NAB In Trouble Again

Summary:
APRA investigation forces NAB CEO Frank Cicutto and Chairman Charles Allen to quit. APRA doesn't trust the board and management of NAB in light of the foreign exchange scandal.

Article Information**Category:** Banking News
Banking Company: NAB
Bank Malpractice Type: Incompetent Business Practices
Other Bad Banking Behaviour
Author: Reporter: Tim Lester
Source: Australian Broadcasting Corporation - 7:30 Report
Date First Published: 24 Mar 2004

Posted ByPeter Brandson
28 Mar 2014 - 11:53am





TV Interview: "Regulator's Report Pans NAB"

KERRY O'BRIEN: Although the National Australia Bank has purged itself of a chairman, chief executive and a raft of senior staff, the bank is still under a cloud thanks to another tough report related to its recent foreign currency trading scandal - this time from Government regulator, APRA.

The 88-page report makes ugly reading for anyone with a stake in the NAB. It outlines a litany of

criticisms that beg further action.

Perhaps most disturbing is the details of APRA's warning to the bank about its lax governance, a year before the currency scandal was discovered.

Business and economics editor Tim Lester reports.

TIM LESTER: For National Australia Bank another bout in its recurring occurring nightmare.

PAUL DOWLING, BANKING ANALYST: It's a large hit for them. It has big credibility impacts for them.

TIM LESTER: Australia's banking regular has given NAB a thorough dressing down.

IAN ROGERS, EDITOR, 'THE SHEET': APRA's treating one of the world's 30 largest banks like a country credit union.

TIM LESTER: It's also making demands of the bank which will inevitably be felt at its bottom line. 12 days ago National Australia Bank's any CEO John Stewart gave a very public run down of the foreign exchange trading scandal that had struck the bank two months earlier.

Using the investigation the bank had ordered he showed how four rogue traders had cheated the bank's systems, apparently to protect their six figure bonuses and ultimately to try and bet their way out of deep trouble.

JOHN STEWART, CHIEF EXECUTIVE, NATIONAL AUSTRALIA BANK: They've all been dismissed. We're looking in other areas of the bank, some people need discipline, some people have been moved, we're putting fresh faces into a number of places. I don't intend to go around the whole list.

TIM LESTER: In fact John Stewart is a fresh face. The crisis forced predecessor Frank Cicutto to quit as well as Chairman Charles Allen.

Now, we have some insight into what may have prodded the two most senior figures at Australia's largest bank to jump.

Perhaps they knew the Australian Prudential Regulatory Authority, APRA, would deliver a scathing report on the crisis that blossomed under their stewardship.

IAN ROGERS: It's a kind of symbolic kick in the teeth for the management and the board.

TIM LESTER: Ian Rogers produces the daily banking industry newsletter 'The Sheet'. Since APRA released its assessment late this morning he and other industry analysts like Smith Barney's Craig Williams have been scouring the 87 pages.

CRAIG WILLIAMS, BANKING ANALYST: When the regulator is undertaking this sort of a report, that it needs to firm and the wording around the report has been strong.

TIM LESTER: APRA's report is deeply critical of NAB’s intern control systems which failed at every level and it's governance model which simply did not function.

Had they been better, they surely would have caught at least one of the many missed opportunities to detect and close down the irregular currency options trades before they ballooned into a $360 million nightmare for the bank.

JOHN STEWART: Quite frankly the risk control framework just broke down.

TIM LESTER: And so the bank now tastes APRA's medicine. The regulator has lifted NAB’s capital adequacy ratio to 10 per cent.

IAN ROGERS: It's increased the amount of capital that it needs to hold to the level of capital that a

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new start up bank or a small foreign bank or a credit union who's directors might be banana growers or teachers are expected to hold.

> Basically APRA's saying they don't really trust the board and management of National Australia Bank.

CRAIG WILLIAMS: It also has required the bank to cease some of its trading activities both in the customer facing capacity but also on a proprietary basis.

The company will also have to make some changes in terms of its use of internal models for calculation of market risk capital.

TIM LESTER: APRA is forcing the bank to a more conservative position.

Maybe management was taking it there anyway but analysts say the regulator's demands in its chase for profits, and take away some of its gloss against its competitors.

IAN ROGERS: The bank's going to make less out of its wholesale banking operations than it used to. It made a bit over $1 billion in the last financial year -- ignoring the $360 million that's been lost, there's now the lost opportunity from being able to make profits from propriety trading on the currency options desk and it sounds like they've now cracked down on limits on all of the Treasury and trading operations, so you would have to imagine that there's $100 million or $200 million of profit that is no longer available.

TIM LESTER: The APRA report tackles the bank's culture, saying two theme emerge. First, the profit motives skewed relations between risk management and business decisions - presumably in favour of the business decisions.

Apparently, in the 60 or so interviews APRA attended with bank staff or others it repeatedly heard the phrase "Profit is king."

The second culture problem - information is managed to discourage the escalation of issues of concern to the board or to relevant external parties.

In NAB, if it's something to smile about it quickly floats to the surface.

If it isn't, it sits like a brick.

JOHN STEWART: In the organisation good news comes up like a lighting rod. Bad news unfortunately gets suppressed.

TIM LESTER: And APRA also reveals how far it went in warning NAB of potential problems one year before the rogue trading came to light.

In mid-January last year the regulator wrote to then chairman Charles Allen and management telling them their bank was lax in its approach to limit management and had a culture of poor adherence to risk management.

APRA told the bank to address these and other complaints quickly, owing to the potential for the issues to give rise to significant problems in the future.

The regulator's report also says it is unknown why chairman Charles Allen did not table a copy of its warning.

PAUL DOWLING: It's really time, I think, Tim, for the bank to get out of this startled rabbit in the headlights mode that they're currently in.

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Very recently we've picked up in our research and analytical programs a roughly 17 per cent decline or attrition in the frequency with which the top 500 market nominate National Australia as their primary or preferred product provider in Treasury and financial markets.

TIM LESTER: Sydney-based analyst with the banking research firm East and Partners Paul Dowling says NAB has to move quickly to plug this leak of corporate and institutional customers.

PAUL DOWLING: Disturbing today. If it continues tomorrow, alarming.

TIM LESTER: We approached the bank for an interview today. It declined. So too, did APRA

Source URL (modified on 13 Jun 2014 - 9:19pm):
https://www.bankreformnow.com.au/node/101

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