



Section 95 – Assessment of Liquidity Risk Controls and Risk Culture

Public Summary

May 2022

Context

Background

As disclosed in Westpac New Zealand Limited's (WNZL) September 2020 Disclosure Statement, WNZL was non-compliant with the Conditions of Registration 14 (requiring compliance with three quantitative ratios for liquidity risk management) where:

- The methodology used by WNZL (since 2017) to determine the cash inflows of certain Revolving Credit Facility (RFC) products for the purpose of calculating mismatch ratios incorporated simplifying assumptions that did not have the effect of decreasing the value of the ratio as required by Liquidity Policy (BS13).
- The methodology used by WNZL (since 2012) to determine cash outflows for the 32-day Constant Maturity Deposits (32 CMD) product cash outflows for the purpose of calculating mismatch ratios did not account for a product feature which allowed the product to be withdrawn prior to the 32-day notice period.

The above non-compliance issues were serious in terms of both the impact on the bank's liquidity ratios, and in terms of the period of time the breaches existed.

Further non-compliance issues were identified by the RBNZ's liquidity thematic review.

The root causes of the non-compliance issues were primarily attributed to a Treasury control environment which lacked accountability, governance, ownership and clear understanding of the end-to-end liquidity risk management. This assessment was further supported by a Treasury Risk Culture review undertaken by an independent consultant in February 2021 which concluded that "WNZL Treasury risk culture was reactive and not proactive".

The outcomes from multiple external reviews, along with the outcomes from the RBNZ liquidity thematic review and the external culture review were consolidated by WNZL to form a Liquidity Remediation Plan.

Scope of our assessment

The objective was for Deloitte to perform an external assessment to assist the RBNZ in assessing:

- WNZL's BS13 control environment;
- WNZL's remediation activities; and
- Whether the scope of the Risk Culture reviews was sufficient to identify the key risk culture issues in WNZL Treasury and the Financial Markets and Treasury Risk (FMTR) teams.

The focus of this assessment was to establish whether issues identified by various reports, including risk culture issues have been sufficiently addressed and that the updated control environment supports ongoing compliance with the requirements of BS13.

Assessment Summary

WNZL's BS13 Liquidity Control Environment

The assessment focused on WNZL's overall liquidity control environment, control testing (design and operating effectiveness), the extent of manual processes weakening the control framework and continued reliance on Westpac Banking Corporation (WBC) for model, calculation and reporting.

Overall, WNZL have improved its liquidity control environment. The repatriation of the liquidity model to New Zealand has necessitated changes to its operating model which has included: transferring responsibilities to WNZL Treasury, Treasury Finance and Market Risk, refreshing existing liquidity risk management frameworks, redefining roles and responsibilities across the three lines of defence, strengthening the reporting to relevant committees and uplifting the governance around product change and modelling. In addition, the repatriation of the model has resulted in rigorous reviews and external validation of model inputs and assumptions prior to implementation. The repatriation of the liquidity model has significantly reduced the reliance on WBC and streamlined the process of calculation and reporting.

Additionally, WNZL reassessed its obligations, risks and controls which led to the development and improved linkage of new and existing controls to manage liquidity risk and support the compliance with BS13 requirements. These controls have been subject to review by first and second-line teams.

Our assessment has found no material gaps or issues and the recommendations listed below support further refinement of the liquidity control environment as new changes are embedded and additional enhancements are identified.

Currently, there are 58 controls linked to liquidity risk. We recommend WNZL:

- Consolidate controls which will help with the ongoing management and review of these controls (examples provided in the long form report);
- Resolve, in a timely manner, areas which are identified as "Requires Improvement" as a result of design and operating effectiveness assessments (4 out of 58 controls); and
- Continue to invest in the automation of controls, particularly those relating to the model and reporting.

In addition, further activities should be explored by WNZL to ensure:

- Continued reduction of dependency on WBC for data and trade booking systems migrated as part of the BS11 (Outsourcing Policy) project;
- Dependency on WNZL technology is mitigated by implementing a Service Level Agreement (SLA) supported with metrics by which the service is measured, and committing to actions required if the agreed level is not achieved;
- Linking General IT or other centralised controls that are subject to review outside Treasury which support the overall liquidity risk management framework and compliance with BS13 in the Treasury documentation as additional means of supporting compliance;
- All control owners and operators become fully aware of their roles and responsibilities;
- Spreadsheets used by Treasury and Financial Markets and Treasury Risk teams adhere to the User Developed Application (UDA) policy where required, and UDA controls owners are at the appropriate level.

WNZL's Remediation Activities

The Liquidity Remediation Plan (LRP) was formed to deliver milestone actions following the external reviews, the RBNZ liquidity thematic review and an independent culture review.

The milestones of the LRP were split into four workstreams to address the different nature of the underlying findings:

1. Governance: Focus on roles and responsibilities, product governance, model governance and liquidity framework documents.
2. Controls: Compliance with BS13 and APRA Prudential Standard (APS210), robust environment to support the new liquidity model.
3. Data and Models: Remediation of non-compliance issues, milestones to support the repatriation of the liquidity model including model methodology documentation and the validation of the model prior to going live.
4. Risk Culture: Assessment of the independent review and transition from a reactive to proactive culture.

At the end of the Deloitte assessment, we concluded that 59 of 73 remediation milestones had been finalised by WNZL. Nine milestones have been marked as closed but have further actions which were to be completed outside of the LRP (i.e. as part of BAU activity) and five milestones remain open as the remediation of these milestones are beyond the timeline of this report.

Based on our work performed and enquiries, we do not believe that the nine closed milestones with additional actions and five open milestones represent significant risk at this time. Management expect these milestones to be finalised later in 2022 or embedded with the wider risk review initiatives currently planned by WNZL.

Assessment of Risk Culture Review

As a result of the risk culture deficiencies, WNZL engaged an external consultant to perform an independent risk culture review of WNZL Treasury. The first review concluded that the risk culture at WNZL Treasury was reactive and identified several findings and recommendations which were incorporated as milestones by WNZL into the LRP. We have assessed the completion of these milestones and note that all the risk culture milestones (13) are closed or closed with additional actions (1) identified.

A second independent review was conducted to assess the progress made since the first review and to make recommendations for future focus. The second review acknowledged that the risk culture has improved since the first review with significant shifts in individual behaviours and mindsets. However, the second review noted that the risk culture at WNZL Treasury still remains reactive, with more work required to complete the transition to a systematic and thereafter, proactive risk culture. To this end, the report made further Treasury specific and WNZL wide recommendations. WNZL is currently proposing to address the Treasury specific recommendations via the Treasury team's Continuous Improvement Plan (CIP), and the WNZL-wide recommendations via the Risk Governance S95 programme and Culture Evolution Programme (CEP). We agree with the proposed next steps.

As a result of our work, we note that the scope of the two risk culture reviews completed was sufficient in identifying key risk culture issues within WNZL Treasury. WNZL has taken the initial steps to enhance their risk culture and are clearly moving in the right direction towards a proactive risk culture with increase in the number of resources, strong focus on governance processes and a shift in behaviours and mindsets. This targeted momentum should continue over the next 2 to 3 years, to see a progressive shift from a reactive to systematic and subsequently, proactive risk culture.

Disclaimers

Limitations

Our work does not constitute a forensic investigation or assessment to identify, search for or quantify breaches or wrongdoing, nor does it express a conclusion about whether such actions are proper or legal. Our work is not designed to examine all actual or potential breaches or issues the review is aware of or becomes aware of.

We provide no assurances that the information supplied is either complete or correct and accept no accountability or responsibility for the information supplied. The assumptions used within this report are based on the *Reserve Bank of New Zealand Act 1989* and regulations in force in New Zealand at the time of writing and the observations have been provided following all reasonable engagement with senior officers of WNZL concerned and the representations made and information supplied by these officers in response to our requests.

Professional standards

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The procedures that we have performed do not constitute an assurance engagement in accordance with Australia and New Zealand Standards for Assurance Engagements, nor do they represent any form of audit under New Zealand Standards on Auditing, and consequently, no assurance conclusion or audit opinion has been provided.

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