Securities Lending Review

22 August 2008

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This review of Australia and New Zealand Banking Group Limited's involvement in Securities Lending was conducted by Chief Executive Officer, Michael Smith assisted by David Crawford together with David Hisco, Managing Director Esanda; Chris Page, Head of Risk ANZ Asia Pacific and Bob Santamaria, Group General Counsel ANZ.

The report examines the development and management of Securities Lending within ANZ and its relationship with Brokers including the Opes Prime group.

The aim of the review is to address the legitimate expectations of ANZ's shareholders, its customers and the wider community, that the way in which ANZ conducts its business should meet the highest standards of ethics and business practice.

The report delivers on a commitment to provide an open and transparent account of the Bank's involvement in Securities Lending, to examine accountabilities within ANZ and to identify and undertake all necessary remedial actions.

ANZ recognises however that there remain broader legal issues to be resolved, particularly those associated with the losses incurred by the clients of the Opes Prime group. There are also significant impacts stemming from the failures of the Opes Prime group and Primebroker Securities on the lives of their clients and their families.

ANZ continues to believe its Equity Finance relationships with Brokers were undertaken on a strong legal foundation and in good faith, and this report does not seek to address these relationship issues directly.

ANZ does however recognise that the legacy of its involvement in Equity Finance may well be with the Bank for many years through legal cases that it will continue to defend and also the impact of these issues on its reputation.

This report has been presented to the ANZ Board, which has accepted the findings and fully supports the remediation program described within it. This report has also been provided to the Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC).

22 August 2008

Glossary of terms

AMSLA – Australian Master Securities Lending Agreement. This is a standardised agreement that is commonly used in Australia to document Securities Lending and Equity Finance arrangements.

ANZ – Australia and New Zealand Banking Group Limited.

Broker – in this Report, this term refers to a company to whom ANZ provided an Equity Finance facility, and which offered Equity Finance facilities to its clients. These companies include Opes and Primebroker.

CTC – Credit and Trading Risk Committee. This is an ANZ committee consisting of selected senior executives and is responsible for oversight and control of credit and market risk.

Equity Finance – a form of Securities Lending. The principal distinctions between Equity Finance and Standard Securities Lending are that the lender of securities is generally motivated by the desire to obtain cash financing by lending out securities that it holds and that, in practice, the collateral provided by the borrower to the lender under this form of transaction is generally less than the value of the securities borrowed.

LVR or loan-to-value ratio – in relation to an Equity Finance transaction, refers to the ratio of the collateral provided by the borrower of securities to the value of securities provided by the lender of those securities.

Primebroker – Primebroker Securities Ltd (Administrators appointed) (Receivers and Managers appointed).

Opes – refers to Opes Prime Stockbroking Limited (Administrators appointed) (Receivers and Managers appointed) or Leveraged Capital Pty Ltd (Administrators appointed) (Receivers and Managers appointed).

Securities Lending – a financial product that involves the temporary transfer of securities from one party (the lender) to another (the borrower) in return for cash or other securities (referred to as collateral). Under a Securities Lending facility the borrower is generally obliged to return borrowed securities (or equivalent securities) either on demand or at the end of any agreed term. The two principal forms of Securities Lending at ANZ were Standard Securities Lending and Equity Finance.

SLORC – Securities Lending Oversight Risk Committee. This was an ANZ committee that was established by the line and risk management officers responsible for the ANZ Securities Lending unit to oversee risk controls relating to Equity Finance and Standard Securities Lending.

Standard Securities Lending – a form of Securities Lending in which the borrower of securities is generally motivated by the desire to acquire particular securities on a short term basis (e.g. to settle 'short' sales). In practice, the collateral provided by the borrower to the lender under this form of transaction is more than the value of the securities borrowed.

Contents

1	**Executive Summary**	**1**
2	**Introduction and overview of Securities Lending**	**4**
3	**The Review**	**5**
3.1	Background	5
3.2	Scope of the Review	5
3.3	Process of the Review	5
3.4	ANZ's relationship with Brokers	6
3.5	Legal issues	6
4	**ANZ's credit and risk governance structures**	**7**
4.1	Board and Board committees	7
4.2	Line and risk management	7
4.3	Management committees	8
5	**Securities Lending and Equity Finance – commencement and development**	**9**
5.1	History of Securities Lending at ANZ	9
5.2	Where does the ANZ Securities Lending unit fit within ANZ?	9
5.3	Equity Finance in the ANZ Securities Lending unit	10
5.4	Approvals for Equity Finance	10
5.5	Encouragement for Equity Finance	11
5.6	Risk review of Equity Finance in 2005	11
6	**Risks associated with ANZ's Equity Finance operations**	**12**
6.1	Classification of credit limits	12
6.2	LVR models	13
6.3	Nature of Brokers' business	14
7	**Operation, governance and oversight of Equity Finance – opinions**	**15**
7.1	Distinction between Equity Finance and Standard Securities Lending	15
7.2	Deficiencies in the Securities Lending Policy	15
7.3	Lack of compliance with approvals and policies	16
7.4	Credit limit calculation reduced visibility of Equity Finance	16
7.5	Deficiencies in the LVR models in Equity Finance	16
7.6	Limitations of CTC	17
7.7	Inappropriate role of SLORC	17
7.8	Failure to identify warning signs	18
7.9	Strategy and costs	18
7.10	Knowledge of the Board	19
7.11	Role of external auditors	20
8	**Investigation of breaches of ANZ employee conduct policies**	**21**
8.1	About the code of conduct investigation	21
8.2	Was there any fraud by ANZ employees?	21
8.3	ANZ employee accounts with Opes	21
8.4	Trading by employees	22
9	**Accountability and Remediation**	**23**
9.1	Themes	23
9.2	Accountability	23
9.3	Remediation actions	23
9.4	Next steps	25

1 Executive Summary

Introduction

This Review examined ANZ's involvement in Securities Lending, and in particular the development and management of ANZ's Equity Finance activities.

The Review was commissioned by the Chief Executive Officer of ANZ, Michael Smith, on 14 April 2008 following the collapse of the Opes Prime group, and was supported by the Board of ANZ.

ANZ's Securities Lending unit has operated since 1999 and the Equity Finance activities had evolved within that unit by 2001.

It is clear now that the differences between Equity Finance and other types of Securities Lending were not fully understood and appreciated by most ANZ staff involved in those products.

The Review Committee considers that, in hindsight, ANZ's Equity Finance business should not have operated in an environment where all the risks were not fully understood and managed. The business posed unacceptable reputational and financial risks to ANZ and these were not properly identified. These risks were compounded by the lack of a proper control environment with respect to the Equity Finance business.

Background

Securities Lending involves the transfer of legal and beneficial title to securities from one person to another in return for cash or other securities. The contractual terms between the parties enable the securities to be dealt with without restriction.

The recipient of the securities has an obligation to transfer an equivalent number of securities in exchange for repayment of the cash or securities originally provided.

Equity Finance is a form of Securities Lending where the value of the transferred securities is more than the value of the cash received in exchange. In this report, 'Equity Finance' is distinguished from 'Standard Securities Lending'.

From 2001, ANZ entered into Equity Finance and Standard Securities Lending arrangements with a number of 'Brokers', including Opes Prime Stockbroking Limited and Leveraged Capital Pty Ltd (referred to collectively as Opes) and Primebroker Securities Limited (Primebroker).

In this report, the term 'Broker' refers to a company to whom ANZ provided an Equity Finance facility, where that company offered Equity Finance facilities to its clients.

The securities lent to ANZ by Brokers were generally obtained as a result of the Equity Finance arrangements between the Brokers and their clients. That is, clients of a Broker would transfer securities to that Broker in exchange for cash collateral (or a right to draw down cash collateral when required). As the Brokers could deal with these securities without restriction, they could transfer them to other parties in return for other securities, or transfer the securities to banks, such as ANZ, in exchange for cash collateral.

The fact that Brokers sourced the securities from their clients was a key distinction between the Brokers and other parties with whom ANZ entered into similar arrangements. The particular consequences to ANZ of this distinction were demonstrated following the appointment of administrators to Opes and Primebroker in March and July 2008 respectively. These consequences were both financial and reputational.

The financial consequences include a provision, now sitting at approximately $70 million, that ANZ has made in relation to its exposure to Primebroker. Additionally there have been significant and ongoing costs in dealing with litigation and regulator requirements arising out of the Broker insolvencies. Provisions related to Securities Lending exposures were disclosed as part of ANZ's Trading Update on 28 July 2008.

The reputational consequences for ANZ arose primarily as a result of the position in which the Brokers' clients found themselves. Upon the appointment of administrators to Opes and Primebroker, clients lost the ability to recall securities that they had transferred to the Brokers, and instead became (or will become) unsecured creditors for any 'netted' amounts owed to them under the Equity Finance arrangements they had with the Brokers.

While clients of Brokers are understood to have signed agreements providing for the transfer of ownership of securities, when the Broker becomes insolvent, ANZ is seen to be, and in fact is, holding the securities that the Broker's clients may have expected would be returned to them. In realising these securities to protect its position, ANZ is regarded by some (including clients of the Brokers) as acting in its own interests and at the expense of the clients of the Broker.

Other issues that have compounded the damage caused to ANZ by its involvement in Equity Finance include:

- the amount of ANZ's financial exposure in respect of the Equity Finance business and the illiquidity of the securities acquired by ANZ to effectively hedge that exposure;
- the fact that five ANZ staff held, or had access to, trading accounts with Opes and some staff traded on those accounts immediately prior to the appointment of receivers.

Key findings and opinions

The Review Committee considers that there were a number of failures and deficiencies in relation to ANZ's Equity Finance business, as summarised below.

Lack of understanding of the distinction between Equity Finance and Standard Securities Lending – Line and risk management did not appear to fully understand the nature of Equity Finance and the differences between Equity Finance and Standard Securities Lending, including the different risks associated with Equity Finance (such as the reputational risk to ANZ arising from the financial standing and nature of the businesses of the Brokers that accounted for the majority of the Equity Finance business). This finding was a contributing factor to most of the other key findings.

Growth in initial business not widely known – There was limited understanding of the existence or significant scale of the Equity Finance business outside ANZ Custodian Services (within which the business resided) before March 2005.

Lack of a proper control environment – The Equity Finance business lacked an appropriate control framework, in particular with respect to credit limits and conditions relating to the quality and quantity of securities accepted by the Equity Finance business and the loan-to-value ratios applied to those securities. The lack of an appropriate framework was not identified by management until early 2005. The deficiencies identified were not then addressed effectively or in a timely manner. There was poor implementation of, and compliance with, the controls that were established.

Poor accountability and 'management by committee' – There was a lack of individual accountability within the line and risk management responsible for the Equity Finance business, with responsibility for many decisions resting with committees. This was compounded by deficiencies in the structure and management of the relevant committees.

Failure to identify and act on warning signs – Various concerns relating to the processes, personnel and systems utilised in the Equity Finance and Securities Lending businesses and the risks associated with these businesses were identified by various staff and in the course of internal audit reviews. However, they were not addressed in a timely or effective manner. There was a history of procrastinating on decisions to either invest in systems to remedy issues or to exit the business.

Failure to report relevant issues to the Chief Executive Officer and Board – The gravity of the issues relating to the Equity Finance business should have been, but were not, properly brought to the attention of the Chief Executive Officer and Board.

Breaches of ANZ employee conduct policies – There were breaches by some members of the ANZ Securities Lending unit of ANZ employee conduct policies.

Remediation actions

The Review Committee has identified 13 remediation actions to be undertaken by ANZ to address the findings contained in this report.

1. *Exit Equity Finance* – The Chief Executive Officer has directed that ANZ withdraw from the Equity Finance business in an orderly manner and rationalise Standard Securities Lending to a few key multinational institutional relationships.
2. *Disciplinary Actions* – There will be disciplinary actions involving a number of employees ranging from written warnings through to termination of employment.
3. *Code of Conduct and Ethics Policies* – ANZ will refresh all of its employee code of conduct, ethics and conflict of interest policies. This will be supported by additional awareness and training programs.
4. *Reputation Risk Framework* – ANZ will implement a new reputation risk framework to establish formal policy and accountability across ANZ for management of reputation risk.
5. *Performance Management Framework* – ANZ will create a new Performance Management framework to better reinforce accountability and compliance.
6. *Training for ANZ Senior Executives* – There will be training including problem escalation, the new Code of Conduct and ANZ's values and people management policies.
7. *Change the fundamentals of committees* – The structure and reporting lines of management committees (including the Credit and Trading Risk Committee or CTC) will be reviewed. This will ensure all committees have clear authority, guidelines, mandates to perform specific functions and accountabilities for performance and failures to perform. This review will also include the form of submissions and the process for recording follow up actions and decisions.
8. *Internal Audits and significant operational control issues* – ANZ will introduce more rigorous management of businesses with adverse Internal Audit ratings and operational control issues identified as 'high'.
9. *Product Management* – There will be a full review of the product approval process in ANZ.
10. *Review classification of facilities* – ANZ will develop an annually reviewed central register of the credit limit classification of all Institutional division products.
11. *Customer exposure reporting* – ANZ will improve exposure reporting to its senior risk and line management that monitors both size and movements in customer activity.
12. *Exposures without limits* – Business unit Managing Directors will undertake reviews to confirm there are no other areas with processes and systems which might permit potential drawdowns without proper arrangements in place.
13. *Wholesale Credit Risk Policy* – There will be a full review of the development and dissemination of the ANZ Wholesale Credit Risk Policy.

2 Introduction and overview of Securities Lending

Securities Lending involves the temporary transfer of securities from one party (the lender) to another (the borrower) in return for cash or other securities (referred to as collateral).

Under a Securities Lending transaction, the borrower can deal with borrowed securities without restriction. This is because full legal and beneficial ownership of the relevant securities are transferred from the lender to the borrower. However, the borrower is obliged to transfer an equivalent number of the same securities to those borrowed either upon demand by the lender or at the end of an agreed term, subject to repayment of the cash or other collateral originally provided by the borrower to the lender.

Securities Lending at ANZ took two principal forms, in this report referred to as 'Standard Securities Lending' and 'Equity Finance'.

The borrower in a Standard Securities Lending transaction is generally motivated by the desire to acquire particular securities on a short term basis (e.g. to settle 'short' sales). The lender is generally a financial institution such as a bank that holds large volumes of securities and wishes to generate fees, income or otherwise have access to liquidity by lending out those securities. In practice, the collateral provided by the borrower to the lender under this form of transaction is more than the value of the securities borrowed.

Under an Equity Finance transaction, the lender of securities is generally motivated by the desire to obtain cash financing by lending out securities that it holds. The borrower is generally motivated by the desire to earn interest on the cash it provides as collateral for the securities and to generate fees from on-lending the securities borrowed. In practice, the collateral provided by the borrower to the lender under this form of transaction will be less than the value of the securities borrowed.

In an Equity Finance transaction, the amount of collateral provided by the borrower is determined by reference to a loan-to-value ratio (LVR), which generally reflects the borrower's assessment of the quality of the securities being lent. For example, a borrower might apply an LVR of 30 per cent to a low quality security. The borrower would then pay cash equal to 30 per cent of the market value of the security as collateral.

The Securities Lending market uses standard documentation. The Australian standard is called the Australian Master Securities Lending Agreement (AMSLA). The AMSLA is based on agreements produced by the UK based International Securities Lending Association. There are standard securities lending agreements and industry associations in major financial markets throughout the world. The Australian industry association is the Australian Securities Lending Association (ASLA) (www.asla.com.au).

Under an AMSLA, where an event of default occurs, the parties' obligations to return borrowed securities and collateral ceases. Instead, the AMSLA provides for a monetary value to be attributed to each party's former obligation to return borrowed securities or collateral, and for those obligations to be netted off against each other.

3 The Review

3.1 Background

On 14 April 2008, ANZ Chief Executive Officer Michael Smith announced a review into ANZ's involvement in Securities Lending, and in particular the development and management of ANZ's Equity Finance activities including ANZ's involvement with Opes.

Mr Smith appointed a Review Committee consisting of himself and:

David Crawford, one of Australia's most experienced company directors with an extensive background in financial services and insolvency administration. Mr Crawford was appointed to ensure the rigour of the Review.

David Hisco, Managing Director Esanda. Mr Hisco joined ANZ in 1980 and has held a number of senior executive positions and has been a member of the Management Board of ANZ.

Christopher Page, Head of Risk Asia Pacific ANZ. Mr Page joined ANZ in January 2008 after a 34 year career with HSBC where he was most recently the Chief Credit Officer, Asia Pacific in which position he had responsibility for risk management activities across more than 20 countries.

Bob Santamaria, Group General Counsel ANZ. Mr Santamaria joined ANZ in August 2007 from Allens Arthur Robinson where he was the Executive Partner of the Corporate department.

The Review Committee was extensively supported in its work by a team of over 20 people, including senior ANZ staff and representatives of PPB Financial Advisors, PricewaterhouseCoopers and Allens Arthur Robinson.

3.2 Scope of the Review

The terms of reference of the Review were to examine:

- oversight and control of ANZ's involvement in Securities Lending and the development and management of ANZ's client relationships including with Opes;
- whether any employee had breached ANZ's internal policies, procedures and ethical standards in Securities Lending and in dealings associated with clients including Opes;
- compliance with Australian law and regulation in relation to Securities Lending;
- all necessary remedial actions to address the issues identified in the Review.

In conducting the Review, it became clear to the Review Committee that relevant issues of concern related primarily to the provision of Equity Finance by ANZ to Brokers (such as Opes and Primebroker). Therefore, the Review did not focus on ANZ's Standard Securities Lending operations (except to the extent that this product was offered to Brokers) or its involvement in the provision of Equity Finance to parties other than Brokers.

3.3 Process of the Review

The findings of the Review are based on facts and, where appropriate, opinions. Over the four months of the Review, the Review Committee had access to, and analysed:

- internal reports;
- customer files;
- internal and external correspondence;
- submission papers and minutes for various committees;
- reports generated by the ANZ Securities Lending unit;
- other records, including internal and external audit reports;
- interviews and discussions with directors, employees and former employees.

3.4 ANZ's relationship with Brokers

The Review Committee conducted extensive investigations into the relationship between ANZ and Opes and other Brokers. This included interviews with those ANZ employees who had business and personal dealings with Opes.

The Review Committee did not identify any evidence to suggest that any personal relationships between ANZ staff and specific Brokers contributed to the issues of concern relating to the Equity Finance business. This was the case notwithstanding that one of the principals of Opes, Lirim Emini, had previously been employed by ANZ and had worked with, and was a friend of, some members of ANZ's Securities Lending unit. Rather, the issues of concern appeared to be principally referable to the nature of the business, operational and governance matters.

Accordingly, relationships between ANZ and the Brokers are not addressed in detail in this report except where relevant to the holding of trading accounts with Opes by some of ANZ's employees.

3.5 Legal issues

The operation of ANZ's Securities Lending unit has given rise to a number of legal issues.

For example, there are a number of outstanding court proceedings and claims against ANZ. These include claims by Opes' administrators that a re-organisation of the Equity Finance and security arrangements between ANZ and Opes that occurred shortly prior to the appointment of administrators to Opes is voidable.

As part of its ongoing investigation of Opes, ASIC has required ANZ to produce various documents and it has conducted formal examinations of some ANZ employees. ASIC also requested that ANZ lodge substantial holding notices in respect of 'relevant interests' arising pursuant to certain AMSLAs. Whilst ANZ did not accept ASIC's view that notices were required, they were lodged (on the assumption that ASIC's view applied). In addition to complying with ASIC's request, ANZ also gave certain undertakings to the Takeovers Panel as a result of an application brought against ANZ.

All current legal issues are the subject of separate consideration by ANZ and its legal advisers. As these issues are or may become the subject of litigation, it is inappropriate at this time to provide any further information on them in this report.

4 ANZ's credit and risk governance structures

There are various levels of governance within ANZ.

4.1 Board and Board committees

4.1.1 Board

The Board is responsible to ANZ's shareholders for the governance of ANZ, and oversees its operations and financial performance.

The Board may delegate any of its powers and responsibilities to Committees of the Board. For the purposes of this report, the most relevant Board Committees are the Risk Committee and the Audit Committee.

4.1.2 Risk Committee

The Risk Committee approves risk management principles, policies, strategies, processes and control frameworks for the management of business, market, credit, operational, liquidity, and reputation risk. It may sub-delegate its powers to executives of ANZ. The Chief Risk Officer is the executive responsible for assisting the Chairman of the Risk Committee. The Risk Committee also approves facilities recommended by CTC which are above CTC's approval authorities.

4.1.3 Audit Committee

The Audit Committee is responsible, among other things, for overseeing and monitoring the work of ANZ's Internal Audit function. The Group General Manager Internal Audit reports directly to the Chairman of the Audit Committee.

4.2 Line and risk management

The Board delegates to the Chief Executive Officer, who delegates further to other senior management, the authority and responsibility for managing the everyday affairs of ANZ.

Various aspects of risk management are managed by different risk functions within ANZ (including market risk, credit risk and operating risk and compliance). ANZ operates its business through various divisions and subdivisions. Each division has a managing director or head of business unit. The reporting line through each level of management to the Chief Executive Officer is known as line management.

4.3 Management committees

There are various management level committees in ANZ. These include various risk, project specific and other committees. There are two such committees which are central to the focus of this report, being CTC and the Securities Lending Oversight Risk Committee (SLORC).

4.3.1 Credit and Trading Risk Committee

CTC is a senior executive committee which operates pursuant to discretions delegated to it by the Board and the Risk Committee. It comprises selected senior Risk Executives, senior Executives and Business Unit Managing Directors and is chaired by the Chief Risk Officer. The Chief Executive Officer is a member of the committee and may attend as necessary, but will not normally be expected to do so. In this regard the Chief Executive Officer did not attend the CTC meetings referred to in this report.

CTC's mandate is to approve credit and market risk control frameworks for ANZ's business. In November 2005, its mandate was extended to also cover reputational risk to ANZ. As part of its mandate, CTC is authorised to make general credit decisions and specific credit decisions for ANZ's larger or higher risk customers, and to approve credit, trading risk and non-traded market risk controls and each business unit's asset writing strategy.

CTC played a pivotal role in relation to the control framework established with respect to Equity Finance. It was asked to consider and approve key parts of the framework developed and recommended by senior line and risk management personnel.

4.3.2 Securities Lending Oversight Risk Committee

SLORC was established in April 2006 by line and risk management representatives responsible for the oversight of the ANZ Securities Lending unit for the purpose of providing oversight in the management of credit and market risk of the Securities Lending business (including the Equity Finance business).

5 Securities Lending and Equity Finance – commencement and development

Summary points

The Equity Finance business evolved out of ANZ's Standard Securities Lending business and was established without formal product approval. The differences between the Standard Securities Lending and Equity Finance businesses were not properly recognised, and the Equity Finance business was not widely known by management outside ANZ Custodian Services until March 2005.

The Equity Finance business grew rapidly with the encouragement of ANZ Custodian Services. By March 2005, when the first credit risk review of the business was undertaken, ANZ's financial exposure in respect of the business was $771 million.

There were deficiencies in the control framework for the Equity Finance business, including a failure to impose credit limits on customers. These deficiencies were identified in the above credit risk review but remedial actions were not implemented in a timely or effective manner.

5.1 History of Securities Lending at ANZ

ANZ has been involved in Securities Lending since the 1980s. In the 1990s, Securities Lending was conducted in different parts of ANZ including ANZ's retail stockbroking business (conducted by ANZ Securities Limited, then known as ANZ McCaughan Securities Limited) and ANZ Investment Bank (a division of ANZ).

In 1999, ANZ Securities Limited sold its retail stockbroking business. The Securities Lending activities were, at that time, discontinued by ANZ Securities Limited and adopted by ANZ Custodian Services. A dedicated team was created for this purpose (the ANZ Securities Lending unit).

5.2 Where does the ANZ Securities Lending unit fit within ANZ?

As shown in the following diagram, the ANZ Securities Lending unit is a part of ANZ Custodian Services which is a business within the Working Capital unit (formerly Trade and Transaction Services) in ANZ's Institutional division. The unit reports through to the Group Managing Director, Institutional and ultimately the Chief Executive Officer.

The diagram describes the current divisions and subdivisions. Over time, there have been several reorganizations and divisional name changes. However, the relative position of the ANZ Securities Lending unit within the hierarchy has remained fairly consistent over the years and the diagram provides an accurate reflection of its historical position within ANZ.

Assets held by the ANZ Custodian Services business are usually held by ANZ Nominees Limited (a wholly owned subsidiary of ANZ) as nominee or sub-custodian for ANZ. Securities transferred to ANZ in the course of Securities Lending or Equity Finance transactions were transferred to ANZ Nominees Limited as the nominee of ANZ.

5.3 Equity Finance in the ANZ Securities Lending unit

The ANZ Securities Lending unit was involved in Standard Securities Lending since inception.

It appears that the unit first became involved in Equity Finance on a small scale, but by late 2001, the product had grown to the point where it was considered to constitute a distinct offering and was referred to as 'Equity Finance'.

The terms 'equity finance' and 'equity financing' had been used in ANZ before 1999 although not necessarily for the form of Securities Lending now known as Equity Finance.

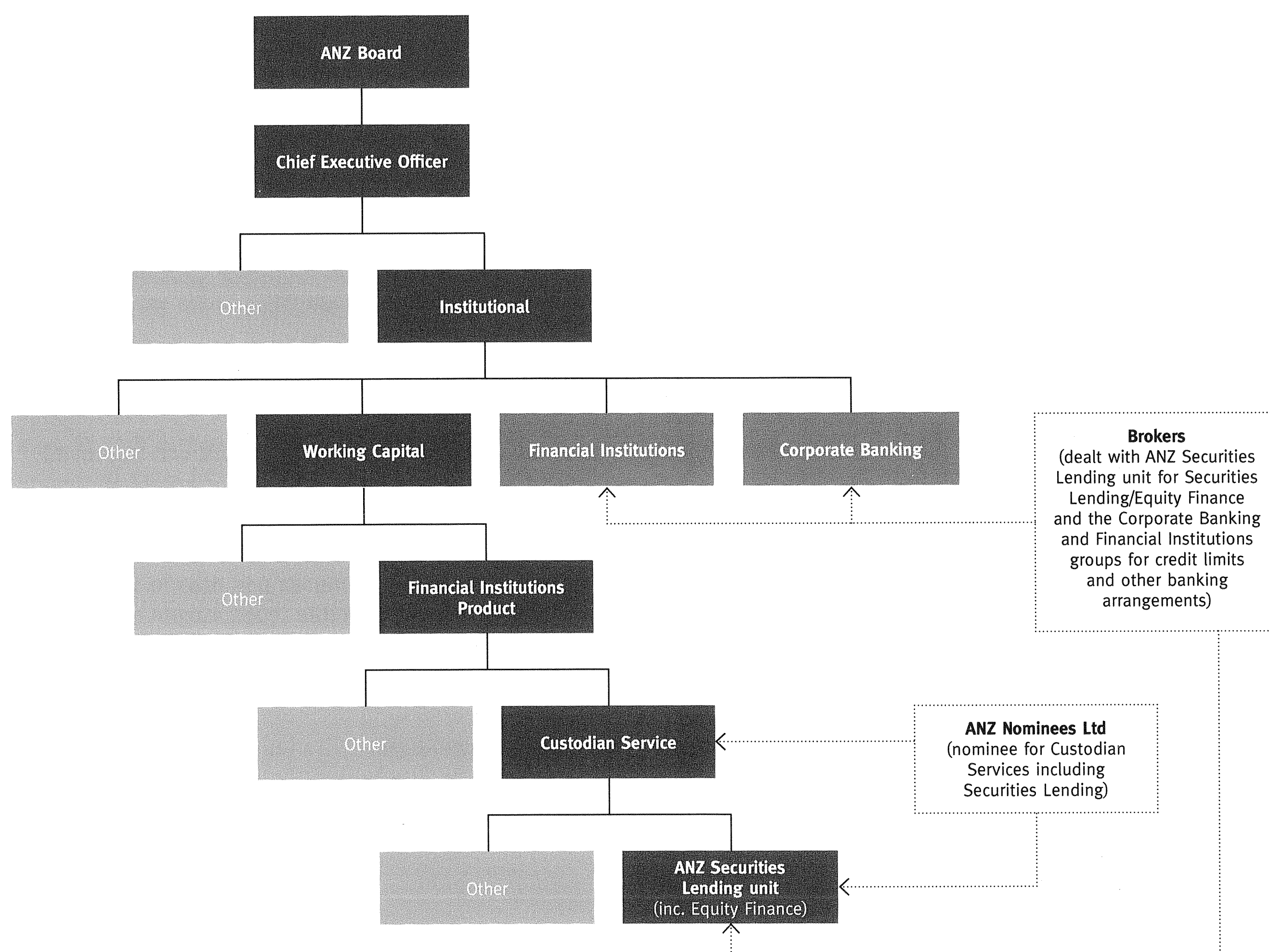
5.4 Approvals for Equity Finance

There is no record that any initial product approval was sought or obtained with respect to the Equity Finance product.

Within the ANZ Securities Lending unit, Equity Finance was often characterised as a part of Standard Securities Lending (or 'reverse stock lending') and not as a separate product.

ANZ's Wholesale Credit Risk unit (which sits within the Institutional Risk area) developed a Securities Lending Policy which was published in June 2002. The policy applied only to Standard Securities Lending and excluded Equity Finance. However, it did not exclude Equity Finance clearly, and was interpreted by ANZ Custodian Services and the ANZ Securities Lending unit as permitting Equity Finance.

Amendments to the Securities Lending Policy were published in May 2006 (with updates in October 2006 and March 2007). As part of the amendments, the policy was broadened to accommodate Equity Finance.



5.5 Encouragement for Equity Finance

At the same time as publication of the initial Securities Lending Policy, management within ANZ Custodian Services issued a set of brief 'guidelines' in relation to the Equity Finance business. The extent to which these guidelines were used in the day to day operations of the ANZ Securities Lending unit is unclear. The guidelines:

- did not limit ANZ's exposure to individual Brokers;
- did not restrict the types and concentrations of securities acceptable to ANZ;
- set a flat LVR without reference to the quality of securities accepted by ANZ.

In general, the ANZ Securities Lending unit was given freedom and encouragement by management of ANZ Custodian Services to grow the Equity Finance business.

From June 2002 (when the Securities Lending Policy was interpreted to permit Equity Finance) until March 2005 (when the first full review into Equity Finance by an ANZ risk officer was produced), ANZ's total financial exposure in relation to the Equity Finance business grew from $33 million to $771 million across a number of Brokers.

5.6 Risk review of Equity Finance in 2005

A credit risk assessment of the Equity Finance business was conducted in March 2005 by an ANZ risk officer, resulting in the production of a 'Securities Lending Review' report. Until this time, the existence of Equity Finance within ANZ was not widely known about or understood by management outside ANZ Custodian Services.

The Securities Lending Review report found that:

- while ANZ's Equity Finance product had similarities to ANZ's retail margin lending product, higher LVRs were applied and a much wider range of securities was accepted by ANZ;
- as at March 2005, ANZ had advanced $771 million to Brokers through the Equity Finance business;
- no credit limits had been established with respect to Brokers participating in the Equity Finance business and no process had been established to assess or manage counterparty credit risk.

The report was provided to relevant senior line and risk management. It recommended that no further expansion of ANZ's Equity Finance activities be undertaken and that credit limits be imposed with respect to the Brokers with whom ANZ had existing Equity Finance arrangements. Both of these recommendations were supported by a senior risk officer.

The recommendation to impose credit limits was also a requirement of CTC when the matter was raised in a submission in May 2005 seeking a credit limit for the largest Broker exposure.

Following the report, the Equity Finance business did not accept any new customers. However, exposures to existing customers were not capped at then current levels pending formal determination of credit limits for those customers.

There was a substantial delay in determining these credit limits. A limit was approved for only one Broker during 2005. Limits for the other Brokers were not approved until mid 2006. ANZ's financial exposure to these other Brokers more than doubled between the date of the Securities Lending Review report and the date on which credit limits were eventually imposed.

6 Risks associated with ANZ's Equity Finance operations

The level of risk associated with ANZ's Equity Finance business was firstly a function of the lack of credit limits and, when credit limits were applied, the classification of those limits. It was also a function of the LVR models applied, including the quality and concentrations of securities accepted by ANZ. A further risk emerged with respect to the financial standing of, and nature of the businesses operated by, Brokers to whom ANZ provided Equity Finance facilities.

6.1 Classification of credit limits

Summary points

For internal reporting purposes, the Brokers' Equity Finance exposures were recorded at 10 per cent of the face value of funds made available to them. This was on the basis that ownership of the collateral by ANZ reduced the risk of loss of those funds. Recording the exposures at 10 per cent of the face value meant that the exposures were not as visible as they would have been had they been recorded on a fully funded basis.

In normal circumstances, ANZ sets credit limits with respect to the various products that it agrees to provide each customer. In determining credit limits for a particular customer, ANZ will have regard to the nature of its exposure to that customer. That exposure will, in turn, vary depending upon the nature of the product offered to the customer.

In the case of standard lending facilities such as overdrafts, loans and financial guarantees ANZ agrees to provide actual (or contingent) funding to its customers and potentially has exposure to the full amount provided. As such, credit limits for these products are determined and recorded in internal reports on a 'fully funded' basis by reference to 100 per cent of the funds available.

Under other types of facilities such as swaps, derivatives and Standard Securities Lending, ANZ does not have exposure to the full face value of the relevant transaction. In the event of customer default, ANZ will normally manage its potential exposure under the transaction by entering into a compensating transaction with another counterparty. In accordance with accepted banking practices, ANZ records limits for such transactions at a percentage of the face value of the transactions reflecting their assessed 'potential exposure risk'.

In April 2006, and following the 2005 Securities Lending Review, a senior risk officer decided that credit limits for Equity Finance should, for internal reporting purposes, be classified on the basis of potential exposure risk, as was the case for Standard Securities Lending facilities. The exposure was calculated at 10 per cent of the face value of funds made available.

This had the effect of reducing the visibility of the Equity Finance business within ANZ (although the Review Committee considers that this was not the intended result of the decision to adopt the potential exposure risk approach). For example, if ANZ imposed a credit limit of $50 million in respect of a particular Broker, the ANZ Securities Lending unit could enter into transactions with that Broker to the value of $500 million of cash or securities. However, the limit of $50 million would be shown for the purposes of internal reporting of large exposures to senior management, Risk Committee and the Board.

The amount of cash and securities advanced by ANZ to Brokers peaked at approximately $2 billion in August 2007, although classification of credit limits on the basis of potential exposure risk meant that the recorded exposures would have been calculated at around $200 million.

6.2 LVR models

Summary points

In February 2006, a risk model was adopted that permitted the Equity Finance business to accept any listed security and which did not limit exposures to individual securities. This resulted in ANZ acquiring many large holdings of illiquid securities in companies with small market capitalisations.

Implementation of an improved risk model which addressed these issues was significantly delayed.

In late 2005, ANZ Market Risk began to design an LVR model for Equity Finance. The model that was developed permitted any listed security to be accepted regardless of its liquidity or the market capitalisation of the relevant company. In contrast, the securities that were approved at that time for the purposes of ANZ's Retail Margin Lending operations were restricted to a list of approximately 300 securities.

Further, the model did not impose limits on the percentage of issued shares of a particular company that could be accepted. This allowed the Equity Finance business to acquire high concentrations of securities in companies with a small market capitalization.

Finally, the model did not apply effectively where ANZ provided both Standard Securities Lending and Equity Finance products to a Broker on the one portfolio (ie where the Broker provided securities to ANZ and in return received a combination of cash under an Equity Finance facility and securities under a Standard Securities Lending facility). In these circumstances, the model calculated LVRs on each security and provided a value for the entire portfolio of securities provided by the Broker. The model did not match particular securities provided by the Broker against the cash provided to the Broker under the Equity Finance facility on the one hand or the securities provided to the Broker under the Standard Securities Lending facility on the other. This resulted in higher quality securities provided to the Brokers (under a Standard Securities Lending facility) effectively being supported by lower quality securities in the portfolio of securities provided by the Broker.

ANZ Market Risk developed a second LVR model from July 2006 which addressed the abovementioned faults. However, there were significant delays in implementing the second LVR model, with final implementation occurring in March 2008. This was too late to have an improving effect on the portfolio of securities provided by Opes and Primebroker.

6.3 Nature of Brokers' business

Summary points

ANZ's Equity Finance arrangement with a Broker gives rise to a potentially significant reputational risk in addition to financial risk. This arises because securities transferred by the Brokers to ANZ are primarily obtained as a result of Equity Finance transactions between the Brokers and their clients. Should the Broker become insolvent, ANZ in protecting its position by selling those securities, may be seen to have acted in its own interests and to the detriment of the Broker's clients.

While ANZ provided Equity Finance facilities to a small number of non-Broker companies, the majority of the Equity Finance business was conducted with Brokers.

The securities transferred by the Brokers to ANZ were primarily obtained by the Brokers as a result of Equity Finance transactions between the Brokers and their clients. That is, clients of a Broker would transfer securities to that Broker in exchange for cash collateral (or a right to draw down cash collateral when required). A Broker could then in turn, and in many cases did, transfer those securities to banks like ANZ in exchange for cash collateral.

Under an AMSLA, where an event of default occurs, the parties' obligations to return borrowed securities and collateral end. Instead, the AMSLA provides for a monetary value to be attributed to each party's former obligation to return borrowed securities or collateral, and for those obligations to be netted off against each other.

If a Broker becomes insolvent, there will be two netting off events: a netting off between ANZ and the Broker, and a netting off between the Broker and its clients.

If the netting off between the Broker and its clients results in payments being due to the clients from the Broker, the clients may not receive full payment as a result of the insolvency of the Broker.

As such, in entering into Equity Finance arrangements with Brokers, ANZ was incurring significant reputational risk. If a Broker becomes insolvent, ANZ is seen to be, and in fact is, holding the securities that the Broker's clients expected in normal circumstances would be returned to them. In realising these securities to protect its position, ANZ could be regarded by the clients of the Broker as acting in ANZ's interests and at the expense of the clients of the Broker.

Equity Finance arrangements expose ANZ to financial risk, reputational risk and the risk of potential litigation. These risks have been demonstrated in the case of Opes. While Opes' clients are understood to have signed agreements providing for the transfer of ownership of securities, many of those clients assert that they regarded their arrangements with Opes as a form of margin lending. Some claim that they did not understand that there was a full transfer of legal and beneficial title in securities to Opes, and that Opes was then free to deal with those securities without restriction, including by transferring them to ANZ.

7 Operation, governance and oversight of Equity Finance business – opinions

The Review Committee's conclusions regarding the operation, governance and oversight of the Equity Finance business are set out below.

7.1 There was a lack of understanding of the distinction between Equity Finance and Standard Securities Lending

The Review Committee considers that line and risk management did not appear to fully understand the nature of Equity Finance and the differences between Equity Finance and Standard Securities Lending. They did not undertake sufficient enquiries to understand fully the business and were often reliant on the views of the ANZ Securities Lending unit.

The lack of recognition of the distinction between Equity Finance and Standard Securities Lending initially resulted in the Equity Finance business being established without any product approval or oversight.

Subsequently, the lack of understanding led to errors and omissions in upward reporting of relevant issues. In some instances, incorrect information was provided.

In particular, CTC was not provided with all information required by it to properly consider the matters submitted to it in relation to the Equity Finance business.

The Review Committee does not consider that submissions to CTC regarding Equity Finance were deliberately inaccurate or misleading. Nonetheless, the errors and omissions in the submissions to CTC were unacceptable.

7.2 There were deficiencies in the Securities Lending Policy

ANZ's Securities Lending Policy was issued in June 2002. The policy was intended to apply only with respect to Standard Securities Lending and to exclude Equity Finance. Amendments to the Securities Lending Policy were published in May 2006 (with updates in October 2006 and March 2007). Amongst other things, those amendments expanded the Securities Lending Policy to cover Equity Finance.

The Review Committee considers that the amended Securities Lending Policy is not of an appropriate standard. It is not structured in a logical manner and does not apply relevant principles in a systematic way to the various Securities Lending products offered by ANZ.

The initial Securities Lending Policy was not updated for almost three years, during which period there had been significant growth in ANZ's Equity Finance business. This growth should have prompted a thorough review of the risks associated with the business and the adequacy of the policy. Instead, later policies simply built upon the earlier policies on a piecemeal basis.

7.3 There was lack of compliance with approvals and policies

In mid-2005, CTC approved various controls to be applied to the Equity Finance business.

A number of these controls took an unacceptably long time to be implemented, in particular controls requiring the funding to a Broker to be reduced or the types of securities to be accepted from a Broker to be limited. For example, where a new credit limit was less than the current exposure to the Broker, the ANZ Securities Lending unit did not stop accepting securities and continued to provide funding. These excesses were generally only brought under control when higher credit limits were approved for the Brokers.

Where a control imposed a new procedure (such as stress testing of the portfolios), implementation would often be delayed. Further, controls on the overall size of the business were often exceeded in the apparent belief by relevant line and risk management that retrospective approvals could be easily sought and obtained.

The Review Committee believes that, in general, ANZ Custodian Services sought to grow the Equity Finance business without sufficient reference to the controls approved for the business by ANZ's risk functions. This was exacerbated by the absence of processes to measure compliance with relevant controls and the fact that no disciplinary measures were imposed if a policy or approval was not followed.

7.4 Credit limits were calculated on a basis that reduced the visibility of the Equity Finance business

The credit limits (as described in section 6.1) that were eventually applied to Equity Finance facilities were calculated on the basis of a potential exposure risk of 10 per cent of funding made available by ANZ. One effect of calculating the limits on this basis was to reduce the visibility of the Equity Finance business within ANZ.

The basis on which the credit limits should be calculated can be a matter of judgement, and there are arguments which support the election of a potential exposure risk based limit in this case. However, the Review Committee considers that:

- given the complexity and potential significance of the issue, the decision to adopt the potential exposure risk model should have been brought to the attention of CTC, and by way of a hindsight review, to the Chief Risk Officer;
- the decision to adopt the potential exposure risk model should only have been made once confirmation had been received that credit limits were being observed and that the Equity Finance business was being restricted to a list of acceptable securities;
- there was insufficient rigour in relation to the decision to calculate the exposure at 10 per cent of ANZ's potential gross exposure.

7.5 There were deficiencies in the LVR models applied in the Equity Finance business

The Review Committee considers that the LVR model for Equity Finance developed in late 2005 had several key deficiencies. In particular, the model did not impose appropriate restrictions on the types of securities, or the percentage of issued shares of a particular company, that could be accepted by the Equity Finance business.

Although development of a second LVR model was commenced in July 2006 which addressed these issues, there were substantial delays in implementing the new model.

7.6 Limitations of CTC

Key decisions relating to Equity Finance were presented to and approved or ratified by CTC in the period from May 2005 to November 2006. CTC makes decisions based on information and recommendations submitted to it by key senior line and risk management personnel.

The Review Committee considers that CTC was not provided with all relevant information that would have allowed it to make informed decisions as to the appropriate controls that should have been implemented. Accordingly, the approvals provided by CTC were inadequate in that CTC was not expressly alerted to the fact that:

- the LVR model they were asked to approve did not adopt CTC's previous instructions regarding restrictions on acceptable securities and on concentration in individual securities;
- the credit limits for Equity Finance were to be calculated on a potential exposure risk basis, rather than a fully funded basis (as CTC had previously been advised would be the case).

Although CTC was not provided with complete and accurate information, the Review Committee considers, CTC did not apply an appropriate degree of rigour to its consideration of issues relating to the Equity Finance business and the content of the approvals being sought. Further, CTC did not discuss or make enquiries regarding any reputational risk to ANZ associated with the Equity Finance business as was required under their mandate.

The Review Committee considers that CTC should have applied greater rigour:

- in monitoring whether conditions attaching to prior approvals given by CTC had been satisfied;
- in enforcing deadlines for the provision of further submissions, where prior approvals were given on a provisional basis pending delivery of such further submissions.

With the increasing scale of ANZ's business and growing product complexity, particularly in areas of new and non-traditional Institutional banking such as Securities Lending, it is now apparent that CTC needs access to additional capability and resources to analyse critically the proposals put to it and inform its members of the nature of those proposals. This should be supported by further expanding its systems for recording action items and ensuring that there is follow up and review by CTC of action items.

7.7 Inappropriate role of SLORC

SLORC did not have a clearly defined role within ANZ's risk framework. Its charter stated that it derived its authority from CTC. Although CTC had been advised of the proposal to establish SLORC, no formal delegations had been made. SLORC was held out in written submissions to CTC to be the key control body for the Securities Lending business. It did not report back to CTC or to any other committee or person in ANZ. SLORC was chaired by the Head of ANZ Custodian Services.

The Review Committee considers that clearly established lines of responsibility, accountability and reporting are essential to the effective operation of any committee, and that SLORC lacked these characteristics.

In practice, SLORC discussed and considered a wide range of risk and other matters relating to the ANZ Securities Lending unit, but did not proactively manage issues raised with it.

The Review Committee considers that reliance by the line and risk management responsible for the ANZ Securities Lending unit upon SLORC constituted an abdication of individual responsibility by the persons with whom that responsibility should properly reside. That is, responsibility for credit risk should reside with ANZ's Credit Executives, responsibility for market risk should reside with ANZ's Market Risk area and responsibility for day to day management of the business should reside within ANZ's line management structure. While it may be appropriate to have a forum to co-ordinate these responsibilities, ultimate responsibility and decision making authority should remain with the various line and risk management positions.

Finally, the Review Committee considers that SLORC was not effective in fulfilling its self-appointed functions due to a range of factors, including:

- the fact that attendance was weighted in favour of representatives of ANZ Custodian Services;
- inappropriate delegation of attendance by senior market and operational risk representatives to more junior employees;
- poor record keeping and failure to action matters in a timely way.

7.8 Failure to identify warning signs

Various concerns were raised on an ad hoc basis by line and risk managers, generally with their peers and immediate superiors within the Institutional division and with credit risk and market risk managers. These concerns related to the processes, personnel and systems used in the Equity Finance and Standard Securities Lending businesses and the risks associated with these businesses.

The issues that were identified were not consistent with good banking practice and should have prompted further investigation and scrutiny.

The Review Committee considers that line and risk management treated each issue raised on a separate basis and did not consider the cumulative impact of the various issues.

Similar issues were also identified:

- in three reviews of the control environment conducted by ANZ internal audit between 2005 and 2007 for ANZ Custodian Services. The ANZ Securities Lending unit (which formed part of ANZ Custodian Services) was given an adverse or seriously adverse rating as part of each audit;
- by PricewaterhouseCoopers, who were engaged by ANZ in late 2007 to review opportunities to grow the Standard Securities Lending and Equity Finance businesses. That review identified that there were significant control issues in relation to the businesses.

Following the 2005 internal audit review, a remediation program was commenced to address the issues identified in that review. However, relevant remediation actions were not completed in a timely manner, or in a way which ensured that actions taken were embedded into processes so that weaknesses did not reappear (as illustrated by the adverse ratings given in subsequent internal audit reviews).

The Review Committee considers that management did not appear to place sufficient focus on the adverse Internal Audit ratings for the ANZ Securities Lending unit and did not take sufficient, timely and appropriate measures to remedy the underlying issues which were the cause of those adverse ratings although they reported to the Audit Committee that remedial actions were being undertaken.

7.9 Strategy and costs

The Standard Securities Lending and Equity Finance businesses were initially modest in scope but over time grew to become an important source of revenue and profit for ANZ Custodian Services. For this reason, further expansion of these businesses was encouraged or was proposed by the management of those businesses.

However, the Internal Audit reviews of ANZ Custodian Services and other internal ANZ strategy documents identified a need to invest in new technology and other systems to enable the ANZ Securities Lending unit to address existing issues and to accommodate further growth. Decisions to invest were delayed by management or were made with respect to only a portion of the expenditure required.

The Review Committee considers that a decision should have been made to either commit the expenditure required to address existing issues within the ANZ Securities Lending unit or, alternatively, to curtail its operations. It was inappropriate to maintain the business on a growth path without committing sufficient funds on a timely basis to address relevant issues, merely because the business was profitable.

7.10 Knowledge of the Board

7.10.1 Knowledge regarding existence of the Equity Finance business and relevant financial exposures

Between 1999 and February 2008 (ie when serious concerns with some of the Brokers became apparent), papers presented to the Board and the Risk and Audit Committees included only occasional references to the Securities Lending business. There were also a small number of references that included the words 'equity finance' or 'equity financing'. The references could not reasonably have been expected to identify the fact that ANZ conducted an Equity Finance business that was distinct from its Standard Securities Lending business. The Review Committee is not aware of any evidence that this fact was brought to the attention of the Board, relevant Board committees or the Chief Executive Officer in any other manner.

The Review Committee considers that the Board, relevant Board committees and the Chief Executive Officer were not provided with a clear understanding of ANZ's potential exposures in respect of the Equity Finance business. This was primarily due to the fact that the Equity Finance business initially did not apply credit limits to its customers, and when credit limits were eventually applied they were calculated on a potential exposure risk basis (ie at 10 per cent of the value of relevant transactions). Nor were there adequate reporting lines in place to ensure that potential gross exposures of significant amounts were identified. With two exceptions, the exposures were not identified in reports provided to the Risk Committee.

The exceptions relate to the October 2005 and April 2006 reports to the Risk Committee relating to customers with credit limits greater than those permitted for their internal customer risk grades. These reports noted that one of the Brokers had a credit limit of several hundred million dollars (at this time the limit was shown at 100 per cent of ANZ's potential gross exposure, as the decision had not yet been taken to classify these limits on a potential exposure risk basis). The Broker was included in a list of 28 customers in the October 2005 report and in a list of 20 customers in the April 2006 report. These excesses were described as resulting from custody 'stock borrowing' activities.

These reports were presented in tabular manner which did not draw specific attention to the Broker, and they did not identify the correct nature of the facility to which the exposure related.

7.10.2 Internal Audit Reports

In 2005, an internal audit of internal controls of the ANZ Custodian Services division gave an adverse rating for ANZ Custodian Services generally and a seriously adverse rating for the ANZ Securities Lending unit in particular. The Audit Committee was made aware of the overall rating for ANZ Custodian Services and was provided with a summary of issues. Subsequent updates to the Audit Committee emphasised that remediation of issues identified was progressing. The Board was made aware of these audit findings, but not provided with any detail. For example the Internal Audit segment report to the Board in October 2005 had one line which noted a new adverse rating for 'Custody, including Securities Lending'.

In the follow-up 2006 internal audit, ANZ Custodian Services was given a satisfactory rating based on the perceived progress made in implementing the remediation program.

In the 2007 internal audit (produced in October 2007) ANZ Custodian Services was given a seriously adverse rating due to concerns that the remediation program was not being implemented as effectively as had been understood during the 2006 Internal Audit. Within this 2007 internal audit, the 'front office' of the ANZ Securities Lending unit was given a satisfactory rating and the 'back office' was given a seriously adverse rating. In October 2007, the Audit Committee meeting was provided with a paper specifically addressing this audit and was advised that management responsible for ANZ Custodian Services had implemented a remediation program (including the use of external consultants) with respect to the issues raised in the 2007 internal audit. The Audit Committee discussed this paper at some length. The Risk Committee was also advised of the seriously adverse rating of the 2007 internal audit.

The Review Committee considers that the Audit Committee and the Risk Committee were only aware of long-term unresolved issues in ANZ Custodian Services and ANZ Securities Lending unit following the seriously adverse internal audit result in October 2007. Even as late as September 2007, Institutional executives provided comfort in a written report to the Risk Committee about the control environment in certain parts of the Institutional division, including ANZ Custodian Services.

Rectification of the issues identified in the October 2007 internal audit report was superseded in early 2008 by problems crystallising within the Equity Finance business. However, the Review Committee considers that a more structured notification and action system for adverse internal audits should be established in the future.

7.10.3 General matters

The 2005 Securities Lending Review found that the Equity Finance business had not previously been recognised or understood outside ANZ Custodian Services and that, at the time of the review, had an exposure of $771 million and an inadequate control framework. These findings should have been specifically brought to the attention of the Chief Executive Officer and the Board. The Board was made aware of the review, but not any details of the key findings.

However, the Review Committee is not aware of any evidence which suggests that there was a deliberate attempt to suppress adverse information. In other cases, such information was circulated as part of general reporting to appropriate levels within ANZ. Nevertheless, the Review Committee considers that the failure to escalate the issues relating to Equity Finance was, of itself, a significant oversight and requires additional focus to be given to upward reporting practices within ANZ.

7.11 Role of external auditors

ANZ's external auditors, KPMG[1], did not conduct detailed audits of the ANZ Custodian Services business (including the ANZ Securities Lending unit) in the course of their annual audit as these businesses did not fall within the materiality criteria applicable to those external audits.

From 2002, KPMG were specifically engaged by ANZ to prepare a semi-annual statement known as a 1026 statement to review certain ANZ management assurances to the auditors of external funds whose assets are managed by ANZ Custodian Services. Within the limited scope of a 1026 statement, KPMG were only required to consider the extent to which these assertions affected the external funds (not how they affected ANZ). As part of the 1026 statement process KPMG separately advised management of any issues that came to their attention. These included some ANZ Securities Lending unit systems issues which were the same as, or similar to, issues raised in the internal audits.

The Review Committee did not find any evidence that KPMG performed their duties inconsistently with what was reasonably expected.

1 Mr Crawford was a former partner of KPMG and, for this reason, was not involved in deliberations of the Review Committee regarding the role of KPMG.

8 Investigation of breaches of ANZ employee conduct policies

Summary points

No evidence of fraud or other unlawful conduct by ANZ employees was identified.

Five ANZ employees had access to trading accounts with Opes.

The accounts of two ANZ employees had been permitted to remain out of order and, accordingly, the subject of a margin call, for a significant period. These employees breached the ANZ Code of Conduct.

Share trading by two other ANZ employees immediately prior to Opes being placed into receivership did not breach relevant ANZ policies and did not appear to have been conducted for illegitimate or unlawful purposes.

8.1 About the code of conduct investigation

The investigation into Code of Conduct breaches was headed by the ANZ Group Head of Workplace Relations and ANZ Deputy General Counsel for Employment Law together with the ANZ Head of Group Investigations.

8.2 Was there any fraud by ANZ employees?

The investigation did not find any fraud or criminal behaviour on the part of any ANZ employees.

8.3 ANZ employee accounts with Opes

The investigation found that four ANZ employees involved with the Equity Finance business held trading accounts with Opes (as defined in section 1.2). Additionally, one employee's spouse held an account with Opes on which the employee was authorised to trade. The investigation did not identify any other ANZ employees as holding accounts with Opes.

Of these five employees, only one had disclosed the existence of their account to their line manager. Although ANZ's Code of Conduct at that time did not require disclosure by the employees regarding their Opes accounts, the Review Committee considers that it would have been prudent for each of the employees to have disclosed their accounts in the circumstances.

Of the five employee accounts, two were not properly maintained. One employee's account had been out of order and, accordingly, subject to a margin call, since October 2005 with $293,000 owing as at 28 March 2008. The employee had been allowed to trade and increase the account even though it was subject to a margin call. The investigation found no evidence that there had been any follow up action by Opes in respect of the margin call and no attempt was made by that employee to pay the margin call. This employee conducted daily Securities Lending trades with Opes.

The other account had been subject to a margin call since October 2007 with $13,000 owing as at 28 March 2008. The employee had been called on by Opes to bring that account to order in October 2007, but had not done so. No further margin calls were made by Opes, nor did the employee make any attempt to bring the account into order.

The investigation concluded that the two employees with accounts with Opes which remained out of order and subject to margin calls breached the conflict of interest requirements of the ANZ Code of Conduct. They received a benefit from a customer with whom they had an ongoing business relationship, and were in a position to treat that customer favourably (whether or not they did so).

The investigation concluded that these two employees further breached the ANZ Code of Conduct by 'failing to at all times act in the interests of ANZ'. These employees did not bring to ANZ's attention the fact that Opes was not making or enforcing margin calls on clients whose accounts were in margin and allowing clients whose accounts were in margin to continue trading.

As a result of the investigation, these two employees will end their employment with ANZ.

8.4 Trading by employees

Two other employees gave instructions to trade on their Opes accounts on 27 March 2008, the day before Opes was placed into receivership. These instructions were examined and no evidence was found that they were pursued for illegitimate reasons or that the relevant employees were in possession of any relevant confidential or inside information.

The investigation found that:

- The first employee gave instructions to sell ANZ securities immediately prior to the normal half-yearly 'blackout' period during which ANZ employees are prevented from trading in ANZ securities. The instructions provided that unless the transaction could be completed on that day at the specified price it should not be completed until after the expiry of the blackout period. The transaction was not completed.
- The trade by the second employee involved the sale of a small proportion of the total number of a particular security held in the account. The investigation concluded that the fact that the employee gave instructions to sell only a small proportion of their holdings of the relevant security suggests that the employee was not acting on any inside information.

9 Accountability and Remediation

9.1 Themes

The Review has highlighted a need for ANZ to sharpen its focus on business practices and risk management procedures in areas of non-traditional banking within its Institutional division. The remediation actions are directed at reinforcing the following values:

- Encouraging individual accountability;
- Improving risk culture;
- Enhancing the importance of ethics in decisions and actions;
- Acting consistently with strategy.

The remediation actions described below include actions which ANZ has already taken as a result of issues arising out of Securities Lending and additional recommendations proposed following the Review.

9.2 Accountability

This report has identified significant issues within ANZ both in respect of the Equity Finance business and other aspects of ANZ's operations (such as those of CTC). The Review Committee considered the question of accountability. As noted above, none of the Board or Board committees were properly informed of the relevant issues notwithstanding the existence of processes which, if followed, should have led to escalation of the issues to them.

The Review Committee considers that the issues identified in this report were, in essence, a failing of management, both 'line management' and 'risk management'.

The issues concerning the operation of CTC over the years covered in this report ultimately rest with senior management who either participated in CTC or who would have been necessarily concerned with its deliberations (as noted below and in the Executive Summary, the Review Committee believes that CTC should be strengthened with appropriate resourcing to ensure proper follow up and escalation).

The report's findings have led to a series of sanctions in respect of ANZ employees. These sanctions reflect the levels of culpability and seniority of each of the persons affected. The sanctions include formal notes placed on staff employment records, adverse bonus impacts and the departure from the Bank of several managers and executives. Where appropriate, these are the subject of a separate public announcement by ANZ.

9.3 Remediation actions

The remediation actions to be taken by ANZ are set out below.

9.3.1 Exit Equity Finance

The Chief Executive Officer has already directed that ANZ withdraw from all Equity Finance business in an orderly manner and rationalise all Standard Securities Lending business to a few key multinational institutional relationships.

9.3.2 Disciplinary Actions

As a result of the Review a number of disciplinary actions will be implemented. The employees involved range throughout many levels of ANZ. Some former employees would also have been subject to these actions if they were still at ANZ.

9.3.3 Code of Conduct and Ethics Policies

ANZ is refreshing all of its employee code of conduct, ethics and conflict of interest policies. This includes development of a new computer based training module covering key areas such as Privacy and Conflict of Interest and implementing an annual attestation for each employee that they understand the key policies and have complied with them. ANZ will also place a prominent link to the above policies on the front page of ANZ's staff intranet and ensure the issue is reinforced through line management communications.

9.3.4 Reputation Risk Framework

ANZ Group Compliance is implementing a new reputation risk framework to clarify what reputation risk is at ANZ, confirm ANZ's reputation risk policy and set clear accountability across ANZ for management of reputation risk.

9.3.5 Performance Management Framework

ANZ Human Resources is creating a new Performance Management framework which will reinforce individual accountability through better role clarification and will take into account any compliance or control breaches in determining final ranking and subsequent bonus allocation.

9.3.6 Training for ANZ Senior Executives

All ANZ senior executives will attend a training session covering areas such as escalation of problems, the new Code of Conduct and case studies that emphasise ANZ's values and people management policies.

9.3.7 Change the fundamentals of committees

The structure and reporting lines of management committees (including CTC) will be reviewed. This will ensure all committees have clear authority, guidelines, mandates to perform specific functions and accountabilities for performance and failures to perform. This review will also include the form of submissions and the process for recording follow up actions and decisions.

9.3.8 Internal Audits and significant operational control issues

ANZ will introduce more rigorous management of businesses with adverse Internal Audit ratings and operational control issues identified as 'high' including:

- additional responsibility for ANZ Management Board to oversee remediation and ensure that there are procedures in place to implement follow-up and provide incentives for good governance;
- the manager of a unit subject to a seriously adverse rating or repeated significant operational control issues will present to the ANZ Management Board meeting and Audit Committee meeting on proposed actions;
- the Group General Manager for Internal Audit, and an External Audit firm representative will attend every Audit Committee and Risk Committee meeting;
- continual reporting of audit issues to the ANZ Management Board, Audit Committee and Risk Committee and highlighting adverse audits and their remediation and poor remediation of other audits.

9.3.9 Product Management

There will be a full review of the product approval process in ANZ.

9.3.10 Review classification of facilities

ANZ will develop an annually reviewed central register of the credit limit classification of all Institutional division products. The methodology for the percentage applied to potential exposure risk facilities should be included on the register. Any changes to classifications are to be hindsight reviewed by the Chief Risk Officer or his delegate.

9.3.11 Customer exposure reporting

ANZ will improve exposure reporting for its senior risk and line management that monitors both size and movements in customer activity.

9.3.12 Exposures without limits

Business unit Managing Directors (and their relevant IT support areas) will review their businesses to confirm there are no other areas with processes and systems which might permit potential drawdowns without proper arrangements in place. Any weaknesses are to be reported back to Chief Risk Officer with details of mitigating controls in place.

9.3.13 Wholesale Credit Risk Policy

There will be a full review of the development and dissemination of the ANZ Wholesale Credit Risk Policy.

9.4 Next steps

ANZ will fully co-operate with its regulators in relation to a detailed program to implement the remediation actions mentioned above including the responsible persons and timeframes. We will also keep our regulators regularly informed of progress of such actions.