

Insight



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An Overview of Our Key Insights for 2019:

Reputation & The Lessons Learned from Westpac

Introduction

The exposure of yet another reputation-damaging event in Australia's biggest financial institutions – this time, Westpac – is sadly becoming less of a surprise and more of a 'predictable event', and only serves to further erode Australian's faith in what should be one of our most trusted institutions.

In this paper we review the current crisis at Westpac to date, based on information available in the media and public domain – and explore possible causalities, through the lens of our previous research into reputation-damaging events, which offers insights into what the boards of the most successful companies have in common.

Westpac – What can we all learn from this experience?

Here's a summary of what we know so far from the public domain:

On 20th November, 2019, AUSTRAC filed a statement of claim against Westpac, accusing it of systemic failures in its control environment, indifference by senior management, and inadequate oversight by the board, due to the Bank's failure to properly resource and monitor its Anti-Money Laundering / Counter-Terrorism Financing functions. Westpac is alleged to have committed 23 million breaches, including failure to report suspicious overseas transactions, which, in the case of 12 customers, allowed payments to be made to fund child sexual exploitation in the Philippines.¹

Despite AUSTRAC putting the board 'on notice' about the seriousness of the breaches in March 2019, it's alleged that the board and senior management failed to make resolving the compliance breaches a priority.^{2,3}

In addition, on 4th November, Westpac proceeded with a \$2.5 billion capital raising without disclosing to shareholders the scale of the AUSTRAC issues.⁴

The board and senior management have denied knowledge of the breaches, which has led to a backlash from regulators, media, shareholders and customers.⁵

Westpac faces a very large fine, potentially as large as \$1 billion, from AUSTRAC.

Meanwhile, ASIC is investigating whether Westpac provided investors with enough information about the breaches in the lead-up to the capital raising, and APRA is interviewing senior executives to ascertain who knew about the breaches and may disqualify individuals under the Banking Executive Accountability Regime (BEAR).⁶

Casualties already include Westpac CEO, Brian Hartzer, Chair, Lindsay Maxsted, and Chair of the Board Risk & Compliance Committee, Director Ewen Crouch. Angry shareholders delivered a second strike rejection of the Remuneration Report at the AGM on 12 December, triggering a motion to spill the board, which was defeated, and all four directors up for re-election managed to retain their positions, albeit in the face of a barrage of shareholder outrage. At the AGM, Lindsay Maxsted also conceded that Westpac's culture might be to blame.⁷ All executive bonuses have been frozen pending the outcome of an investigation by external firm, Promontory.^{8,9}

¹ <https://www.austrac.gov.au/about-us/media-release/civil-penalty-orders-against-westpac>

² <https://www.afr.com/chanticleer/westpac-s-board-was-deluded-20191128-p53f47>;

³ <https://www.smh.com.au/business/banking-and-finance/the-westpac-scandal-how-did-it-happen-20191206-p53ho2.html>

⁴ <https://www.afr.com/chanticleer/westpac-s-board-was-deluded-20191128-p53f47>;

⁵ <https://www.afr.com/chanticleer/the-four-things-needed-to-save-hartzer-20191124-p53dlz>

⁶ <https://www.afr.com/companies/financial-services/the-regulatory-nightmare-awaiting-westpac-s-new-boss-20191207-p53hrx>

⁷ <https://www.theguardian.com/australia-news/2019/dec/12/furious-shareholders-front-incompetent-westpac-executives-at-agm>

⁸ <https://www.smh.com.au/business/banking-and-finance/the-westpac-scandal-how-did-it-happen-20191206-p53ho2.html>

⁹ <https://www.abc.net.au/news/2019-11-24/westpac-freezes-executives-bonuses-money-laundering-scandal/11733196>

The questions that arise from this that have been raised in public forums are not new, and indeed link with themes which were raised in our previous Thought Paper about Reputation:¹⁰

- How is it that the board and executive management claim that they did not know about (or perhaps, did not believe) the gravity of the breaches – despite being informed about the seriousness of the investigation by AUSTRAC in March 2019?
- Given that CBA faced an AUSTRAC investigation in August 2017, and subsequent \$700 million fine in June 2018, for AML/CTF breaches, how is that the CEO and Risk Committee at Board level did not push to check whether Westpac had any similar breaches that might land them in trouble?
- Is it a case of wilful blindness, or is something preventing the reporting of ‘unpalatable’ news from reaching the executive and board levels?
- Has pressure from investors for high dividends, along with a focus on short-term profit led to a systemic lack of investment in building technology and IT systems that are capable of managing potential breaches?
- Is there a culture of entitlement and avoidance of responsibility that has contributed to the current mess?
- And, why did the Bank proceed with a \$2.5 billion capital raising without informing investors of the seriousness of the breaches and investigation by AUSTRAC? What message does this send about the Bank’s attitude to investors and regulators?

These questions will not be fully answered until the results of all the investigations (Promontory, ASIC, APRA) into the Bank have been released.

Our Reputation paper titled, Devastating Reputation Failures – which we’ve discussed extensively with chairs and boards this year and has been well received – explored the reasons why companies face reputation damaging events, and presented what the most successful boards do in order to protect their companies from such events.

Reputation

A summary of our Reputation paper is as follows – to re-read the full article, follow this link.

Significant research has found that the highest impact issues leading to reputational crises globally can be classified into the following categories:

- The singular focus on delivering profit for the shareholder
- Measurement & Reward Systems that focus on short-term profit, or rewards that are out of the direct control of employees and therefore lead to slack behaviour
- Culture: the withholding of ‘bad’ news for reasons of fear of retribution; institutional conformity; a culture of denial or wilful blindness towards risk
- Siloed organisational structures
- Lack of capability, knowledge and, experience at board and executive levels.

The companies that have thrived over the long term and tend not to experience reputation-damaging events to the same extent have the following in common:

- A very strong purpose
- A long-term perspective

¹⁰ <https://www.afr.com/chanticleer/westpac-s-board-was-deluded-20191128-p53f47>;
<https://www.afr.com/chanticleer/the-four-things-needed-to-save-hartzer-20191124-p53dlz>;
<https://www.afr.com/chanticleer/director-jobs-on-the-line-at-westpac-agm-20191121-p53cmj>;
<https://www.afr.com/companies/financial-services/westpac-execs-driven-by-status-money-power-20191201-p53fsj>

- A balanced view of who the key stakeholders are
- Leaders at board and executive levels with the appropriate experience, knowledge, character, values and mindset
- Leadership that is obsessed with delivering customer value
- Driving a very strong innovation culture which focuses on customer needs and improving internal systems and processes
- Leadership that is focused on developing a new generation of leaders
- An “always on” strategy mindset and process
- Active management of a very strong culture underpinned by aligned remuneration and measurement systems.

Putting in place the above conditions for success will mitigate these reputation-damaging events from happening again. The best companies have strong leaders who foster and develop strong cultures within their organisations.

I have much experience in assessing CEO and other senior candidates. An observation I would make from doing this work for 15 years is that many boards are very focused on the person’s track record and historical performance, and less focused on their character – and this has been the catalyst for writing our next paper which we’ll share with you in early 2020 – Leader Character.

A further thought for consideration

A brief reflection – it would seem that there is a level of complacency towards risk in some of our biggest financial institutions. The losses are financial and reputational – but, in the most part, not life threatening.

By comparison, companies that offer services or products that directly impact lives take a different approach to risk – because the safety of their people, be they clients, staff or other stakeholders, is directly at risk. For example, companies such as Qantas and BHP have developed a culture where safety is the most important area of focus. A key ingredient in averting catastrophic accidents is that the entire workforce is encouraged to raise concerns about potential safety issues – they are indeed rewarded and supported for doing so, and this culture is reinforced through HR, training and development.

Contrast this culture with what we have seen from the Hayne Royal Commission and numerous reputation-damaging events emerging from our financial institutions and it becomes evident that a culture which is opposite to that of the safety-conscious Qantas or BHP is at play. When information about potential risks isn’t able to filter up to the board, or when whistleblowers are punished or ignored it is clear that the culture of the organisation is compromised.

It is the board’s responsibility to ensure the business has a strong culture. Perhaps if they were to adopt a mindset of ‘safety first’ – treating risks with the same level of vigilance as we would if lives were at risk – perhaps then we would see monumental change in our financial institutions – and monumental change may be what is needed to rebuild trust.

Conclusion

We look forward to sharing with you our finalised Leader Character thought paper in the new year, and we will also bring you a separate thought paper providing an in depth exploration of the Westpac investigation, examining how the breaches occurred, why they were not taken seriously, and what boards can do to avoid such devastating reputation-damaging events and ‘smell the smoke’ sooner.



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