

GOVERNANCE, ACCOUNTABILITY AND CULTURE SELF-ASSESSMENT WESTPAC BANKING CORPORATION

28 November 2018

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In this report, a reference to “Westpac”, “Group” or “Westpac Group” is to Westpac Banking Corporation ABN 33 007 457 141 and its subsidiaries unless it clearly means just Westpac Banking Corporation.

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PART A

INTRODUCTION

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- Chapter 2. Self-assessment approach
- Chapter 3. Risk and customer evolution at Westpac

CHAPTER 1:

REVIEW TEAM REPORT OVERVIEW AND HIGH-LEVEL FINDINGS

CHAPTER 1. REVIEW TEAM REPORT OVERVIEW AND HIGH-LEVEL FINDINGS

In this overview, the Review Team¹:

1. provides some context for the work that it undertook;
2. outlines its high-level findings on how Westpac's governance, accountability and culture settings influence the organisation's non-financial risk² performance;
3. identifies strands of Westpac's "corporate DNA" that, although not universal in their application, warrant close attention as Westpac assesses and implements the recommendations outlined in this report; and
4. summarises the recommendations flowing from its findings.

1.1. Context for the Review Team's work

- 1.1.1. The financial services industry is no stranger to external scrutiny. The efficient and effective functioning of the industry is essential to Australia's economic wellbeing and social cohesion, and this gives governments a strong incentive to keep the industry under close watch, which they do. The industry is aware of its special position, and largely accepts that its central role in the economy carries with it special responsibilities.
- 1.1.2. Until relatively recently, scrutiny of the industry centred on issues which, although frequently controversial, did not generally call into question the integrity of industry participants. There were exceptions, but external interest largely focused on such matters as industry role, efficiency, effectiveness, access to services, and ownership. There were also issues of consumer protection and competition regulation, but they rarely extended into the realms of fundamental honesty or ethics.
- 1.1.3. This began to change as the impacts of the global financial crisis were felt by governments and communities. Responsibility for the excesses that led up to the crisis may rest in many quarters, but bankers have rightly been criticised for their contribution. Moral hazard amongst bankers became a topic of conversation amongst governments and regulators. So too did the concept of organisations "too big to fail." Criticism of banks grew and awareness of banker failures spread into the wider community. The scene was set for a loss in trust.
- 1.1.4. For a time, it looked as though the worst of this may have passed Australia by. The industry had experienced a relatively mild strain of the crisis. Helped by sound prudential supervision and government liquidity support, Australian banks dipped but recovered more quickly than most. But support for customers while this was happening was patchy. Banks also took steps to protect their financial strength through enforcement practices and management of interest rates, particularly mortgage rates. The self-interest in this did not go unnoticed. And when banks stumbled and did the wrong thing in their customer dealings, people were not inclined to give them the benefit of the doubt. Politicians, the media, customers and regulators were ready to assume the worst.
- 1.1.5. In reality, the industry has no one to blame but itself. In the past decade it provided the country with what seemed an endless supply of customer failings, many giving rise to genuine questions about bank and employee integrity. These were portrayed by media and political figures as scandals of the worst kind. The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (**Royal Commission**) was announced.
- 1.1.6. The Royal Commission has done valuable work. It has revealed how banks, regardless of intent, can too frequently mistreat their most vulnerable customers, among other failings. It

¹ An overview of the Review Team is provided in chapter 2: *Self-assessment approach*.

² Refer to paragraphs 2.2.6 and 2.2.7 for a description of non-financial risk.

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has also helped banks to understand that their behaviours need further improvement and that trust has to be rebuilt before reputations can sustainably improve.

- 1.1.7. How could a large, mature, sophisticated and generally conservative industry work itself into such a position? And are there notable differences among the contributions of industry participants? APRA's Prudential Inquiry³ into the drivers of various failings at the Commonwealth Bank of Australia (**CBA**) shed sobering light on these questions. The findings of the Prudential Inquiry were sufficiently concerning for APRA to ask other large financial institutions to undertake a similar exercise.
- 1.1.8. Implicit in APRA's request was the possibility that many of the banks' failings were the result of a complex combination of causes. There are certainly questions about organisational ethics and greed to answer, but those close to banks also know the considerable efforts those organisations have been making to improve customer service and customer satisfaction.⁴ How could this be reconciled with mistreatment of customers while those high-profile programs were running? Were there cultural factors at play? Was governance a driver? Were bankers being properly held to account for their actions? And to what extent can bank performance be explained by the fact that banks just hadn't focused enough on identifying, understanding, controlling and managing a range of largely operational risk and compliance factors in their day-to-day work?
- 1.1.9. In response to APRA's request for a self-assessment of these matters, the Review Team has prepared this report on Westpac's governance, accountability and culture settings and, in particular, the impact that they have on Westpac's non-financial risk performance. Dealing with those issues has necessitated an understanding of the drivers of Westpac's behaviours, and why those drivers exist. That, in turn, has entailed consideration of events in Westpac's history that have heavily influenced its culture and approach to risk management, before focusing attention on current practice.⁵

1.2. High-level findings

- 1.2.1. Detailed findings for each of the thematic of governance, accountability and culture appear in Parts B, C and D of this report. The Review Team's high-level findings are outlined below:

1) Westpac's governance, accountability and culture settings, in their totality, generally support sound management of the Group's non-financial risks.

Comment: This is a balanced judgement formed by the Review Team. A wide range of shortcomings and opportunities to enhance frameworks and practices are identified in this report, but these do not aggregate to a level of significance that would call into question Westpac's fundamental ability to manage⁶ non-financial risk. This judgement incorporates consideration of misconduct and other non-financial risk failings at Westpac, as well as the observed strengths in Westpac's governance, accountability and cultural settings.

2) Westpac's management of non-financial risks across all lines of defence remains generally less mature than its management of financial risks and this factor is

³ Prudential Inquiry into the Commonwealth Bank of Australia (**Prudential Inquiry**).

⁴ Refer to section 3.2: *Customer service and values*.

⁵ Refer to brief overviews of Westpac's risk management and customer, service and culture evolutions in chapter 3: *Risk and customer evolution at Westpac*.

⁶ In the context of the Review Team's findings, the terms "manage" and "management" include assurance over management.

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likely near, or at, the root cause of many of Westpac’s non-financial risk-related issues.

Comment: Many of the improvement recommendations in this report are directed at lifting this level of maturity. In the interim, the maturity gap may contribute to further issues.

- 3) The prominent behavioural characteristics at CBA identified by the Prudential Inquiry, particularly a sense of chronic ease, complacency, and certain governance-related issues, are not similarly prominent at Westpac. To the extent seen at Westpac, the behaviours do not alter the Review Team’s judgement in finding 1.**

Comment: A number of the less central and determinative findings at CBA did have resonance at Westpac. These include a lack of clarity on accountabilities and consequences, and challenges in rapidly identifying, prioritising, escalating and remediating issues.

In relation to the findings:

- None is intended in any way to excuse or mitigate misconduct at Westpac.
- Westpac must not allow efforts to mature its non-financial risk capabilities to detract in any way from its financial risk management capability.
- They are current as at the date of this report, taking into account recent improvement activity to the extent only that implementation and adherence to any associated policies and processes have been demonstrated.

1.3. Corporate DNA strands at Westpac

- 1.3.1. The authors of the Prudential Inquiry report formed their views on a complex set of multi-dimensional outcomes around a small number of prominent behavioural traits at CBA. This approach gave those responsible for responding to that Inquiry a useful frame of reference to assess the efficacy of remedial action.
- 1.3.2. As noted in finding 3, the prominent CBA traits noted in the Prudential Inquiry report were not similarly prominent at Westpac. But there were others. In discussing them below, the Review Team adopts the imperfect, but convenient, analogy of DNA.
- 1.3.3. There were three strands of Westpac’s “corporate DNA” frequently observed through the Review Team’s work, all deeply inter-woven, and each with positive and negative facets. These tendencies in the organisation - behaviours that are prevalent, but of course not universal - merit serious consideration.
- 1.3.4. The first DNA strand could be summarised as an **organisational tendency to cultivate complexity**. Westpac has a high level of comfort with complexity, including complex interactions within the Group, multiple frameworks and policies dealing with what are really common issues, and complex systems and processes. To achieve satisfactory outcomes amidst this complexity, there is too often reliance on personal networks, critical employees and ad hoc workarounds. The inefficiencies and the opportunity for errors in this, including in risk management, are obvious.
- 1.3.5. The second corporate DNA strand observed – **a tendency to privilege upfront conceptual work over execution and implementation**, including a fading of focus as work proceeds

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from idea to action – featured widely in the self-assessment.⁷ Consequences include an execution deficit, delayed and inadequate embedding of change, additional cost and a lack of accountability for outcomes. While Westpac has taken steps to build its execution capability, including through the Westpac Next initiative, gaps remain. These present themselves in various ways, including in the effectiveness and efficiency of risk-related change implementation. The issue is often characterised as Westpac having a dominant intellectual or analytical culture, but the shadow of this is, too frequently, sub-par execution.

- 1.3.6. The third of these DNA strands is an **organisational imperative for safety**, both at a company and employee level. In many respects, this is a strength, and one that has held Westpac in good stead for much of its history. Westpac's near insolvency in the early 1990s reinforced the trait as Westpac slipped from being Australia's largest to third largest bank. That experience drove focus on management of financial risk, especially credit risk, embedding skills that proved invaluable during the global financial crisis. It also made Westpac sceptical about becoming involved in things that it didn't fully understand or which did not seem to make sense, again of value during the crisis. None of which is to say that the organisation does not and will not misstep, as a casual observer would readily see.
- 1.3.7. Another positive side of the safety imperative is the significant time that Directors and Group Executives devote to risk matters, facilitating deep and healthy debate and discussion about the Group's risk profile.
- 1.3.8. But there can be a less positive side to the safety imperative. At an organisation level, over-focus on safety can inhibit proper empowerment of employees by unnecessarily restricting decision rights, leading to gaps in individual accountability and an overweighting to matrix-managed collective decision-making. It can also foster competing notions of safety where the stronger voice in the debate prevails, sometimes with negative consequences. For example, the legitimate concern in the Finance function that the organisation protects itself through strong financial results can crowd out claims for additional spending on risk or compliance issues from what might at the time be less strong voices in Risk or Compliance.
- 1.3.9. The desire to err on the side of safety can also at times be problematic for individuals in their contributions to the company's risk management. Undue caution may prevent them from speaking up about risk issues when they should. Decisions may be delayed or avoided while further analytical work is done, although that work adds little value. Safety may be sought in numbers, with decisions in effect delegated to committees or informal groupings of peers or more senior people.⁸ Governance forums can unnecessarily proliferate and be used as safe harbours from personal risk, rather than just for oversight and guidance. The result can be excessive consumption of scarce time and resources generating too little progress, and the crowding out of headspace that could be devoted to improving the company.
- 1.3.10. In the Review Team's judgement, implementing the recommendations in the report should modify those DNA strands in a positive way, promoting forces working for, rather than against, more effective and efficient risk outcomes. Monitoring these strands as remedial work progresses will help those involved understand how effective they are being, enhancing positive dimensions of the trait and minimising the "watch areas", and assist in identifying adjustments to approach. It will also help to ensure that the work itself does not succumb to the very traits that it seeks to address.

⁷ A driver of this characteristic is likely to be the volume and pace of issues confronting employees, and the perceived need to move onto the next issue as soon as possible.

⁸ Although this characteristic also has a positive side, reflected in strong collaborative behaviours seen at Westpac.

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1.4. Recommendations

- 1.4.1. Recommendations following from the Review Team's findings appear through the body of the report and an integrated discussion on the suggested approach to addressing recommendations is in chapter 14: *Review Team suggested approach to implementation of recommendations*.
- 1.4.2. Westpac has a number of initiatives underway that address many of the Review Team's observations and these should largely continue as planned. The Review Team provides recommendations that will further enhance governance, accountability and culture across the Group and supplement the current initiatives.
- 1.4.3. To achieve the desired state for Westpac, the Review Team suggests that an overarching, cohesive program sponsored by the CEO, and overseen by the Executive Team and the Board Risk & Compliance Committee,⁹ be established to implement the recommendations.
- 1.4.4. The program should be structured around five streams, each with an accountable executive.
- 1.4.5. These are:
- **Board and Executive Governance:** A set of initiatives related to Board and executive matters, including reporting and paper preparations, risk appetite-setting and review of the governance structures through the Group.
 - **Risk and Compliance:** Recommendations spanning all lines of defence, including:
 - initiatives to enable a consistent, effective and efficient Three Lines of Defence (**3 LOD**) model across Westpac;
 - a Line 2-driven review of the risk operating model; and
 - a broader uplift in efficiency of risk and compliance management.
 - **Customer:** Recommendations covering enhanced practices relevant to the experience of customers, particularly the management of customer complaints.
 - **Remuneration and Accountability:** Recommendations related to accountability, including the application, reporting and embedding of risk gates and risk adjustments, and updates to remuneration frameworks and policies.
 - **Culture:** Recommendations to shape and enhance Westpac's culture through a long-term, systemic and systematic program of work that builds on existing programs to the extent possible, focused on leadership (supporting leaders and equipping leaders to be more effective), enhancements to "ways of working", new skills and attitudes, and increased recognition of desired behaviours.
- 1.4.6. Having regard to the capacity of the organisation to absorb change effectively, it may be necessary to prioritise and stage the remedial work contemplated by the recommendations. This could mean some recommendations being implemented before others, and recommendations involving significant work being implemented over an appropriately extended timeframe.
- 1.4.7. In undertaking detailed implementation planning, it will be necessary to complete a "stocktake" of current and prospective initiatives relevant to the scope of proposed remediation work. Where desirable and practical, these initiatives can be incorporated in the overarching program to facilitate an appropriately holistic approach.

⁹ Membership of this Committee comprises all non-executive Directors of the Board.

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2.1. Background

- 2.1.1. On 1 May 2018, APRA released the final report of the Prudential Inquiry. The Prudential Inquiry was established in 2017 to examine frameworks and practices in relation to governance, culture and accountability at CBA, following a number of mainly non-financial risk-related incidents that damaged CBA's reputation and public standing.
- 2.1.2. In June 2018, APRA requested that Westpac, together with other large financial institutions, perform a self-assessment of governance, culture and accountability, including consideration of whether issues similar to those raised in the report of the Prudential Inquiry might exist.¹⁰ The report of the self-assessment is to be provided in Board-endorsed form to APRA by 30 November 2018.
- 2.1.3. The Board subsequently commissioned a special-purpose Review Team¹¹ to undertake the self-assessment. The Board endorsed the Review Team's proposed approach to this exercise, including scope, methodology, execution and assurance model, in June 2018.
- 2.1.4. The Review Team was:
- overseen in an executive capacity by a former executive of the company;
 - operationally led by a General Manager removed from day-to-day executive reporting lines and accountabilities;
 - supported with expert contribution from external consulting firm, Oliver Wyman, under Partner-level leadership;
 - staffed by a blended complement of Westpac and Oliver Wyman practitioners, selected for relevant expertise and experience; and
 - run under the auspices of the Board and a delegated Review Director from the Board,¹² rather than the CEO or other senior line manager.
- 2.1.5. The work of the Review Team was subjected to Board oversight during the assessment process, including through regular meetings with the Review Director and written and verbal updates at Board meetings. An Executive Steering Group, comprising members of the Westpac Executive Team, was established and functioned principally to review facts, factual omissions and logic. Final editorial rights were the preserve of the Review Team, other than on independent assurance matters.¹³

2.2. Scope

- 2.2.1. The objective of the self-assessment was to review, assess and identify strengths and shortcomings in Westpac's governance, accountability and culture frameworks and practices, particularly insofar as they affected the organisation's non-financial risk performance in its **Australian operations**.
- 2.2.2. In addition, the Review Team sought to recommend, at a high level, appropriate remedial or improvement action in response to the conclusions it reached.
- 2.2.3. In forming its conclusions, the Review Team considered evidence that it gathered or originated as well as relevant Australian and global peer "better practice" and the findings and observations of the Prudential Inquiry.

¹⁰ Refer to APRA's letter to the Chairman dated 4 June 2018.

¹¹ Details of the Review Team structure and personnel are set out in Appendix A.

¹² The Chairman of the BRCC undertook this role.

¹³ Assurance processes relating to the self-assessment are described in section 2.4.

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- 2.2.4. To assist the evaluation of the relevance to Westpac of the findings and observations of the final report of the Prudential Inquiry, the high-level subject matter scope of the self-assessment was aligned to the Terms of Reference of the Prudential Inquiry, particularly the consideration of:
- Westpac's organisational structure, governance, financial objectives, remuneration and accountability frameworks and the extent to which they conflict with or promote sound risk management and compliance outcomes; and
 - any remediation initiatives that Westpac has underway to enhance its governance, culture and accountability frameworks and practices.
- 2.2.5. Notwithstanding this alignment, the self-assessment was not limited to topics contained within the report of the Prudential Inquiry.
- 2.2.6. However, the primary focus on non-financial risk in the Review Team's scope was consistent with the scope of the Prudential Inquiry. For the purposes of this assessment, "non-financial risk" refers to operational risk (including data and technology risk¹⁴), compliance, conduct risk and reputation risk.¹⁵ This scope encompassed, among other things, the frameworks and practices employed in the management of Westpac's compliance with regulatory obligations as enforced by APRA, the Australian market conduct and enforcement regulator (ASIC) and other regulators (AUSTRAC, OAIC and ACCC) covering anti-money laundering and counter-terrorism finance, sanctions, bribery and corruption, privacy and competition at a Group and Divisional level in Australia. **Unless otherwise noted or readily inferred from context, this report uses the term "risk" to refer to non-financial risk:** further terminological details are provided in section 2.5.
- 2.2.7. This report uses Westpac's definitions of major risk classes. **Operational risk** is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events and includes legal risk, but excludes strategic and reputation risk.¹⁶ **Compliance risk** is "the risk of legal or regulatory sanction, financial or reputational loss, arising from [Westpac's] failure to abide by the compliance obligations required of [Westpac]."¹⁷ **Conduct risk** is "the risk that [Westpac's] provision of services and products results in unsuitable or unfair outcomes for our stakeholders or undermines market integrity".¹⁸ **Reputation risk** is "the risk of the loss of reputation, stakeholder confidence, or public trust and standing."¹⁹
- 2.2.8. In assessing the impact on Westpac's governance, accountability and culture frameworks and practices, the Review Team considered bounded examples of strengths and shortcomings in the management of particular risks and / or compliance obligations, as manifestations of the frameworks and practices. However, the overall effectiveness of management of any category of risk or compliance (including direct assessment of the capabilities of associated individuals or functions), and the degree to which legislative and regulatory compliance is achieved, were explicitly out of scope.²⁰ The assessment of Westpac's frameworks and practices is a current-state assessment; however, the Review Team's work drew on data from July 2013 to June 2018, going as far back in that period as particular subject matter warranted. This period was sufficient to capture a broad and

¹⁴ The definition of operational risk in Basel Committee on Banking Supervision, *Principles for the Sound Management of Operational Risk*, June 2011 encompasses data risk and technology risk.

¹⁵ Business risk (i.e., the risks arising from the strategic objectives and business plans), related entity risk and sustainability risk were not within scope of the assessment.

¹⁶ Refer to definition in footnote 14.

¹⁷ Definition in *Risk Management Strategy* (August 2018).

¹⁸ *Ibid.*

¹⁹ *Ibid.*

²⁰ Refer to out-of-scope statement in Appendix B.

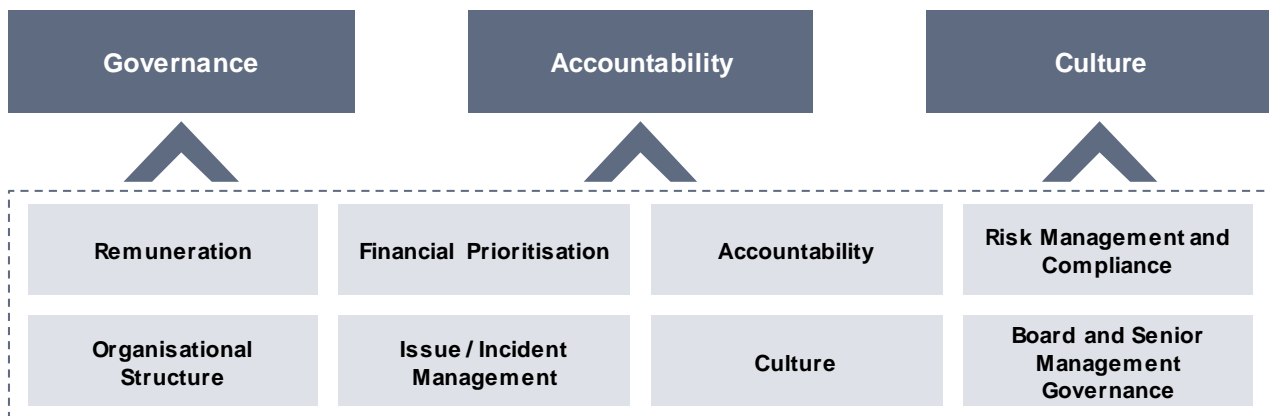
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organisationally representative set of decisions and outcomes, including those arising from strategic review and long-term investment cycles.²¹

2.3. Methodology

- 2.3.1. The methodology used in the self-assessment was principally inductive. Generalised findings regarding Westpac’s governance, accountability and culture frameworks and practices were derived from comprehensive review of triangulated data. The data used to ground these findings were extensive – including documents (such as policies, procedures and committee papers),²² interviews, surveys, workshops and comprehensive case studies constructed from the data and provided as secondary inputs to the assessment. In addition, certain inductive propositions relating to culture were tested for statistical generalisability via tailored survey questions.
- 2.3.2. The self-assessment was structured around the three thematic areas referred to in the APRA request: governance, accountability and culture. These themes were decomposed into eight assessable elements, referred to as “dimensions”, and each dimension decomposed into analytically-useful attributes known as “sub-dimensions”. The thematic areas and dimensions overlap and are interdependent, and are presented in Figure 2A.

Figure 2A Dimensions of self-assessment



- 2.3.3. The Review Team formulated and tested hypotheses regarding Westpac’s state in each of these dimensions, informed but not constrained by “better practice” maturity matrices provided by Oliver Wyman that described deficient, developing, good and better practice at relevant Australian and global peers, at sub-dimension level.²³
- 2.3.4. The range of activities undertaken by the Review Team to develop and test hypotheses about strengths and shortcomings in Westpac’s frameworks and practices is described in more detail in Appendix C. Case studies were one important element of this process, contributing rich detail and texture through an articulation of the ways that governance, accountability and culture frameworks operate in practice.
- 2.3.5. The approach of the Review Team to cultural assessment was practical. It was focused on behaviours and related drivers, with the objective of identifying manifestations of culture that

²¹ The time frame is also consistent with the time frame observed in the Prudential Inquiry.

²² Refer to Appendix C for additional detail on documents reviewed.

²³ While dimensions and sub-dimensions exist for Culture, there is no “better practice” maturity matrix for Culture. In this context, culture is examined as it bears on the management of non-financial risk and compliance – not in general.

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were amenable to concrete interventions to reinforce, strengthen or improve. In addition to reviewing secondary data, the Review Team generated new data to support the assessment, including extensive content from interviews, focus groups and responses to tailored questions sent to over 3,600 employees as an augmentation of the September 2018 Employee Sentiment survey. The assessment methodology for the Culture stream is described more fully in Appendix C.

- 2.3.6. Each hypothesis developed by the Review Team was the subject of scrutiny, debate and challenge by members of the Review Team. Some hypotheses were also workshopped with Oliver Wyman's global expert panel. All "accepted" hypotheses were supported by multiple data points. The subsequent framing and description of any agreed shortcoming or strength in this report was also subjected to extensive Review Team validation, as well as factual verification by subject matter experts, to ensure the accurate and fair representation of facts and findings.

2.4. Assurance

- 2.4.1. Independent assurance to the Board regarding the rigour of work performed and findings made by the Review Team provided a further layer of challenge to the self-assessment. This was provided under a "co-sourced" model by Deloitte and Westpac Group Audit.
- 2.4.2. Assurance scope was divided between Deloitte and Westpac Group Audit (collectively, the **Internal Audit Team**) after consideration of expertise, management of conflicts of interest, and resource availability. Some work was performed exclusively by one organisation or the other; some was shared.
- 2.4.3. The Internal Audit Team was independent and objective: it did not develop or implement the self-assessment methodology and was not involved in the operational management of the self-assessment.
- 2.4.4. The Internal Audit Team's opinion on the self-assessment covered the extent to which there were any significant concerns with the:
- design and operating effectiveness of the self-assessment scope and methodology to meet the self-assessment objectives outlined in APRA's letter to the Chairman dated 4 June 2018; and
 - the findings as documented in this report, based on the Internal Audit Team's documented knowledge of the Group and knowledge gained during the self-assessment.
- 2.4.5. The Internal Audit Team's report (including scope, approach, opinions and related definitions and limitations) is provided separately to the Board.

2.5. Terminology

- 2.5.1. In this report, subsequent references to **Risk** are to the Risk division that is overseen by the CRO. References to **Operational Risk**, **Assurance** and **Compliance** are to the respective business units within Risk (as at October 1, 2018). As stated earlier, the term **risk** is used to refer to non-financial risk unless otherwise noted or readily inferred from context.

2.6. Report structure

- 2.6.1. The following chapters of the report are set out in four parts. As the assessment of accountability frameworks and practices was informed by governance considerations, and as cultural findings were shaped significantly by governance and accountability factors, Parts B, C and D address the three thematic areas of Governance, Accountability and Culture in that order. Part E brings together recommendations contained in preceding sections, as well

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as implementation considerations. Given the compressed timeframe over which this assessment was undertaken, many recommendations will require additional detailing ahead of implementation.

CHAPTER 3:

RISK AND CUSTOMER EVOLUTION AT WESTPAC

CHAPTER 3. RISK AND CUSTOMER EVOLUTION AT WESTPAC

3.1. Risk management

- 3.1.1. While Westpac has been managing risk since 1817, its approach to risk in 2018 has been shaped largely by events of the past quarter-century. That shaping has occurred in distinct stages, as sketched below.
- 3.1.2. Westpac's "near-death" experience of the early 1990s, when corporate credit losses pushed the bank to the brink of insolvency and saw it slip from being Australia's largest to third-largest bank, still looms large in corporate memory. This trauma galvanised a comprehensive rebuilding of the company's credit risk culture, systems, processes, organisation and personnel, under the leadership of Bob Joss. More broadly, it led to a modernisation of information systems (such as the creation of a single general ledger and group data warehouse) and management systems (including a significant uplift in metrication of performance measurement and reward) used to run the bank.
- 3.1.3. These changes were ingrained during the David Morgan era of consolidation, growth and high returns, and in most respects they remain sources of strength for the Group. However, during this period of relative calm – Asian crisis notwithstanding – risks were brewing, both in Westpac and in the global financial system. Those risks crystallised in the last years of the previous decade, just as Gail Kelly assumed leadership of Westpac.
- 3.1.4. The global financial crisis (**GFC**) forced Westpac to focus with sustained urgency on funding, liquidity risk and capital levels. It was a turning point in the management, regulation and public perception of banks, the effects of which are felt strongly to this day.
- 3.1.5. While Westpac grappled with the financial risks of the GFC and the complexities of its 2008 merger with St.George, it contended with another challenge. Following an extended period of what, in hindsight, was underinvestment in technology after the overreach of the CS90 program in the early 1990s,²⁴ it was confronted late last decade by a range of significant maintenance and stability problems. The merger with St.George in December 2008 also added a large suite of systems to the already-complex Westpac Group environment, including systems from earlier St.George acquisitions that had not been integrated with St.George parent systems.
- 3.1.6. The work to integrate Westpac and St.George systems following the merger proved more difficult and protracted than was expected. There is still a legacy of complexity, replication and high cost of maintenance and change. That legacy has to an extent been self-perpetuating, as the change needed to undo it is complicated and expensive, and the organisation has added layers of business process in the course of adapting to it over ten years.
- 3.1.7. In responding to the maintenance and stability problems, the profile of technology risk management was raised, the Technology function was elevated in stature, a comprehensive IT strategy was developed and a multi-year program of remedial and strategic work was initiated. Robust governance of this effort was essential, an important component of which was a Board Technology Committee, established in 2008.
- 3.1.8. While the bank-killing potential of liquidity and credit risk events was necessarily given priority during extended periods of crisis, Westpac has been compelled to turn its attention over the past decade to an array of non-financial risks. This started with technology risk, but heightened public, political and regulatory scrutiny of banking practices arising from the GFC

²⁴ In 1987, Westpac publicly announced the launch of a major project, CS90 (Core Systems 90), to build a core banking system. The project faltered, and Westpac terminated it and 500 jobs in 1992, incurring a \$150 million loss. One legacy of this debacle was organisational scepticism regarding the value of technology investment and capability of the technology function.

CHAPTER 3. RISK AND CUSTOMER EVOLUTION AT WESTPAC

and various banking scandals in the United States and United Kingdom also brought to the fore risks relating to conduct, compliance and reputation.

- 3.1.9. Financial risks are easier to quantify and manage centrally than non-financial risks. Non-financial risk is inherently more dispersed in its drivers and demands on management. In this context, the growing emphasis on non-financial risk management aligned well with the adoption by Westpac of the 3 LOD risk governance model in 2010. Reflecting the principle that “risk is everybody’s business”, the 3 LOD model made clear that responsibility and accountability for risk began with the business that originated the risk. The implementation of this framework has, however, been intermittent, imperfect and inconsistent between divisions, as illustrated in one of the Review Team’s case studies.
- 3.1.10. Recognising the relative immaturity of its compliance capability, Westpac began a journey of enhancement in 2011. Compliance was lifted out of the Risk division and centralised in the Group Services division under a Chief Compliance Officer (**CCO**), and work began to build the foundations of a capable Compliance function. The immediate priority was the thorough documentation of obligations and associated controls against which business practices and projects could be assessed and monitored. In 2014, the Board Risk Management Committee was renamed the Board Risk & Compliance Committee, reflecting this heightened focus on compliance and recognition of its differentiation from traditional risk management.
- 3.1.11. The maturation of the Compliance function continued from 2013 under a combined role of General Counsel and Chief Compliance Officer and then, from 2016 – as the Compliance, Legal and Secretariat leadership role was elevated to Group Executive level – under the leadership of a senior General Manager dedicated to the function. The latter phase of compliance evolution has entailed extensive work to increase the quantity, seniority and expertise of individuals in the function. It has also seen considerable effort – still work in progress – to give Compliance a more prominent “seat at the table”.
- 3.1.12. From October 1 this year, a much more mature (but not yet fully mature) Compliance function once again sits in Risk, where it will work closely to further align frameworks and practices with those of other risk classes, particularly operational risk. Like compliance, operational risk has received considerably more attention in recent years, including from APRA. Certain classes of operational risk, such as cyber risk, have been the subject of concerted attention for a long period, but operational risk in general needs and has seen (and continues to see) a step-up in organisational awareness and focus. Reflecting this, a General Manager-led Centre of Excellence for the risk class was established as part of a Risk re-organisation in 2015.
- 3.1.13. The importance of conduct risk and compliance continues to be reinforced through ongoing internal review of products and practices, regulatory action and engagement, the Royal Commission, public scrutiny and a range of legislative reforms such as the Banking Executive Accountability Regime (**BEAR**). Much of the metrication of sales-related performance management and reward that had its origins in the Joss era has been undone in the process.
- 3.1.14. In 2018, Westpac is still more mature in its management of financial risks than of non-financial risks. Perhaps this is to be expected, given organisational history and the evolution of the political, economic, social and technological environment. Be that as it may, Westpac is only part-way on its journey to fully mature practice, despite significant progress in the past few years. The recommendations in this report are intended, when implemented, to expedite that journey.

CHAPTER 3. RISK AND CUSTOMER EVOLUTION AT WESTPAC

3.2. Customer service and values

- 3.2.1. The past 25 years have been similarly central in shaping the customer service and values focus of Westpac in 2018.
- 3.2.2. Banking has always been at its heart a service business. Axiomatically, the customer is central to a bank's success. However, the conceptual and normative frameworks that have guided how banks interact with customers have evolved considerably since the early 1990s.
- 3.2.3. The 1990s saw the adoption of certain metaphors that, enacted in management practice, had profound effects on banking – especially consumer banking. Most notable of these were descriptors of consumer banking as “retailing”, of branches as “stores”, of products as things “manufactured” for “sale”, and of service employees as “sales people” and “sales managers”. Allied with – and partly driving – these retail industry frames of reference was the rise of “scorecards”, “leaderboards” and pervasive “metrication” of performance measurement and reward. Reward assumed characteristics of commission payment, varying directly with quantity and value of products “sold”. The result was a sales culture, situated in turn within a financial management milieu informed heavily by market-related concepts and disciplines that gained prominence in the 1980s – such as “maximise shareholder value”, “economic value added” and the demands of an assertive and impatient market for capital.
- 3.2.4. These developments were not, at the time, understood as conflicting with the interests of customers. After all, many would argue that successful salespeople took the time to listen to customers, elicit expressed and unexpressed needs, and match an offering to those needs. More subtly, however, they did introduce new risks. A hard-nosed sales culture of “exposure mechanisms” (such as leaderboards) and direct links between metricated outcomes and employee consequences (positive and negative) meant significant pressure on individuals to “deliver”. The responses to that pressure could vary widely in degree of productiveness. At the less positive end of this spectrum, there was the risk of “pushing” products onto customers with inadequate regard for circumstances. At the management level, there was also the risk that decisions about product features or processes could be taken without adequate regard for the customer or for the long term.
- 3.2.5. This state of affairs began to change materially at Westpac under Gail Kelly's leadership. A central legacy of the Kelly era was a renewal of the idea that the customer should be at the centre of the company's decisions. In a service business, the only enduring differentiation is that achievable through the experience of the customer – and to drive that differentiation, a company's behaviours, processes and priorities, its *culture*, must be anchored to the customer. Kelly brought conviction and persistence to this message, embedding it in stated vision and values and leaving behind in 2015 an organisation more conscious of the customer in the choices that it made. The earlier merger with community-oriented St. George, and the vision to hold onto every customer, had reinforced this shift.
- 3.2.6. Brian Hartzler's appointment as CEO saw an acceleration of trends begun during Kelly's tenure. The genesis of the Service Revolution championed by Hartzler was the understanding that banking is a *service* business – not a product or retailing business. This understanding was accompanied by the recognition that long-ingrained mindsets and practices – not least those relating to metrication and sales management – were not always aligned to the service vision. Thus began the next stage of Westpac's cultural journey.
- 3.2.7. In 2015, Westpac conducted the Denison Organisational Culture Survey, to better understand the company's culture and the extent to which the culture would enable Westpac to realise its vision: to be one of the world's great service companies, helping [its] customers, communities and people to prosper and grow. Data were collected from approximately 9,000 people and 20 focus groups. Findings and inferences included:
- Westpac's people are motivated by the company's vision and strategy;

CHAPTER 3. RISK AND CUSTOMER EVOLUTION AT WESTPAC

- they see a link between their job and the goals of the organisation;
- there is an ethical code that guides behaviour, with clear and consistent values; and
- with a strong community focus, Westpac's people are driven by a genuine desire to help others and make a difference.

3.2.8. Through the Denison work it was determined that three cultural shifts were necessary if Westpac was to bring its vision to life:

- Service Orientation – putting customers' needs and service first;
- Trust and Care – always doing the right thing by its customers, communities and each other so that Westpac gains their trust, as well as creating a caring environment, so that people feel that it's safe to speak up; and
- Agility and Innovation – by challenging the status quo, looking for new ideas, owning problems, sharing solutions, failing fast and learning from past experiences.

3.2.9. Since then, Westpac has taken concerted action in support of these shifts, including the:

- adoption of the Service Promise (crafted not by management, but by employees) in 2016;
- updating of the Code of Conduct in 2017 to raise standards and incorporate the Banking and Finance Oath;
- strengthening of whistleblower policy and processes in 2017;
- transitioning of all employees to the behaviours-led Motivate framework for performance, development and reward over 2017 and the first half of 2018;
- introduction of the *Group Consequence Management Framework* in 2018;
- introduction of the *Conduct Framework* in 2018;
- tightening of recruitment processes and remuneration governance in 2018;
- implementation of the Sedgwick recommendations in October 2018, two years early, to strengthen the alignment of banker pay and customer outcomes;
- rollout of the Leadership Star in 2016 and Our Compass in 2017;
- creation of Westpac NEXT in 2015, to enable more effective, customer-centred change and innovation in projects;
- introduction of the "Get it Right, Put it Right" philosophy to guide the review of products, processes and policies to ensure that they serve customers' best interests and meet community standards, and reinforce the importance of prompt resolution of any customer-related issues;
- appointment of an independent Customer Advocate in 2016 and the appointment of a new Group Executive, Carolyn McCann, in June 2018 to oversee all customer complaints and their resolution across the Group; and
- launch of Navigate – a company-wide conversation in September 2018 about values and behaviours in real-life customer and employee scenarios, followed by a 30-minute online training intervention to reinforce the messages.

3.2.10. At the time of writing this report, there is work left to do to embed the changes introduced through these actions. This is reflected in subsequent chapters. The Review Team does, however, view Westpac's direction and intent as supportive of sound and fair outcomes for customers, employees, the community and, over the long term, shareholders.

PART B

GOVERNANCE

- Chapter 4. Governance prologue
- Chapter 5. Board and senior management
- Chapter 6. Risk management and compliance
- Chapter 7. Issue and incident management
- Chapter 8. Financial prioritisation

CHAPTER 4: GOVERNANCE PROLOGUE

CHAPTER 4. GOVERNANCE PROLOGUE

The assessment of governance involved consideration of:

- Board and senior management;
- non-financial risk management and compliance;
- issue and incident management - specifically, matters of concern raised by Westpac's employees, regulators and other external parties, customers and whistleblowers;
- financial prioritisation; and
- organisational structure.

A range of shortcomings and opportunities to enhance frameworks and practices were identified, but these did not, in the Review Team's judgement, aggregate to a level of significance that would call into question Westpac's fundamental ability to manage non-financial risk. These shortcomings and opportunities are described in the following four chapters.

Primary findings and recommendations are summarised below.

4.1. Board and senior management

4.1.1. Findings

- Westpac is well governed, with 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.
- The Executive Team is generally well regarded, providing the right "tone from the top" and, similar to the Board, operating robust and comprehensive risk governance committees and processes that are supported by reporting of generally high quality.
- Inclusion of all non-executive Directors in the membership of the Board Risk & Compliance Committee (**BRCC**), and the standard practice of Group Executive and relevant General Manager and functional Head attendance at this committee contribute positively to Westpac's governance of risk, compliance and related frameworks.
- There is scope for Group Executives to challenge each other more and, in the view of some Directors, reduce the tendency to "position" difficult messages to the Board.
- At times, the extensive reporting provided to the Board and Executive Team can be challenging to absorb.
- Across Board and senior management, there is a growing focus on non-financial risks and a conscious effort, including organisational structure and reporting enhancements, to examine issues through customer and reputation lenses.
- A more stringent approach to oversight of issues and out-of-appetite risks is appropriate, having regard to the significance of these matters and noting that prompt and effective issue resolution and closure are crucial to a robust risk and control environment.
- Below the Executive Team, there are many committees and forums, which in aggregate create excessive burdens on management time and headspace, add complexity and bureaucracy, and constrain accountability.

4.1.2. Recommendations

- Board, Board committee, Executive Team and Westpac Group Executive Risk Committee (**RISKCO**) practice can be strengthened through:

CHAPTER 4. GOVERNANCE PROLOGUE

- reporting enhancements that provide a more informative summary of principal risks and issues, bring out underlying assumptions and risks (including risks associated with investment allocation) and generally ease navigation of an extremely demanding risk and compliance agenda;
 - formalising the Chairman of the BRCC as a member of the Board Audit Committee (**BAC**);
 - additional focus on risks out of appetite and resolution of issues; and
 - further enhancements of customer reporting to Board and senior management, principally in relation to the “tail” of adverse and extended customer complaints (see *Issue and incident management* recommendations).
- In addition, that the Chairman of the BRCC, assisted by the Chief Risk Officer (**CRO**) and Group Executive, Legal and Secretariat, undertakes an assessment of the efficiency with which time is utilised in the BRCC meetings and the adequacy of the time allocated overall for the Committee’s work.
 - A review of all formal and informal governance committees and forums, divisional and Group-level, should be undertaken, with a view to rationalising – within prudent limits – the number, scope, overlap, duration, frequency and membership of such bodies.

4.2. Risk management and compliance

4.2.1. Findings

- While Westpac has made concerted efforts to strengthen its management of non-financial risk, it remains less mature in this realm than in the management of financial risk, necessitating ongoing attention.
- As in many financial institutions, the 3 LOD model at Westpac has proven conceptually simple but challenging to ingrain to maturity.
- 3 LOD maturity varies by division and is greatest in those divisions in which Line 1 has taken the lead in implementation.
- Line 1 ownership and maturity require uplift in some divisions, and Line 2 in some cases compensates for this by performing Line 1 activities, resulting in some blurring of responsibilities across the lines.
- The current Divisional CRO set-up, involving (for several divisions) small teams supported by shared Centres of Excellence, may not be optimal to support the efficient performance of the CRO role.
- While the self-assessment did not entail holistic appraisal of risk management and compliance capability in any risk class, there is a widespread view among senior interviewees that Operational Risk and Compliance teams would benefit from a strengthening of skills and a consequent “louder voice”: in the case of Compliance, work is underway to that end.
- Group Audit has at times not exerted sufficient influence on matters of concern, and it can on occasion intensify focus on certain issues only after regulator attention: it may also benefit from additional expertise in some fields, and is investing in 2019 to that end.
- Westpac’s risk and control environment could be enhanced through the development of a common risk and control language, an integrated process to regularly test non-financial risk controls, and strengthening of the existing process to identify “key” risk issues.
- Westpac’s articulation of non-financial risk appetite can be expressed at a more granular level, utilising more sophisticated measures and metrics.

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- While receiving significant attention, the management of conduct risk is nascent: sensitising the organisation to the “should we?” consideration in the “can we? should we?” frame will require concerted ongoing effort.
- While management of reputation risk is somewhat more mature, there remains considerable scope to strengthen and embed the framework in divisional processes and across the 3 LOD.
- Divisional variation in approaches to managing risk, together with a lack of integration of systems acquired through mergers and acquisitions and consequent proliferation of processes to accommodate these disparate systems, create complexity and raise the degree of difficulty in aggregating and managing risk.
- Line 2 does not always engage with and educate businesses, and then monitor and escalate concerns to the extent necessary, to ensure that policies are understood and adhered to.
- Current arrangements for the management of regulatory relationships, while structurally different from those of many peers, work satisfactorily.

4.2.2. Recommendations

- Westpac should take the following actions to strengthen its risk management and compliance practices:
 - review aspects of the 3 LOD implementation, including clarity and consistency of roles and responsibilities (including across end-to-end processes), efficiency of the Divisional CRO team set-up and strength of Line 1 contribution to risk and compliance management;
 - uplift certain skills and capabilities;
 - adopt a common risk and control language;
 - consistently link controls to risks and obligations in JUNO (Westpac’s automated system of record for risks, compliance obligations, controls and issues);
 - implement one common process to review, assess and test non-financial risk controls;
 - increase specificity of risk appetite in some areas;
 - enhance processes to identify new, emerging and heightened risks;
 - consider, design and implement a conduct risk program to instil the “should we?” consideration in the “can we? should we?” frame in Group-wide decision-making and reinforce the centrality of the customer, including emotionally resonant communication;
 - further embed reputation risk management in decision-making processes and forums across the 3 LOD, including in divisional risk committee agendas; and
 - review division-specific and brand-specific risk and compliance policies for rationalisation opportunities.

4.3. Issue and incident management

4.3.1. Findings

- Consistent with better practice and with CEO and senior management communication and initiatives to foster a “speak up” culture, the majority of issues and incidents are raised by Line 1 – and this percentage has been increasing.

CHAPTER 4. GOVERNANCE PROLOGUE

- Mechanisms to regularly test and report on the strength of Westpac’s “speak up” culture are in place and working effectively.
- Processes to regularly identify systemic issues rely on manual processes and are impeded by the lack of a common control language.
- Despite the lack of formal, mandated escalation requirements, comprehensive reporting ensures that RISKCO and BRCC are, in practice, notified of high-rated issues.
- There is no systematic mechanism in place to report near-misses to RISKCO or BRCC.
- Matters raised by regulators are accorded highest priority and attention, although, perhaps reflecting the degree of difficulty of such matters and associated assurance requirements, their resolution dates are extended more often than issues raised internally.
- Resolution of issues in general is often challenging, for reasons that include difficulties in ascertaining root causes, complexity and cost of solutions, optimistic or “placeholder” time estimates, and a certain inertia that can arise from cultural biases toward process over outcomes, conceptualisation over execution, and diffused, collective action.
- There has been a notable uplift in Westpac’s frameworks and practices to handle customer complaints, including:
 - the “Get it Right – Put it Right” philosophy;²⁵
 - creation of the Customer Advocate role;
 - establishment of the Customer & Corporate Relations division;
 - the new Group Complaints Management Standard (implementation of which is a work in progress);
 - improvements in customer complaint reporting; and
 - various steps to enhance the identification of vulnerable customers.
- Notwithstanding this uplift, there are opportunities to strengthen customer complaint (and issue) reporting and to better reflect the importance of complaint resolution in Group Executive scorecards.
- Whistleblower frameworks and processes are consistent with the Australian Banking Association’s guiding principles for *Improving Protections for Whistleblowers*, and a program of work to uplift Westpac to a higher standard is underway.
- There are no shortcomings identified in relation to whistleblower practices, although there are opportunities to increase Group-wide consistency of approach to investigations, enhance reporting and reinforce messages that build employee confidence – all the subject of planned or in-flight initiatives.

4.3.2. Recommendations

- Westpac should take the following actions to strengthen its incident and issue management practices:
 - establish a formal process to identify thematic trends and systemic issues;
 - adopt a common risk and control language, and consistently link controls to risks and obligations in JUNO (also a *Risk Management and Compliance* recommendation);
 - establish Compliance ex-post assurance sampling of issues and increase the scope of Operational Risk Data Quality Reviews;

²⁵ Refer to section 3.2: *Customer service and values*.

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- formally mandate the escalation and notification of high-rated issues (and extensions to agreed due dates for such issues) and incidents (including significant near-misses) to RISKCO and the BRCC;
- establish a comprehensive program to train relevant employees in the identification and analysis of issue and incident root causes; and
- assess the adequacy of issue closure considerations in accountability mechanisms and, to the extent appropriate, increase their prominence and scale of application.
- Westpac should take the following actions to ensure that customer considerations are better instilled in decision-making, and that business unit budgetary concerns potentially impeding prompt and effective resolution of complaints are dealt with:
 - complete a currently-planned initiative to rationalise the nine different systems used for customer complaint management into one system from which aggregation and analysis can be more readily performed;
 - extend the current process that is used to aggregate customer complaint data and identify and report trends in root causes to also include indicators of systemic customer complaints, by product, business unit and geography;
 - provide full coverage of the “tail” of adverse and extended customer complaint cases in Board and executive reporting, to uplift attention on individuals and cohorts and ensure that extreme cases are not lost among averages and aggregates;
 - introduce reporting on long-dated matters that are not complaints but which carry significant conduct and reputation risk (such as insurance claims and collections), and consider their inclusion in an expanded version of the reporting on customer complaints to the Board and Executive Team;
 - consider transitioning of customer complaint handling for life and general insurance matters from BTFG to Customer & Corporate Relations;
 - update and / or replace the customer outcomes in Group Executive scorecards to include progress in reduction of long-dated complaints or a similar metric that attaches accountability to the resolution of matters most likely to entail or result in poor customer outcomes; and
 - formalise engagement of Compliance and Operational Risk to examine certain complaints within prescribed materiality / severity levels.
- Westpac should establish a single, Group-wide approach to handle whistleblower investigations.

4.4. Financial prioritisation

4.4.1. Findings

- There are instances in which Westpac has made resourcing and investment decisions that have been informed by financial considerations without appropriate attention to associated risks. These generally appear to have occurred as a result of factors such as:
 - incomplete or absent risk-related content in decision-supporting investment allocation documentation;
 - very strong Finance and Human Resources functions, widely perceived as control functions that exercise a high degree of influence (or “veto” rights) over investment and day-to-day operational decisions that can have bearing on the management of risk;
 - still-maturing Operational Risk and Compliance functions;

CHAPTER 4. GOVERNANCE PROLOGUE

- still-maturing non-financial risk awareness across the organisation; and
- potential unintended skewing to financial considerations as a result of frequent delegation of senior investment committee membership to divisional Chief Financial Officers.
- The governance of mandatory regulatory change is a strength that mitigates to a large extent the risk of significant impact from the factors described above: it is robust, provisioned financially and guided by decision-makers who include the most senior Risk and Compliance professionals in the company.
- For other project-delivered change, there is less mitigation, which, in conjunction with shortcomings in project governance (including those identified by Group Audit), leaves Westpac exposed to potential compromises of scope or solution that have implications for risk and compliance.

4.4.2. Recommendations

- To further mitigate the risk that investment decisions fail to account adequately for risk considerations, and noting implicit areas of focus in the factors outlined above, Westpac should:
 - mandate inclusion of risk considerations alongside benefit descriptions in the articulation of potential initiatives in investment allocation submissions presented to the Board and Executive Team;
 - mandate detailed coverage of risks and assumptions, and the state of those risks and assumptions, as the first item in steering committee agendas and materials after program status;
 - mandate transparent and auditable tracking of changes in project scope, schedule, solution and expected benefits from project inception in steering committee materials;
 - clarify the decision rights of Finance and Human Resources functions versus Group Executives and General Managers in operational decisions that have implications for risk and compliance; and
 - increase Group Executive attendance at Enterprise Portfolio Oversight Committee meetings and enhance oversight of associated delegations.

4.5. Organisational structure

- 4.5.1. To the extent that organisational structure was of significance to findings and recommendations, it did not warrant its own chapter: relevant content is covered in the other four chapters.

CHAPTER 5:

BOARD AND SENIOR MANAGEMENT

CHAPTER 5. BOARD AND SENIOR MANAGEMENT

A financial institution's governance - that is, the system by which it is controlled and operates, and the mechanisms by which it and its people are held to account - is central to its financial soundness and ability to meet its risk management and compliance obligations.

In this context, the Review Team has examined the functioning of the Westpac Board of Directors (**Board**) and relevant Board Committees, across several focus areas. The Review Team has also performed equivalent reviews in relation to the Executive Team and RISKCO. The Review Team's findings from this work are set out in this chapter.

5.1. The functioning of the Board

Board composition, experience and skills

- 5.1.1. A Board should comprise members with a broad range of financial and other skills, experience and knowledge necessary to guide a financial institution's business, including:
- strategic and commercial acumen;
 - financial services experience;
 - an understanding of risk management and compliance matters;
 - an understanding of the application of technology in large, complex businesses;
 - knowledge of corporate governance and sustainability;
 - experience in people matters;
 - experience in senior leadership roles;
 - an ability to contribute to inclusion and diversity; and
 - senior international leadership and business experience.
- 5.1.2. The extent and mix of skills, experience and knowledge of Westpac's Board appear appropriate.

Board engagement

- 5.1.3. Interviews with senior management frequently conveyed a high degree of respect for and confidence in the Board. The Board was described as very engaged and frequently challenging of senior management, particularly in relation to risk and compliance matters. Interviewees commented that interactions with the Board can be intimidating, but that Board "probe and challenge" occurred politely and respectfully.
- 5.1.4. Senior management confirmed that the Westpac Board solicits information from different sources and poses the same question to different individuals to test that responses are consistent.
- 5.1.5. Interviewees also perceived that the Board had thoroughly reviewed papers in advance of meetings and expected management to be "on top of the detail".
- 5.1.6. Interviews with Directors confirmed that interactions between Board members are open and reflective. For example, non-executive Director meetings at the end of Board sessions give feedback about the meeting and its effectiveness and any areas that needed more attention or engagement.
- 5.1.7. Directors have noted an increased Board focus on non-financial risk, including customer and reputation matters.

CHAPTER 5. BOARD AND SENIOR MANAGEMENT

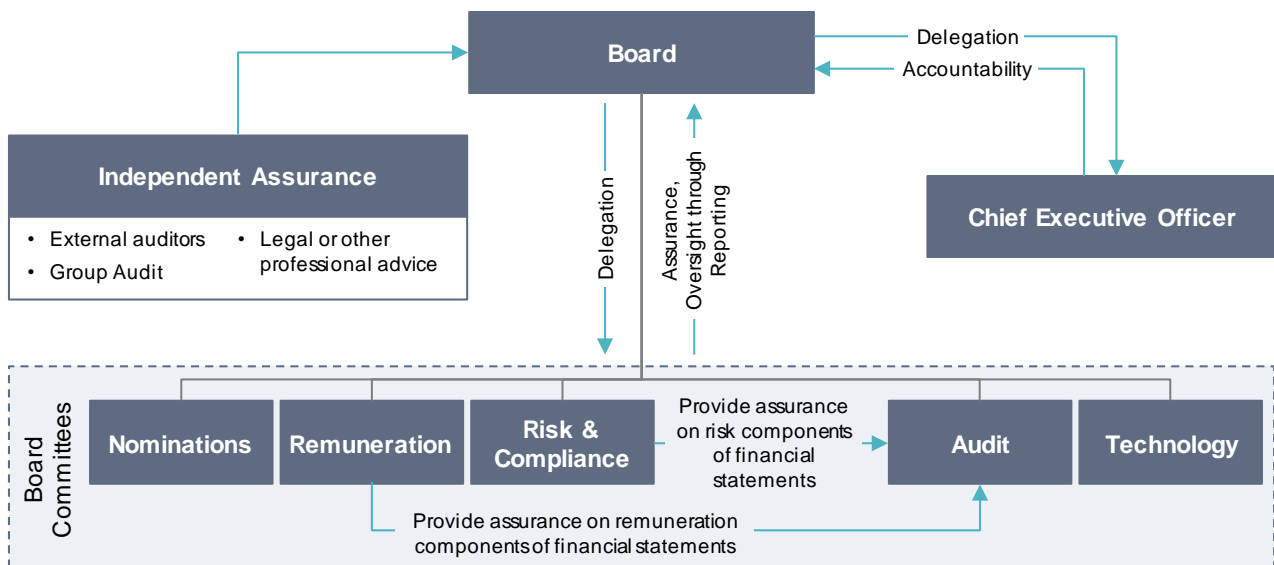
5.1.8. The Review Team has observed that the Board sets a good “tone from the top” regarding organisational culture and its bearing on risk culture. Chapter 13: *Culture* contains more commentary on Westpac’s leadership.

5.2. The functioning of Board Committees

5.2.1. As shown in Figure 5A, the Board has established five standing Committees, namely the:

- Board Audit Committee (**BAC**);
- Board Risk & Compliance Committee;
- Board Remuneration Committee (**BRCC**);
- Board Nominations Committee; and
- Board Technology Committee.

Figure 5A Board Committee structure



5.2.2. There is good information flow between the Board and relevant Board Committees. Committees provide updates to the Board, either verbally or through the circulation of Committee minutes. All Directors can elect to receive all Board Committee papers and attend any meeting of a Board Committee of which they are not a formal member, provided that there is no conflict of interest.

The BRCC

5.2.3. The BRCC comprises all non-executive Directors, of which there are presently nine. Other than Macquarie Group, Westpac is the only major Australian financial institution with a Board Risk Committee comprised of all Non-executive Directors.

5.2.4. The practice of overlapping membership facilitates seamless communication between the BRCC, Board and other Board Committees, and assists in the integration of risk management with other frameworks such as the remuneration framework.

5.2.5. Global practices in this regard vary and are not always readily comparable. For example, in the United States it is not common practice to have all non-executive directors as members

CHAPTER 5. BOARD AND SENIOR MANAGEMENT

of the Board Risk Committee. However, the Review Team's analysis indicates that, on average, relevant US peers have a board comprised of approximately 16 directors (often including several executive directors), and it is not considered feasible to have that many directors oversee the risk and control framework.

- 5.2.6. The Chairman of the BRCC meets with all presenters before BRCC meetings to familiarise himself with matters on the BRCC agenda and satisfy himself that matters will be adequately dealt with.
- 5.2.7. The structure of BRCC meetings gives the Directors the opportunity to challenge senior management, and to satisfy themselves that senior management is adequately informed of risks and issues relevant to the Group. The standard practice of Group Executives, relevant General Managers and Heads of relevant functions attending and presenting to the BRCC gives Directors direct access to employees with day-to-day responsibility for the oversight and management of specific risks; it also enables Directors to assess the capabilities of employees and ensure that undue reliance is not placed on just a few individuals.
- 5.2.8. BRCC meetings are also attended by the General Manager of Group Audit, helping to ensure good flow of information between Group Audit and the BRCC.
- 5.2.9. The average duration of BRCC meetings is approximately five hours, during which time more than 40 papers can be considered. This is reflective of the number and complexity of issues before the Committee. One measure to optimise these meetings is further enhancement and streamlining of reporting (see next section). Another is to assess the efficiency with which time is utilised in the meetings, and the adequacy of time allocated overall for the BRCC's work.

G1 It is recommended that the Chairman of the BRCC, assisted by the CRO and Group Executive, Legal and Secretariat, undertakes an assessment of the efficiency with which time is utilised and the adequacy of the time allocated overall for the Committee's work.

Reporting to the BRCC

- 5.2.10. Group Executives of each division prepare and submit an update to the BRCC on the main issues being managed in their division and divisional risk and compliance committees. This is strong practice. The BRCC does not solely rely on reporting produced by Risk, and having Group Executives report and discuss their divisional risk and compliance issues sends a strong message about the accountability of Line 1 for such matters.
- 5.2.11. Directors recognise the importance of comprehensive reporting to the performance of their oversight responsibilities, particularly in light of a rapidly evolving risk environment. However, they have also commented on the large number of reports submitted to the BRCC. For example, at the March 2018 meeting of the BRCC, there were 41 agenda items, supported by 36 reports. Some Directors have commented that, notwithstanding the generally high quality of papers, they have difficulty digesting the sheer volume and complexity of the information that they are given.
- 5.2.12. In assessing Westpac's culture, the Review Team has observed that employees can have a tendency to pursue an overly-extensive level of analysis and documentation, which is part of a broader tendency toward what can be summarised as "completeness". This can lead to inefficiencies, capacity constraints and negative impacts on clarity – for example, when large volumes of information can distract from what ought to be an emphasis on the most significant matters. This tendency may contribute to the volume of BRCC reporting.
- 5.2.13. Reports must be consistent with the Group-wide template established by Secretariat, which requires papers to include an upfront "Key Considerations" section that outlines the main points for consideration. However, the information contained in this section does not always

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highlight the main points made in the body of the report, nor does it always give a sense of the gravity of a particular risk or issue being highlighted.

- 5.2.14. Directors have commented that reporting should be enhanced to include better upfront coverage of the top issues requiring their focus and attention. Directors have also commented that at times they would like management to be more forthright in their reporting and escalation of issues. Directors have noted that there are cases where management focus is on the “good news”, and that executives could provide more balanced information at times. There is a tendency for reporting of issues to be accompanied by “comforting” messages regarding actions underway to address issues, such as “Get to Green” programs, and to “manage” messages and weight toward “good news”.
- 5.2.15. Lengthy reporting is a challenge that many boards face, as is management’s tendency to reassure Directors when reporting risks and issues. Reducing and streamlining papers is a complex and arduous process. The redundancy generated by lengthy and overlapping information can also be a strength, mitigating the risk of issues or perspectives being missed through provision of multiple perspectives / coverage of the same or similar matters. Notwithstanding the form of papers, the Review Team also notes that the presence of relevant Group Executives, General Managers and functional Heads during discussion of papers in the BRCC meetings adds insight, context and detail to written content.
- 5.2.16. A better practice observed elsewhere that could further encourage discussion, debate and challenge is the requirement that BRCC papers, where relevant, include:
- a summary of the options that were explored by management in response to the issue at hand, including features and considerations and a brief explanation as to why they were discounted relative to the advocated approach;
 - the assumptions, judgements, sensitivities and limitations underpinning proposed actions, as well as a brief summary of the evidence to support assumptions and judgements;
 - analysis of the impact of relevant initiatives on resourcing and FTE²⁶; and
 - a formal suggested rating of importance and urgency for the BRCC’s attention, to inform the allocation of time on agendas.

G2 It is recommended that BRCC reporting be enhanced, including the development of a template that entails a more informative summary of the principal risks and issues requiring the BRCC’s attention, overt articulation of the gravity of such risks and issues, and augmented coverage of options considered and underlying assumptions.

The BAC

- 5.2.17. BAC meetings are attended by the Chairman of the Board, as well as senior management, including the CEO, CRO and the Group Executive, Legal and Secretariat.
- 5.2.18. The Chairman of the BRCC also attends most BAC meetings. This is a strong, albeit less formal, process that helps to ensure that the BRCC is aware of matters escalated to the BAC and vice versa.

G3 It is recommended that the Chairman of the BRCC is formalised as a member of the BAC.

²⁶ Full-time equivalent employees.

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BAC reporting from Group Audit

- 5.2.19. Group Audit provides comprehensive information to the BAC, including information about the effectiveness of the internal control environment and the highest priority matters for the BAC's consideration.
- 5.2.20. Before October 2016, Group Audit provided the BAC with summaries of each "red"-rated audit. "Red" audits indicate that the control environment is unsatisfactory, and constitute the highest level of assessed impact or weakness.
- 5.2.21. In October 2016 this practice stopped. The Review Team understands that this was due to concerns about the length of Group Audit reports. From that time, Group Audit provided the BAC with summary information about "red" audits that were deemed to be of sufficient significance, but did not provide the BAC with summaries of every "red" audit or the actions and deadlines to address issues identified in "red" audits. The BAC was also not provided with summary or thematic information about all "amber" audits. In the absence of such reporting, the BAC was not fully informed in writing of the weaknesses identified by Group Audit, the remedial actions that were agreed in response and the associated resolution timeframes.
- 5.2.22. In July 2018, reporting practices were updated to include summaries of all "red-" and "amber-" rated reports. The BAC is still not made aware of extensions to all agreed due dates to resolve high-rated issues raised by Group Audit (or through other lines of defence).

G4 It is recommended that all extensions to agreed due dates to resolve high-rated issues be reported to the BAC (or BRCC, as appropriate).

5.3. Board and Board Committee areas of focus

Customer complaint reporting to the Board

- 5.3.1. Before June 2018, reporting to the Board about customer complaints was limited to trends in Westpac's Net Promoter Score (**NPS**) rating and high-level, aggregated information about the volume of customer complaints and trends in certain thematic categories.
- 5.3.2. From June 2018, reporting of customer complaints has been significantly enhanced. The Board is provided with a *Customer Complaints Dashboard* that includes trend analysis and reporting on the total number of new complaints received, long-dated customer complaints, top five complaint themes, new complaints by division, open complaints, average days to resolution and narrative on insights and actions. Further detailed reporting by division is also provided, as well as a selection of individual customer complaints. In addition, the Executive Team is provided with five relevant customer stories a week to keep complaints on the agenda.
- 5.3.3. However, the *Dashboard* does not include discrete reporting on the negative "tail" of customer complaints - that is, the most serious and extreme customer complaints - and in chapter 7: *Issue and incident management*, the addition of this information is recommended.

G5 It is recommended that the Board prioritises the review of negative "tail" complaints once reporting practices have been updated.

Investment allocation decisions made by the Board

- 5.3.4. Each year, the Board makes initial, high-level decisions about the allocation of investment funds. The Review Team has considered how funding decisions are made, including the information presented to the Board to facilitate decision-making in relation to allocation of

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investment to Westpac's largest funding pool, the Enterprise Investment Pool (**EIP**). In chapter 8: *Financial prioritisation*, the Review Team has noted its finding that the submissions presented to the Board to approve the overall size and composition of the EIP do not describe the risk and compliance issues inherent in – and in not proceeding with – each underlying initiative. As a result, decisions about the EIP may inadvertently underweigh risk considerations.

G6 It is recommended that the Board explicitly considers the risks arising from proceeding or not proceeding with each EIP-related initiative put forward for the Board's consideration and approval.²⁷

BRCC monitoring of risk appetite

- 5.3.5. Since 2016, metrics in BRCC papers as presented in the *Group Risk Appetite Dashboard* indicate that aspects of operational risk have been regularly out of appetite, and that quantified appetite is not yet fully established for conduct risk.
- 5.3.6. *Risk Management Dashboards* included in BRCC papers also indicate that non-financial risk classes are often outside of tolerance (“amber”) and outside of appetite (“red”).
- 5.3.7. The *Group Risk Appetite Statement (RAS)* sets the boundaries within which the financial institution should operate. Banks at better practice standard typically view being out of appetite as a matter that requires urgent attention, and place significant emphasis on completing actions to bring the institution back within appetite as quickly as possible.
- 5.3.8. It is recognised that some non-financial risks are outside of Westpac's stated risk appetite as a result of the later maturation of non-financial risk management. In these cases, the appetites were set long after relevant business practices began and were in some cases “red” upon inception – as is the case, for example, in relation to Westpac's appetite for inadequate data management. In these situations, managing through the “out of appetite” position is necessary and may take considerable time. For some always-evolving categories of risk, such as cyber risk, where inherent risk is rising and Westpac is “playing catch-up” in its mitigation efforts, it may be difficult for the Group to prudently agree that it is within appetite and therefore the “out of appetite” rating may support the ongoing position.
- 5.3.9. Notwithstanding the focus on out-of-appetite risks, the Review Team has observed that associated actions are not always taken as promptly as it would have expected, having regard to the number and duration of risks nearing or outside of appetite.
- 5.3.10. This may reflect varying views as to what it means to be outside of appetite. Employees have commented that having risks flagged as “amber” and “red” helps to ensure that management and Board attention on the risk is maintained. Some interviewees have noted that, following the Prudential Inquiry, the level of urgency has increased: for example, risks flagged as “red” are now questioned more assertively by the Board as to whether they have been “red” for too long. The extended out-of-appetite positions may also reflect the need to further develop non-financial risk appetite measures and metrics as Westpac's management of non-financial risk evolves and matures. Recommendations to enhance non-financial risk appetite principles, measures and metrics are provided in chapter 6: *Risk management and compliance*.

G7 It is recommended that work be undertaken to develop realistic timeframes and associated accountabilities for moving “out of appetite” risks back within appetite.

²⁷ Refer to related discussion regarding investment allocation decisions in paragraphs 8.1.2 to 8.1.5.

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BRCC oversight of issue resolution and closure

- 5.3.11. In assessing Westpac's frameworks and practices to manage issues and incidents, the Review Team has observed that approximately 30% of issues are extended and that approximately 16% of open issues are long-outstanding issues – that is, raised more than 365 days ago. Risk has acknowledged in BRCC reporting that this number is too high.
- 5.3.12. Reporting to the BRCC on Westpac's adherence to risk appetite limits indicates that the percentage of high-rated issues extended more than once is outside of risk appetite. Reporting also repeatedly highlights Westpac's performance in managing and rectifying issues. For example, a recent *Operational Risk Report* provided to the BRCC states that, whilst long-outstanding issues have reduced slightly, "focus is required to deliver an ongoing and permanent reduction as the current level remains too high" and "divisions need to ensure they are actively managing actions through to closure".
- 5.3.13. The Review Team has not observed the "chronic ease" in relation to the oversight of issue management and closure that was reported in relation to the CBA Board in the Prudential Inquiry. Nevertheless, given that prompt and effective issue resolution and closure are crucial to a robust risk and control environment, a more stringent approach to oversight is appropriate.

G8 It is recommended that work be undertaken to develop realistic, verifiable timeframes and associated accountabilities for the prompt and effective resolution of long-outstanding issues. This should include a review of the *Issue and Action Management Policy's* provisions for issue extension, to ensure that the provisions reinforce any associated enhancement of accountability.

Board Remuneration Committee

- 5.3.14. In addition to the APRA-required Board Remuneration Committee, Westpac has established a number of Group-wide and divisional committees to oversee the effective implementation of Westpac's remuneration framework, and this is strong governance practice.

5.4. The functioning of the Executive Team

- 5.4.1. The Executive Team, comprising the CEO and his direct reports (the **Group Executives**), is the most senior management group at Westpac.
- 5.4.2. People frequently commented positively on the strength of the Executive Team. However, they provided conflicting views on the level of challenge that occurs amongst Executive Team members.
- 5.4.3. Group Executives referred to the practice of taking a conversation "offline" – that is, reserving further discussion until the conclusion of the Executive Team meeting in order to bilaterally challenge and potentially resolve issues. Depending on context, this may or may not be problematic, but it is worthy of Executive Team reflection.
- 5.4.4. In chapter 13: *Culture*, the Review Team has noted how Westpac's leadership has influenced the company's culture through a clear vision and associated values. The strong "tone from the top" has meant that employees generally believe in the vision and values; however, translation of strategy and vision into purposeful action for employees occurs with mixed results.

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- 5.4.5. Despite recent improvements, there are remnants of a “good news” culture in the Executive Team.²⁸
- 5.4.6. Finally, the Review Team has observed an increasing focus on risk and compliance, particularly non-financial risk and customer matters.

5.5. The functioning of RISKCO

- 5.5.1. RISKCO includes all Group Executives as members, and leads the management and oversight of material risks across the Group, within the Board-approved risk appetite. RISKCO is overseen by the BRCC, which has delegated authority for certain matters to RISKCO. The Chairman of RISKCO, the CRO, has formal discretion, after advising the CEO, to escalate issues to the BRCC in certain circumstances.
- 5.5.2. RISKCO membership includes some Risk GMs, but not Divisional CROs. This reflects the “group” nature of the committee, noting the membership of Divisional CROs in divisional risk committees. While not a formal recommendation, the Review Team suggests that RISKCO should consider whether current membership is adequately aligned to the mandate of the committee.
- 5.5.3. RISKCO has a number of sub-committees, including:
- those that focus on specific risk classes and regulatory requirements, such as CREDCO (credit risk), OFCO (operational risk and financial crime), ALCO (funding, liquidity and capital), MARCO (market risk) and the PRCC (prudential reporting and standards); and
 - divisional risk and compliance committees.
- 5.5.4. In line with better practice peers, RISKCO oversees all material risks faced by Westpac, including operational risk and compliance.
- 5.5.5. As is the case for BRCC reporting, reporting to the RISKCO is comprehensive, and papers are generally of high quality.
- 5.5.6. Reporting of risk and compliance matters to the RISKCO and the BRCC is consistent. The majority of papers submitted to RISKCO are materially the same as those submitted to the BRCC, and, accordingly, the Review Team’s observations on BRCC reporting are also relevant to RISKCO reporting. Consequently, the Review Team’s recommendations to enhance BRCC reporting practices also apply to RISKCO reporting practices.
- 5.5.7. The Review Team’s observations about reporting to the BRCC, Group Audit reporting to the BAC, customer complaint reporting, the way in which the Board views situations in which Westpac is “out of appetite”, issue resolution and risk considerations in EIP allocation, are equally relevant to the Executive Team.

G9 It is recommended that the Review Team’s Board, BRCC and BAC-related recommendations summarised in paragraph 5.5.7 be applied to the Executive Team / RISKCO (as relevant).

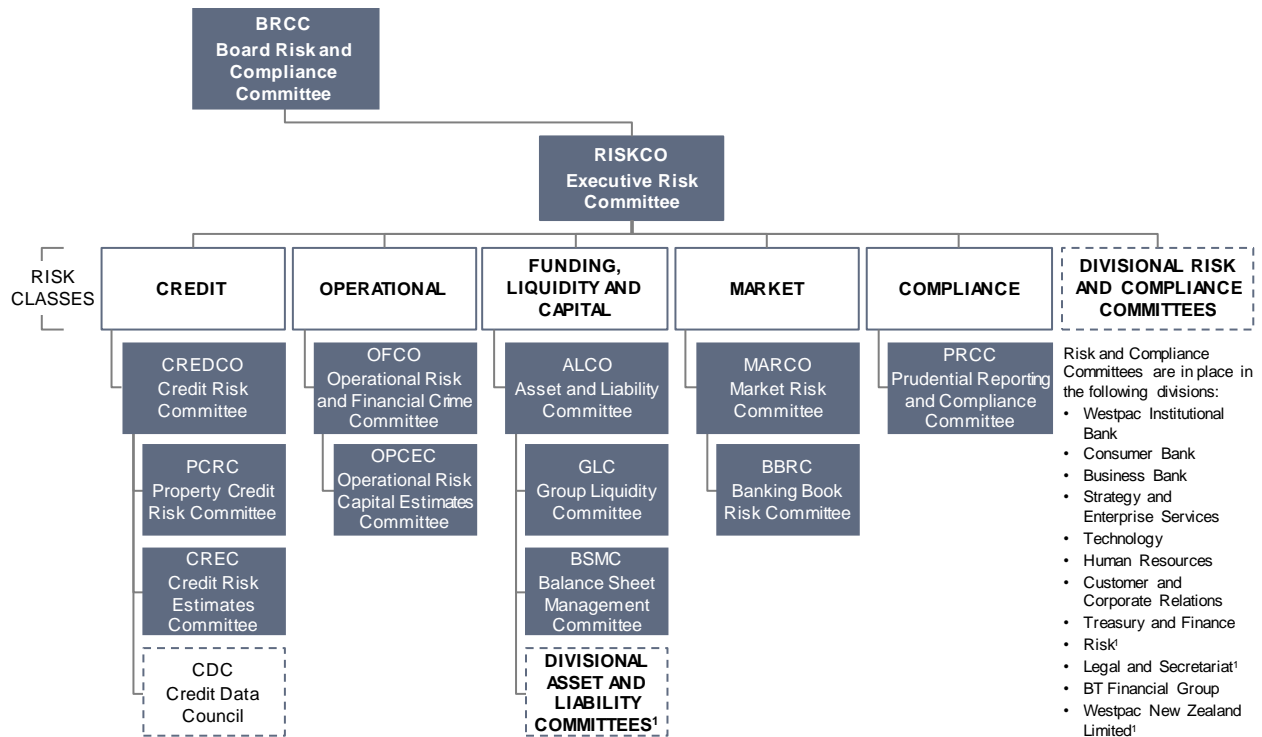
²⁸ See comments in paragraph 5.2.14.

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5.6. Proliferation of governance committees

5.6.1. Figure 5B shows the executive and Group-level committees that oversee risk and compliance matters.

Figure 5B Westpac Group-wide Risk Governance Committee structure



5.6.2. In addition to the above, there are also committees, both formal and informal, to oversee risks and issues and govern various projects. Interviewees frequently commented on the significant number of committees and forums at Westpac, and how this increases complexity and bureaucracy. Interviewees have also commented that time dedicated to preparing for, and attending, multiple committees is extensive. The degree of governance is a strength in many respects, but taken too far it consumes excessive management capacity and creates or manifests cultural shortcomings discussed later in this report.

5.6.3. In chapter 13: *Culture*, the Review Team highlights Westpac's tendency to perpetuate complexity, by introducing, amongst other things, new committees, which can lead to capacity and execution constraints, a lack of clarity regarding decision makers or issue owners, employee feelings of disempowerment, lack of clarity of accountabilities and introduction of additional risk.

G10 It is recommended that:

- a review and, within prudent limits, rationalisation of the number, scope, overlap, duration, frequency and membership of committees and other governance forums (e.g., project steering committees and working groups) Group-wide, both formal and informal, be undertaken; and
- criteria be established to determine how and when new committees should be established, adopting the default principle of "one in, one out" to ensure that the high burden of meetings is not made worse.

CHAPTER 6:

RISK MANAGEMENT AND COMPLIANCE

CHAPTER 6. RISK MANAGEMENT AND COMPLIANCE

The Review Team has examined the risk governance model adopted by Westpac (the 3 LOD model), as well as Westpac's frameworks and practices to manage compliance, conduct, operational and reputation risks.

This chapter sets out resultant findings about the way that Westpac manages risk and compliance and, in particular, the:

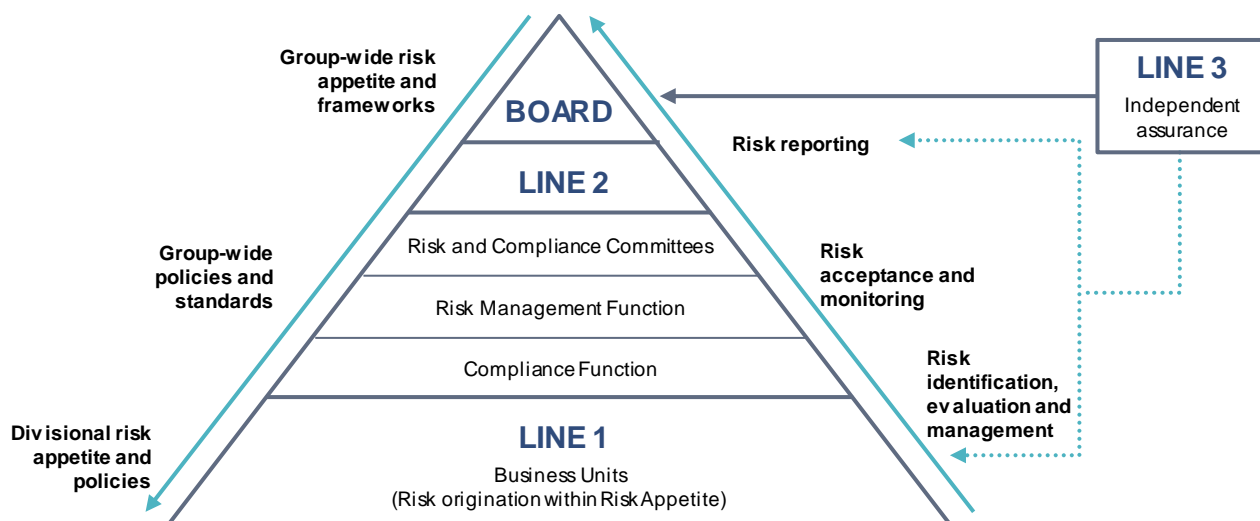
- maturity of the 3 LOD model;
- skills and capabilities to manage risk and compliance across the 3 LOD;
- risk and control environment, including the language used to describe risks and controls, and the assurance processes in place to assess controls;
- way in which Westpac sets and measures its risk and compliance appetite;
- approach to manage conduct and reputation risk;
- variation in approaches to manage risk and compliance at the divisional level;
- way in which Group-wide policies to manage risk and compliance are embedded; and
- role and remit of Compliance.

In summary, Westpac has made concerted efforts to strengthen its management of non-financial risk, but remains less mature in this realm than in the management of financial risk, necessitating ongoing attention.

6.1. Westpac's implementation of 3 LOD

- 6.1.1. Like the majority of its peers globally, Westpac has adopted the 3 LOD risk governance model, as shown in Figure 6A.

Figure 6A The Westpac Three Lines of Defence Pyramid



- 6.1.2. Line 1 consists of customer-facing and functional support businesses, including employees in those businesses who are dedicated to risk and compliance activities.
- 6.1.3. Line 2 comprises Westpac's independent risk functions, which are principally the business units that constitute the Risk division. The Risk division is overseen by the CRO, and

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includes Centres of Excellence that support the Group and teams led by divisional CROs that are aligned to each division to oversee and manage the specific risks of those divisions.

- 6.1.4. Line 2 also includes the Compliance function. From October 2018, the Group CCO reports to the CRO. The Compliance function is comprised of:
- Enterprise Compliance, Regulatory Change and Lifecycle Governance, and Chief Operating Officer teams that oversee the Group-wide management of compliance and the function;
 - teams aligned to each division (other than BTFG²⁹) to oversee and manage compliance specific to those divisions, led by Divisional CCOs; and
 - the function that oversees and manages compliance with financial crime obligations (which moved from Operational Risk function to Compliance in October 2018).
- 6.1.5. Line 3 is Westpac's independent assurance over Line 1 and Line 2, performed primarily by the internal audit function (referred to as **Group Audit** in this report).
- 6.1.6. Whilst the 3 LOD model is conceptually simple, the implementation of the model has proven difficult for the financial services industry. Several factors have contributed to this industry challenge, including:
- supervisory signals that impose considerable regulatory expectations and requirements on Line 2, with less corresponding emphasis on expectations and requirements for Line 1;
 - legacy legalistic approaches to risk management and compliance;
 - inconsistent application of risk governance models within organisations, which has led to fragmentation and duplication across the 3 LOD;
 - inadequate role definition and clarity; and
 - the need to respond to newer focus areas such as conduct risk that, until recently, have been inconsistently conceived and relatively unmanaged.
- 6.1.7. Since 2010, Westpac has undertaken various initiatives, at Group and divisional level, to establish and enhance 3 LOD, and there is an observable increase in maturity and evolution of approach over this time. However, further enhancements are needed, noting that 40% of Group Audit reports in FY18 featured "amber" or "red" opinions on Risk Management Maturity (which encompasses Line 1 and Line 2 in aggregate).
- 6.1.8. Line 1 does not always take ownership of, and accountability for, the risks of the business. Interviewees commented that, in some divisions, the principles of Line 1 risk ownership are not clear or well understood.
- 6.1.9. The separation between Line 1 and Line 2 has been blurred because, in some divisions, Line 2 performs activities that should be performed by Line 1, often to compensate for inadequate Line 1 maturity. For example, a previous assessment of operational risk management maturity in Consumer Bank and Business Bank revealed that Line 1 relied heavily on Line 2 to perform tasks that should be performed by Line 1, such as control documentation. Line 2's ability to provide independent review and challenge of Line 1 decisions may be compromised when those decisions have been heavily influenced by Line 2.

²⁹ The BT CRO is also the BT CCO and reports to the CRO.

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- 6.1.10. The descriptions of the roles and responsibilities of each of Line 1 and Line 2 to manage non-financial risk require enhancement. Descriptions have not been adequately clarified at the Group level nor cascaded to some divisions with sufficient granularity. Descriptions that have been established often articulate roles and responsibilities for each risk discipline, which may make it difficult to understand how the 3 LOD in its entirety should be implemented. Descriptions are not consistently clear across all divisions. More generally, there are a number of descriptions of roles and responsibilities that need to be detangled in order to achieve necessary clarity and consistency for employees.
- 6.1.11. Some Divisional CROs have small teams. For example, in Consumer Bank and Business Bank, the Divisional CRO teams are comprised of four employees and two employees, respectively. Given the scale and complexity of risks and issues that must be dealt with by these CROs, considerable effort can be required, and personal networks and influencing skills relied upon, in order to obtain the information or other resources required from the Centres of Excellence. This contrasts with the more “integrated” team led by the BTFG CRO, inclusive of compliance specialists.

G11 It is recommended that:

- Line 1’s ownership of, and accountability for, risk and compliance management are strengthened, including through enhancements to remuneration and consequence management frameworks and an uplift of capabilities where needed;
- roles and responsibilities across the 3 LOD for non-financial risk management are clarified - including through high-level principles for the Group and each division, and role and responsibility mapping (including across end-to-end processes) - to ensure that, where relevant, the 3 LOD model is consistent across divisions; and
- the set-up of the Divisional CRO teams is reviewed, having regard to the need for efficient, CRO-prioritised access to specialist resources (presently housed in Centres of Excellence).

In the Review Team’s judgement, the same model should apply across the organisation unless there are compelling reasons to do otherwise. In reviewing the Divisional CRO team set-up, a formal “compare and contrast” exercise should be undertaken, involving consideration and assessment of the rationale and operation of the outlier BTFG model versus that of other divisions. Such an exercise will assist in crystallising the set of decision-relevant parameters for the review, noting that the Review Team’s recommendation should not be construed as advocacy of any particular model.

- 6.1.12. In implementing these recommendations, consideration should be given to factors that have contributed to, and in some cases detracted from, the success of earlier initiatives, as identified through the Review Team’s detailed assessment of 3 LOD rollout and enhancement activities over recent years.
- 6.1.13. The Review Team’s assessment has indicated that Line 1 ownership is central to the success of any initiative. In some divisions, inadequate Line 1 ownership limited the adoption of 3 LOD. In other divisions, strong Line 1 ownership and accountability were primary determinants of successful implementation, albeit that external focus and major incidents appear to have been factors in those divisions having acted in such a manner. The success of initiatives led and sponsored by Line 2 were compromised when Line 2 did not spend adequate time and effort “socialising” initiatives with Line 1. In some cases, Line 2 stewardship of 3 LOD implementation was sporadic, initiatives that were initially Group-led being left to divisions to define and execute, resulting in inconsistent implementation of 3 LOD across divisions.

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6.2. Skills, capabilities and stature

- 6.2.1. Interviews have revealed a widely-held perception that skills and capabilities to manage risk and compliance across all 3 LOD should be strengthened.
- 6.2.2. Relevant employees should have the skills and orientation to be forward-looking in order to discern new or previously-undetected risks, and be able to link disparate sources of information to identify changes in risk profile. This aptitude is underpinned by curiosity, a “learning” mindset and a practice of continually scanning and considering changes in the internal and external landscape. These skills and orientations do not sit easily with the process orientation that is common in Westpac.
- 6.2.3. Risk, compliance and audit professionals should have a deep understanding of the businesses and functions that they oversee. This should be complemented by soft skills needed to influence the business - for example, in relation to the risks that may arise from a proposed initiative.
- 6.2.4. It is noted that there is a general, industry-wide shortage of suitably qualified risk, compliance and audit professionals, not just in Australia but globally. Some offshore financial institutions are increasingly looking for non-traditional skills to supplement risk management resources, and there is an emerging trend to hire data and analytics personnel in order to optimise controls and support management decisions.
- 6.2.5. The Review Team has not assessed the skills and capabilities of individual employees to oversee and manage non-financial risk. Such assessments were not in the scope of this exercise. The Review Team’s observations relate to additional attention relative to an aspiration, not to basic competence, and draw on senior Westpac employees’ own views on the topic.

Line 1

- 6.2.6. The need to improve Line 1 skills, capabilities and mindsets to manage risk and compliance has been acknowledged by Westpac, and a number of training, education and recruitment programs to achieve this have been established. Doing so will accelerate the maturation of Line 1 ownership of the risks in their business.
- 6.2.7. The brevity of commentary in this report on Line 1 capability relative to that on Line 2 and Group Audit should not be construed as suggesting that the latter are in greater need of attention. Rather, the concentrated and specialised nature of Line 2 and Group Audit activities lends itself to more detailed observation than does the more diverse and dispersed nature of Line 1 activities.

Operational Risk and Compliance

- 6.2.8. Interviewees have suggested that, while the skills and capabilities of the Operational Risk and Compliance teams have improved, further uplift is needed, including an increase in understanding of the business. Compliance has acknowledged this: its April 2018 *Compliance Strategic Plan* includes initiatives to enhance skills and capabilities.
- 6.2.9. A perception that some Operational Risk and Compliance employees lack the desired skills and capabilities is likely to affect the stature, standing and hence authority of those functions, and the ability of Line 2 to effectively challenge Line 1. Interviewees have commented that the “voice” of these functions is not consistently strong. Similar comments have been made in relation to the “voice” of assurance across all three lines.
- 6.2.10. Recent analysis by Compliance of its “seat at the table” has shown that, while the stature of the function has increased considerably, senior Compliance representation is incomplete at

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the divisional and functional executive-team levels. For example, there is no senior Compliance representation at certain divisional forums and committees, and senior Compliance representation at the GM leadership team level has only recently improved.

- 6.2.11. Limited commentary was provided by interviewees on other Line 2 functions.

Group Audit

- 6.2.12. There are mixed views on the skills and capabilities of Group Audit employees. Some interviewees perceive that the generalist nature of certain Group Audit team members can at times lead to inadequate understanding of the businesses being audited. Others are more complimentary and suggest that Group Audit skills and capabilities have improved over the last few years.
- 6.2.13. Analysis of case studies has highlighted that, at times, Group Audit has not exerted sufficient influence to ensure that risks and issues were given the necessary attention. The Review Team and some interviewees have also observed a tendency to focus more intently on a particular risk or issue after a regulator has focused on that risk or issue. These observations may indicate a lack of “voice” at times, as well as gaps in skills and capabilities needed to confidently discern the full gravity of certain matters in the absence of external reinforcement.
- 6.2.14. Group Audit has identified the need to broaden its skills in areas such as technology, compliance and analytics. It has taken a number of steps to develop its capabilities and the FY19 budget for Group Audit has been increased by 20-25% to secure additional capacity and expertise. This is commendable.

G12 It is recommended across the 3 LOD that:

- skills and capabilities to be strengthened are identified and articulated, to ensure that recruitment and training are consistent and targeted;
- training and education programs to respond to identified skills and capability gaps are developed;
- an internal mobility program, whereby high-potential employees can be rotated through the business, Risk, Compliance and Group Audit, is developed;
- a program to continually emphasise and encourage the importance of a learning mindset and business acumen in risk and compliance work is developed; and
- opportunities to elevate the stature of Operational Risk and Compliance employees, including ensuring that relevant employees have a “seat at the table” at relevant committees and forums, are considered.

6.3. The risk and control environment

- 6.3.1. Effective risk management relies on employees identifying and understanding the specific risks faced by the company, the establishment of robust controls to manage each risk, and a process to regularly review and assess the ongoing effectiveness of each control.

A common risk and control language

- 6.3.2. Many of the risks faced by financial institutions, including Westpac, are common across different divisions, as are the controls established to manage those risks. Describing each risk and control in the same way, using an intuitive, internally consistent and common language (also sometimes known as a typology or taxonomy), ensures that common risks

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and controls are understood and considered consistently, irrespective of where they manifest. A common language also:

- enables comparisons of risks and controls – for example, the identification, monitoring and management of risks and controls that are common across functions – because risk and control names and definitions are aligned;
- facilitates the identification and rationalisation of key controls, leading to simplification of the control environment and testing;
- allows effective communication across different divisions and control functions; and
- facilitates establishment of common data and technology infrastructure.

Risk language component

- 6.3.3. Westpac is in the process of developing a common compliance and conduct risk language to bring it into line with better practice peers. A common risk language should be reasonably granular, in line with the example provided in Figure 6B.

Figure 6B Example of a common risk language for a compliance risk

Level 1	Level 2	Level 3	Examples
Compliance risk	Breach of duty to clients <i>Failure to comply with consumer protection laws, regulations, industry codes of conduct and public commitments in place to protect and inform clients of financial products and services</i>	Product / service design failure	<ul style="list-style-type: none"> • Inadequate categorisation of product (e.g., overly complex / too illiquid) • Other product / service design failure
		Inadequate sales marketing and promotion	<ul style="list-style-type: none"> • Use of inappropriate / restricted channels • Failure to comply with marketing / communication requirements

- 6.3.4. While Westpac has established a common risk language for operational risk, it is not at a sufficiently granular level that aligns with better practice.

Control language component

- 6.3.5. The Risk division maintains a master control library of approximately 220 controls that features a single, consistent identifier for each common control across Westpac. However, each business unit can tailor a control, and give it an identifier that is specific to that business.
- 6.3.6. The absence of a sufficiently granular common control language could hamper Westpac's ability to identify gaps in the control environment, identify systemic breakdowns in controls, understand how control breakdowns in one division may be relevant to another division, and undertake thematic reporting. A lack of common control language also makes it more difficult for Westpac to aggregate information about controls, and to understand the effectiveness of the Group-wide control environment.
- 6.3.7. Furthermore, not all controls are linked to compliance obligations in JUNO. This challenges the ability of employees across the 3 LOD to promptly identify the controls established to manage compliance obligations. In chapter 7: *Issue and incident management*, it is observed that inconsistent linkage of obligations and controls may constrain Westpac's ability to understand the nature and significance of control breakdowns when they occur.

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The process to regularly review, assess and test controls

- 6.3.8. Controls must be regularly reviewed and assessed to ensure that they are designed and operating effectively. At Westpac, the Risk and Control Management (**RCM**) process has been established to review, assess and test controls.
- 6.3.9. The testing of controls to manage certain compliance obligations³⁰ is performed by Assurance. Outside of these arrangements, there is no additional process by which Compliance employees regularly review and test the design and operating effectiveness of controls to manage compliance obligations.
- 6.3.10. At Australian and global banks, compliance functions draw on the equivalent of Westpac's RCM process to review and test compliance-related controls, employing an enterprise-wide non-financial risk and control language in the process. Compliance and operational risk functions in these organisations work together with Line 1 to use a single RCM-equivalent process to review and test the control environment. This allows efficient use of existing processes.
- 6.3.11. Compliance has acknowledged the need to draw on existing processes such as RCM and is working with the Operational Risk and Assurance functions to do this. Compliance has also established an initiative to build monitoring and surveillance capabilities. Given the infancy of these initiatives, the Review Team could not assess how effective they are likely to be.

Identification of new, emerging and heightened risks

- 6.3.12. Line 2 functions prepare a *Key Risk Issues* report, which, as the name suggests, highlights the principal risk issues for RISKCO and the BRCC's attention. In the judgement of the Review Team, the report does not consider internal and external developments - such as changes to business activities and areas of focus, or control breakdowns and other risk issues at peers - to the extent necessary to reliably identify new and emerging risks or changes to the materiality of risks already faced by Westpac.

G13 It is recommended that:

- one common risk and control language for non-financial risk is developed, which is sufficiently granular and aligned to better practice;
- existing controls are reviewed and updated in accordance with the common risk and control language;
- all compliance obligations are linked to controls in JUNO;
- one common process to regularly review, assess and test the effectiveness of controls to manage non-financial risk is developed, which draws on existing processes where possible and involves employees from Line 1, Operational Risk, Compliance and other Risk functions as appropriate; and
- processes to identify new, emerging and heightened risks, incorporating regular consideration of developments in the internal and external landscape and how such developments may change the risk profile, are enhanced.

³⁰ SoX, APRA Prudential Standard and compliance controls.

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6.4. Setting and monitoring risk and compliance appetite

Westpac's non-financial risk appetite

- 6.4.1. Westpac has no appetite to breach compliance obligations. Consistent with this, the RAS states that “Westpac complies with its legal obligations, regulatory requirements, voluntary codes of practice to which it subscribed and Group policies including the Westpac Code of Conduct.”
- 6.4.2. The risk appetite principles that describe the amount of compliance and conduct risk that Westpac is willing to accept, as set out in the RAS, are broad, and generally do not define Westpac's appetite for each of the specific compliance and conduct risks that it faces, such as its appetite for conflicts of interest and privacy risk. While operational risk appetite has been described in more detail, there are opportunities to further enhance Westpac's articulation of operational risk appetite. In contrast, peers use a common risk language to articulate and define appetite risks at a granular level to ensure that employees understand the organisational appetite, if any, for specific risks.
- 6.4.3. Consistent with this limited detail in risk appetite articulation, measures and metrics have not been established for each specific compliance and conduct risk. Some measures are aggregated across multiple classes of non-financial risks, such that a significant increase in one risk may be diluted in reporting. Moreover, non-financial risk measures are relatively basic. Appetite is sometimes measured through a “red”, “amber” or “green” status without detailed explanation or description of what a specific rating means.
- 6.4.4. A majority of measures are lagging measures that only retrospectively indicate changes in risk. Better practice would see Westpac use, for example, quantitative, leading compliance and conduct risk measures that signal changes in the likelihood of a risk event occurring, enabling the Board and management to more proactively address areas of increased risk.
- 6.4.5. Compliance is progressing an initiative to enhance how Westpac articulates its compliance and conduct risk appetite, utilising the newly-established risk language and inclusive of the development of more granular measures. The Review Team is not aware of any equivalent in-flight initiative to enhance operational risk appetite, although it understands that one is being considered.
- 6.4.6. Notwithstanding the significant work that has been done or which is planned in relation to risk appetite, Westpac requires greater rigour and specificity in this critical area.

G14 It is recommended that the common risk language to be developed is used to inform the setting of risk appetite principles for compliance, conduct and operational risks at the Level 2 and Level 3 level, as well as associated quantitative leading and lagging metrics for each risk appetite principle. The risk appetite framework, including reporting dashboards, should also be updated to support the enhanced articulation of non-financial risk appetite.

6.5. Management of conduct and reputation risks

- 6.5.1. Industry better practice sees conduct risk management extending beyond analysis of what is strictly allowed under law and regulation (“can we do it?”) to include consideration of whether an action is appropriate or ethical (“should we do it?”). Such consideration is vital in earning and maintaining the trust of customers and other stakeholders.
- 6.5.2. Conduct risk should be distinguished from reputation risk, the latter arising from changes in perceptions by important stakeholders, including customers, investors and regulators. Such changes can stem from a wide range of events - including, for example, significant financial underperformance, internal fraud, mistreatment of customers or failure of internal processes

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- but are driven by the belief that the ability of an organisation to meet stated goals and performance targets will be lower than previously expected, given the information that has come to light. In this context, most, if not all, conduct risks lead to reputation risks, but not all reputation risks are conduct risks.

Conduct risk management

- 6.5.3. In 2018, Westpac established the *Conduct Framework*, which is designed to enable management of the risk of misconduct. In it, satisfactory conduct is defined as “behaviours and practices that deliver suitable, fair and clear outcomes for our customers and that support market integrity.” The *Risk Management Strategy*, which describes Westpac’s approach to manage risk, more narrowly defines conduct risk as the risk that Westpac’s “provision of services and products results in unsuitable or unfair outcomes for our stakeholders or undermines market integrity”.
- 6.5.4. While the *Conduct Framework* is a positive development, it is new and not yet ingrained in practice. Group Audit rates Westpac’s management of conduct risk as unsatisfactory in its quarterly risk management dashboard provided to the Board. This is well acknowledged by management, and a number of relevant initiatives are underway.
- 6.5.5. In the Review Team’s opinion, the “can we? should we?” frame provides a powerful and readily-understood perspective when making decisions that affect customers.

G15 It is recommended that:

- further conduct risk training and education programs across the 3 LOD are completed, reinforced by emotionally resonant communication such as Royal Commission examples of customer mistreatment;
- workshops with Line 1, facilitated by Line 2, to identify the specific conduct risks faced by each business, are completed;
- Westpac considers, designs and implements a conduct risk program to instil the “should we?” consideration in Group-wide decision-making and reinforce the centrality of the customer;
- conduct risk is a standing agenda item in divisional risk committees; and
- conduct risk is incorporated into HR frameworks and practices, including those relating to recruitment and hiring, training and education, and remuneration and accountability.

Reputation risk management

- 6.5.6. Westpac’s *Reputation Risk Management Framework*, owned by the Customer & Corporate Relations (**CCR**) division, acknowledges that reputation risk can arise from many sources, including the management of other risks that arise from day-to-day activities such as management of financial crime, compliance, operational risk and lending – for example, reputation risk is an element in corporate credit underwriting standards. The Framework also lays out processes to identify, assess and escalate reputation risks.
- 6.5.7. A recent external review of the Framework³¹ suggested that Westpac was well placed relative to local and overseas peers, while also noting that peers were investing considerably to strengthen their management of reputation risk. Notwithstanding any assessment of relative position, the Framework has not been - and must be - comprehensively rolled out across the 3 LOD to clarify roles and responsibilities in identifying and escalating reputation

³¹ September 2018 review commissioned by management and performed by a consulting firm.

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risks arising from underlying non-financial risks, and is being revised for submission to RISKCO in December 2018.

- 6.5.8. The Review Team understands that an initiative, led by the CCR division, to enhance reputation risk management is underway.

G16 It is recommended that:

- roles and responsibilities across the 3 LOD for reputation risk identification, assessment, management and escalation are clarified; and
- practices to identify reputation risks that may arise through underlying non-financial risks are further incorporated in decision-making processes and forums.

6.6. Divisional approaches to manage risk and compliance

- 6.6.1. Group-wide policies that set a minimum risk management standard across the company have been supplemented in some areas by overlapping, division-specific policies and processes. This has added complexity and, at times, challenged Westpac's ability to form an aggregate, Group-wide view of certain risks.
- 6.6.2. The Compliance function is addressing some of these issues by consolidating certain division-specific policies into new, Group-wide policies (e.g., policies covering complaints, customer remediation and compliance with responsible lending obligations).
- 6.6.3. Risk and complexity have also increased as a result of mergers and acquisitions. Several of Westpac's brands have established bespoke processes, training, monitoring and controls, often for similar products and services, and the portfolio sits on a disparate set of IT systems.
- 6.6.4. Complexity arising from multiple system use was a consistent theme heard in interviews. Interviewees commented that businesses running on multiple overlapping systems, with associated multiple processes, increased complexity and therefore risk. The increased cost of system changes that arises from this complexity is itself problematic.

G17 It is recommended that division-specific and brand-specific operational risk and compliance policies and processes are reviewed to ensure that differences between them are necessary, and where they are not, that relevant policies and processes are rationalised.

6.7. Embedding Group-wide policies in the business

- 6.7.1. Risk and Compliance should place more emphasis on change management (e.g., training and consultation) in conjunction with the development of Group-wide policies, to ensure that policies are understood and adhered to in Line 1. The Review Team has heard that the design, implementation and communication of policies do not follow a systematic and user-centric approach. In chapter 13: *Culture*, the Review Team observes a relevant tendency to focus on conceptualisation over embedding, and provides recommendations to address this.

6.8. The role and remit of Compliance

- 6.8.1. Compliance functions at global peers have evolved, incorporating risk management disciplines in their repertoire in order to better manage compliance obligations. Compliance functions globally have also expanded their remit to focus not only on "black letter law", but also on broader standards of behaviour, including the oversight and management of conduct

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risk. There is also an emerging trend of compliance function oversight of corporate governance.

- 6.8.2. The *Compliance Strategic Plan* establishes initiatives aimed to bring Westpac's Compliance function in line with better practice peers, including the use of risk management disciplines such as the RCM process to manage compliance risk and the expansion of Compliance's remit to include conduct risk.
- 6.8.3. Shortcomings arising from having Risk, rather than Compliance, manage regulator relationships have not been observed, due to the constructive relationship between these functions, formal processes to regularly share information, and the strong and comprehensive frameworks and practices applied to management of regulatory relationships.

CHAPTER 7:

ISSUE AND INCIDENT MANAGEMENT

CHAPTER 7. ISSUE AND INCIDENT MANAGEMENT

Substandard issue and incident management practices can increase the length of time that a control gap or weakness persists and increase the risk of significant financial losses, compliance obligation breaches, poor customer outcomes and reputational damage.

Like its peers, Westpac has established policies and procedures that govern each stage of the issue and incident management lifecycle: identification, escalation, notification, reporting, root cause analysis, resolution, closure and thematic reviews. The way in which Westpac manages issues and incidents identified by employees, issues raised by regulators and other external parties (auditors and consultants), customer complaints and matters of concern raised by whistleblowers at each of these stages, has been reviewed, and the Review Team’s findings are set out in this chapter.

7.1. Issues and incidents identified by Westpac employees

7.1.1. Westpac differentiates between:

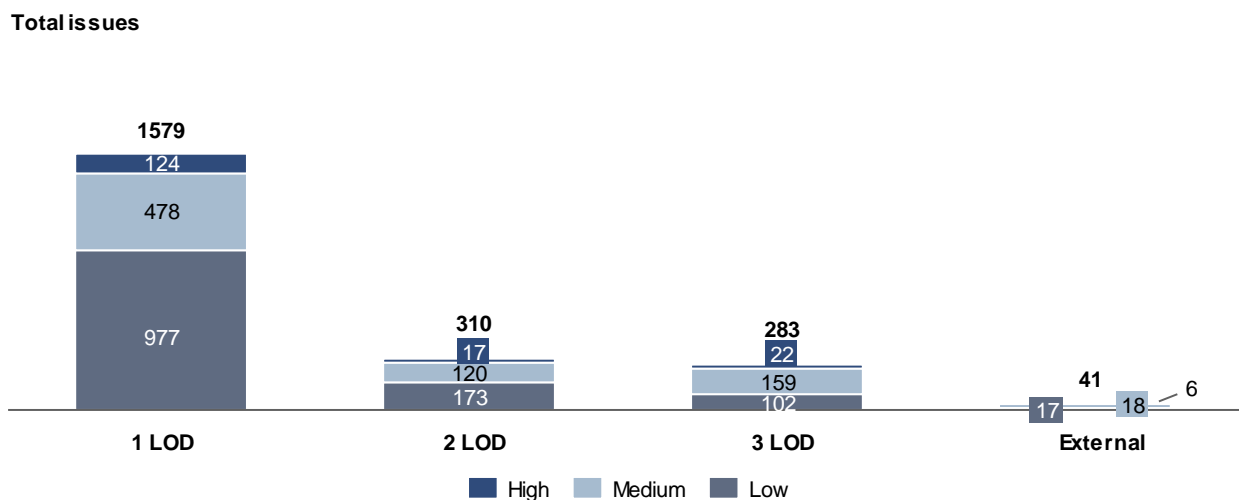
- “issues”, which are control gaps or weaknesses that compromise the effectiveness of the design and / or operation of a control to manage a risk, and which expose Westpac to an increased likelihood and / or impact of a risk crystallising; and
- “incidents”, which are events that arise as a result of “inadequate or failed internal processes, people and systems or from external factors, which may or may not result in financial loss.”

7.1.2. For the purposes of this report, and unless specifically noted otherwise, both issues and incidents are referred to as “Issues”.

Issue identification

7.1.3. Once an Issue has been identified it must be logged in JUNO. As shown in Figure 7A, the majority of issues logged in JUNO are identified by Line 1, and there has been a steady and observable increase in the number of Line 1-identified issues over time.

Figure 7A Identification of issues across the Three Lines of Defence³² as at 31 July 2018



³² Data to perform similar analysis on incidents are not readily available.

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- 7.1.4. The growing incidence of Line 1 self-identification of issues is indicative of Line 1's increasing risk ownership and maturity, and may also be attributable to initiatives to foster a "speak up" culture.
- 7.1.5. Regular communication from the CEO and senior management on the importance of "speaking up" reinforces the value of this behaviour, and Westpac's remuneration framework includes reward for positive risk behaviours such as "proactively identifying and preventing an issue that was likely to otherwise result in a material adverse outcome." A number of employees interviewed by the Review Team also confirmed the increased sense of accountability for Issue identification. However, despite an increase in "speak up" behaviours, the assessment of Westpac's culture (reported in chapter 13: *Culture*) indicates further room for improvement across all levels and divisions.
- 7.1.6. Mechanisms to regularly test and report on the strength of Westpac's "speak up" culture are in place and are operating effectively. For example, Westpac's monthly Employee Sentiment survey asks a broad sample of Westpac employees whether or not they agree with the statement that "I feel safe calling out issues, risk and / or concerns".
- 7.1.7. Senior management and the BRCC receive regular reporting on Issues, involving analysis of Issues by risk theme and division. They also gain regular insight into "speak up" culture through comprehensive reporting, including a "safe to speak up" metric in the *Group Risk Appetite Dashboard*.
- 7.1.8. Aggregated reporting on the breakdown of newly-identified issues by each Line of Defence, as shown in Figure 7A, is not produced at Westpac, and the Review Team's observations are derived from its own analysis. The Review Team suggests that Westpac considers developing such reporting.

Systemic Issue identification

- 7.1.9. Westpac's processes to identify systemic Issues are constrained by the need to manually aggregate and analyse Issue data.
- 7.1.10. Many financial institutions globally have structured, formalised processes to aggregate data relating to Issues within and across divisions, to facilitate identification of systemic Issues. They also have processes to link Issue data with other sources of information, such as customer complaint and whistleblower data.

G18 It is recommended that processes are established to regularly:

- use JUNO to aggregate Issue data to identify thematic trends and indicators of systemic Issues; and
- link JUNO data with other data sources, including customer complaint data and business process data, to assess and test control effectiveness, and to identify thematic trends and indicators of systemic issues.

Governance and reporting of thematic trends and systemic issues should also be enhanced, including reporting of such matters to RISKCO and the BRCC.

Issue escalation

- 7.1.11. When employees identify an incident, they must assess, and confirm in JUNO, whether that incident has resulted in an actual, potential or likely breach of compliance obligations, and assess the significance of the incident. Whilst this may be a relatively simple task in some instances, reliance on employees who may not have adequate compliance or operational

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risk knowledge to perform this assessment exposes Westpac to the risk of incorrect or incomplete assessments.

- 7.1.12. For Issues that may entail a compliance impact, this situation is exacerbated by the fact that compliance obligations in JUNO are not consistently linked to controls, as noted in chapter 6: *Risk Management and Compliance*. When an employee logs an Issue in JUNO, it may not be readily apparent that a control involved is relied upon to manage a compliance obligation.
- 7.1.13. In practice, this shortcoming is partially offset by ex-post sampling. Compliance performs quarterly hindsight reviews of a sample of incidents to ensure that incidents have been appropriately assessed for compliance impact. The sample size is not fixed, varying in 2018 between approximately 10% and 19% of incidents. Between 7% and 9% of incidents sampled in that period were assessed as having been incorrectly classified as “no compliance impact”. The Review Team notes that Compliance is currently enhancing the sampling process, including the development of a formalised sampling methodology. Compliance does not perform ex-post sampling of issues.
- 7.1.14. Whilst Operational Risk performs Data Quality Reviews (**DQR**) – a process that involves regular hindsight assurance over the accuracy, validity, timeliness and consistency of Issue data in JUNO - DQRs are not conducted with the objective of ensuring that significance assessments are accurate.

G19 It is recommended that:

- The Compliance function performs ex-post sampling of issues, increases incident sample size and sets a minimum incident sample size; and
- the scope and objectives of the DQR process are expanded by Operational Risk to include the accuracy of significance assessments.

Issue reporting

Reporting of high-rated Issues to RISKCO and the BRCC

- 7.1.15. There are no formal requirements in Westpac’s Issue management frameworks and policies to notify RISKCO or the BRCC of high-rated Issues and significant near-misses.³³
- 7.1.16. Despite the lack of formal, mandated escalation requirements, Westpac’s comprehensive reporting practices ensure that RISKCO and the BRCC are notified of high-rated *Issues*. Reports on operational risk and compliance matters include significant and material Issues that could change the Group’s risk profile and / or indicate weaknesses in the risk and control framework.
- 7.1.17. However, the reliance on the discretion of critical individuals to report such matters creates an unnecessary vulnerability that could be easily addressed by formalising existing reporting practices – in, for example, relevant policies and frameworks.
- 7.1.18. There is no systematic mechanism in place to report significant near-misses (however defined) to RISKCO and the BRCC.

³³ “Near-misses” are incidents that have not resulted in any actual financial or non-financial consequence but had the potential to do so.

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G20 It is recommended that the Operational Risk and Compliance functions formalise in policies the current practice to notify the RISKCO and the BRCC of high-rated Issues, as well as a requirement to notify RISKCO and the BRCC of significant near-misses.

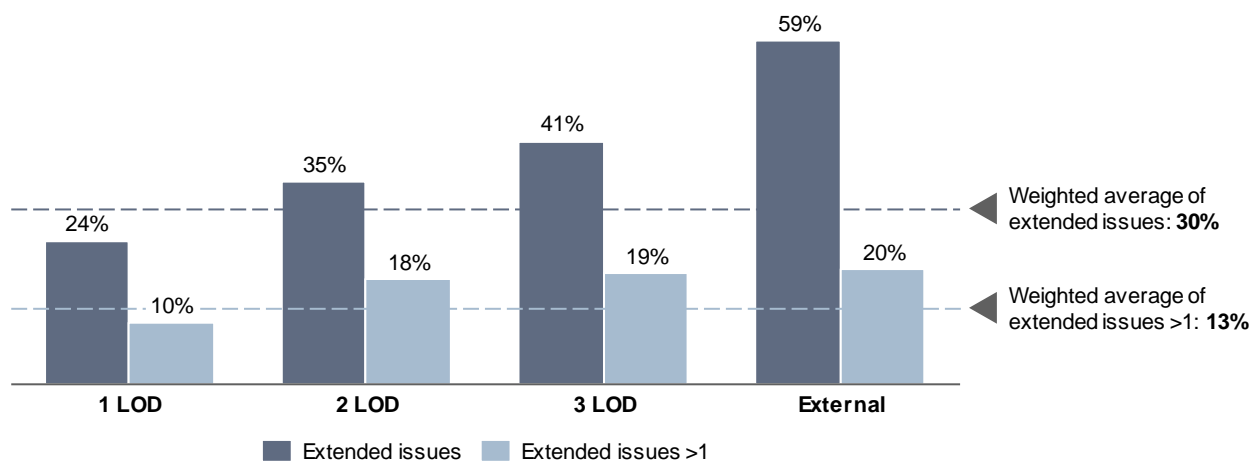
7.1.19. The Review Team notes that a system limitation in JUNO means that, even when Issues are given the highest rating, a notification to relevant stakeholders is only triggered if the employee verifying the Issues manually adds each stakeholder in JUNO. Consequently, appropriate escalation relies on employees having sufficient knowledge and understanding of policy and procedure triggers.

G21 It is recommended that a JUNO system limitation, which sees highest-importance Issues notified to relevant stakeholders only if the verifying employee adds each stakeholder into JUNO, is assessed for feasibility of resolution, including through incorporation in version upgrades.

Issue resolution and closure

7.1.20. 16% of open issues are long-outstanding issues. Approximately 30% of open issues are extended and approximately 13% of issues are extended more than once, as shown in Figure 7B. Issues identified by Group Audit are extended more often than issues identified by Line 1 and Line 2, as also shown in Figure 7B.

Figure 7B Issue extension across the Three Lines of Defence³⁴ as at 31 July 2018



7.1.21. Group Audit has observed that issues identified by Line 1 are not always effectively closed, and recommended that Line 1 and / or Line 2 risk specialists review the design of remedial actions as part of the initial response to new issues so as to improve the effectiveness of those actions in dealing with root causes and mitigating risks fully. The Review Team was not able to verify this, as JUNO does not easily track issues that have been closed and subsequently re-opened.

7.1.22. There are a number of factors that may contribute to Westpac's capacity to promptly and effectively close Issues:

- An external risk culture review in March 2018 highlighted a lack of confidence "that action will be taken when [staff] believe that the issue is not likely to be the subject of

³⁴ Data to perform similar analysis on incidents are not readily available.

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regulator or media scrutiny, where there is a lack of transparency regarding any planned action or where the cost to fix the issue is perceived as too high.”

- Interviewees noted that employees frequently assumed too short a period of time to rectify Issues, only to later identify that a longer period was needed after deeper analysis, often because of system complexity and dependencies involved in the effective closure of Issues.
- Risk and compliance capability gaps may impede the accurate identification of the root cause of Issues, which at times may mean that the actions to resolve and close Issues are not appropriate and will not prevent the Issue from reoccurring. It should be noted that the Review Team did not assess the overall capability (or capacity) of employees to manage risk and compliance.
- Interviewees often noted an insufficient organisational emphasis on execution. Others shared perceptions of inertia in the analysis and rectification stage of the Issue management process.
- Related to the above, greater focus is placed on Issue identification than on Issue assessment, resolution and closure in relevant policies and frameworks. Comprehensive guidance is provided on how to identify an Issue, and on the process to log an Issue in JUNO, but considerably less guidance on how to assess, manage and rectify Issues is provided.

G22 It is recommended that a program is developed to:

- train and educate relevant employees across the 3 LOD to identify and analyse the root cause of Issues, and ensure that any actions to resolve Issues are effective; and
- ensure accountability for the timely and effective closure of Issues, including enhancements to remuneration and consequence management frameworks.

7.2. Issues identified by regulators and other external parties

- 7.2.1. Case studies have confirmed that issues identified by regulators are given the highest priority and attention, and Westpac mobilises quickly to respond to regulator concerns, often establishing governance structures to oversee and manage Westpac’s response to regulator issues. Interviewees have commented that Westpac respects the views of its regulators, and chapter 13: *Culture* includes description of the organisational attention given to regulator concerns.
- 7.2.2. Issues raised by regulators are also promptly and comprehensively reported to RISKCO and the BRCC.
- 7.2.3. However, despite the organisational focus on responding to issues identified by regulators, as well as issues identified by other external stakeholders such as Westpac’s external auditor, these issues are extended more often than issues identified by employees.
- 7.2.4. There are several possible explanations for this. Issues raised by regulators tend to be more substantive and systemic, and therefore harder to fix. They are also subject to more intense pre-closure scrutiny by management, Group Audit and the regulators themselves. Furthermore, the sense of urgency to respond promptly to regulator-raised issues can limit the amount of time invested in comprehensive consideration of proposed actions to address and resolve issues before targeted resolution dates are communicated to regulators.
- 7.2.5. The recommendations provided in paragraph 7.1.27 also apply to these findings.

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7.3. Customer complaints

- 7.3.1. The *Westpac Group Complaints Management Policy* sets out the process for handling complaints, which are defined as “expressions of dissatisfaction made to Westpac Group when a response or resolution is explicitly or implicitly expected”.
- 7.3.2. Most customer complaints are handled by Westpac’s service employees, such as branch managers. Complaints that cannot be resolved to a customer’s satisfaction, or complaints that are complex, are referred to Westpac’s dedicated Customer Solutions (**CS**) team. Some complaints are also lodged directly with CS.
- 7.3.3. Customers who are not satisfied with the outcome of their complaint can also escalate the matter to Westpac’s Customer Advocate. The Customer Advocate performs a number of roles, including independent review of complaints made by retail and small business customers outside of Westpac’s standard internal review process. The Customer Advocate is empowered to overturn previous decisions made by Westpac in relation to a customer complaint up to AU\$1 million per matter, and does so routinely. There is no restriction on the number of times that the Customer Advocate can exercise this power in any given period.
- 7.3.4. To the extent that a customer is still unsatisfied, a complaint can be made to the Financial Ombudsman Service (and other specialised forums) and, from 1 November 2018, the Australian Financial Complaints Authority.
- 7.3.5. There has been a notable uplift in Westpac’s frameworks and practices to handle customer complaints. The CCR division established in June 2018 elevates Westpac’s general focus on complaints handling. A new *Group Complaints Management Standard* establishes the Group-wide minimum standard for the handling of customer complaints to ensure that complaints are dealt with promptly, fairly and consistently. The standard addresses previous issues that arose from having division-specific approaches to customer complaint handling – noting that, as reflected in a recent audit, there is considerable work to do to robustly implement the standard. Reporting practices have also been enhanced, including the introduction of a *Customer Complaints Dashboard* that includes comprehensive analysis and information about customer complaints.
- 7.3.6. Many of the initiatives to enhance customer complaint handling have only recently been completed, or are still in progress, and, if properly implemented and embedded, will address many of the Review Team’s findings. However, consistent with observations made in chapter 6: *Risk management and compliance*, the “should we?” consideration in the “can we? should we?” frame must be further embedded in decision-making to ensure that customer considerations are adequately considered as part of decision-making, including decisions about how customer complaints will be handled.

Identification of systemic customer complaints

- 7.3.7. Recent enhancements to customer complaint reporting include analysis of customer complaint root cause by theme. Systemic customer complaints are not, however, currently reported, although there is an initiative planned to address this.
- 7.3.8. Furthermore, identification of systemic customer complaints is made difficult by the use of nine different complaints management systems to record customer complaint data, necessitating manual aggregation of data from these disparate systems in order to identify similar complaints made by a large number of customers. The Review Team understands that an initiative to rationalise systems into a single platform is underway. Other enhancement initiatives, including the establishment of a single, Group-wide approach to customer complaint management, will also help to ensure data quality and consistency, two important elements in the identification process.

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G23 It is recommended that the initiative to converge disparate customer complaints management systems onto a single customer complaint platform is progressed to conclusion.

7.3.9. There is currently no requirement to record complaints that have been resolved within five business days in complaints management systems. While this is consistent with ASIC requirements,³⁵ it may obscure the identification of systemic complaints because not all data are captured and considered. This too is being addressed through a new requirement in the revised *Group Complaints Management Policy*.

G24 It is recommended that CCR extends the current process that is used to aggregate customer complaint data and identify and report trends in root causes to also include indicators of systemic customer complaints, by product, business unit and geography.

Customer complaint reporting

7.3.10. As set out in chapter 5: *Board and senior management*, the Board has historically only been provided with reporting of NPS trends and high-level, aggregated information about customer complaints. Since June 2018, reporting practices have significantly improved, primarily through the establishment of the *Customer Complaints Dashboard*.

7.3.11. While the Dashboard includes reporting of long-dated customer complaints, it does not yet include reporting on the negative “tail” or most extreme customer complaints.

G25 It is recommended that negative “tail” complaints are reported in the *Customer Complaints Dashboard*, to uplift attention on individuals and cohorts and ensure that extreme cases are not lost through averages and aggregates.

7.3.12. The current *Customer Complaints Dashboard* provided to the Board includes reporting on all long-dated complaints. However, there are other long-dated matters, such as general and life insurance claims, collections matters, and legal disputes managed in the Dispute Resolution Group legal team, which are inherently sensitive and can cause both customer harm and reputation issues. While these matters are not complaints as such, it may be worth including them in the Dashboard, so that the Board and Executive Team have awareness of certain matters carrying significant conduct and reputation risk.

G26 It is recommended that BTFG, Collections and Legal work with the CS team to consider and, if deemed appropriate, proceed with the classification and reporting of long-dated customer matters for inclusion in an expanded version of the *Customer Complaints Dashboard*.

7.3.13. While the recently-formed CCR division is accountable for the handling of complaints across all divisions, the complaints-handling process for life and general insurance matters remains within BTFG. Specialist knowledge and skills are required to handle such complaints, and ongoing connection between the handling of complaints and the operations of the BTFG insurance businesses is essential. However, these requirements do not conflict inherently with CCR having responsibility for insurance complaints in the same manner as it does for the complaints of customers from other divisions.

7.3.14. Given the high conduct and reputational risk arising from insurance matters, there is a strong case for taking steps to ensure that the standards and processes applying to insurance customers are consistent with those applying to customers across the rest of the Westpac Group (noting that many insurance customers are banking customers). This consistency is

³⁵ ASIC Regulatory Guide 165 – Licensing: Internal and external dispute resolution, issued by ASIC in May 2018.

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more likely when complaints are handled in the one dedicated customer complaints function, and the default position of the Review Team on matters of divisional operating model variation is that the same model should apply unless there are compelling reasons to do otherwise.

- 7.3.15. The consistency described above includes consistency of data collection, structure and presentation across all divisions. Such consistency facilitates easier Group-wide issue aggregation and hence the enhanced systemic issue identification that is the subject of a separate recommendation in this report.

G27 It is recommended that consideration be given to the transitioning of customer complaint handling for life and general insurance matters from BTFG to CCR.

- 7.3.16. The customer outcomes measured in Group Executive scorecards do not entail consideration of customer complaints or issues directly. The NPS metric in these scorecards is high-level, survey-based, assessed only in relative terms against peers (in several instances) and inherently low in insight and actionability. Furthermore, improvements in such a metric can occur without material progress in resolution of systemic issues or the negative “tail” of customer complaints.

G28 It is recommended that the customer outcomes in Group Executive scorecards are updated and / or replaced to include progress in reduction of long-dated complaints or a similar metric that attaches accountability to the resolution of matters most likely to entail or result in poor customer outcomes.

Escalation of customer complaints

- 7.3.17. There is no requirement to engage or consult Compliance or Operational Risk when assessing whether customer complaints may affect compliance or the management of operational risk. This may limit Westpac’s ability to identify those complaints that relate to weaknesses in the operational risk framework or Westpac’s management of compliance obligations.

G29 It is recommended that the *Customer Complaints Management Policy* is updated to require that the Compliance and/or Operational Risk functions are engaged for complaints that relate to compliance obligations or operational risk, within prescribed materiality/severity levels.

Identification of vulnerable customers

- 7.3.18. Westpac has previously acknowledged shortcomings in its processes to identify vulnerable customers, largely due to its reliance on manual processes and inadequate guidance on vulnerability indicia. These shortcomings have been raised by Group Audit, as well as an external party engaged by Westpac to review the complaints-handling process. Shortcomings were also noted by interviewees.
- 7.3.19. Westpac has established several initiatives to enhance identification of vulnerable customers. These include processes to analyse verbatim feedback obtained in complaints that may indicate that a customer is vulnerable. A *Vulnerable Customer Index*, which sets out criteria that may indicate vulnerability, has been established to help employees to identify vulnerable complainants. A process to manually review long-outstanding customer complaints has also been created, given that a notable proportion of such complaints stems from vulnerable customers. Finally, a new *Vulnerable Customer Action Plan*, presented to the Executive Team this year, provides a formalised foundation for how Westpac identifies and deals with vulnerable customers or those who may be at risk of being vulnerable.

CHAPTER 7. ISSUE AND INCIDENT MANAGEMENT

7.4. Issues identified by whistleblowers

- 7.4.1. Westpac recently enhanced its frameworks and practices to manage concerns raised by whistleblowers as part of a broader industry initiative to implement the Australian Banking Association's guiding principles for "*Improving Protections for Whistleblowers*".
- 7.4.2. Westpac has also benchmarked its whistleblower frameworks and practices, and initiated an "uplift" program to further enhance the way that the company deals with whistleblower concerns. The program aims to increase the use of technology in the whistleblower concern process, and enhance investigations, management information, governance and oversight, and engagement and resourcing.
- 7.4.3. Reporting practices have also been strengthened. Historically, the Executive Team and the Board only received information on referral volumes, aggregated commentary on the significance of whistleblower concerns and aggregated information by concern theme. Reporting now includes more granular detail, and planned automation of a system to record whistleblower concerns will further improve reporting practices.
- 7.4.4. Westpac is currently considering establishing a single, Group-wide approach to handle whistleblower investigations consistently. The Review Team is of the view that a consistent approach to such a sensitive matter is a sensible step.

G30 It is recommended that a single, Group-wide approach to handle whistleblower investigations consistently across the Group is developed.

- 7.4.5. Westpac has launched regular awareness campaigns to promote and foster a "speak up" culture. Notwithstanding these, the use of whistleblower channels varies considerably across divisions.
- 7.4.6. To build sustainable confidence in, and awareness of, the whistleblower program, Westpac has acknowledged the requirement to understand why whistleblower channel use varies across divisions. The outcome of this process will, more generally, inform how Westpac promotes a "speak up" culture. Westpac also plans to establish an Oversight Group and Practice Group to strengthen whistleblower governance and integrate whistleblower initiatives with the broader program to enhance conduct risk management and risk culture.
- 7.4.7. In performing its work, the Review Team did not engage with whistleblowers to ascertain the experiences of those who have raised concerns through the whistleblower channel, given the sensitive status of such individuals.

CHAPTER 8:

FINANCIAL PRIORITISATION

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Decision-making has to be sensitive to an array of complex and often competing demands: the short-term and long-term interests of Westpac's shareholders, strategic initiatives that promote Group "strength", Westpac's risk and compliance obligations and regulatory expectations, the impact of decisions on customers and markets, and maintenance of momentum in the transformation agenda.

All financial institutions aim to undertake their operations in a financially sound, efficient and ultimately profitable manner. However, in some instances, this can have the effect of muting or dulling risk considerations in decisions. The Review Team has observed instances when Westpac has made decisions that, usually inadvertently, have over-weighted financial considerations relative to risk considerations. This chapter sets out a number of factors that contribute to this.

8.1. Prioritisation decisions

Case study analysis

- 8.1.1. In one case studied by the Review Team, a business was acquired by Westpac on the assumption that risk and compliance matters would and could be resolved during integration, without a full understanding of those matters. In another case, funding decisions were made without full appreciation of significant risk and compliance issues.

Investment allocation decisions

- 8.1.2. Every year, as part of the Board Strategy Review (**BSR**) process, the Executive Team and the Board make initial, high-level decisions about how to allocate investment funds, including the confirmation of initiatives that will be prioritised and the amount of funding to be allocated to each initiative. Any initiatives endorsed by the Executive Team and the Board are then subject to further scrutiny by various Group and divisional governance committees, including re-evaluation of the amount of funding that is allocated to each initiative and the outcomes and benefits to be achieved.
- 8.1.3. The Review Team has considered how funding decisions are made throughout the lifecycle, with a particular focus on how initial funding decisions are made as part of the investment allocation process for Westpac's biggest funding pool (the Enterprise Investment Pool).³⁶
- 8.1.4. Divisions prepare submissions for each initiative that is being put forward for consideration. The submissions describe the financial considerations and strategic benefits of each initiative. Submissions do not describe the non-financial risks inherent in each initiative, nor do they describe the non-financial risks that may arise if the initiative does not proceed. Furthermore, while Operational Risk and Compliance are involved throughout the investment allocation process, the Review Team is not aware of any formal process across the Group for these functions to review submissions to identify risks and document their risk analyses in the submissions.
- 8.1.5. The absence of risk analysis in submissions means that when the Executive Team and the Board make a decision whether to endorse an initiative, that decision may not have taken adequate account of non-financial risks.

G31 It is recommended that EIP-related submissions to the Executive Team and the Board are reviewed by Operational Risk and Compliance functions to identify the risks of each initiative, including any risks arising if the initiative does not proceed, and include coverage of the resultant risk analysis.

³⁶ Investment allocation for FY19 as a proportion of total investment: EIP 74%, Refresh and Reliability (**R&R**) 12%, Business as Usual (**BAU**) 12%, Scheme 3%. For the purposes of the self-assessment, spending on property was not considered. The Review Team observations apply only to EIP initiatives - i.e., do not cover R&R, Scheme, BAU and Property.

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Project delivery

- 8.1.6. Once an initiative has been endorsed and approved by the Executive Team and the Board as part of the investment allocation process, a project steering committee is established to oversee implementation of the initiative. The project steering committee oversees the more detailed formulation of the initiative, as well as refinement of cost estimates, resourcing needs, timelines and milestones and other standard governance matters. Steering committees also oversee the process to submit initiatives for further review and consideration by one of several Group-wide committees that scrutinise the execution of initiatives.
- 8.1.7. In some instances, there can be pressure to adhere to initial project cost estimates that were necessarily generated at a high level without the benefit of detailed solution design or verified assumptions. Succumbing to this pressure can result in extensions to project schedule, reduction in scope and / or compromised solutions. This, in turn, can result in “delivered risk” for business unit change recipients.
- 8.1.8. Consistent with a recent Group Audit’s report on Operational Risk in Projects, this “delivered risk” can include solutions that do not adequately take account of risk and compliance requirements, or do not do so in durable fashion.
- 8.1.9. In conjunction with any pressure to adhere to initial cost estimates obtained before detailed solution design or assumption validation, there can be challenges to benefit realisation.
- 8.1.10. The nature of project status reporting is such that schedule, scope and / or solution compromises relative to original goals can co-exist with ongoing “Green” status. Those who are not very close to the project can be unaware of progressive dilution of the eventual outcome.
- 8.1.11. In one case study, there was significant pressure to ensure that a project did not exceed initial high-level cost estimates, which exacerbated the risks and challenges that Westpac faced in seeking to achieve the intended objectives. In this case, and other projects that the Review Team is aware of, failure of initial assumptions to hold was a major factor in the challenges faced.

G32 It is recommended that reporting templates for project steering committees are updated so that risks and all material underlying assumptions feature prominently at the front of steering committee reports and receive ample attention and challenge.

G33 It is recommended that reporting templates for project steering committees are updated so that changes in scope, schedule, solution and expected benefits from project inception are transparently tracked in auditable form, and that such reporting is mandated.

8.2. Factors that contribute to prioritisation of financial considerations

- 8.2.1. The Review Team has identified four factors that may contribute to the prioritisation of financial considerations over risk considerations in decision-making. The impact of these factors is mitigated to a large extent for mandatory regulatory change initiatives due to the robustness of the regulatory change governance framework, in which Risk and Compliance have a clear and prominent role and required funding is prioritised in Westpac’s funding allocation process.

1. The “voice” of Finance and Human Resources

- 8.2.2. Interviewees consistently noted the strength and maturity of the Finance function, and the influence that the function exerts across the company. Similarly, they noted the prominence of the Human Resources function in day-to-day decision-making of business units.

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- 8.2.3. In chapter 13: *Culture*, the Review Team has observed that the Finance and HR functions are perceived as exerting considerable influence and control over businesses. A significant proportion of interviewees expressed the view that their ability to make appropriate and timely decisions has been hampered by the dominance and perceived veto-rights of these functions, which enforce budget, headcount, remuneration, timing and organisational structural constraints on management action.

2. The “voice” of Operational Risk and Compliance

- 8.2.4. As noted in chapter 6: *Risk management and compliance*, the stature, standing and authority of the Operational Risk and Compliance functions are not yet sufficiently elevated.
- 8.2.5. The weaker “voice” of these functions may mean that financial considerations are inadvertently over-emphasised. The recommendations made by the Review Team in chapter 6: *Risk management and compliance* to strengthen the Operational Risk and Compliance functions, should, if implemented, ensure that these functions have a more prominent “seat at the table” when supporting the Group to make decisions, providing a sufficient counter-balance to more mature functions.
- 8.2.6. There is an element of two-way causation in the “weaker voice” of these functions. Lack of stature, standing and authority constrains influence; however, it is also reasonable to infer that the relative lack of pan-organisational maturity in the management of non-financial risk will manifest in less active “listening” to the views of Operational Risk and Compliance.

G34 It is recommended that the decision rights of the Finance and HR functions versus Group Executives and General Managers in operational decisions that have implications for risk and compliance are clarified.

3. Westpac’s understanding of, and approach to managing, risk and compliance

- 8.2.7. Sufficient understanding of the risk and compliance implications of any decision is important, but this is particularly so for financial prioritisation decisions, which must strike a balance between financial outcomes and risks over relevant timeframes. All risks should be considered, both financial and non-financial (including potential impacts on the customer and the market).
- 8.2.8. As noted in chapter 6: *Risk management and compliance*, Westpac has enhanced its management of non-financial risk across the Three Lines of Defence but further work is required in this area. This includes work to ingrain the “should we?” consideration in decision-making.
- 8.2.9. The absence of a sufficiently robust approach to manage non-financial risk may create instances when: risks are not identified; the gravity, extent and implications of risks are not appreciated; mitigants are not identified; risks are not being given due attention; and / or the “should we?” consideration is not appropriately informing decisions.

4. Delegation by Group Executives of their responsibility for decisions about projects

- 8.2.10. Westpac has a governance committee to scrutinise project-delivered initiatives once endorsed by the Executive Team and approved by the Board as part of the initial investment allocation process.
- 8.2.11. The Enterprise Portfolio Oversight Committee (**EPOC**), which superseded the Committee for Project Investment Approvals (**CPIA**), considers non-regulatory change initiatives. As at June 2018, its members included representatives from Finance (the CFO, Deputy CFO and

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CFO WIB), Risk (the CRO), Compliance (Group Executive, Compliance, Legal & Secretariat³⁷) and each other division, ensuring a balanced range of views and perspectives.

- 8.2.12. Minutes of meetings of CPIA and EPOC meetings from November 2016 to July 2018 show that several Group Executives delegated their attendance to their respective divisional CFOs for 64-71% of the meetings.
- 8.2.13. Given that one of the main roles of a divisional CFO is to ensure the financial soundness and in-year financial results of their division, there is a risk that CFOs will naturally focus more on immediate financial considerations than risk considerations when making decisions about initiatives. This is a statement about functional perspectives – not the capable individuals in these roles.
- 8.2.14. This risk is contextualised by the fact that EPOC already includes three representatives from Finance. There are credible reasons for Group Executives to regularly delegate their seat to CFOs, and it is not suggested that CFOs do not bring a broad perspective as the Group Executive's delegate. However, the Review Team does believe that there is a risk that CFOs may bring unconscious functional bias towards shorter-term financial considerations when assessing investment funding decisions.

G35 It is recommended that, given the importance of the EPOC, Group Executives more regularly attend EPOC meetings. It is also recommended that a formal assurance process for oversight of delegation is established, which includes requirements for transparency and documentation of the rationale for temporary delegation as permitted by the committee Terms of Reference.

³⁷ From October 2018, the Compliance function has moved to Risk and reports to the CRO.

PART C

ACCOUNTABILITY

Chapter 9. Accountability prologue

Chapter 10. Remuneration

Chapter 11. Other consequence management

CHAPTER 9: ACCOUNTABILITY PROLOGUE

CHAPTER 9. ACCOUNTABILITY PROLOGUE

For accountability to be effective in an organisation, there must be consequences to drive and reinforce behaviour. The assessment of accountability in this chapter involves consideration of two primary enablers of accountability:

- remuneration specifically; and
- other consequence management mechanisms more generally.

These dimensions of assessment enabled a thorough examination of the more formal and governed frameworks and practices through which Westpac enforces employee accountability. Significant *cultural* aspects of accountability are explored in Part D.

A range of shortcomings and opportunities to enhance frameworks and practices were identified, but these did not, in the Review Team’s judgement, aggregate to a level of significance that would call into question Westpac’s fundamental ability to manage non-financial risk. These shortcomings and opportunities are described in the following two chapters.

Primary findings and recommendations are summarised below.

9.1. Remuneration

9.1.1. Findings

- In recent years, Westpac has taken action to enhance and simplify remuneration frameworks and practices, including implementing the Sedgwick reforms.
- An enhancement is the *Group Risk Adjusted Reward Framework (GRARF)*, which requires Risk involvement in variable reward criteria and outcomes and encompasses positive adjustments for strong risk behaviours as well as negative adjustments: this framework, and multiple governance layers that oversee remuneration decisions, are strengths.
- The risk and reputation component of the scorecard modifier introduced in 2018 for senior management is a material step to correct for the more limited formal role that risk previously played in scorecard outcomes, acknowledging that there *was* scope to adjust variable reward to 0% for poor risk behaviours or outcomes previously.
- The *Group Variable Reward Deferral Framework* is a strength, and mandatory deferral thresholds for Group Executives and General Managers are in line with better practice.
- Westpac does not produce aggregated data showing the quantum and thematic categories of remuneration adjustments and this, together with inconsistencies in terminology and record-keeping practices, can make it difficult to analyse the effectiveness of Westpac’s remuneration framework.
- Business Bank and Consumer Bank use risk gates to effect risk-based remuneration consequences with notably higher frequency than other divisions: this and other divisional variability may not be inappropriate given differences in business and role composition, but a process to validate the reasonableness of divisional variations has not been observed.
- Formal adjustments to variable reward are relatively low in incidence, suggesting that their role in rewarding and deterring risk behaviours and outcomes is limited principally to employees for whom variable reward is a material element of total remuneration: removal of access to variable reward consideration via gate closures is the prevalent means of remuneration impact for other employees.

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- Where employees are subject to discretionary variable reward schemes – for example, in WIB – the effect of risk-related considerations on remuneration outcomes is likely to be limited by weaker “anchoring” of remuneration expectations and lack of formalised communication of the degree of risk-related contribution to outcomes.
- Given strong frameworks and governance foundations, the opportunity to reinforce remuneration-driven consequence management lies principally in approaches to *application*.

9.1.2. Recommendations

- To enhance rigour of oversight, Westpac should produce aggregated data showing the quantum and thematic categories of remuneration adjustments for Group-level remuneration oversight committees: this data should be the subject of reporting to, and analysis by, the Risk, Compliance and Human Resources functions.
- To otherwise enhance remuneration-related practice, the following matters should be regularly reviewed:
 - the specificity of the “Reputation and Risk” component of the scorecard modifier;
 - the appropriateness of the risk-adjustment process for discretionary variable reward plans; and
 - divisional consistency, stringency, specificity and application to non-front office employees of risk gates and risk-based adjustments to remuneration.
- To ensure alignment of terminology and required record-keeping practices across remuneration frameworks and policies, and to identify any associated rationalisation opportunities, a comparative review of these documents should be undertaken.

9.2. Other consequence management

9.2.1. Findings

- The concept of accountability, as distinct from responsibility,³⁸ is not elevated among Westpac’s five core values or defined in a consistent way for employees.
- Accountability is sometimes difficult to establish, for a variety of reasons that include:
 - a strong tendency toward collective decision-making (discussed further in Part D);
 - a related absence of formalised end-to-end “ownership” of processes that cut across business units (commented upon extensively in interviews); and
 - lack of role clarity, including residual blurring of Line 1 and Line 2.
- Reflecting the need for greater consistency and transparency in consequence management, the *Group Consequence Management Framework (GCMF)* introduced in 2018 provides detailed, step-by-step guidance for application that includes categorisation of behaviours into four levels of severity with associated examples and consequences: it is robust.
- The *GCMF* co-exists with a range of other divisional policies and the *Misconduct and Disciplinary Action Policy*: the additional detail in some of these policies assists with role-

³⁸ In this report, “accountability” is the answerability of an individual for behaviour and outcomes within a designated zone of influence (such as a business unit or process), while “responsibility” is the obligation of an individual to perform a designated task with requisite competence and behaviours. While these concepts are not mutually exclusive, accountability differs from responsibility in that an accountable individual is answerable for the actions and effects of others, whereas the responsible individual is not. Both concepts entail consequences for the individual concerned.

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specific application, although the interoperability of various documents is not always clear.

- There is significant divisional, “front office versus back office” and “GM versus GM-1” variation in consequence management (and remuneration) outcomes: this may be explained by differences in business and role composition, but there is no regular, Group-wide process to ensure that such considerations are appropriate and that employees therefore are being held comparably accountable for comparable behaviours.

9.2.2. Recommendations

- To enhance accountability, Westpac should:
 - undertake a Group-wide review of all consequence management (and remuneration) policies and frameworks for:
 - consistency (including consistency of terms);
 - acceptability of divisional deviations;
 - treatment of support and control functions; and
 - opportunities to simplify.
 - test and satisfy itself that variation in per-capita rates of divisional, “front office versus back office” and “GM versus GM-1” consequence management (and remuneration adjustment) outcomes are appropriate, having regard to differences in business and role composition.
 - make accountability the subject of overt, Group-wide organisational focus, potentially including:
 - establishment of a Group-wide definition of “accountability”;
 - enhanced representation in Westpac’s articulation of its values; and
 - a communication program to embed the idea and importance of accountability, and its distinction from responsibility.
 - ensure that consequence management frameworks and practices can be applied effectively to collective bodies in light of Westpac’s tendency to make decisions collectively, rather than individually.

CHAPTER 10: REMUNERATION

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10.1. Introduction

- 10.1.1. The concept of accountability has received growing attention in recent years. Financial institutions have been challenged to define and establish accountability clearly, particularly for senior management roles that encompass processes and decisions that cut across business lines.
- 10.1.2. Clear articulation, understanding and realisation in practice of the difference between *accountability* and *responsibility* are essential to corporate governance. Accountability is the answerability of an individual for behaviour and outcomes within a designated zone of influence (such as a business unit or process), while responsibility is the obligation of an individual to perform a designated task with requisite competence and behaviours. While these concepts are not mutually exclusive, accountability differs from responsibility in that an accountable individual is answerable for the actions and effects of others, whereas the responsible individual is not. Both concepts entail consequences for the individual concerned.
- 10.1.3. The accountable individual profits from positive developments within his or her zone of influence, while paying a price for adverse developments, in neither case necessarily having played a material causal role. When accountability is weak, it is asymmetrical: positive developments are accounted for against the individual, while consequences for negative developments are diffused across others.
- 10.1.4. In more junior roles, particularly those entailing no management duties, accountability and responsibility overlap – sometimes entirely. With increasing seniority, as scope of influence and resource base expand, accountability and responsibility move further apart: individual actions and decisions play a diminishing role in the totality of affairs that fall within the manager's zone of influence.
- 10.1.5. Accountability is a challenging concept for many, carrying connotations of unfairness when consequences are applied for situations over which the accountable individual exerts no direct control. Yet without accountability – felt and formal - there is insufficient incentive for managers to perform their roles with due care.
- 10.1.6. During the work of the Review Team, it was evident that the concepts of accountability and responsibility are often conflated. In Westpac, much of what is described as accountability is more akin to responsibility, the consequence of which is ongoing risk of diffused accountability. Untangling these concepts and ensuring that frameworks and practices – whether in remuneration or other consequence management application - are accordingly supportive of genuine accountability will require ongoing effort.
- 10.1.7. For clarity, much of what is described and assessed in this and the following chapter as accountability also relates to *responsibility* or to activities for which (in the case of more junior roles) accountability and responsibility are largely synonymous.
- 10.1.8. Effective management of accountability has several enablers. Clarity of roles and processes is central, as is an appropriate level of empowerment. The consequences of negative risk behaviours and poor customer outcomes must be outlined clearly and understood by employees, and these consequences applied consistently and in a timely manner. These enablers underpin the frameworks that establish accountability and contribute to fostering a culture that is conducive to accountability.
- 10.1.9. The enforcement of accountability through consequence management can take a number of forms. Material adjustments to remuneration, as detailed in this chapter, are a powerful method for holding individuals to account and a major subset of consequence management mechanisms. Other consequences, such as coaching, formal warnings or termination of

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employment, are also effective means of holding people accountable for actions and outcomes: these are the focus of chapter 11: *Other consequence management*.

- 10.1.10. Chapter 11: *Other consequence management* also outlines the factors that inform accountability outcomes in Westpac, including frameworks and policies, lack of end-to-end process accountability and a propensity for collective decision-making.
- 10.1.11. Cultural dimensions of accountability – particularly matters such as personal ownership and empowerment, and associated tendencies to default to collective decision-making and diffused accountability – are also significant to the self-assessment and are explored within Part D of this report.
- 10.1.12. As Westpac proceeds to sharpen individual accountability, it will need to be mindful that a corollary of accountability is empowerment. In light of the high degree of control exerted through strong functions and matrix management, it will be necessary to formally consider the decision rights granted to individuals in conjunction with any moves to improve the management of accountability.

10.2. Westpac's remuneration approach

- 10.2.1. Remuneration is a central means by which consequence management is effected. Adjusting remuneration for positive and negative risk behaviours and outcomes, in a manner that is fair and proportionate to circumstances, sends a powerful message to employees.
- 10.2.2. Consistent with better practice approaches observed at global peers, Westpac's remuneration framework focuses on behaviour. In 2018, Westpac finished transitioning employees to *Motivate* – a “behaviours first” approach to performance, development and reward that elevates the importance of behaviours over outcomes, reflective of Westpac's commitment to build its service culture, improve the company and affirm its ethical foundations – across all divisions.
- 10.2.3. At Westpac, remuneration is comprised of:
 - Fixed pay – salary and salary-sacrificed items paid to employees having regard to role, responsibilities, experience, skills and market conditions; and
 - Variable reward (**VR**), of which there are two forms – (1) Short Term Variable Reward (**STVR**), which may take the form of cash and / or deferred Westpac shares or share rights; and (2) Long Term Variable Reward (**LTVR**), which is awarded to the CEO, Group Executives and GMs in the form of Westpac shares or share rights, and subject to restrictions and / or performance hurdles.
- 10.2.4. There are two principal risk-related mechanisms affecting granting and quantum of STVR awarded: risk gates and risk adjustments. Westpac's philosophy is that risk gates and risk adjustments are not only used to deter negative risk behaviours but also to encourage and promote positive risk behaviours.
- 10.2.5. For serious misconduct, employees are terminated, and lose all rights to remuneration and incentives, including those that have been deferred.

10.3. Risk gates

- 10.3.1. Risk gates establish the criteria used to determine whether employees will be eligible for consideration for STVR in any given period. If an employee fails to satisfy gate criteria, then he or she will not be eligible for such consideration.

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- 10.3.2. The Review Team is of the view that, consistent with the findings in the report of the Prudential Inquiry, the use of risk gates to effect remuneration consequences separately from any broader consideration of overall performance and reward is a strength.
- 10.3.3. Westpac has established Group-wide risk gate criteria that apply to all employees who are covered by VR plans. Divisions have also established specific risk gate criteria for their employees.

Group-wide risk gate criteria

- 10.3.4. Group-wide risk gate criteria are set out in Westpac's *Group Remuneration Policy*. They are communicated through Motivate and are comprised of a:
- behavioural gate that requires employees to act in accordance with Westpac's core values and *Code of Conduct*; and
 - gate that requires employees to "comply with risk management and compliance requirements" - which in some roles has been translated as the completion of mandatory compliance training.

Divisional risk gate criteria

- 10.3.5. Group-wide risk gate criteria are supplemented by bespoke criteria set at the division level.
- 10.3.6. In accordance with the GRARF, established in 2016 to strengthen practices to adjust remuneration for risk behaviours, Risk and Compliance, together with HR, must be involved in the selection and setting of divisional risk gate criteria. The Review Team is of the view that this requirement is a strength, helping to ensure that criteria appropriately reflect risk and compliance considerations.
- 10.3.7. A review of divisional risk gate criteria indicates that the nature and stringency of criteria vary across divisions. Certain divisions, such as Consumer Bank, have established very specific criteria that clearly articulate the behaviours that will result in the risk gate being shut. Other divisions have established less prescriptive criteria. While variation is not inherently problematic, the Review Team has not observed any process at the Group level to ensure that risk gate criteria are sufficiently stringent across all divisions and that inconsistencies are appropriate and warranted.
- 10.3.8. Furthermore, divisional criteria are predominantly aimed at employees performing front-line roles. It does not appear that there are specific criteria that cater to the nature of activities performed by support, back-office and control functions, including employees performing risk and compliance activities.

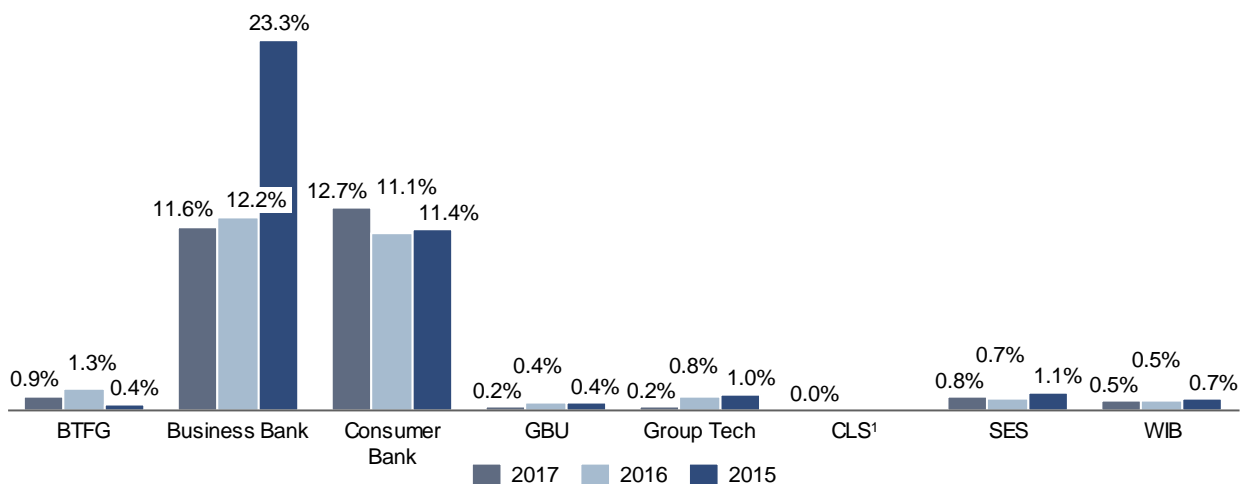
Risk gate closures

- 10.3.9. Any proposed closure of an employee's risk gate is reviewed by Risk and Compliance, as well as the HR functions, as mandated by the GRARF. Again, the involvement of these functions in the application of criteria is a strength.
- 10.3.10. Any proposed recommendation is then tabled at the relevant remuneration committee/s that oversee the application of Westpac's remuneration frameworks and policies.
- 10.3.11. In relation to risk gate closures from FY15 to FY17, and as shown in Figure 10A, the proportion of employees below GM-1 level who have their risk gate "shut" and cannot access VR for risk, compliance or behavioural grounds varies substantially across divisions.

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10.3.12. Consumer Bank and Business Bank have the highest number of gate closures, likely in large part because those divisions have a higher proportion of employees in non-complex roles with well-defined compliance and other obligations that can be readily articulated in risk gate criteria and tested. The higher proportion of gate closures therefore may not be inappropriate; however, as a process to consider and confirm this has not been observed, it is possible that variation is not driven entirely by differences in business and role composition.

Figure 10A Number of mandatory VR gate closures for employees below GM-1 level from FY15 to FY17 (% of FTE by division)



1. Compliance, Legal & Secretariat (CLS) components were included in Group Business Units (GBU) for 2015 and 2016.

10.4. Risk adjustments

10.4.1. If risk gate criteria have been met, then further risk-, compliance- and behaviour-related criteria determine any adjustment to STVR, noting that many employees will not have performed or behaved to a level to have warranted any STVR in the first instance. Adjusting STVR to drive or reinforce behaviour plays a more prominent role for employees who have a greater proportion of their total remuneration as STVR, although risk adjustments for other employees can still be used to encourage positive or discourage negative risk behaviours.

10.4.2. As is the case for risk gate criteria, Risk and Compliance, together with HR, must be involved in the setting and application of risk adjustment criteria, and any proposed adjustments to remuneration are reviewed by these functions before associated recommendations are passed to the relevant remuneration committee.

Risk adjustment criteria for employees below GM

10.4.3. The stringency and specificity of risk adjustment criteria for employees below GM level vary considerably across divisions.

10.4.4. Similar to the divisional risk gate criteria process, there is no Group-wide process to review the nature of criteria across the Group, including stringency and consistency.

Risk adjustments for employees below GM between FY15 to FY17

10.4.5. Data available to the Review Team show that, over FY15 to FY17, at most 1%–2% of each division's FTE had their remuneration adjusted for negative risk behaviours.

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- 10.4.6. The Review Team cannot verify whether this number of adjustments was appropriate. To do so would have necessitated detailed investigation of every matter potentially warranting a remuneration consequence.

Risk adjustments for senior management

- 10.4.7. For the CEO, Group Executives and GMs (and some other employees), metricated scorecards are used to guide remuneration outcomes. Metrics are given a percentage weighting of the overall scorecard and are tailored to each role.
- 10.4.8. Before 2018, the only explicit risk-specific scorecard measure was an *Adherence to Risk Appetite Statement* metric, weighted at 10%, although there was an ability to reduce STVR to 0% for poor risk behaviour or outcomes.
- 10.4.9. Scorecard design was such that the ability to adjust remuneration for a risk metric by no more than 10% of the overall outcome “[could] result in a high percentage of target incentive achieved even when [the] risk management score was low.”³⁹ Leaders who had engaged in negative risk behaviours could still theoretically receive the great majority of their STVR if they performed well on other STVR metrics - noting that in practice, due to varying levels of an individual’s ability to directly influence each scorecard metric, a 10% metric could influence an individual’s behaviour by more (or less) than the percentage would suggest.
- 10.4.10. Whilst the framework did allow for STVR to be reduced to 0% for poor risk behaviour, an APRA review of Westpac’s remuneration practices in 2017 noted that “Executive remuneration outcomes appear overly tied to group financial performance with little sensitivity to individual risk management performance”.
- 10.4.11. In 2018, Westpac introduced a scorecard modifier, including the consideration of a “Reputation and Risk” component, to make (positive and negative) risk adjustments more explicit by formalising what had previously been a discretionary process. The modifier is a significant positive development, although it is not articulated at a granular level of detail to describe specific activities that should be considered when applying the modifier.
- 10.4.12. The Review Team observed robust processes to adjust individual remuneration outcomes for GMs, having regard to thematic risks and issues. A material number of GMs had adjustments relating to risk and conduct matters applied in FY17.

Risk adjustments for employees on discretionary STVR plans

- 10.4.13. Some Westpac employees are eligible to receive discretionary STVR – that is, variable reward that is not determined by reference to scorecards or guided by a target but, rather, is determined by management discretion. The nature of work undertaken by employees on discretionary plans varies significantly.
- 10.4.14. Some of these employees have STVR as a large portion of total remuneration, and adjusting their STVR can be an effective way to enforce accountability and promote positive risk behaviours.
- 10.4.15. However, the Review Team has observed that *formal* risk adjustments are rarely applied to employees on discretionary STVR plans. Risk behaviours and outcomes are considered as part of an overall appraisal of reward entitlement, but discretionary schemes are not designed to incorporate the application and recording of discrete risk adjustments.

³⁹ Observation from APRA’s review of Westpac remuneration practices in 2017.

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10.4.16. The absence of a discrete risk-adjustment process for discretionary STVR plans can limit the effectiveness of STVR adjustment in encouraging or discouraging behavior. Such plans are most used in WIB, support and control functions, and at the GM-1 level.

A1 It is recommended that the appropriateness of the risk-adjustment process for employees on discretionary STVR plans is reviewed.

Reporting of risk adjustments

10.4.17. Westpac does not produce aggregated data showing the quantum of remuneration adjustments. The Review Team believes that such data are helpful in understanding how effective remuneration outcomes are at deterring negative risk behaviours.

10.4.18. In the materials available to the Review Team, reasons for adjustments were not specified at the aggregate level. While the varying nature of the reasons for adjustments makes this task challenging, aggregating data about the reasons for adjustments can enable more accurate detection of trends in behaviours underpinning risk adjustments.

Efficacy of risk adjustments

10.4.19. As not all Westpac employees receive or expect to receive STVR, the impact of remuneration adjustments for risk-related behaviour is obviously limited to some extent. The absence of a perceived “anchor” or indicative level of STVR to which adjustments can be made can restrict the impact of risk adjustments in encouraging good, or discouraging bad, risk behaviour. This is the case for employees on discretionary schemes, although many such employees will have a reasonable sense of potential reward through experience and guidance documents.

10.4.20. The explicit recording and clear communication of impacts on individual remuneration arising from risk, compliance, customer or behavioural matters are important in ensuring that adjustments foster desired behaviours.

10.4.21. Westpac is in the process of addressing this by introducing the Variable Reward Guidance (VRG) initiative. The VRG provides a guiding baseline value of potential STVR that could be available to employees on discretionary STVR plans without targets. The VRG is being implemented to accompany Motivate.

A2 It is recommended that risk gate and risk adjustment criteria at relevant organisational levels are:

- regularly reviewed to ensure that the specificity of the “Reputation and Risk” component of the scorecard modifier is adequate for purposes of guidance and application;
- regularly reviewed to ensure that criteria for each division are appropriate (including appropriately granular), having regard to the nature of activities conducted by each division, and sufficiently stringent to deter negative risk behaviour and promote positive risk behaviour;
- regularly reviewed to confirm that inconsistency across divisions is appropriate; and
- supported in application by aggregated data showing the size of, and reasons for, remuneration adjustments by division, for consideration by relevant committees and functional areas.

These recommendations pertain to both sections 10.3 and 10.4.

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10.5. Navigation and consistency of frameworks and policies

- 10.5.1. Another strength of the *GRARF* is its considerable focus on mechanisms to reward positive risk behaviour, including practical examples of such behaviour.
- 10.5.2. However, the Review Team had some difficulty navigating the multitude of Group-wide and divisional frameworks and policies that govern remuneration - acknowledging HR's significant efforts to rationalise frameworks and policies from a considerably more complex former state.

Terminology and record-keeping practices

- 10.5.3. The way in which different divisions and remuneration committees define and refer to risk gate and risk adjustment criteria varies. Some divisions use the term "risk adjustment", while others use the term "risk gate closure". While a risk gate closure can be considered a form of risk adjustment, the distinction between being made ineligible for STVR consideration and having one's STVR adjusted is a useful one.
- 10.5.4. Inconsistency in terminology and recording practices makes it difficult to aggregate and analyse information when assessing the effectiveness of Westpac's remuneration framework.

A3 It is recommended that remuneration frameworks and policies are reviewed to ensure that they are aligned (e.g., in the use of terminology), require consistent practices across divisions (for example, in the recording of adjustments) and, where possible, are rationalised in number.

10.6. APRA review of Westpac's remuneration practices

- 10.6.1. Many of the Review Team's findings are consistent with APRA's observations arising out of its 2017 review. Westpac has established a broad range of initiatives to respond to APRA's observations.⁴⁰

10.7. Use of malus provisions

- 10.7.1. Westpac has malus⁴¹ provisions that apply to variable reward that has been granted but not vested. Malus can be applied for matters that have resulted in material financial or reputational harm, inaccurate performance measurement or misconduct. The CRO, CFO, Group Executive, Human Resources and Group Executive, Legal & Secretariat contribute to the determination of possible malus cases, and make recommendations to the CEO, BRC and Board if they believe that there are sufficient grounds to apply malus. Consistent with many industry peers, Westpac has not established mechanisms to claw back variable reward after it has vested or been paid, for reasons of impracticality.
- 10.7.2. Before 2018, Westpac had not applied any malus provisions, which the Review Team understands is reflective of Westpac's preference to deal with relevant issues by adjusting STVR in the current year, which has a more immediate perceived impact on the individual in question.

⁴⁰ Westpac already conducts an effectiveness review of the remuneration framework every three years. In response to APRA's feedback, Westpac will enhance the next review (FY19) to include a review of how remuneration practices support the Group's risk management strategy.

⁴¹ "Malus" permits an organisation to reduce the value of all or part of deferred compensation based on ex post risk adjustment before it has vested. "Clawback" is a process under which an employee has to return an amount of variable compensation already paid or already vested to the relevant employing organisation, under certain conditions.

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10.7.3. In 2018, Westpac has applied malus in two instances.

10.8. Deferral of variable reward

10.8.1. The Review Team's view is that the *Group Variable Reward Deferral Framework* is a strength.

10.8.2. The *Group Variable Reward Deferral Framework* is applicable to all employees who receive STVR. For employees below GM, thresholds are set to determine the portion of STVR to be deferred. The deferred portion increases with the amount of STVR earned.

10.8.3. Better practice deferral frameworks ensure that recipients of substantial variable reward are invested in the long-term interests of the bank. To achieve this, they incorporate a deferral threshold of at least 40% of STVR, as well as a minimum deferral period of two years and at least 50% of the deferred portion being paid in equity.

10.8.4. Westpac has a two-year deferral period for Group Executives and most GMs (GMs in Financial Markets and Treasury have a two-year deferral period that will be extended to four years in FY19). The mandatory deferral threshold for Group Executives is 50% of STVR, and for GMs is 40%. This is in line with better practice.

10.9. Implementation of Sedgwick recommendations

10.9.1. Given the significant role played by remuneration in enforcing desired behaviours, Westpac decided to implement the Sedgwick recommendations for employees from 1 October 2018, two years early. These transformational changes – endorsed fully by the Review Team, but not within the accountability-focused scope of this assessment – complement a range of enhancements to Westpac's remuneration framework and practices that have been examined by the Review Team.

CHAPTER 11: OTHER CONSEQUENCE MANAGEMENT

CHAPTER 11. OTHER CONSEQUENCE MANAGEMENT

11.1. Introduction

- 11.1.1. This chapter extends the review of accountability frameworks and practices to the non-remuneration components of consequence management. Applied fairly and in a manner that is proportionate to circumstances, these play an important role in the suite of accountability measures at Westpac.
- 11.1.2. Informal consequence management practices are necessarily outside the scope of the self-assessment. The focus of this chapter is formal coaching, formal warnings and termination of employment, across different organisation levels and role types.
- 11.1.3. With the benefit of having also reviewed remuneration-related accountability frameworks and practices, this chapter also provides an overview of the factors that inform accountability outcomes at Westpac more generally.

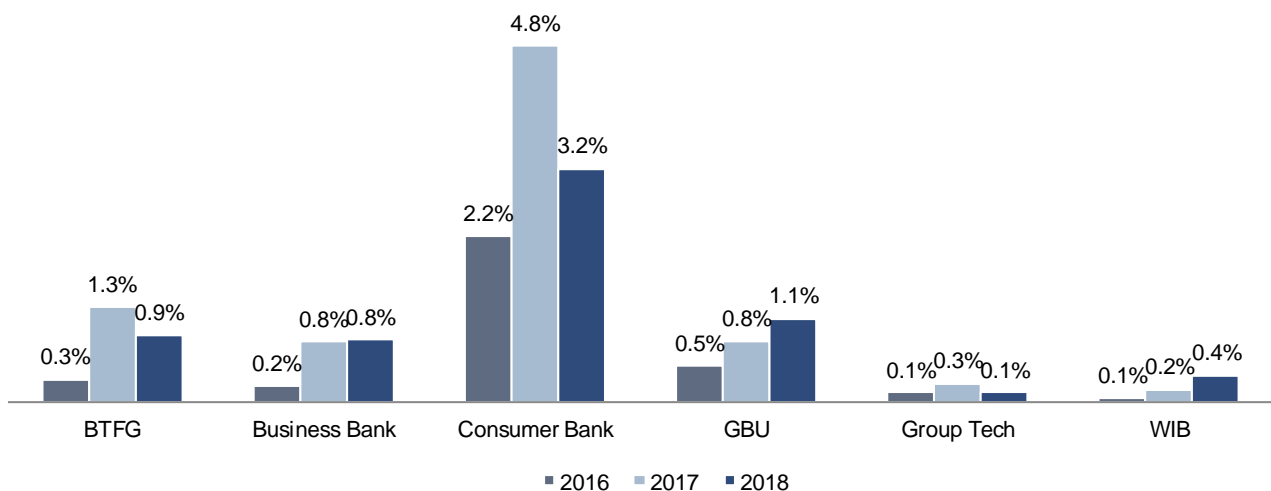
11.2. Consequence management outcomes for Westpac employees

- 11.2.1. The Review Team has assessed how non-remuneration consequences have historically been applied to employees across the Group. Detailed investigation of individual cases has not been performed.

Consequence management outcomes for employees below GM-1 level from FY16 to FY18

- 11.2.2. Non-remuneration consequences principally comprise formal coaching, formal warning and termination. As shown in Figure 11A, some divisions have more frequently applied such consequences for employees below GM-1 level in FY16 to FY18⁴² than others.⁴³

Figure 11A Non-remuneration consequence management outcomes⁴⁴ for employees below GM-1 level, FY16 to FY18 (% of FTE by division)



⁴² Data for FY18 only cover the first 10 months of the year at the time of writing. The Review Team has chosen to include the 2018 data to provide a view over a three-year period (there are no comparable data available for FY15 or earlier).

⁴³ Noting that: 1) with the exception of WIB and Group Technology (which have applied few non-remuneration consequences of any type), the proportion of each type of non-remuneration consequence is broadly consistent across divisions; and 2) formal warnings make up a majority of total non-remuneration consequences in each division.

⁴⁴ Formal coaching, formal warning and termination.

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- 11.2.3. Consumer Bank exhibits the most frequent application of non-remuneration consequences, at 2%–5% of FTE. As noted in chapter 10: *Remuneration*, VR gates are also regularly closed. Consumer Bank also has relatively stringent risk gate criteria and a consequence management framework that provides examples of unacceptable behaviours and associated consequences.
- 11.2.4. Business Bank’s application of non-remuneration consequences is not as frequent as Consumer Bank’s and it uses different levers to hold people accountable. Business Bank closes VR gates more frequently than any another division, while non-remuneration consequences are less commonly applied.
- 11.2.5. WIB and BTFG have the lowest frequency of application of non-remuneration consequences of the business divisions. Both divisions also rarely apply VR gate closures (see chapter 10: *Remuneration*).
- 11.2.6. Back office and support functions have also less frequently applied consequences, including formal remuneration consequences.
- 11.2.7. When considered together with the nature of divisional risk gate and risk adjustment criteria, it appears that accountability efforts at Westpac focus more on “front office” roles - that is, roles that entail direct engagement with Westpac’s customers. Ensuring that front office employees are accountable for their actions is obviously important. However, so is ensuring that accountability frameworks and practices are appropriate for all employees, and cater to the wide range of roles and responsibilities across the Group.
- 11.2.8. While some difference in outcomes between divisions is to be expected, there is no regular, Group-wide process to review outcomes to ensure that inconsistencies are appropriate, and the Review Team is of the view that further investigation is needed to understand whether all employees are being held accountable for comparable behaviours in consistent ways.

Consequence management outcomes for General Managers and GM-1 level

- 11.2.9. In FY17 and FY18, 6.7% and 8.5% of GMs, respectively, received formal warnings or were terminated. Considered together with remuneration outcomes, there is a clear indication that employees at this level are held accountable for their actions.
- 11.2.10. Non-remuneration consequences for employees at the GM-1 level have been applied less frequently – only 1.5% of GM-1s had such consequences applied in FY18. In FY17 this percentage was 0.4%.
- 11.2.11. Again there is no regular, observable Group-wide process to review outcomes for employees at these levels to ensure that, in aggregate, they are appropriate, and that inconsistencies between the levels are appropriate.
- 11.2.12. At the divisional level, the Review Team found evidence of proactive strengthening of accountability. For example, Group Technology self-identified room to improve the accountability of managers at these levels for issue management, and has taken steps to do so.

A4

It is recommended that:

- a process is established to regularly review consequence management outcomes across the Group to ensure that any inconsistencies across divisions, and between GM and GM-1 employees, are appropriate; and
- consequence management frameworks and policies are regularly reviewed to ensure that they appropriately cater for all roles and responsibilities across divisions, including back office, support and control functions.

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11.3. Factors that inform accountability outcomes

- 11.3.1. There are a number of factors that inform the way in which employees at Westpac are held accountable for their actions. Each of these factors is explored below.

1. Accountability frameworks and policies

Defining accountability

- 11.3.2. Frameworks and policies do not articulate what accountability is, and what it means at Westpac, and accountability is not referenced in Westpac's core values. Accountability, as distinguished from responsibility, is also not defined.

Accountability guidance

- 11.3.3. Before 2018, the *Misconduct and Disciplinary Action Policy* was the primary Group-wide policy to manage unacceptable behaviour. This policy did not provide sufficient guidance to employees about the outcomes that should apply for different types of misconduct.
- 11.3.4. In 2018, Westpac established the *Group Consequence Management Framework* to provide more granular detail of consequence management processes and ensure a greater level of consistency of consequence management across the Group.
- 11.3.5. The *Framework* provides detailed, step-by-step guidance about the application of consequences for behaviour that does not meet Westpac's expectations. The *Framework* categorises behaviours into four levels of severity, provides clear and realistic examples of behaviours for each level, and outlines the consequences that should be applied for each level. The *Framework* also establishes a clear process and governance structure to consider and apply consequences. The Review Team is of the view that the *Framework* is a strength.
- 11.3.6. The *Framework* is supplemented by consequence management frameworks established for Consumer Bank, Business Bank and BTFG, and other policies that govern outcomes for specific behaviours.
- 11.3.7. The Review Team found it difficult to navigate the multitude of Group-wide and divisional policies to understand how consequence management works, and this may contribute to inconsistency in outcomes across divisions.

A5

It is recommended that:

- accountability is made the subject of overt, Group-wide organisational focus, potentially including establishment of a Group-wide definition of "accountability" and a communication program to embed the idea and importance of accountability and its distinction from responsibility; and
- a review of all consequence management and remuneration policies and frameworks is undertaken, to ensure that they are consistent where needed and any deviations are acceptable, and that they are otherwise simplified and consolidated.

2. Diffusion of accountability

- 11.3.8. The Review Team has established a number of factors that may contribute to the diffusion of individual accountability, by which is meant the application of distributed accountability for a situation without an appropriate level of accompanying individual accountability for the more senior individual in whose zone of influence the situation occurred:

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- an absence of formalised, end-to-end accountability for processes that cut across business units;
- a lack of clarity of roles and responsibilities; and
- insufficient personal ownership and empowerment, which has led to a tendency to default to collective decision-making.

3. End-to-end accountability

- 11.3.9. Deficiencies in end-to-end accountability and lack of complementary empowerment have been recurrent themes raised by interviewees.
- 11.3.10. Interviewees commented that the ability to implement and embed initiatives that span divisions was impeded by a lack of end-to-end accountability, challenging the implementation of Group-wide or cross-divisional tools, the embedding of AML risk mitigation controls, product delivery (e.g., mortgages) and the identification of accountable persons for responsible lending issues.
- 11.3.11. Some interviewees commented that the introduction of BEAR, which is described in more detail below, would help to clarify accountability at senior levels for issues that span multiple divisions. Westpac's implementation of BEAR, including accountability "archetypes" that distinguish between a "standard owner" and an "implementer" of discrete components of issues that span divisions, is designed to achieve this objective. Westpac is also establishing statements of responsibility for GMs, to be fully implemented by 2019.
- 11.3.12. Other interviewees stated that while BEAR may strengthen accountability at senior levels, it risks making Group Executives and some GMs "accountable for everything". This could have the unintended consequence of relieving GM-1 and GM-2 employees of accountability.

4. Clarity of roles and responsibilities

- 11.3.13. Interviewees commented on widespread lack of understanding of the difference between accountability and responsibility, and a tendency to conflate the two.
- 11.3.14. The greater clarity of responsibility in front line roles may be a contributor to the higher incidence of consequences in such roles when compared to support and control functions, discussed earlier in this chapter.
- 11.3.15. As noted in chapter 6: *Risk management and compliance*, Line 1 in some divisions does not always take ownership of, and accountability for, the risks of the business. Accountability has also been diffused because roles and responsibilities across Line 1 and Line 2 are in some cases blurred.

5. Cultural propensity toward collective decision-making

- 11.3.16. Chapter 13: *Culture* includes a finding that there is perceived to be insufficient ownership of actions and outcomes, driven by a lack of empowerment, which has led to a tendency to default to collective decision-making, manifested in behaviours such as making decisions in committees.
- 11.3.17. When decisions are made in collective bodies such as committees, the individuals involved may neither feel nor be held as accountable as they would be had they made such decisions alone, because there is less personal causal influence at work. In these circumstances, the conflation of accountability with responsibility is likely in practice to reinforce lack of both felt and formal accountability.

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11.3.18. Westpac's initiatives to operationalise BEAR may shift Westpac toward greater individual accountability. Nevertheless, ensuring that Westpac's accountability frameworks and practices are appropriate given the company's propensity to make decisions as a collective body will be necessary. For example, Westpac should ensure that there are measures in place to hold a collective body to account for a particular decision or outcome if collective decision-making is genuinely practised.

A6 It is recommended that accountability frameworks and practices are reviewed and enhanced to ensure that they are appropriate in light of Westpac's propensity towards collective-decision-making.

11.4. The Banking Executive Accountability Regime

- 11.4.1. BEAR, which came into effect in July 2018, is intended to strengthen APRA's powers in assessing the transparency and accountability of decision-making processes within authorised deposit-taking institutions (**ADIs**). Under this regime, ADIs are required to notify APRA of Accountable Persons with defined areas of responsibility and obligations. APRA is authorised to disqualify individuals who breach the required standards.
- 11.4.2. At the most senior leadership level, Westpac's implementation of BEAR has strengthened the formal articulation of accountability for Directors, Group Executives and some GMs. This is operationalised through policies and frameworks such as the *BEAR Governance Policy*, *Reasonable Steps Framework* and Operational Plans.⁴⁵
- 11.4.3. Given the infancy of BEAR and its implementation at Westpac, the effects of BEAR in practice are yet to be seen.

⁴⁵ The Review Team notes that the BEAR Accountability Statements will be updated as required, and that some of the BEAR Operational Plans made available to the Review Team were works in progress. **BEAR Governance Policy** – sets out the overall approach of Westpac to achieve compliance with the BEAR obligations. **Reasonable Steps Framework** – a framework for the non-executive Directors and Group Executives that draws on global practices and existing governance, control and risk management frameworks. **Operational Plans** – each Accountable Person and his/her team have developed an Operational Plan that details specific accountabilities, alignment with Group-wide frameworks, “key” direct reports and delegations.

PART D

CULTURE

Chapter 12. Culture prologue

Chapter 13. Culture

CHAPTER 12:

CULTURE PROLOGUE

CHAPTER 12. CULTURE PROLOGUE

The Review Team has observed that Westpac's culture rests on solid foundations, including clear vision and values that enjoy widespread support, diversity and inclusion, care and collaboration, community connection, a deep sense of history, and a custodial bias to strength.

A significant body of cultural work has been undertaken at Westpac in recent years, including that arising from the KPMG risk culture reviews and Denison Organisational Culture Survey of 2015, the recent Nous focus groups and Westpac's monthly Sentiment surveys.

This section of the report differs from other sections in its approach to recommendations. As cultural findings are highly interdependent, and as culture permeates the subject matter of this report, measures to effect change relative to those findings must be more holistic in nature than for other dimensions of the self-assessment. Consequently, recommendations should be construed as applying to the findings as a whole, even when referencing an individual finding.

A range of shortcomings and opportunities to enhance aspects of Westpac's culture were identified, but these did not, in the Review Team's judgement, aggregate to a level of significance that would call into question Westpac's fundamental ability to manage non-financial risk. These shortcomings and opportunities are described in the following chapter.

The findings are a mix of reported perceptions of Westpac people and observations of their behaviours. The common factor among all findings was a constraining effect on achievement of Westpac's ambitions – in relation not only to risk and compliance, but also to employee engagement, efficiency and effectiveness.

Primary findings – heavily interdependent – are summarised below. Drivers of these findings are outlined in the following chapter.

Unsurprisingly, a number of the behavioural traits commented upon in the findings had both positive and negative aspects.

12.1. Findings

12.1.1. Vision, values and strategy set at the top are clear, but translation by leaders into purposeful action for employees can be improved.

- Integrity appears to be best embedded among Westpac's five core values: people genuinely want to *do the right thing*.
- Service and One Team are front of mind, but not sufficiently embedded – particularly Service at lower levels of the organisation, where inadequate contextualisation of commercial considerations and the day-to-day burdens of process and complexity are felt strongly.
- Courage is less embedded (e.g., comfort with "speaking up" and challenging) despite recent leadership attention, and Achievement is also not well embedded.
- The variable embedding of values is principally a function of leadership: there is demonstrable need for more focused leadership actions, at all levels, to bring the values to life for employees, when 45% of employees surveyed for the self-assessment agree that the *organisation is better at talking about the values than putting them into practice*.

12.1.2. Management of non-financial risk, although recognised as important, is not as well understood and embedded as it should be.

- While financial risk awareness is strong, as is regard for Westpac's capability to manage financial risks, the awareness of non-financial risk is less pronounced, and views of the

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capability to manage it and degree to which it is embedded in the day-to-day are more mixed.

- Until non-financial risk awareness is ingrained in the organisation, it is likely that some employees will make inappropriate trade-offs (e.g., between perceived demands of service and the requirements of compliance) that could have adverse consequences.

12.1.3. The organisation is people-oriented, but can overplay its caring, relationship-focus and collaboration attributes.

- The strong people focus at Westpac is manifested in the intensity of these attributes.
- The shadows of these positive attributes include, in the case of relationship focus, difficulties for new starters to onboard and contribute the ideas and experience for which they were hired, the need to work around the idiosyncratic styles and preferences of influential individuals, reluctance to challenge, and sheltering of underperforming employees.
- Collaboration is a strength that, through overuse, can become a burden on the organisation – driving an unnecessarily high level of meetings and committees, excessive numbers of people involved in decisions, slowness, diffusion of accountability and a crowding-out of valuable thinking time.

12.1.4. There is insufficient personal ownership and empowerment, leading to a tendency to default to collective decision making and diffused accountability.

- The majority of Westpac's surveyed employees believe that the level of ownership in the organisation should and must increase.
- Lack of such ownership is seen as reflecting, among other things, lack of empowerment, and there is a resultant tendency to default to collective decision-making and diffused accountability.
- Consequences such as diffused accountability, challenges to ownership (of issues and outcomes, for example) and perceived or real constraints on responding to service difficulties all have bearing on the effectiveness and efficiency with which risk, compliance and customer matters are managed.

12.1.5. There is a tendency towards “completeness”, which can lead to acceptance and perpetuation of organisational complexity.

- There is a propensity in Westpac to believe that “more is more”: more analysis, more information, more documentation, more iteration of papers, more sign-offs, more meetings, more policies, more frameworks, more “stuff” – frequently layered on without offsetting reduction or rationalisation.
- This can add rigour and thoroughness, but also unnecessary complexity, slow or impeded execution on a range of fronts, and challenges to cognition and thinking space.
- This behaviour, labelled completeness for want of a better term, is paired with an acceptance and perpetuation of complexity: many employees resign themselves to complexity as the natural state of affairs at Westpac, and their response to that complexity is often to wrap more complexity around it – potentially adding risk in the process.

12.1.6. Focus on speak-up and challenge has increased, but more work is needed to increase employee comfort and listening by leaders.

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- The importance of speaking up has received much attention by the current and previous CEOs.
- Nevertheless, 26% of surveyed employees responded as not agreeing with the statement that *I feel safe calling out issues, risks and / or concerns*.
- Focus group participants have suggested that leaders are central to reducing this discomfort, by more actively seeking out and being open to feedback and issues raised, consciously welcoming and cultivating ideas from new employees (often hired for their different perspectives), and deemphasising hierarchy in their communication.

12.1.7. There is insufficient discipline in prioritising, making decisions and saying “no”.

- Outside of a major external stimulus – such as natural disaster, regulatory matter or major risk event – or a directive from a senior internal authority, Westpac can struggle to cut through and attain clarity as to matters most needing attention.
- Cultural attributes noted elsewhere, including over-collaboration, “completeness”, collective decision-making and diffused accountability, are not conducive to quick and clear decisions regarding allocation of effort and resources.
- The implications of this finding include slowed execution, suboptimal resource allocation, confusion and lack of clarity on the part of employees as to where to focus their efforts.

12.1.8. There is a tendency to focus on conceptualisation over embedding and process over outcome.

- There is tendency in Westpac to privilege upfront conceptualisation – designing frameworks and policies, and generally “starting new things” – over the hard and often less “glamorous” work of execution that is needed to see concepts through to operational reality.
- More broadly, there is strong evidence of a related bias toward process over outcomes, which in turn can reflect – among other things – the safety that comes from following a process, a submission to complexity, and lack of ownership and accountability for outcomes.

12.1.9. A lack of institutional learning and reflection holds the organisation back.

- While Westpac has numerous “hard-wired” mechanisms to help individuals learn, such as LearningBank, the Westpac Institute and Motivate, learning and reflection are not sufficiently incorporated in day-to-day operating rhythms.
- There is little evidence of an institutional norm for employees to take time to learn and reflect among competing priorities, a practice that could yield benefits across many areas of the business, including the management of risk.
- Similarly, learning and reflection are not adequately hard-wired at the institutional level, as evidenced by the recurrence of similar failings in project execution and multiple remediation programs covering similar process deficiencies.
- In the context of accelerating rates of change, including greater workforce mobility and the transition to more agile ways of working, it is logical to infer that this cultural attribute will assume growing significance if unaddressed.
- More positively, many employees *have* noted the learning and reflection that have arisen from the current fierce scrutiny of the financial services industry.

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12.2. Recommendations

12.2.1. Recognising that cultural change is inherently difficult, requiring systemic and systematic intervention:

- A formal cultural program should be established to target a defined set of desired cultural shifts, as determined by consideration of the self-assessment.
- Given that Westpac already has an organisation-wide series of culture initiatives, a holistic review of these should be undertaken in the near term to enrich them in line with the findings from the self-assessment.
- This program should address the four main areas of development:
 - Leadership
 - “Ways of working”
 - Learning
 - Reward and recognition
- Leadership initiatives should support leaders in creating conditions for psychological safety in their teams by:
 - harnessing and selectively uplifting existing leadership programs and cultural events, including the Navigate series;
 - covering activities to support leaders’ own development and help leaders instil targeted change in their teams (e.g., specific behaviour-based training, and dilemma- and scenario-based learning);
 - using continuous “nudges”, guidelines and reinforcing mechanisms to make sure that the learning and change stick in daily practice; and
 - addressing the level of tolerance that Westpac has for those who do not meet required standards.
- “Ways of working” initiatives should lay foundations for stronger personal ownership, greater empowerment and more efficient and effective workflow, through:
 - ongoing reinforcement of “Check, Confirm, Create” and similar existing initiatives in relevant divisions;
 - reviewing and refining decision-making rights for specific roles along end-to-end business chains, including consideration of functional “veto” rights;
 - creating a series of guidelines and “principles” to support greater outcome-focus, high-quality meetings and prioritisation discipline; and
 - introducing a Risk function / business rotation program.
- Learning underpins several of the other recommendations and will need to become the norm through:
 - supplementing and repurposing existing initiatives in alignment with the desired culture change – for example, by further evolving “Service Huddles” to bring out other elements of the Compass; and
 - providing targeted training interventions in areas such as individual and team learning and reflection processes (e.g., learning how to receive feedback and challenge, influencing and having impact, and listening for leaders).
- Reward and recognition plays a central role in supporting culture change and, in addition to the actions recommended in chapter 10: *Remuneration*:
 - recent and in-flight scorecard and remuneration enhancements should be continued and, where necessary, augmented to more prominently recognise and reward

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behaviours that have been identified as supportive of the cultural shifts targeted by the overall program.

- Immediate next steps include: getting Westpac leaders (regardless of level) “behind” the findings and nuances through a series of facilitated conversations; embedding the four development areas in the existing culture initiatives and detailing initiatives further; and selecting a small number of areas in the organisation to undertake “cultural change pilots” (including examining the “exemplars”).
- Westpac should regularly monitor changes in its culture against a defined target state. It should supplement existing culture monitoring tools and activities (e.g., the Sentiment survey) with the capability to deep-dive into specific sub-cultures, behavioural patterns and root causes.

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Westpac thinks of “culture” as the “way we do things around here”.

While culture has significant bearing on the management of risk and compliance, Westpac does not regard “risk culture” – the behavioural norms of individuals and groups that influence the identification, understanding, discussion and escalation of current and future risks – as something independent of the overall culture. Rather, managing risk and helping to protect its customers, communities and people are seen as *part* of Westpac’s culture.

In this context, and in order to understand how Westpac’s culture influences its management of non-financial risk, risk culture was conceived as a subset of organisational culture.

There are four, interwoven elements of culture used to describe the operation and dynamic of culture within the Group. The first three elements – Drivers of culture,⁴⁶ the Mind elements⁴⁷ and Behaviours⁴⁸ – must be considered holistically with Outcomes. Consideration of each of these elements informed the findings in this chapter.

The Review Team observed solid foundations in Westpac’s culture for the management of risk and compliance. However, within those foundations were cultural elements that warrant concerted attention. The nine findings in this chapter relate primarily to those elements, the first one encompassing fundamental issues that permeate all subsequent findings.

In summary, the nine findings are that:

- Vision, values and strategy set at the top are clear, but translation by leaders into purposeful action for employees can be improved.
- Management of non-financial risk, although recognised as important, is not as well understood and embedded as it should be.
- The organisation is people-oriented, but can overplay its caring, relationship-focus and collaboration attributes.
- There is insufficient personal ownership and empowerment, leading to a tendency to default to collective decision-making and diffused accountability.
- There is a tendency towards “completeness,” which can lead to acceptance and perpetuation of organisational complexity.
- Focus on speak up and challenge has increased, but more work is needed to increase employee comfort and listening by leaders.
- There is insufficient discipline in prioritising, making decisions and saying “no”.
- There is a tendency to focus on conceptualisation over embedding and process over outcome.
- A lack of institutional learning and reflection holds the organisation back.

13.1. Finding 1: Vision, values and strategy set at the top are clear, but translation by leaders into purposeful action for employees can be improved

- 13.1.1. Westpac has set a clear vision, values and strategy, which employees generally believe in. However, the values are not always sufficiently lived, across all business areas and levels of seniority, to allow Westpac to achieve its desired future state.

⁴⁶ Context, structures and mechanisms that influence the mind and behaviours.

⁴⁷ Formed by the accumulation of knowledge, beliefs, values, attitudes, traits, biases and personalities.

⁴⁸ Actions and statements that are visible to others.

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- 13.1.2. Westpac's five core values – *Integrity, Service, One Team, Courage and Achievement* (listed in order of importance⁴⁹) – are well articulated through corporate communication channels and initiatives such as the recent Navigate events to reinforce the Compass.⁵⁰ However, in the September 2018 Employee Sentiment survey, which included additional questions in support of the self-assessment (the **self-assessment survey**), over 45% of employees agreed that “The organisation is better at talking about the values than putting them into practice”. This sentiment was similarly expressed in focus groups covering a wide range of business units and brands.
- 13.1.3. The extent to which each of these values is embedded is linked to the cultural strengths and shortcomings outlined in each of the findings. For example, a well-embedded value of Courage is likely to result in the propensity to speak up and challenge. The following exploration of the values therefore lays the foundation for the rest of this chapter.
- 13.1.4. **Integrity** appears to be the most strongly embedded of the core values. A common sentiment expressed during interviews and focus groups was that “people want to do the right thing”⁵¹ for customers, the bank and colleagues.
- 13.1.5. The values of **Service** and **One Team** are front of mind among Westpac employees but not yet sufficiently ingrained. Service, the Service Promise and service-oriented vision have been the subject of significant reinforcing communication. Over 30% of recent⁵² CEO all-staff emails mentioned Service, and Service Huddles and scorecards reinforce the messaging. Nevertheless, the concept of service lacks resonance and contextualisation for many at lower levels of the organisation in both customer-facing and non-customer facing roles. Cultural evidence highlighted uncertainty about alignment of Service, commerciality and day-to-day work, and concerns that “internal service” is not felt in the day-to-day. Furthermore, there is a perception that complexity and process hindered the embedding of Service.⁵³ Similarly, evidence suggests that the value of One Team is well-intentioned and largely lived across the organisation, within business areas and teams, and across divisions by senior management (Group Executives and GMs); however, when overplayed, the One Team value results in over-collaboration and an over-focus on relationships (as outlined in Finding 3).
- 13.1.6. **Courage** appears to be less well embedded, despite recent leadership attention, including at the 2018 People Leader Forums.⁵⁴ Courage received little positive mention by employees in the evidence. People frequently spoke of being “fearful”,⁵⁵ with obvious implications for speaking up, managing messages, challenging and taking ownership and accountability.
- 13.1.7. The value of **Achievement** received little attention in interviews, focus groups and free-form text responses to the self-assessment survey. Although senior management focus on delivering results, the strategy-related aspects associated with Achievement (e.g., productivity) often came with negative connotations, such as cost reduction.
- 13.1.8. The tone and intent from the top are strong and in order to translate the vision, values and strategy, leaders receive training (see Finding 9) and have access to supporting

⁴⁹ Refer to CEO email of October 2017.

⁵⁰ Navigate aims to reinforce the Compass as a framework to use when making tough decisions and garnering the confidence and courage to challenge decisions.

⁵¹ Representative quotation from numerous interviews.

⁵² From January 2017 to June 2018.

⁵³ In the 2017 YourVoice survey (sample size 31,080), only 57% respondents agreed with the statement “Our policies and processes are designed to make it easy for customers to do business with us.”

⁵⁴ People Leader Forums are regular events in which leaders at all levels of the company are provided with updates on, and insights into, current strategic priorities and important initiatives.

⁵⁵ A word often used in self-assessment survey free-form text responses, interviews and focus groups.

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mechanisms such as the Leadership Star⁵⁶ and Service Huddles. However, interviewees and focus group participants highlighted a variety of leadership shortcomings across various levels of seniority that are hampering Westpac's aspirations.

- 13.1.9. The Group Executives (and particularly the CEO) were generally reported to be setting a good tone and role-modelling good behaviour, with the Board and GMs praising ability, character and commitment. However, the comfort to speak up and challenge *within* the Executive Team was reported to be inconsistent and therefore inconsistently role-modelled. Although improvements have been seen, there are also perceptions of insufficient prioritisation and aversion to making difficult decisions (see Finding 8). Furthermore, despite examples of good efforts, the Group Executives were seen by a significant minority of employees as removed from the lower levels of the organisation.⁵⁷
- 13.1.10. GMs are perceived to be “enterprise connectors” who bridge the gap between divisions. GMs consider themselves to be a cohort with wide remit but a focus on the details, whose members display “collegiality and trust”⁵⁸ while “run[ning] the Group”⁵⁹ day to day. However, others’ perception of GMs suggests that there are leadership issues at the GM level, too. GMs were, at times, described as bottlenecks to decision-making, managing and filtering upward messaging. There was also a feeling that there is an excessive focus on personal image and reputation, resulting from an historical (and, to a lesser extent, continued) “good news culture.”⁶⁰ Reasons cited for GM shortcomings include the high number of stakeholders and expectations that GMs must manage and remnants of the (changing) historical culture.
- 13.1.11. At GM-1 level, positive traits include the perception that this is one of the most influential levels of leadership in its importance to getting things done. GM-1s were described as subject matter experts and good role models, instilling a good speak-up culture in some areas. However, it was suggested to the Review Team that there was discouragement of “speak-up” in several business areas, excessive concern about career repercussions for delivering bad news, “managing” of messages to GM level and patchy ownership of outcomes due to blurriness of accountability between GM and GM-1 roles in some instances. It should be noted that, while there is a range of leadership programs for GMs, GM-2 and GM-3 leaders, as well as for young future talent, there is a notable gap at GM-1 level. A GM-1 leadership program is due to be designed and rolled out in 2019 and these findings suggest that such an investment will be worthwhile.
- 13.1.12. Similarly, at levels GM-2 and below, many leaders were described as excellent role models, but focus group attendees also discussed how some leaders were overly concerned with self over team, discouraging speak-up and being unbalanced in their focus on short-term pursuit of outcomes (e.g., sales targets). Insufficient consequences for falling short of desired behaviours and lack of clarity with regard to accountability (Finding 4) may be among drivers of shortcomings at this level.
- 13.1.13. In summary, it was found that the variation in, and in some cases lack of, translation of the vision, values and strategy at Westpac is driven primarily by shortcomings in leadership. At each level of the organisation, there are leaders displaying behaviours that, despite positive overall efforts, get in the way. To some extent, this is an expected result of the natural variation in people. Nevertheless, as leadership is both the “force multiplier” of any

⁵⁶ The Leadership Star is a tool for leaders that encompasses: “care about people as individuals”, “give people context to help them understand the connection between the Group’s vision and strategy and what they do every day”, “give people clarity around expected results and behaviours”, “clear the way for them of anything that hinders success”, and “celebrate their success and learning in big and small ways”.

⁵⁷ In the self-assessment survey, 30% of surveyed staff disagreed with the statement that “senior leaders have good understanding of the day to day realities of this organisation.” A further 21% were neutral.

⁵⁸ Representative quotation from an interview.

⁵⁹ Representative quotation from an interview.

⁶⁰ A phrase used by many interviewees and focus group participants.

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organisation's agenda – including risk and compliance – and amenable to interventions, concerted efforts to tackle leadership shortcomings can be expected to yield a wide range of benefits, not least to the risk profile of the organisation.

13.2. Finding 2: Management of non-financial risk, although recognised as important, is not as well understood and embedded as it should be

- 13.2.1. Generally, people agreed that there is a high level of risk awareness in the company, and financial risk management is seen as particularly strong. There is good perceived tone from the top regarding risk and risk is central in leadership communication and agendas. Additionally, people have reported confidence in the organisation's overall ability to manage risk and in the quality of input from the Risk function, as highlighted by data from the Sentiment Survey: approximately 90% of employees agreed with the statements "I am confident that I know what risks I need to consider when making decisions to achieve the service promise" and "While it takes time to complete risk management and compliance requirements, I understand the value they add."⁶¹ Discussion of risk awareness and aversion in focus groups and interviews reinforced this.
- 13.2.2. Awareness of *non-financial risk*⁶² is generally perceived by employees to be less mature than that of financial risk. This awareness differs by level. The Board and Executive Team generally have a heightened focus on these risk classes (see chapter 5: *Board and senior management*). However, perceptions of GM and GM-1 leaders were materially inconsistent, while employees at GM-2 level and below were perceived to be lagging in this area. Examples of ill-conceived trade-offs being made against non-financial risk were highlighted by interviewees and focus group participants, indicating that non-financial risk awareness has not yet become "muscle memory". To illustrate, people mentioned instances of not following lengthy processes in order to save time, which could introduce risk, or even non-compliant behaviour, in an attempt to provide customers with "better" service. Furthermore, although survey respondents mentioned that they had a high level of general risk awareness, they also indicated a lower level of risk consideration in everyday action, with only 65% of self-assessment survey respondents agreeing with the statement "People in this organisation always consider risks before they take action."
- 13.2.3. Non-financial risk *capability* was highlighted as an issue by many despite significant improvements in recent years. Group Executives and GMs expressed lower confidence in capabilities in these areas relative to financial risk, some questioning whether Westpac had the right people in non-financial risk roles and even suggesting that the way that operational risk was managed, was, in some teams, *creating* operational risk. The Review Team notes this perception, but expresses no view on the underlying capabilities, as such assessment was outside the scope of the self-assessment.
- 13.2.4. There are a number of drivers of this perception of lower non-financial risk awareness and capability. Focus group participants described perceived time and capacity constraints, along with competing priorities, as reasons for having to make trade-off decisions and otherwise focus less on risk than they would like to. Furthermore, there was a continued perception of sales pressure, focus on targets and lack of reward for good risk behaviour: given the long history of extensive sales performance metrication, it will take time and ongoing leadership effort to ensure that recent scorecard changes and initiatives such as the CEO Risk Awards take root fully. There was also a commonly perceived lack of transparency and clarity regarding consequences for poor risk management and behaviour,

⁶¹ Based on aggregate responses over a six-month period November 2017 to April 2018: sample size 7,210. No individual is chosen to participate in the survey twice in six months, so these respondents are unique. These questions were discontinued after April 2018.

⁶² Here, people primarily spoke about operational, compliance and, occasionally, reputational risk when referring to non-financial risk.

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and a common perception that consequences for poor risk management were not consistently applied due to the caring nature of the organisation (as discussed in Finding 3).

- 13.2.5. In summary, non-financial risk awareness and capability have been improving at Westpac but are still not as ingrained as financial risk management, particularly at lower levels of the company. Several of the drivers outlined above can be readily influenced, which will accelerate the maturation and ingraining of desired non-financial risk behaviours and attitudes.

13.3. Finding 3: The organisation is people-oriented, but can overplay its caring, relationship-focus and collaboration attributes

- 13.3.1. Westpac is a highly people-oriented organisation, which manifests itself through the traits of caring, relationship-focus and collaboration.
- 13.3.2. **Caring** is a very positive trait that was highlighted in the 2017 YourVoice survey results,⁶³ focus groups and interviews. Care for the broader community is particularly noteworthy and Westpac is known for its support of Australians through natural disasters, the Rescue Helicopter Service and the Westpac Foundation. Furthermore, the Group appreciates long-tenure employees, is strong on inclusion and diversity, and has good policies in place to support employees.⁶⁴
- 13.3.3. The primary driver appears to be an historical and continuing focus on helping. This encompasses helping internally, as reflected in the inclusion of Care in the Leadership Star. It also includes helping externally, as reflected in the Service Promise (“we are people always helping people”) and in the roughly one-third of recent CEO emails to employees referencing the need to support the community.
- 13.3.4. **Relationships** are integral to working life across the company, including risk matters. They allow people to overcome complexity and to seek advice without relying on policies. External relationships are also strong: for example, interviewees mentioned Westpac’s desire to have strong relationships with regulators, which aids the management of risk and compliance. There are a number of drivers of this strongly-reported relationship orientation, including an historical predisposition and an inherent need for a web of relationships in order to navigate complexity in the organisation, including complexity of frameworks, policies and processes (see Finding 5).
- 13.3.5. Downsides include that it can be difficult for new employees to be onboarded, carry out tasks and have ideas and suggestions (often derived from the experience for which they were hired) heard. Secondly, outcomes can become overly dependent on the working style or preferences of individuals. Employees provided insights into this by stating, for example, that “in the risk community, you’ve got to be more of a politician than a risk manager.”⁶⁵ Others noted that the relationship focus sometimes leads to a blurring of roles and accountabilities (particularly between Line 1 and Line 2), as people seek help from any individual with whom they have a strong relationship, rather than following the remits of dedicated roles. Finally, excessive focus on relationships can prevent people from speaking up and challenging (see Finding 6), and protect people who have underperformed or displayed poor behaviour at lower levels. **Collaboration** was described by many as a trait that can help people make better decisions, devise better solutions and lead to ideas being tested and challenged more, as long as the right people are involved. However, at Westpac there is often *over-collaboration*, which manifests itself in an unnecessarily high number of

⁶³ In the 2017 YourVoice survey (sample size 31,080), 86% of surveyed staff across the Group agreed with the statement “My people leader displays genuine care for me.”

⁶⁴ E.g., “Full time hours of work” policy and “Working Flexibly”.

⁶⁵ Representative quotation from a focus group.

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meetings and committees and the involvement of too many people in decision-making, leading to slowness, diffusion of accountability (see Finding 4 and chapter 11: *Other consequence management*) and loss of thinking space. This was mentioned by many interviewees. It should be noted that a *lack of* collaboration between business divisions at *lower* levels was also a frequently cited concern,⁶⁶ although the nature of the roles involved suggest that this is more likely to reflect organisational complexity than anything else.

- 13.3.6. Challenges to collaboration between the Risk function and “business” functions were shared with the Review Team, with free-text survey responses, focus groups and interviewees indicating a lack of open communication and collaboration between Risk and business. In particular, a lack of working toward common goals was perceived, with business professionals describing risk as “something that somebody does *to* them” without sufficient guidance on how to interpret and follow policies. The Compliance function, particularly, was perceived to be “policing”, rather than supporting the business in meeting compliance requirements. Employees also often reported being unsure who to ask for support and needing to work with multiple support teams (Operational Risk, Compliance and Legal) to solve problems.
- 13.3.7. Employees attributed some of this perceived lack of collaboration to gaps in risk capability in the business and business acumen in the Risk function.⁶⁷ Additionally, insufficient clarity regarding end-to-end accountability and ownership at various points along the value chain was seen to hamper different teams from working toward common goals with a shared understanding.
- 13.3.8. In summary, Westpac’s caring culture is primarily positive. However, the relationship focus in the organisation has downsides, and these need to be addressed. Similarly, the collaborative culture has many strengths, but these are less realised in the case of business and Risk collaboration and elsewhere can extend into *over*-collaboration. Taming these general excesses and consciously working to increase the partnership between the business and Risk will yield increased efficiency and effectiveness of many activities, including those relating to risk and compliance.

13.4. Finding 4: There is insufficient personal ownership and empowerment, leading to a tendency to default to collective decision-making and diffused accountability

- 13.4.1. The related topics of ownership, accountability and empowerment⁶⁸ were common themes throughout cultural evidence. **Personal ownership** was reported as insufficient by employees, the majority of surveyed employees (61%) agreeing with the self-assessment survey statement that “The level of ownership in this organisation needs to increase.” Many focus group attendees also reported that ownership is currently lacking. Consequences are manifold and explored in Findings 3, 6 and 8.
- 13.4.2. A significant driver of the perceived insufficient ownership is a lack of empowerment, discussed below. People also cited a “fear”⁶⁹ of failure and resulting consequences, leading to a reluctance to take ownership. Other drivers include insufficient clarity of direction, complexity and prioritisation difficulties (see Findings 1, 5 and 7), which together affect

⁶⁶ Only 55% of Employee Sentiment survey respondents agreed that “People collaborate for the good of the organisation as a whole rather than focusing on their own area.” WIB and BTFG agreement were lowest. Rate based on aggregation of six-month period January-June 2018: sample size 6,968. No individual is chosen to participate in the survey twice in six months, so these respondents are unique.

⁶⁷ As found in interviews and focus groups, as well as the 2015 KPMG “Westpac culture – high level analysis of risk components” report.

⁶⁸ “Accountability” is explained in chapter 10: *Remuneration*. “Ownership” is a mentality of ensuring that a particular outcome is realised rather than simply performing one’s role. “Empowerment” refers to an individual’s freedom to take actions in pursuit of desired outcomes.

⁶⁹ Word used by several focus groups and interviewees.

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people's understanding of their role in the end-to-end chain and their capacity and willingness to contribute. There is, furthermore, a perceived difficulty in determining who should own issues, exacerbated by complexity and the collaborative, consensus-driven culture (see Finding 3). This last point was less evident in the Credit Risk function due to well-established and defined delegations of authority to individuals.

- 13.4.3. Insufficient **empowerment** is the second aspect of this finding, as supported by self-assessment survey results⁷⁰ and focus group findings. Lack of empowerment was frequently described as driving poor outcomes, such as difficulty in delivering optimal service. Drivers include highly constrained zones of discretion, significant time navigating complex structures, and certain processes and policies that are not conducive to actual and felt ownership.
- 13.4.4. Some positive mechanisms have recently been put in place to improve empowerment, which are intended to enable better service to customers. These include the Empowerment Fund, the Empowerment Box in retail branches, and the "Check, Confirm Create" principle.⁷¹ However, focus group participants and interviewees indicate that there is scope for increased uptake of these mechanisms.
- 13.4.5. Drivers of the lack of perceived empowerment include hierarchical structure, complexity of processes and policies, complex structures that necessitate the involvement of multiple stakeholders, and perceived resource constraints. Additionally, the Review Team noted that the Finance and HR functions are perceived to exert considerable influence at Westpac, operating principally as control functions that can significantly impede speed and scope of action, even when risk-related matters are involved.
- 13.4.6. The above traits were found to lead to a tendency to default to **collective decision-making**. This manifests itself in behaviours such as making decisions in groups (e.g., through committees or extensive sign-offs), unclear accountability for issues, and lack of a single point of end-to-end accountability (e.g., for risk, products or the customer lifecycle). The main drivers of collective accountability are the aforementioned lack of ownership and empowerment. Other drivers include structural complexity and bureaucracy,⁷² and the previously-discussed tendency to over-collaborate (see Finding 3). Several interviewees noted that the introduction of BEAR is likely to drive individual accountability, although perhaps at the price of lower collaboration and an overly "functional" view of accountability.
- 13.4.7. The perceived lack of personal ownership and empowerment and a tendency to default to collective accountability underpin several of the other findings.

13.5. Finding 5: There is a tendency towards "completeness", which can lead to acceptance and perpetuation of organisational complexity

- 13.5.1. There is an organisational tendency that has been labelled by the Review Team as "**completeness**", an umbrella term for a certain "maximalism" in the way that people tend to approach work. For example, employees are frequently described as highly analytical, as seeking "more information" before making decisions, as involving "everyone" in meetings and decision-making forums (see Finding 3), as seeking or requiring extensive "sign-offs" (see Finding 4), and iterating documents an unusually large number of times - well beyond the point of diminishing returns. Employees are perceived to prefer to put more (rather than fewer) pieces of information into reports (as discussed in chapter 5: *Board and senior*

⁷⁰ A relatively low proportion (63%) of self-assessment survey respondents agreed with the statement that "This organisation makes me feel empowered" and an even lower percentage (58%) agreed that "Individuals in this organisation feel confident making decisions".

⁷¹ Also referred to as the "Empowerment Model": "Check your actions are consistent with Our Service Promise; Confirm at least one colleague agrees it's the right thing to do; Create magic for your customer."

⁷² Bureaucracy was often linked to complexity in focus groups.

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management). They are also reported to prefer to layer on – over reducing or rationalising - processes, policies and complexity. In short, there is a tendency toward “more is more” in the organisation, notwithstanding (and to some extent undermining) the simplification agenda.

- 13.5.2. “Completeness”, on a positive note, leads to rigour and thoroughness, including in risk management. However, it was reported to lead to slowness of execution, which may in turn lead to reduced capacity and fewer opportunities for learning and reflection (see Findings 7 and 9 respectively). Frameworks, policies and procedures that are overly complete can be difficult for people to interpret and apply, as indicated by interviewees and focus group participants. Similarly, reports and documents that are exhaustive may hinder ready comprehension of main points (including at Board level: see chapter 5: *Board and senior management*).
- 13.5.3. One driver of this appears to be the desire for safety. It is perceived to be safer to over-analyse, over-report and layer on processes than to omit something that may later be found to be crucial. This is exacerbated by external scrutiny. An additional driver is Westpac’s self-perceived historical preference for the analytical and the technical, and the tendency to focus on conceptualisation over embedding (see Finding 8).
- 13.5.4. In addition to “completeness”, there is a perceived **acceptance and perpetuation of complexity**.⁷³ Complexity was frequently used as an explanation of issues within teams or business areas, accompanied by an acceptance that it is “part of life” and something that “we do around here”. Focus groups often referred to structural complexity, as well as process and policy complexity or “bureaucracy”. Complexity does indeed drive some traits such as lack of empowerment (Finding 4) and focus on process over outcome (Finding 8). Whilst many people refer to the high levels of complexity, few discussed meaningful efforts or creative ideas to resolve it. As a result of this and the consequent work-arounds to get things done, Westpac may be assuming additional risk.⁷⁴
- 13.5.5. In summary, Westpac’s tendency to “completeness” and associated acceptance and perpetuation of complexity can hold the organisation back. Although “completeness” has positive consequences, such as thoroughness, it can result in an organisation that is “busy” but not necessarily taking strides forward.

13.6. Finding 6: Focus on speak-up and challenge has increased, but more work is needed to increase employee comfort and listening by leaders

- 13.6.1. **Speaking up** is a topic that has received a lot of attention from current and previous CEOs, through numerous initiatives. Even with this focus, Westpac’s Risk Appetite Dashboard rates speak-up culture as “red”, as more than a quarter of surveyed employees still do *not* agree with the Employee Sentiment survey statement: “I feel safe calling out issues, risks and / or concerns.”⁷⁵ The degree of leadership enablement of a positive speak-up culture varies by organisational level (see Finding 1).
- 13.6.2. Like speak-up, **challenge** *does* occur in some parts of the bank, but observed exceptions suggest need for improvement. Over a quarter of 2017 YourVoice respondents did not express confidence that Westpac’s environment enabled challenge.⁷⁶ A notable difference in

⁷³ The structural elements of complexity are discussed in chapter 6: *Risk management and compliance*.

⁷⁴ The majority (64%) of surveyed employees agreed with the self-assessment survey question “This organisation’s level of complexity may create additional risks.” This was further supported by focus group participants who also frequently discussed trade-off situations.

⁷⁵ Sentiment Survey agreement rate 74%. Rate based on average agreement over first six months of 2018 (January to July). Sample size 6,968: no individual is chosen to participate in the survey twice in six months, hence the sample is comprised of unique individuals.

⁷⁶ In the 2017 YourVoice survey (sample size 31,080), 73% of employees agreed that “This organisation is creating an environment in which people can challenge the traditional way of doing things.”

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challenge culture was found between established employees and new hires. The latter voiced particular frustration with “defensive”⁷⁷ leadership behaviour and the attitude of “this is the way it’s always been done”,⁷⁸ when trying to improve processes and draw on the industry experience for which they were often hired.

- 13.6.3. Drivers of the reported current state of speak-up and challenge culture can largely be linked back to the leadership shortcomings outlined in Finding 1, particularly in relation to fostering of the value of Courage. An additional driver is the fact that the focus on employee “speak-up” has not yet been matched by management “listening up”: that is to say, there is no strong organisational norm around leaders actively seeking out and being open to feedback and raised issues, focus group participants expressing a desire that “leaders listen better and take feedback on board.”⁷⁹ Further drivers include hierarchical behaviour not conducive to upward challenge, fear of consequences if people do challenge their superior and a lack of confidence that sufficient action will result from raising of issues.⁸⁰
- 13.6.4. In summary, the recent focus on speak-up culture should be maintained, but more effort – principally by leadership – is needed to ensure that speak-up and challenge are truly embedded. The benefits to risk and compliance are obvious.

13.7. Finding 7: There is insufficient discipline in prioritising, making decisions and saying “no”

- 13.7.1. Many employees perceive that prioritisation is not working well and are not expressing strong confidence in leaders’ ability to prioritise and make trade-offs.⁸¹ Interviewees also talked about the inability (often of leaders) to face issues and make difficult decisions, specifically when they are required to say “no.”
- 13.7.2. Risk management appears not to be exempt from these prioritisation issues. Interviewees pointed to a proliferation of risk-related requirements without any guidance on prioritisation. Frequent reporting of risks and issues, including Audit issues, as “amber” also does not assist with prioritisation and orientation towards resolution. The tendency for Group Audit to rate the majority of Audit issues as “requires remediation” (amber) further accentuates this issue.
- 13.7.3. Drivers of the perceived lack of prioritisation and inability to say “no” include the tendency to add processes and add to processes, as well as the tendency for “completeness” (see Finding 5). Involving too many people (Finding 3) can contribute to complexity and make it more difficult to prioritise and make decisions. Hierarchy and the large number of people with actual or perceived veto rights may prevent people from saying “no”. People may also seek to avoid conflict or feel uncomfortable challenging others (see Finding 6). Consensus-driven and collaborative traits (coupled with fear) tend to diffuse personal ownership and accountability, and confuse decision-making authority (see Finding 4), limiting the ability to prioritise.
- 13.7.4. A common refrain at Westpac is that “we do well in a crisis.”⁸² In particular, employees generally believe that prioritisation works when something is urgent and important, or when there is sufficient impetus provided by senior (internal or external) levels of authority. However, there is also a perception that issues raised to senior management can result in

⁷⁷ Representative quotation from a focus group.

⁷⁸ Representative quotation from a focus group.

⁷⁹ Representative quotation from a focus group.

⁸⁰ This was also highlighted in the previous cultural review by Nous Group in 2018.

⁸¹ In the self-assessment survey, a significant proportion of surveyed employees either agreed or were neutral on the statement “Leaders in this organisation have difficulty prioritising and making trade-offs.” Specifically, 29% agreed, 40% were neutral, and 31% disagreed. “Neutral” responses should be considered as a sign that further improvement is needed.

⁸² Quotation from several interviews.

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overly quick and intense responses that do not leave room for reflection or strategic thinking. Employees further perceive that this leads to suboptimal outcomes such as duplicated efforts or solutions not addressing the root cause.

- 13.7.5. The driver behind the perception that prioritisation is working well in the above instances appears to be an atypical sense of urgency. In these cases, the organisation manages to mobilise, create clear lines of accountability and empowerment of individuals, and establish clear and common purpose.
- 13.7.6. In summary, prioritising and making difficult decisions need to be stronger at Westpac. Where prioritisation is done “successfully”, Westpac will benefit from studying and harnessing positive traits that do allow prioritisation to work well in some instances.

13.8. Finding 8: There is a tendency to focus on conceptualisation over embedding and process over outcome

- 13.8.1. Numerous interviewees and focus group participants referred to a preference for “form over substance”⁸³ at Westpac. This manifests itself in two ways. First, Westpac employees (and especially leaders) appear to be good at **conceptualising** – designing frameworks and policies, and “starting new things” – but less strong (and sometimes less interested) in ensuring that these conceptual products are brought to fruition through rigorous execution.
- 13.8.2. The drivers of this tendency include a perceived insufficient appreciation of day-to-day realities by leaders, who are often considered too removed from what is happening on the ground (see Finding 1). Reluctance to challenge upward (Finding 6) is an additional impediment, as leaders may not be made aware of embedding difficulties. Interviewees also highlighted how management interest and involvement can fade as the less “glamorous” (and less “safe”) post-conceptualisation activity of implementation comes to the fore, or as other pressing concerns consume scarce time reserves. Finally, there may be a perceived need by employees to move on to the next urgent matter requiring attention in a complex and fast-moving environment.
- 13.8.3. Additionally, there can be an orientation to **process over outcomes** at Westpac, as highlighted by the self-assessment survey.⁸⁴ Data from focus groups and interviews supported this finding, with many people expressing sentiments such as: “I think we’re much more a compliance culture than a risk culture. We’re good at ticking boxes, not necessarily addressing the intent of what we’re trying to manage”.⁸⁵ The Compliance function was highlighted as particularly “adversarial,” focusing more on attestation and policy than managing compliance risk.
- 13.8.4. The drivers here are similar to those mentioned in other findings – specifically, fear of consequences and a perception that there is safety in a process, lack of personal ownership and accountability (Finding 4), perceived capacity and complexity issues (Finding 5), and a reluctance to challenge the status quo (Finding 6).
- 13.8.5. In summary, Westpac’s strengths in conceptualisation and following processes are not matched by embedding and focus on outcome. These need to be aligned if there is to be consistent success in achieving desired outcomes from new policies, projects and other change initiatives.

⁸³ Representative quotation from several focus groups and interviews.

⁸⁴ A significant proportion (42%) of employees agreed that “People are more focused on processes than outcomes in this organisation.”

⁸⁵ Representative quotation from an interview.

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13.9. Finding 9: A lack of institutional learning and reflection holds the organisation back

- 13.9.1. Westpac has a number of well-received, “hard-wired” mechanisms oriented toward helping employees learn (particularly at the individual level) – e.g., self-directed learning through LearningBank⁸⁶, accredited further learning through the Westpac Institute⁸⁷ and Motivate’s explicit focus on the growth mindset and continuous improvement. Nevertheless, learning and reflection were found to not be well embedded in day-to-day work operating rhythms.
- 13.9.2. In particular, there is a lack of an institutional norm for employees to take time to learn and reflect amidst other competing priorities. Although many people value learning and reflection, a significant number of people expressed opinions such as “No-one else puts learning first, why should I?”⁸⁸ and that there was a lack of time to learn. Lack of learning and reflection have clear implications for a wide range of activities, including those pertaining to risk and compliance.
- 13.9.3. Learning and reflection are not seen to be adequately embedded at an institutional level. Although there are post-implementation reviews following projects, there is scant evidence that findings are systematically distilled and disseminated, and people spoke of the tendency to “solve a complex issue and move on” and “not document for future reference”.⁸⁹ Multiple remediation programs in the same areas over the past two decades also suggest a lack of systematic sharing of best practices, often called out by employees in focus groups as an example of a missed opportunity to learn. The outcome of these tendencies is a greater risk of errors and, indeed, examples of similar errors occurring across multiple projects or timeframes have been seen, suggesting a weaker norm of institutional learning.
- 13.9.4. The relatively high level of discomfort reported in sharing vulnerability and failure and learning from mistakes is a further concern. In the self-assessment survey, less than half (44%) of respondents agreed with the statement that “In this organisation, it is safe to fail and learning from mistakes is encouraged.” For some leaders, this also manifests itself in a lack of listening and a defensiveness to challenge (see Finding 6).
- 13.9.5. A number of drivers influence the levels of learning and reflection. Employees at all levels frequently refer to perceived capacity constraints as a reason for not taking the time to learn and reflect. Other drivers include the tendency to adhere to status quo, rather than challenge it (see Finding 6), reflected in the commonly-heard attitude of “that’s the way we’ve always done it.”⁹⁰ On a positive note, individuals at multiple levels discussed the learning and reflection resulting from recent external scrutiny, particularly the Royal Commission: they saw the process as reinforcing the importance of risk and compliance management, noted that individuals who testified took time to share lessons from the experience with others, and maintained that it was important that this heightened focus remained once external scrutiny lessened.
- 13.9.6. In summary, Westpac needs to improve its institutional practices around learning and reflection. Without these, it may be missing out on a strong feedback loop that allows the organisation to learn from costly previous mistakes and adapt for the future. Learning and reflection will underpin recommendations to continue to improve culture at Westpac. These practices will assume increasing importance in light of accelerating rates of change in the

⁸⁶ The Westpac online learning platform.

⁸⁷ Provides externally recognised accreditation.

⁸⁸ Representative quotation from a focus group.

⁸⁹ Representative quotation from a focus group.

⁹⁰ Representative quotation from a focus group.

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industry, including greater workforce mobility and the transition to more agile ways of working.

13.10. Recommendations

- 13.10.1. By building on the current culture program of work to introduce actions arising from the following recommendations, and doing so in a systematic and systemic way, Westpac will enhance its ongoing efforts to effect sustained cultural change. Due to the high level of interdependency of cultural findings, the associated recommendations take a holistic, integrated form, rather than constituting a set of discrete initiatives that respond individually to each finding. A list of short and long-term initiatives, which should be considered in the context of existing programs of work, can be loosely grouped into the areas of leadership, "ways of working", learning, and reward and recognition. These areas are outlined in Stream 5: Culture, in chapter 14: *Review Team suggested approach to implementation of recommendations*.

PART E

RECOMMENDATIONS

Chapter 14. Review Team suggested approach to implementation of recommendations

CHAPTER 14:

REVIEW TEAM SUGGESTED APPROACH TO IMPLEMENTATION OF RECOMMENDATIONS

CHAPTER 14. REVIEW TEAM SUGGESTED APPROACH TO IMPLEMENTATION OF RECOMMENDATIONS

14.1. Program of work

- 14.1.1. Westpac has many initiatives related to culture, governance and accountability underway that align with Review Team observations.⁹¹ The recommendations provided in this report will complement such initiatives, noting that management, in assessing and responding to this report, may deem it appropriate to reject, modify or combine recommendations. A suggested first step is a comprehensive “stocktake” of all relevant work across the Group, mapped to the recommendations.
- 14.1.2. The recommendations form a body of work that will span several years, across all divisions. They vary considerably in significance, degree of difficulty, timing and resourcing demands. To the extent possible, proposed initiatives should be merged with relevant other existing and planned activities to ensure efficiency, coordination and lack of duplication. To bring this together, and ensure comprehensive and durable implementation, a detailed program plan is needed.
- 14.1.3. The program plan should be developed with a target state in mind and defined with reference to the descriptions of better practices included in this report. The program should include further and more defined objectives and milestones that Westpac can concretely act upon, track progress against and adjust as required.
- 14.1.4. To ensure that there is the right degree of organisational backing for this work, the plan should be executed as a Group-wide, overarching endeavour, sponsored by the CEO and overseen by the Executive Team and the BRCC.
- 14.1.5. Oversight from Group Executives and Board will be critical to ensure that program ownership is clear and specified outcomes agreed. As the program is likely to require sustained effort over some years, surety of multi-year funding will be needed.
- 14.1.6. Vigilant monitoring for any tendency to succumb to the very aspects of Westpac’s “corporate DNA” to which the program is partly targeted will be equally essential. It will be prudent to routinely test the program’s decisions and progress against the three DNA strands.

14.2. Program streams

Stream 1: Board and Executive Team Governance

- 14.2.1. This stream should be overseen by the Group Executive, Legal and Secretariat.

Recommendation area	Comment	Owner	Degree of difficulty	Importance	Number
BRCC	BRCC Chairman, assisted by the CRO and Group Executive, Legal and Secretariat, undertakes an assessment of the efficiency of time utilisation and adequacy of time allocated overall for the BRCC’s work.	BRCC Chairman, Group Secretariat	Medium	High	G1

⁹¹ Several of these initiatives are nascent and, as such, the Review Team could not confirm whether they would adequately address the Review Team’s findings.

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Recommendation area	Comment	Owner	Degree of difficulty	Importance	Number
BRCC and RISKCO reporting	Enhance BRCC and RISKCO reporting, including development of a template for reporting of risk and compliance matters.	Group Secretariat Risk	High	High	G2, G9
BAC membership	BRCC Chairman to become a member of the BAC.	Group Secretariat	Low	Medium	G3
BAC, BRCC and RISKCO reporting	Enhance reporting to include all extensions to agreed due dates for high-rated issues.	Group Audit Risk	Low	Medium	G4, G9
Board and RISKCO customer complaints reporting	Prioritise the review of “tail” customer complaints – that is, the most serious and extreme customer complaints.	Chairman of the Board, CEO	Medium	High	G5, G9
Investment allocation decisions [links to recommendation G31 in Stream 2]	Consider risks arising from each EIP-related initiative put forward for the Executive Team and the Board’s consideration and approval.	Chairman of the Board, CEO	Low	Medium	G6, G9
Risk appetite	Develop timeframes and accountabilities for moving “out of appetite” risks back within appetite.	Chairman of BRCC, CEO	Medium	High	G7, G9
Issue resolution and closure	Develop timeframes and accountabilities for the prompt and effective resolution of long-outstanding issues, including review of the <i>Issue and Action Management Policy’s</i> provisions for issue extension.	Chairmen of BRCC and BAC, CRO	High	High	G8, G9
Governance committees	Review and, where relevant, rationalise the number, scope, frequency, etc. of committees and other governance forums (e.g., project steering committees and working groups), Group-wide (formal and informal). Establish criteria to govern how and when new committees should be established.	Group Secretariat, CRO	Medium	High	G10

Stream 2: Risk and Compliance

- 14.2.2. This stream should be overseen by divisional Group Executives, with advice and support from the Risk function, consistent with the Review Team’s observations that Line 1 ownership of projects can be highly impactful. Initiatives within this stream that relate to the

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specification of the 3 LOD model and the Operational Risk and Compliance functions should be led by the CRO.

Recommendation area	Comment	Owner	Degree of difficulty	Importance	Number
Three Lines of Defence	<p>Strengthen Line 1's ownership of, and accountability for, risk and compliance management. To include enhancements to remuneration and consequence management frameworks and uplift of capabilities.</p> <p>Clarify roles and responsibilities across 3 LOD for non-financial risk management through high-level principles for the Group and each division, and role and responsibility mapping (including across end-to-end processes), to ensure that, where relevant, the 3 LOD model is consistent across divisions.</p> <p>Review the set-up of Divisional CROs.</p>	CRO, with divisional Group Executives accountable for Line 1 implementation	High	High	G11
Skills, capabilities and stature	<p>Identify and articulate skills and capabilities to be strengthened to ensure that recruitment and training are consistent and targeted.</p> <p>Develop training and education programs to target identified skills and capability gaps.</p> <p>Develop an internal mobility program, through which high-potential employees can be rotated through the business, Risk, Compliance, and Group Audit.</p> <p>Develop a program to continually emphasise and encourage the importance of a learning mindset and business acumen.</p> <p>Consider opportunities to elevate the stature of all Operational Risk and Compliance employees, including ensuring that relevant employees have a "seat at the table" at relevant committees and forums.</p>	All Group Executives	High	High	G12

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Recommendation area	Comment	Owner	Degree of difficulty	Importance	Number
Risk and control environment	<p>Develop one common risk and control language for non-financial risk, which is sufficiently granular and aligned to better practice.</p> <p>Review existing controls and update in accordance with the common risk and control language.</p> <p>Link all compliance obligations with controls in JUNO.</p> <p>Develop one common process to regularly review, assess and test the effectiveness of controls to manage non-financial risk, drawing on existing processes where possible. Performance of control assessment and testing should involve employees from Line 1, Operational Risk, Compliance, and other Risk functions as appropriate.</p> <p>Enhance processes to identify new, emerging and heightened risks, including regular consideration of developments in the internal and external landscape and how such developments may change the risk profile.</p>	Line 1 and Risk and Compliance functions	High	High	G13
Risk Appetite Statement	<p>Use the common risk language developed as part of recommendation G13 to set risk appetite principles for compliance, conduct and operational Level 2 and Level 3 risks, and quantitative leading and lagging metrics for each risk appetite principle.</p> <p>Update the risk appetite framework, including reporting dashboards, to support the enhanced articulation of non-financial risk appetite.</p>	Line 1 and Risk and Compliance functions	High	Medium	G14

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Recommendation area	Comment	Owner	Degree of difficulty	Importance	Number
Conduct risk	<p>Complete further conduct risk training and education programs across the 3 LOD.</p> <p>Complete workshops with Line 1, facilitated by Line 2, to identify the specific conduct risks faced by each business.</p> <p>Implement a conduct risk program to instil the “should we?” consideration in Group-wide decision-making and reinforce the centrality of the customer.</p> <p>Conduct risk to be a standing agenda item in divisional risk committees.</p> <p>Incorporate conduct risk in HR frameworks and practices, including those relating to recruitment and hiring, training and education, and remuneration and accountability.</p>	CRO	Medium	High	G15
Reputation risk	<p>Clarify roles and responsibilities across the 3 LOD for reputation risk identification, assessment, management and escalation.</p> <p>Further incorporate practices to identify reputation risks that may arise through underlying non-financial risks in decision-making processes and forums.</p>	CRO, Customer & Corporate Relations	Low	Medium	G16
Divisional risk and compliance management	<p>Review division-specific and brand-specific risk and compliance policies and processes to ensure that differences are necessary and rationalise where appropriate.</p>	Operational Risk and Compliance	Medium	Medium	G17

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Recommendation area	Comment	Owner	Degree of difficulty	Importance	Number
Identification of systemic Issues	<p>Enhance governance and reporting of thematic trends and systemic Issues, including for RISKCO and the BRCC.</p> <p>Establish processes to regularly:</p> <p>Use JUNO to aggregate Issue data to identify thematic trends and indicators of systemic Issues.</p> <p>Link JUNO data with other data sources, including customer complaint data and business process data, to assess and test control effectiveness and identify thematic trends and indicators of systemic issues.</p>	Line 1 and Risk and Compliance functions	Medium	Medium	G18
Ex-post issue sampling	<p>Compliance performs ex-post sampling of issues. Incident sampling size should also be increased and a minimum incident sample size established.</p> <p>Operational Risk to expand scope and objectives of the DQR process to include the accuracy of significance assessments.</p>	Operational Risk and Compliance	Low	Low	G19
Escalation and reporting of Issues	<p>Formalise current practice to notify the RISKCO and BRCC of high-rated Issues, and expand to include significant near-misses.</p> <p>Assess JUNO system limitation for feasibility of resolution.</p>	Line 1 and Risk and Compliance functions	Low	Medium	G20, G21
Issue closure	<p>Train and educate relevant employees across the 3 LOD to identify and analyse the root cause of issues and ensure that any actions to resolve issues are effective.</p> <p>Ensure accountability for the timely and effective closure of issues, including enhancements to remuneration and consequence management frameworks.</p>	Group Executives	High	High	G22

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Recommendation area	Comment	Owner	Degree of difficulty	Importance	Number
Approach to manage whistleblower investigations	Establish a single, Group-wide approach to manage whistleblower investigations.	Compliance	Medium	Medium	G30
Investment allocation decisions [links to recommendation G6 in Stream 1]	Operational Risk and Compliance to review EIP-related submissions to the Executive Team and the Board to identify the risks of each initiative, including any risks arising if the initiative does not proceed, and include coverage of the resultant risk analysis.	CRO, Group Strategy	Low	Medium	G31
Project steering committee governance and oversight	Update reporting templates for committees, so that risks and all material underlying assumptions feature prominently at the front of steering committee reports and receive ample attention and challenge.	CRO, Strategy & Enterprise Services	Low	Medium	G32
Project steering committee governance and oversight	Update reporting templates for committees, so that changes in scope, schedule, solution and expected benefits from project inception are transparently tracked in auditable form, and mandate such reporting.	CRO, Strategy & Enterprise Services	Low	Medium	G33
“Voice” of Finance and HR	Clarify decision rights of Finance and HR functions versus Group Executives and General Managers in operational decisions that have implications for risk and compliance.	CEO	Medium	High	G34
Group Executive attendance at EPOC	Group Executives to more regularly attend EPOC meetings. Establish a formal assurance process for oversight of delegation, which includes requirements for transparency and documentation of the rationale for temporary delegation as permitted by the committee Terms of Reference.	CEO	Low	Medium	G35

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Stream 3: Customer

14.2.3. This stream should be overseen by the Group Executive, Customer & Corporate Relations.

14.2.4. While other streams have bearing on customer matters, this stream is focused on concrete steps to better understand, manage and resolve complaints and issues that have – or have the potential to result in – adverse effects on Westpac's customers.

Recommendation area	Comment	Owner	Degree of difficulty	Importance	Number
Customer complaints management systems	Progress the initiative to converge disparate customer complaints management systems onto a single customer complaint platform to conclusion.	Customer & Corporate Relations	Medium	Medium	G23
Identification of systemic customer complaints	Extend the current process to aggregate customer complaint data and identify and report trends in root causes to include indicators of systemic customer complaints, by product, business unit and geography.	Customer & Corporate Relations	Medium	Medium	G24
Reporting of "tail" complaints	Include "tail" customer complaints – that is, the most serious or extreme customer complaints - in the <i>Customer Complaints Dashboard</i> .	Customer & Corporate Relations	Medium	High	G25
Reporting of long-dated complaints and other customer matters	Consider and, if deemed appropriate, proceed with, the classification and reporting of long-dated customer matters for inclusion in an expanded version of the <i>Customer Complaints Dashboard</i> .	BTFG, Collections, Legal, and Customer & Corporate Relations	Medium	High	G26
Life and general insurance complaint handling	Consider transitioning of customer complaint handling for life and general insurance matters from BTFG to Customer & Corporate Relations.	Customer & Corporate Relations, BTFG	Low	Medium	G27
Accountability for customer complaint resolution	Update and / or replace customer outcomes in Group Executive scorecards to include progress in reduction of long-dated complaints or similar metric that attaches accountability to the resolution of matters most likely to entail or result in poor customer outcomes.	Customer & Corporate Relations and HR	Low	Medium	G28

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Recommendation area	Comment	Owner	Degree of difficulty	Importance	Number
Escalation of customer complaints	Update <i>Customer Complaints Management Policy</i> to require that Compliance and / or Operational Risk are engaged for customer complaints that relate to compliance obligations or operational risk matters, within prescribed materiality / severity levels.	Customer & Corporate Relations	Low	Low	G29

Stream 4: Remuneration and accountability

14.2.5. This stream should be overseen by the Group Executive, Human Resources, with advice and support from the Risk function.

Recommendation area	Comment	Owner	Degree of difficulty	Importance	Number
Risk-adjustments for discretionary VR plans	Review the appropriateness of the risk-adjustment process for employees on discretionary STVR plans.	HR	Low	Medium	A1
Risk gates and risk adjustments	Regularly review risk gate and risk adjustment criteria at relevant organisational levels, to: Ensure that specificity of the “Reputation and Risk” component of the scorecard modifier is adequate for purposes of guidance and application. Ensure that criteria for each division are appropriate, having regard to the nature of activities conducted by each division, and sufficiently stringent to deter negative risk behaviour and promote positive risk behaviour. Criteria should also be sufficiently granular. Confirm that inconsistency across divisions is appropriate. Produce aggregated data showing the size of, and reasons for, remuneration adjustments by division for consideration by relevant committees and functional areas.	HR, CRO	Low	Medium	A2

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Recommendation area	Comment	Owner	Degree of difficulty	Importance	Number
Remuneration frameworks and policies	Review remuneration frameworks and policies to ensure that they are aligned (e.g., in relation to the use of terminology), require consistent practices across divisions (e.g., in relation to recording of adjustments) and, where possible, rationalise them.	HR	Low	Medium	A3
Accountability outcomes and “front office” focus	Regularly review consequence management outcomes to ensure that any inconsistencies across divisions, and between GMs and GM-1 employees, are appropriate. Regularly review consequence management frameworks and policies to ensure that they appropriately cater for all roles and responsibilities across divisions, including back-office, support and control functions.	HR	Low	Medium	A4
Accountability frameworks and policies	Review frameworks and policies that govern consequence management (including remuneration) to ensure that they are aligned, require consistent practices across divisions and, where possible, are simplified and consolidated.	HR	Low	Medium	A5 (second part)
Defining accountability and alignment with Westpac culture	Make accountability the subject of overt, Group-wide organisational focus, potentially including establishment of a Group-wide definition of “accountability” and a communication program to embed the idea and importance of accountability (and its distinction from responsibility). Review and enhance accountability frameworks and practices to ensure that they are appropriate in light of Westpac’s propensity towards collective-decision-making.	HR	Medium	High	A5 (first part), A6

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Stream 5: Culture

- 14.2.6. This stream should be overseen by the CEO, supported by the Group Executive, Human Resources and led by all members of the Executive Team.
- 14.2.7. This stream constitutes a systematic and systemic shift in the current cultural interventions across leadership, “ways of working”, learning and reward, and recognition.
- 14.2.8. Given the high-level of interdependency of cultural findings, the Culture work stream cannot constitute a discrete set of initiatives that respond individually to each finding. Work will necessarily take a more holistic and integrated form.
- 14.2.9. The recommendations below include examples of initiatives that could be implemented in the short-term across each of these areas, as well as long-term initiatives, all of which should be considered in the context of existing programs of work.

Development area	What does Westpac want to achieve?	How should Westpac achieve it? (Examples)	Number
<i>Leadership</i>	People Leaders who understand the Westpac and external context, exercise strong business judgement and leadership capabilities, authentically engage their teams around the vision and values and strategy, and then execute against the aspirations. Leaders must be able to create the conditions for psychological safety in their teams, set clear expectations of behaviours and role-model them, clarify individual accountabilities (to improve decision-making and workflow) and manage against this.	Westpac should supplement existing leadership programs with specific behaviour-based training and initiatives, interactive dilemma- and scenario-based learning, coaching, and follow-ups that are steeped in the Westpac context and highly tailored to the issues faced within leadership cohorts (e.g., levels and businesses). These supplementary activities should build upon the recent Navigate event series and existing leadership programs. Continuous “nudges”, guidelines and reinforcing mechanisms should be introduced as a follow-up to these initiatives. These will ensure that leadership learning occurs beyond one-off interventions, and behavioural shifts become embedded in daily practice. Examples include the formal use of “peer trios” or guidelines on number of days spent with teams. To achieve and maintain consistency and a high calibre of leaders, Westpac should consider the level of tolerance it has for those who do not meet the required standards.	C1
<i>“Ways of working”</i>	Stronger personal ownership and greater empowerment; more effective and timely decision-making; clear prioritisation that enhances workflow; and reduced over-collaboration	Westpac should supplement existing activities (e.g., “Check, Confirm, Create” and “Service Huddles”) with a coordinated set of new / refined mechanisms or initiatives to improve the ways of working. Examples may include: reviewing the decision-making rights for specific roles and then refining these; creating organisation-wide guidelines or “principles” such as a formal outcome focus (“What’s the impact?” “What value have I / we added”); applying disciplines to meetings (relevance of attendees, outcome-focused agendas, the setting of actions, and feedback / reflection moment); using a simple application to calculate the cost of meetings / committees based on time and attendees; and applying “prioritisation” disciplines or checks (“saying no”). Risk / business rotation programs like those outlined in chapter 6: <i>Risk management and compliance</i> could be a valuable addition to existing programs.	C2

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Development area	What does Westpac want to achieve?	How should Westpac achieve it? (Examples)	Number
<i>Learning</i>	Institutional learning and reflection become the norm (rather than in pockets). Time for learning and self-reflection is allocated into the flow of work for all individuals.	Westpac should build on existing learning programs and supporting infrastructure such as LearningBank and Post-Implementation Reviews through a series of initiatives, including: evolving Service Huddles into broader cultural huddles; creating a tailored platform for best-practice and “failure” sharing; training on “listening” for leaders and “how to receive feedback and challenge” for all employees; upskilling of risk and compliance professionals through “influencing” / “having impact” training; and formally carving out time for reflection.	C3
<i>Reward and recognition</i>	Reward and recognition mechanisms support the desired behavioural traits.	Westpac should “double down” on the overhaul of scorecards and remuneration changes, including embedding Motivate, in conjunction with new recognition mechanisms: for example, rewarding long-term embedding and execution in BAU operations, sharing stories, and celebrating excellent risk awareness, practice and management.	C4

- 14.2.10. Immediate next steps include: getting Westpac leaders (regardless of level) “behind” the findings and nuances through a series of facilitated conversations; embedding the four development areas into the existing suite of culture initiatives and detailing initiatives further; and selecting a small number of areas in the organisation to undertake “cultural change pilots” (including examining the “exemplars”).
- 14.2.11. More broadly, Westpac should define target states for high-priority aspects of its culture and then regularly monitor progress toward those states, supplementing existing culture monitoring tools and activities (such as the Sentiment survey) with “deep dives” into specific sub-cultures, behavioural patterns and associated root causes. For each targeted culture component, the behavioural shifts required should be articulated and prioritised, having regard to impact on management of non-financial risk. As behavioural shifts are inherently difficult and require concerted effort and senior sponsorship, only a small number of them (no more than three from each of the four development areas) should receive systematic attention at any time. The form of this attention should include communication programs, reward and recognition activities, and inclusion in employee performance and behaviour assessment. When adequate progress has been achieved, the focus should shift to maintenance activity and the next set of prioritised behaviours.

PART F

APPENDICES

APPENDIX A. REVIEW TEAM STRUCTURE AND PERSONNEL

- A.1. The Review Team was operationally led by Leif Evensen (Westpac Review Team lead) and Ed Emanuel (Oliver Wyman lead), under the senior executive-level oversight of John Arthur. Leif Evensen also led a program management office (**PMO**) that included Westpac and Oliver Wyman representatives.
- A.2. Review Team members were grouped into individual work streams for the self-assessment, collectively operating under the stewardship of the PMO. The PMO was responsible for writing this report under the guidance of John Arthur, Leif Evensen and Ed Emanuel.

[Names of employees on Review Team redacted]

Role of Oliver Wyman

- A.3. Oliver Wyman provided rigour and thought-provoking challenge to the assessment. The firm also provided expert, external perspectives - including subject matter expertise and insight into local and global peer practice - as well as assessment methodology, process and capacity. Supplementing the work of the Review Team, an Oliver Wyman global expert panel provided input to better practice definition, facilitated workshops on areas of interest, and shared research and published thoughts on assessment topics.

APPENDIX B. OUT-OF-SCOPE STATEMENT

The primary purpose of the self-assessment was to:

- form empirically-grounded conclusions regarding the strengths and shortcomings of Westpac's governance, accountability and culture frameworks and practices, having regard to Australian and global peer "better practice" and the findings and observations in the CBA Prudential Inquiry Final Report, as these strengths and shortcomings bear on the sound management of (principally) non-financial risk in Australian operations; and
- recommend, at a high level, any remedial action that is deemed appropriate in response to those conclusions.

These frameworks and practices constitute the formal and informal context within which risk and compliance are managed in Westpac. They were decomposed for the purposes of this exercise into eight assessable dimensions: (1) remuneration; (2) financial prioritisation; (3) accountability; (4) risk management and compliance; (5) organisational structure; (6) issue / incident management; (7) board and senior management governance; and (8) culture, as it relates to the management of risk and compliance.

In assessing the frameworks and practices, it was necessary to consider bounded examples of strengths and shortcomings in the management of particular risks and / or compliance obligations, as *manifestations* of the frameworks and practices. The Review Team did not, however, need to consider the overall effectiveness with which any category of risk or compliance was managed, as it was not directly assessing the holistic state of risk management or compliance.

It follows that the matters below were outside the required scope of the final report:

1. overall conclusions regarding the effectiveness with which any category of risk is managed, including direct assessment of the capabilities of individuals or functions to manage any such category;
2. overall conclusions regarding the degree to which legislative and regulatory compliance is achieved; and
3. conclusions regarding activities and operations outside of Australia, other than to the extent that these are implicit, without having been specifically targeted, in the assessment of any Group-level matter

APPENDIX C. REVIEW TEAM ACTIVITIES

- C.1. The Review Team undertook a comprehensive range of activities to review, analyse and assess Westpac's governance, accountability and culture frameworks and practices. These activities are summarised below.

Document review

- C.2. More than 65,000 documents were collated as potential source material for the self-assessment. These documents included frameworks, policies, procedures, Executive Team and Board papers, project documentation, internal communication, employee data, audit reports, regulatory findings and external reviews on various topics. A material subset was drawn upon by the Review Team in its analysis.

Case studies

- C.3. Four deep-dive case studies were conducted to obtain insight into Westpac's governance, accountability and culture frameworks and behaviours in practical contexts, including how the organisation responds in situations of stress and challenge.

Interviews and workshops (excluding culture work)

- C.4. More than 50 extensive (typically 90-minute) interviews were conducted by the Review Team, covering:

- all Board members;
- all Executive Team members, including the Chief Executive Officer, and a former Executive Team member;
- senior Westpac employees across the 3 LOD, including GMs and direct reports to GMs, whom the Review Team considered to be in a position to provide valuable insights on the matters in scope; and
- executive representatives of three of Westpac's major partner organisations.

- C.5. In addition, a number of workshops were held with Westpac staff across a range of management levels and business lines, including discussion of better practice at peer institutions.

Culture assessment

- C.6. Cultural analysis concentrated on the identification and articulation of tangible behaviours and linking these to associated perceptions and drivers. The analysis drew on existing cultural data, such as previous Westpac surveys, organisation-wide communications, strategy papers, policy documentation and external culture reviews. This data set was significantly expanded by primary data generation, consisting of:

- tailored survey questions incorporated in the September 2018 monthly Employee Sentiment Survey. The survey featured fifteen specific statements that employees responded to on a 5-point Likert scale ("Strongly Agree" to "Strongly Disagree"), as well as the free text response question "What would you recommend to improve the risk culture of the organisation?" The questions were chosen to provide a statistically valid view of significant cultural findings (complementing the nuance and depth of learnings from interviews and focus groups), and to provide geographic coverage across Westpac;⁹²

⁹² The survey was sent to over 3,600 employees, and over 1,300 responses were received, including more than 350 verbatim responses.

APPENDIX C. REVIEW TEAM ACTIVITIES

- 39 culture-specific interviews with Executive Team members and other senior leaders and cultural influencers across the Group – undertaken by senior Oliver Wyman experts without Westpac interviewer involvement, to facilitate impartial interaction and open discussion;
- 16 focus groups across customer-facing and functional business units in Sydney, covering a range of brands and levels of seniority up to Senior Manager, each:
 - comprising staff from a common area and of broadly similar seniority, but otherwise randomly selected,
 - involving structured discussion, on a confidential basis, focused on the organisational and risk culture of Westpac, and
 - facilitated by Oliver Wyman employees without Westpac Review Team attendees, again to promote impartial interaction and open discussion; and
- a Board culture workshop that collected the views of Directors on a range of topics having relevance to the Board's role in shaping the culture, including risk culture, of Westpac, conducted by global culture experts from Oliver Wyman.

APPENDIX D. GLOSSARY OF TERMS AND ACRONYMS

accountability	The answerability of an individual for behaviour and outcomes within a designated zone of influence (such as a business unit or process)
APRA	Australian Prudential Regulation Authority
ACCC	Australian Competition and Consumer Commission
ADIs	Authorised deposit-taking institutions
ASIC	Australian Securities and Investments Commission
Assurance	The Assurance business unit in the Risk division
AUSTRAC	Australia's financial intelligence agency, with regulatory responsibility for anti-money laundering and counter-terrorism financing
BAC	Board Audit Committee
BEAR	Banking Executive Accountability Regime
BRC	Board Remuneration Committee
BRCC	Board Risk & Compliance Committee
BSR	Board Strategy Review, an annual process through which the Board formally considers the Group's strategic direction and associated high-level investment priorities
BTFG	BT Financial Group (Australia), the Australian wealth management and insurance arm of the Westpac Group, providing a broad range of associated services
Business Bank	The division of Westpac responsible for sales and service to small-to-medium enterprises and commercial business customers in Australia. The division operates under the Westpac, St.George, Bank of Melbourne and BankSA brands
CCO	Chief Compliance Officer
CCR	Customer & Corporate Relations division
CFO	Chief Financial Officer
Clawback	A process by which an employee has to return an amount of variable compensation already paid or already vested to the relevant-employing organisation, under certain conditions
Compliance	The Compliance business unit in the Risk division (effective 1 October 2018)
Compliance obligations	Requirements set out in legislation, regulation, licence conditions and Westpac Group policies, as well as regulatory standards, guidance, rules and key voluntary codes of practice to which Westpac subscribes. Obligations arising out of the Group's contractual arrangements are excluded from the definition
compliance risk	Defined by Westpac as the risk of legal or regulatory sanction, or financial or reputational loss, arising from its failure to abide by the compliance obligations required of it
conduct risk	Defined by Westpac as the risk that its provision of services and products results in unsuitable or unfair outcomes for its stakeholders or undermines market integrity
Consumer Bank	The division of Westpac responsible for sales and service to consumer customers in Australia under the Westpac, St.George, Bank of Melbourne, BankSA and RAMS brands
CPIA	Committee for Project Investment Approvals
CRO	Chief Risk Officer
CS	Customer Solutions team

APPENDIX D. GLOSSARY OF TERMS AND ACRONYMS OF TERMS AND ACRONYMS

Discretionary STVR plans	Variable remuneration plans that do not entail communication of a priori targets or other qualitative indicators of variable remuneration potential, used to recognise and reward behaviour and performance of employees
DQR	Data Quality Reviews
EIP	Enterprise Investment Pool
EPOC	Enterprise Portfolio Oversight Committee
Executive Team	The CEO and Group Executives, collectively
FTE	Full-time equivalent employees
FY	Twelve months ending 30 September
GBU	Group Business Units
GE	Group Executive
GM	General Manager
GM-1	The management level immediately below GM (excluding administrative and other executive support employees reporting to GMs)
GM-2	The management level immediately below GM-1 (excluding administrative and other executive support employees reporting to GM-1s)
Group Audit	Westpac's Line 3 assurance function
HR	Human Resources
Internal Audit Team	The team of Deloitte and Westpac Group Audit employees that provided assurance over the self-assessment
JUNO	Westpac's automated system of record for risks, compliance obligations, controls and issues
LOD	Lines of Defence
LTVR	Long Term Variable Reward, which is provided to the CEO, GEs and GMs in the form of Westpac shares or share rights, subject to restrictions and / or performance hurdles
Malus	A mechanism that permits an organisation to reduce the value of all or part of deferred compensation based on ex-post risk adjustment before it has vested
Near-misses	Incidents that have not resulted in any actual financial or non-financial consequence but had the potential to do so
NPS	Net Promoter Score
OAIC	Office of the Australian Information Commissioner
Operational Risk	The Operational Risk business unit in the Risk division
operational risk	Defined by Westpac as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal and regulatory risk but excluding strategic risk
Prudential Inquiry	Prudential Inquiry into the Commonwealth Bank of Australia
RAS	Risk Appetite Statement
RCM	Risk and Control Management
reputation risk	Defined by Westpac as the risk of the loss of reputation, stakeholder confidence, or public trust and standing
responsibility	The obligation of an individual to perform a designated task with requisite competence and behaviours
Risk	The Risk division, overseen by the CRO

APPENDIX D. GLOSSARY OF TERMS AND ACRONYMS OF TERMS AND ACRONYMS

risk	Unless otherwise noted or readily inferred from context, the term “risk” refers to non-financial risk
RISKCO	Westpac Group Executive Risk Committee
Risk gates	Risk-related criteria used to determine whether employees are eligible for consideration for STVR
Risk gate closure	A mechanism to render an employee ineligible to be considered for STVR because he or she did not satisfy criteria articulated in a risk gate
Risk adjustment	A mechanism whereby the amount of STVR for an employee who is eligible for STVR is decreased or increased in response to risk behaviours or outcomes
Royal Commission	Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry
Sedgwick recommendations	The recommendations of the independent Retail Banking Remuneration Review, led by Stephen Sedgwick AO, reviewing product sales commissions and product-based payments in retail banking in Australia, as reflected in the Retail Banking Remuneration Review final report issued on 19 April 2017
self-assessment survey	The September 2018 Employee Sentiment survey, which included additional questions in support of the self-assessment
SES	Strategy & Enterprise Services division
STVR	Short Term Variable Reward, which may take the form of cash and / or deferred Westpac shares or share rights
VR	Variable reward, of which there are two forms – STVR and LTVR
VRG	Variable Reward Guidance, which provides a guiding baseline value of potential STVR that could be available to employees on discretionary STVR plans without targets
WIB	Westpac Institutional Bank, the division of Westpac delivering a broad range of financial products and services to commercial, corporate, institutional and government customers with connections to Australia and New Zealand

Confidential

This document is confidential. Any views, analysis, findings and conclusions are those of the Review Team and recommendations have not been approved or adopted by Westpac.