HOUSE OF REPRESENTATIVES STANDING COMMITTEE ON ECONOMICS

REVIEW OF THE FOUR MAJOR BANKS (SECOND REPORT)

Westpac

Westpac60QW: Please provide a detailed brief as to how the Bank's risk management framework proactively addresses the risk factors which are not captured by the APRA Prudential Standard CPS220.

Answer: APRA Prudential Standard CPS 220 requires Westpac to "*maintain a risk management framework that enables it to appropriately develop and implement strategies, policies, procedures and controls to manage different types of material risks…* [and] *provide the Board with a comprehensive institution-wide view of material risks.*[1]

… the risk management framework is the totality of systems, structures, policies, processes and people within [Westpac] *that identify, measure, evaluate, monitor, report and control or mitigate all internal and external sources of material risk. Material risks are those that could have a material impact, both financial and non-financial, on* [Westpac] *or on the interests of depositors and/or policyholders*."[2]

Westpac distinguishes between different types of risk and takes an integrated approach toward identifying, assessing and managing all material risks including through the annual review of the Westpac Group Risk Management Strategy (RMS). The RMS captures the material risks relating to our business. This includes those risk classes listed in CPS 220 and any other risk class we identify as material.

The RMS is approved by the Board and is reviewed annually by the Board Risk and Compliance Committee (BRCC) or more frequently where required by a material business or strategy change or a material change to the Group's risk profile. Through this process, new risks can be identified as material and captured in the RMS. All risk classes captured in the RMS are managed through the Group's risk management framework.

In accordance with APRA Prudential Standard APS 330 Public Disclosure, Westpac is required to disclose prudential information about our risk management practices on a semi-annual basis. The relevant disclosure, the quarterly Pillar 3 report, details the risk classes addressed through our RMS. An overview of these key risk types from the September 2016 Pillar 3 Report is provided below:

- *credit risk* - the risk of financial loss where a customer or counterparty fails to meet their financial obligations to Westpac;

[1] APRA CPS 220 – Risk Management, clause 21
[2] APRA CPS 220 – Risk Management, clause 22

- *liquidity risk* - the risk that the Group will be unable to fund assets and meet obligations as they become due;
- *market risk* - the risk of an adverse impact on earnings resulting from changes in market factors, such as foreign exchange rates, interest rates, commodity prices and equity prices. This includes interest rate risk in the banking book - the risk to interest income from a mismatch between the duration of assets and liabilities that arises in the normal course of business activities;
- *operational risk* - the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This definition is aligned to the regulatory (Basel II) definition, including legal and regulatory risk but excluding strategic and reputation risk;
- *conduct risk* - the risk that our provision of services and products results in unsuitable or unfair outcomes for our stakeholders or undermines market integrity;
- *compliance risk* - the risk of legal or regulatory sanction, financial or reputational loss, arising from our failure to abide by the compliance obligations required of us;
- *business risk* - the risk associated with the vulnerability of a line of business to changes in the business environment;
- *sustainability risk* - the risk of reputational or financial loss due to failure to recognise or address material existing or emerging sustainability related environmental, social or governance issues;
- *equity risk* - the potential for financial loss arising from movements in equity values. Equity risk may be direct, indirect or contingent;
- *insurance risk* - the risk of mis-estimation of the expected cost of insured events, volatility in the number or severity of insured events, and mis-estimation of the cost of incurred claims;
- *related entity (contagion) risk* - the risk that problems arising in other Westpac Group members compromise the financial and operational position of the authorised deposit-taking institution in the Westpac Group; and
- *reputation risk* - the risk of the loss of reputation, stakeholder confidence, or public trust and standing.