



**ASIC**

Australian Securities & Investments Commission

**REPORT 517**

# **Response to submissions on CP 263 Risk management systems of responsible entities: Further proposals**

March 2017

## **About this report**

This report highlights the key issues that arose out of the submissions received on Consultation Paper 263 *Risk management systems of responsible entities: Further proposals* (CP 263) and details our responses to those issues.

### About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

**Consultation papers:** seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

**Regulatory guides:** give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

**Information sheets:** provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

**Reports:** describe ASIC compliance or relief activity or the results of a research project.

### Disclaimer

This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

This report does not contain ASIC policy. Please see [Regulatory Guide 259](#) *Risk management systems of responsible entities* (RG 259).

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## A Overview/Consultation process

- 1 In [Consultation Paper 263](#) *Risk management systems of responsible entities: Further proposals* (CP 263), we consulted on proposals to provide guidance to responsible entities on our expectations for compliance with their obligation to maintain adequate risk management systems under s912A(1)(h) of the *Corporations Act 2001* (Corporations Act).
- 2 CP 263 built on the proposals in [Consultation Paper 204](#) *Risk management systems of responsible entities* (CP 204), released in March 2013. As we were awaiting the outcome of the 2014 Financial System Inquiry, we did not implement any of the proposals outlined in CP 204.
- 3 In CP 263, we sought feedback on our expectations for responsible entities to have:
  - (a) overarching risk management systems in place;
  - (b) processes for identifying and assessing risks; and
  - (c) processes for managing risks.
- 4 We also sought feedback on our proposed good practice guidance for responsible entities.
- 5 This report highlights the key issues that arose out of the submissions received on CP 263 and our responses to those issues.
- 6 This report is not meant to be a comprehensive summary of all responses received. It is also not meant to be a detailed report on every question from CP 263. We have limited this report to the key issues.
- 7 We received five non-confidential responses to CP 263, which included three from industry bodies. We are grateful to respondents for taking the time to send us their comments.
- 8 For a list of the non-confidential respondents to CP 263, see the appendix. Copies of these submissions are currently on the ASIC website at [www.asic.gov.au/cp](http://www.asic.gov.au/cp) under CP 263.

### Responses to consultation

- 9 Each of the submissions supported the release of additional guidance for responsible entities on risk management systems and reflected that the guidance would be helpful.
- 10 The key feedback related to the proposed interim approach to compliance with the guidance, some aspects of our proposed guidance and some aspects of our proposed good practice guidance.

## B Proposed guidance on risk management systems

### Key points

This section outlines the submissions on our proposed guidance for responsible entities.

Issues raised in response to CP 263 related to:

- our interim approach to compliance;
- taking into account relevant industry, local and international standards;
- maintaining a risk register for material risks of the scheme;
- including additional guidance for particular business models; and
- stress testing at the responsible entity level.

### Interim approach to compliance

- 11 In CP 263 we outlined our intention to take a facilitative approach to any breaches of the guidance for a period of 12 months from the date of release, if the relevant responsible entity can show that it is taking steps to bring its risk management systems into compliance with the guidance.
- 12 Based on the submissions there are differing views on what transitional arrangement is appropriate for responsible entities to comply with the guidance. We received one submission that a six-month formal transition period would be appropriate, while another submission outlined that an 18-month interim approach would assist smaller responsible entities.

#### *ASIC's response*

Responsible entities are currently required to comply with the requirement, under s912A(1)(h), to maintain adequate risk management systems. We consider that the requirements outlined in the guidance are not new but are our view of the current requirement regarding risk management. Accordingly, we maintain the view that a formal transition period is not appropriate.

We consider that the 12-month facilitative approach to compliance provides a suitable timeframe for responsible entities to implement arrangements that comply with the guidance: see [Regulatory Guide 259](#) *Risk management systems of responsible entities* (RG 259) at RG 259.23.

## Relevant industry, local and international standards

- 13 CP 263 sought feedback on our proposed guidance that in developing, implementing and reviewing its risk management systems, a responsible entity should take into account relevant industry, local and international standards.
- 14 We received one submission that it is not the responsibility of a responsible entity to be aware of and comply with all of the international standards that may be relevant to their industry but are not part of Australian law and not enforced locally.

### *ASIC's response*

In light of feedback received, we have clarified in the guidance that we expect at a minimum that responsible entities will consider whether the guidance that exists for the material risks identified for the business and schemes operated would be useful to adopt: see RG 259.59–RG 259.61.

We have, however, maintained the position (at RG 259.61) that liquidity is a material risk for schemes. We consider that, in developing their liquidity risk management process, responsible entities should take into account:

- the International Organization of Securities Commissions' (IOSCO) Principles of Liquidity Risk Management for Collective Investment Schemes; and
- the Financial Stability Board's (FSB) Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities.

We consider that this relevant international guidance outlines tools to help responsible entities manage liquidity risk.

## Maintaining a risk register

- 15 In CP 263 we sought feedback on our proposed guidance for responsible entities to maintain one or more risk registers, for recording material risks to the business and schemes, as part of their identification process.
- 16 We received one submission that it is onerous to assess and maintain a risk register for the risks of each scheme. In the submission it was outlined that current risk systems address risks generally at an entity level rather than at a scheme level.

### *ASIC's response*

We acknowledge that there may be common risks that apply across schemes operated and we have provided flexibility for the risks to be documented in one or more risk registers. However,

we remain of the view that it is important that the risk management systems implemented address the material risks of the responsible entity and each scheme operated to ensure that these risks are adequately identified, assessed and managed.

In light of the feedback received, we have now clarified in the guidance that responsible entities are not required to keep separate risk registers at the responsible entity and scheme level or for each scheme they operate, as long as the material risks for the business and each scheme operated are identified and addressed in the registers maintained: see RG 259.78.

## Additional guidance for particular business models

- 17 The proposed guidance outlined in CP 263 applies to all responsible entities and business models operated.
- 18 We received one submission that considered that some of the guidance does not appear to take into account that a responsible entity may outsource its services on a ‘trustee for hire’ basis. In such cases it is more common for such a responsible entity to exercise oversight through due diligence and service level agreement reporting from the external manager.

### *ASIC’s response*

As the guidance applies to all responsible entities, we have not made any amendments to include specific guidance on a particular business model. Given the number of responsible entities and divergent business models operated, we do not consider that this is practical or will be effective to provide adequate guidance to industry as a whole.

In relation to outsourcing of arrangements, our guidance outlines that where external third-party service providers are used, we expect responsible entities to have sufficient skills to independently identify material risks and to monitor and assess the service provider’s performance and ongoing suitability: see RG 259.31–RG 259.32. We also note that under s601FB responsible entities retain ultimate responsibility for the operation of the scheme.

## Stress testing at the responsible entity level

- 19 In CP 263 we sought feedback on our proposed guidance for responsible entities to conduct stress testing and/or scenario analysis of the liquidity risks for the responsible entity’s business and the schemes they operate.
- 20 We received two submissions that stress testing at the business level appears unnecessary and may not generally be undertaken by industry currently.

*ASIC's response*

In light of feedback received, we have removed the expectation for stress testing to be undertaken at the business level from the mandatory guidance. We expect that responsible entities will comply with their financial resource requirements under s912A(1)(d). We also expect responsible entities to comply with our guidance that their risk management systems include a liquidity risk management process: see RG 259.56–RG 259.58 and Table 3 of RG 259.

We have retained our good practice guidance on stress testing and/or scenario analysis of all material risks: see RG 259.110. This guidance is not mandatory.



## C Good practice guidance

### Key points

This section outlines the submissions on our proposed good practice guidance and our response to those submissions.

Issues raised in response to CP 263 related to:

- the purpose of the good practice guidance;
- disclosing risk management policies;
- compliance plan procedures;
- supplementary reviews of risk management systems;
- appointing a dedicated chief risk officer;
- stress testing and/or scenario analysis of all material risks; and
- maintaining a written risk treatment plan.

### Purpose of good practice guidance

- 21 Based on the submissions received there appeared to be some confusion about the purpose of the proposed good practice guidance and concerns about the impact and costs involved with compliance with the guidance.

#### *ASIC's response*

As stated in CP 263, the good practice guidance is not mandatory for responsible entities. It merely outlines measures that responsible entities can adopt to enhance their risk management systems and operate at a level above their statutory obligations. We consider that responsible entities are best placed to identify whether the good practice measures are appropriate for their business.

### Disclosing risk management policies

- 22 In CP 263 we outlined our proposed good practice guidance that, in addition to its obligation under Pt 7.9 of the Corporations Act to disclose information about significant risks and risk management arrangements in the Product Disclosure Statement (PDS), a responsible entity may provide additional transparency to investors about its arrangements by publicly disclosing appropriate details of its risk management systems. This guidance is not mandatory for responsible entities.

- 23 We received two submissions that the requirement to publicly release details of the risk management policies did not appear to add value or assist investors and there were issues of commercial sensitivity. However, another suggested that this requirement should be mandatory, rather than mere good practice guidance, to assist investors.
- 24 One submission noted that the guidance incorrectly stated that responsible entities have an ‘obligation to disclose information about significant risks and *risk management arrangements* in the Product Disclosure Statements (PDS) under Pt 7.9 of the Corporations Act ...’ (emphasis added). There is no current obligation under Pt 7.9 to release details of risk management arrangements.

#### *ASIC’s response*

In light of feedback received, we have clarified our good practice guidance to state that a summary of the key aspects of the risk management systems be disclosed publicly: see RG 259.72. We consider this summary information will help ensure investors are informed of the risk management arrangements in place.

At this stage we have not imposed this as a mandatory requirement, in light of the concerns raised in feedback from industry.

We have also omitted the reference in the guidance that Pt 7.9 of the Corporations Act requires disclosure of the risk management arrangements.

## Compliance plan procedures

- 25 CP 263 sought feedback on our proposed good practice guidance for the compliance plan of a scheme to detail procedures for ensuring that the risks identified for the responsible entity are relevant and managed. This guidance is not mandatory for responsible entities.
- 26 We received two submissions that considered that including this content in the compliance plan would be burdensome. Feedback included that the guidance may require amendments to existing compliance plans and go beyond and confuse the content of compliance plans that is prescribed by law and supplemented by [Regulatory Guide 132](#) *Managed investments: Compliance plans* (RG 132).

#### *ASIC’s response*

We have now clarified in the guidance that our recommendation is that a compliance plan include procedures for ensuring that the material risks identified for the scheme are relevant and managed: see RG 259.112. This recommendation supplements

the existing legislative obligation for compliance plans and these procedures may be included as an appendix to the compliance plan. For existing schemes, this may be considered as part of any broader review or update of the compliance plan by the responsible entity to minimise the cost and impact of making the amendment.

As a responsible entity is required under s601HA to maintain a compliance plan for each scheme operated, we remain of the view it is good practice to include procedures regarding risk management in the compliance plan.

## Reviewing risk management systems

- 27 CP 263 sought feedback on our proposed good practice guidance for responsible entities to undertake the following supplementary independent reviews of their risk management systems:
- (a) a review to determine whether the risk management systems have been complied with and are operating effectively (at least annually); and
  - (b) a comprehensive review of the appropriateness, effectiveness and adequacy of the risk management systems (at least every three years).

This guidance is not mandatory for responsible entities.

- 28 One submission outlined that the annual independent review may be costly for smaller responsible entities and that an independent review ‘as appropriate’ is preferable and ideally should be part of the comprehensive review at least every three years.
- 29 Another submission considered that it should be mandatory, rather than good practice, for a responsible entity to carry out a comprehensive review of the risk management systems at least every three years.

### *ASIC’s response*

We remain of the view that a supplementary review is good practice for responsible entities to undertake. We note that the additional comprehensive review is similar to the Australian Prudential Regulation Authority’s (APRA’s) requirements and guidance on risk management. We acknowledge that for some responsible entities undertaking supplementary reviews will not be appropriate, given the cost and impact on the responsible entity.

We have omitted the good practice guidance that responsible entities should carry out an additional review (at least annually), in light of the current expectation for an at-least annual review of risk management systems: see RG 259.37. We remain of the view that it is appropriate for risk management systems to be reviewed

at least annually—or more frequently, depending on the nature, scale and complexity of the business and schemes operated.

We have not imposed the comprehensive review as a mandatory requirement, given the potential compliance costs that may be incurred (particularly for smaller responsible entities) and the current expectation for review of risk management arrangements (at least annually) outlined in the guidance.

## Appointing a chief risk officer

- 30 CP 263 sought feedback on our proposed good practice guidance for responsible entities to appoint a dedicated chief risk officer. This guidance is not mandatory for responsible entities.
- 31 One submission outlined that it was unclear whether the dedicated chief risk officer could also have other roles, as it is too expensive and unnecessary for a smaller responsible entity to have a dedicated chief risk officer with no other roles or responsibilities.

### *ASIC's response*

We consider that it is important for the dedicated chief risk officer to not undertake other roles or responsibilities. The segregation of the role is intended to help manage any conflicts. Accordingly, we have not made any amendment to the guidance. Our guidance does, however, outline that it will depend on the nature, scale and complexity of the business of the responsible entity as to whether the appointment of a dedicated chief risk officer is appropriate: see RG 259.71.

We acknowledge that the appointment of a dedicated chief risk officer may not be appropriate for some responsible entities, given the costs involved.

## Stress testing and/or scenario analysis of all material risks

- 32 CP 263 sought feedback on our proposed good practice guidance for responsible entities to undertake stress testing and/or scenario analysis of all material risks to the responsible entity's business and the schemes it operates. A key risk area for stress testing and analysis is market and investment risk. This guidance is not mandatory for responsible entities.
- 33 One submission outlined that stress testing and scenario analysis programs that go beyond traditionally tested risks—such as liquidity, market and investments risks—will require a significant increase in the sophistication of such programs across the industry. It was suggested that an appropriate transition period be considered.

*ASIC's response*

We remain of the view that stress testing and/or scenario analysis can help responsible entities identify how they will be affected and respond in different scenarios before they arise. Accordingly, we have not made any amendment to the guidance.

While stress testing and/or scenario analysis for liquidity risk is mandatory, testing and analysis of other risks is not mandatory and therefore we do not consider any transitional period is necessary for this aspect of the guidance.

As a matter of good practice we consider a key risk area for additional testing and analysis is market and investment risk. It appears from the submission that this is undertaken within industry.

We acknowledge that the undertaking of additional stress testing or scenario analysis may not be appropriate for some responsible entities, given the costs involved.

## Risk treatment plan

- 34 CP 263 sought feedback on our proposed good practice guidance for responsible entities to have a documented risk treatment plan setting out how each material risk will be treated.
- 35 One submission outlined that it was unclear what a written risk treatment plan is and requested further detail in the guidance.

*ASIC's response*

We consider that responsible entities should document how material risks will be treated and we have clarified this in the guidance. The use of a risk treatment plan (i.e. a plan that includes specified content about how a risk is treated) is a way for responsible entities to document how material risks are treated.

The use of risk treatment plans is also reflected in [International Standard ISO 31000:2009 Risk management: Principles and guidelines](#).

In light of feedback received, we have included additional guidance on the role and recommended content of the plan: see RG 259.111.

## Appendix: List of non-confidential respondents

- 
- Financial Services Council
  - Alternative Investment Management Association
  - Association of Financial Advisers Ltd
  - Maple-Brown Abbott Limited
  - Challenger Limited
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