things like this right, safe in the knowledge that the banks will be better businesses in 10, 20, 30 and 40 years time for it.

And yes, that may well mean, in the Australian context at least, that the banks can no longer afford to pay up to 80 per cent of their profits out as dividends.

"The long-term investors are the ones that really can make a difference here," Sheedy says. "It’s got to be OK for the banks to cut back on the dividends in the short term. The kinds of return on equity we’ve seen in the past are just not sustainable."

Sheedy's other great hope is that APRA's Banking Executive Accountability Regime (BEAR) might prove its worth in reaction to the Westpac case.

Sheedy has long argued that one of the big problems with banking regulation - and the way that banks have structured their organisational maps - is that it has allowed individuals to avoid accountability. But BEAR was designed to break through this and the Westpac scandal surely gives APRA the perfect test case.

"If we can make this BEAR program work, it does offer us some hope," Sheedy says.

Westpac board passes the buck

The Westpac board wants independent experts to review accountability. Sorry guys, that's your job.

Westpac’s board, led by chairman Lindsay Maxsted, has badly failed to seize control of the narrative surrounding its ugly AUSTRAC scandal.

In its first public statement since it was revealed on Wednesday’s that the bank failed to put in place adequate measures to identify suspicious payments connected to child exploitation – with at least one customer funnelling money to a man later arrested for child sex trafficking – the board apologised unreservedly.

And then it kicked the can down the road.

Apparently the community is supposed to be satisfied that there is “a multilayered review” underway to fix the existing problems and prevent them from happening again.

And if that doesn’t reassure you, then the board “will appoint independent experts to oversee the program including a review of accountability … An assessment of suitably qualified candidates to lead that review is underway.”

Sorry, what?

What is the Westpac board, if it is not a group of suitably qualified, independent experts?

And while they may not have deep knowledge and expertise in anti-money laundering matters, surely one of their most important roles is to understand, monitor and police how accountability works in the bank, particularly at its highest levels.

You don't pass this job onto someone else under the auspices of a review. That's not what shareholders expect.

Don't forget, these Westpac directors would have spent literally hundreds of hours around the board table in the last 12 months understanding how accountability works in this new environment.

How do we know? Because the prudential regulator ordered the bank to perform a self assessment of its culture, governance and accountability just last year. The 131-page report was published in July, a move applauded at the time.

Now, that report did give the board a pretty glowing pass mark, saying the bank was "well governed, with a respected and suitably challenging board, good 'tone from the top.'" After what we've learned this week, a fresh assessment of the culture and governance of the top levels of this bank is definitely required, although surely at a later date.

But there should be no need to review accountability. It starts and ends at the top of the organisation. You shouldn't need an independent expert's review to tell you that.

That the board has promised further updates in the coming days speaks to how this was little more than a holding statement.

What will realistically change in just a few days, other than that perhaps Maxsted and chief executive Brian Hartzer getting a bit more time for their private accountability review?

It's notable that Maxsted didn't use Friday's statement to provide Hartzer with any sort of support or cover; given Prime Minister Scott Morrison even suggested the board should reflect on Hartzer's tenure and show accountability, overt support for Hartzer wouldn't have been wise.

Surely the next update from the board will arrive quickly, and bring meaningful change at the top of this bank.

Websites For More Information: Source - AFR - Chanticleer - 21.11.19
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