

1 September 2016

Ms. Leanne Damary

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Level 5, 100 Market Street

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By email only-

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Dear Ms. Damary

**CONSULTATION PAPER 263: Risk management systems of responsible entities:  
Further proposals (CP 263) and draft Regulatory Guide (Draft RG)**

The Financial Services Council (**FSC**) has over 115 members representing Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks, licensed trustee companies and public trustees. The industry is responsible for investing more than \$2.6 trillion on behalf of 11.5 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the third largest pool of managed funds in the world. The FSC promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

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We refer to CP 263 and the draft RG. Thank you for the opportunity to make a submission. We have set out our comments in relation to the material below.

**General Observations**

1. Members who have contacted us concerning this matter, generally do not have any major concerns with the policy intent of the material but some reservations have been expressed in relation to how particular matters are addressed;
2. The FSC and its members accept the need for and support the proposition that Responsible Entities should have appropriate risk management systems. We do confirm however our earlier comments in our submission of 26 February 2016 (**February submission**) that any new regulatory guidelines should be aligned to APRA's existing guidance, specifically for dual regulated entities.
3. Specifically, in relation to entities which are "dual regulated" and operate subject to APRA requirements such as *SPS 220, Risk Management*, we note that it is important to avoid any duplication or overlap with APRA requirements. Thus, a common theme or issue for our membership is that there be no duplication of existing obligations for financial resources or capital requirements. This is particularly relevant for dual APRA-ASIC regulated entities. In addition, members who operate these kinds of entities, would wish to ensure that there is a "level playing field" with non-APRA regulated REs.
4. Finally, by way of general observation, members have expressed a preference that the proposed ASIC guidance focus on the substance and be principles based while not focussing on the matters of form (e.g. Compliance Plans and Disclosure).

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**Specific Comments on Questions raised in Part B of CP 263**

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***B1Q1 Overall, is the proposed guidance helpful?***

5. Members have indicated that the draft RG is helpful given that it outlines ASIC's expectations concerning Responsible Entity (**RE**) risk management systems and compliance with s912A(1)9(h) of the *Corporations Act*. The proposed inclusion of good practice guidance as a guide only will be of assistance to REs in understanding the levels of better and best practice and minimum levels of risk management maturity;
6. A further benefit potentially is that the guidance will encourage and provide an incentive for REs and managers to implement more robust risk management frameworks or outsource to independent REs who can provide the infrastructure required, which in turn will be beneficial to investors;
7. Nevertheless, it is important that ASIC exercise discretion and some latitude in applying the RG given the diverse nature, scale and complexity of RE business models.
8. We envisage there will be a need to update existing documentation to reflect requirements and to tailor these to the specific REs and schemes. In this regard, we note your comments that the proposed Regulatory Guide will not impose new obligations.
9. However, we refer to the "Good Practice Guidance" and confirm some members' views outlined in our February submission that the proposed guidance would add regulatory burdens without commensurate benefits. In this regard, we refer to the matters we discuss further under C1Q1- 'publicly disclosing appropriate details of the responsible entity's risk management system' and 'including within the compliance plan procedures, the key risks identified for the responsible entity and relevant scheme'.
10. From a practical perspective, we would caution that the proposed RG does not give rise to inconsistencies in the frequency and content of existing reporting requirements.

***B1Q2 Is there an alternative approach to the guidance that you consider is more appropriate to help responsible entities comply with their obligation under s912A(1)(h)? If so, please provide details.***

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11. Member responses we have received indicate a level of comfort with the proposed ASIC approach. However, members welcome the continued collaboration with APRA to remove any inconsistencies between ASIC's and APRA's guidance in the case of dual-regulated entities.
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***B2Q1 Do you agree with our proposed 12-month interim approach to compliance? Please give reasons.***

12. Members have noted that, broadly speaking, the 12month interim approach appears reasonable if there is an appropriate degree of latitude and discretion in the practical application of the draft RG (recognising the diversity of RE business models outlined above. On this view, the proposed 12-month interim approach to compliance will provide the industry the opportunity to demonstrate uplift by taking the right steps to bringing their risk management systems into compliance with this guidance. Such an approach also fosters a more open and transparent relationship between responsible entities and ASIC in working together towards an industry comprising of responsible entities with a robust risk management framework.
  13. Another view expressed to us however is that this timeframe for "smaller" REs is likely to be too short. Accordingly, in order to accommodate the diversity of the industry, it may be appropriate to implement an 18 month interim period.
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***(Risk Management systems etc)***

***B3Q1 Do you agree with our proposed guidance? If not, please give reasons.***

14. Broadly, members agree with the proposed guidance, subject to a caveat in respect of the expression of item B3 (b). It is not the responsibility of an RE to be aware of and comply with all of the international standards that may

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be relevant to their industry *but* which are not part of Australian law and thus are not enforced locally. Where there is a relevant international standard or regulation, which ASIC believes should apply to Australian REs, this does need to be introduced into Australian domestic law. For example, Government and APRA have implemented in Australian law standards developed by the Basel Committee on Banking Supervision (BCBS). Where such BCBS principles and guidelines are considered appropriate and relevant for Australia, these are implemented and enforced through the local prudential framework;

15. However, we assume that, consistent with usual practice, if ASIC were considering adoption of international rules into the Australian domestic framework, issues of cost impacts and regulatory compliance burdens would be canvassed and considered.
  16. Commonly, in the group context, as we note in more detail below, there will be a risk management framework which details the group approach to the identification, assessment, management, reporting and monitoring of risks. It is applied consistently across all entities within the group, including those which are REs. Those material risks listed in the table generally seemed to be included in members' risk management framework. Given the number of schemes managed by group REs and the necessary complexity of group business, a process of continuous improvement forms part of the matrix of a group's risk management in mind obligations. To this end, a new regulatory guide will act as both a completeness check to an independent source for a risk management framework and importantly provide further clarity around ASIC's expectations. This is important also for "stand-alone" REs.
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***B3Q2 To what extent do you already implement these risk management arrangements?***

17. The response we have received from members is that, subject to the caveat we have made above, these risk management arrangements already would be in place. Members who are part of international groups also may have

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adopted a more “global” approach consistent with a global risk management framework.

18. As we have indicated the feedback from responding members in a group context is that they comply currently with the majority of the proposed obligatory requirements for Risk Management Systems. Practical examples in in a group context include-

- (a) business units follow and adopt a group risk management frameworks and policies that cover the identification and assessment of risks and control;
- (b) the Risk Management Framework (**RMF**) is embedded within relevant business units. The risk management forum includes all key components such as policies, processes, training, monitoring and reporting This is done at a business level rather than an RE or responsible superannuation entity level. Risk registers thus are completed at the business level and assess inherent and residual risk, which may apply to either ASIC or APRA regulated entities. This approach is consistent with the February submission that guidance should not be overly prescriptive and the RE should retain discretion over the management of all identified risks;
- (c) roles and responsibilities are defined. The businesses adhere to and adopts a clear and dedicated *three lines of defence* model (see response to B4Q2 for more detail);
- (d) business units commonly use an electronic compliance and risk management system, which documents and monitors the business’s risk and compliance obligations;
- (d) governance structures are in place and designed to reinforce control objectives, maintain effective and efficient operations, provide accurate reporting and ensure compliance with applicable laws and regulations. Responsibility for controls is rests with management and ultimately with the RE Board;
- (e) most businesses adopt a Risk Appetite Statement (**RAS**) being an overall statement of the amount and type of risks that we are willing to accept in order to achieve its strategic objectives. RASs (including formalised risk settings) are formally monitored by the business and the RE Board;
- (f) businesses also adopt self-assessment procedures on aperiodic, say, semi-annual basis;
- (g) some businesses as we have indicated have a first-line compliance function, separate from the Risk function, which distributes information on relevant industry, local and international standards to

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- both the broader business and other lines of defence. Further, business units generally adopt operational compliance plans which detail all relevant regulatory and compliance obligations applicable to the business units and associated controls/processes to mitigate the obligations is maintained and reviewed on a semi-annual basis;
- (h) similar risk management processes are applied for liquidity management;
  - (i) Quarterly risk management reports are provided to management and form part of Board reporting processes;
  - (j) external service providers are monitored as part of the process;
  - (k) Risk Management Strategy (**RMS**) documents that describe the strategy for managing risk are implemented for a group's AFSL holding entities, having regard to management of group wide enterprise risks in compliance with APRA Prudential Standard CPS220;
  - (l) As you would be aware, REs engage independent auditors who provide an annual opinion on the statutory accounts and compliance plans of the registered managed investment schemes and managed portfolios.
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***B3Q3 Please provide details of any costs or benefits that may result from the proposed guidance. If possible, please quantify.***

- 19. It seems to us that that any particular costs will vary depending on the size, complexity and the maturity of the RE, the risk management system and any enhancements that may be required to accommodate any requisite changes.
- 20. We do note however that members have indicated that there will be an increase in costs initially to review current frameworks to ensure completeness against issued guidance and develop documentation at the scheme and RE level which will include, but not be limited to RASs, Risk Registers and Compliance Plan documentation.

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21. Members also have noted that there will be an ongoing cost around the maintenance of component documentation and the costs associated with the annual and triennial reviews. Members have indicated that these reviews will be duplicated by existing Prudential Standards reviews, GS007, Compliance Plan Audits and ongoing internal audits. An overall estimate of costs is yet to be determined.
  22. A similar comment could be made in respect of any benefits arising from the guidance. However, we are able to comment that there are likely to be less tangible benefits from the proposed guidance, such as raising the standards of risk management practices across the managed investment scheme industry as well as lifting consumer confidence.
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***(Risk Management Processes etc)***

***B4Q1 Do you agree with our proposed guidance? If not, please give reasons.***

23. There is general agreement amongst members who have responded to us with comments concerning the processes and guidance detailed in paragraphs B4 (b) and (c). However, it appears that some of the guidance (such as that referred to in B4 (a)) does not take into account that an RE may outsource its services, on a “trustee for hire” basis. In such instances, it may not be feasible for such an RE to implement risk registers for each of the external schemes to which it is appointed an RE. Rather, it is more common for such an RE to exercise oversight through due diligence and Service Level Agreement reporting from the external manager that includes key risk indicators. We would be grateful if you could consider this point and provide some further comments or guidance in this area. The processes in this context we have identified should address any policy concerns and achieve the policy intent.
24. A more general observation should be made here. It is important for risks to be considered at an RE level and indeed required and achieved by use of Compliance Plans at scheme level. However, existing risk management systems may consider these risks more holistically. A requirement imposing risk registers at both RE and scheme level may impose duplication of risk assessment approaches – it is more important to ensure that the relevant



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risks have been considered, rather than specifying at what level these risks are to be considered. Creating layers of risk registers (at organisational, RE and scheme level) in fact may lead to over complication and result in risk registers being less effective and becoming more of a compliance exercise rather than effective risk management.

25. One of our members has noted that it operates in excess of over 400 schemes. Consistent with the above observations, the member notes that although risk management systems should address all material risks at both the RE and scheme level, it is critical to ensure that a more holistic approach is taken and that it should be made clear that in these circumstances, there is not an expectation that risks be individually identified on a per-scheme basis. That would not be possible to achieve, nor would it achieve any sensible supervisory objective.
26. Specifically, in a group context, it has been noted by a member that it adopts a *three Lines of Defence* approach. Under this approach-
- First Line – the REs are responsible for owning and managing the risks originating within the businesses;
  - Second Line - The Risk develops and maintains the RMF for business application and provides risk insight, risk appetite and risk oversight to ensure that each RE's RMF is being effectively implemented and managed.
  - Third Line - Internal Audit provides independent assurance over the RMF and business application, e.g. Internal Audit reviews, monitors and tests 1st and 2nd line risk activities.  
(In addition to the above, the REs engage independent external auditors who conduct a variety of audits/reviews).
27. Risk profiles for relevant business units are maintained and reviewed at least on a quarterly basis. Risk profiles mainly focus on operational risk. Risks such as strategic, investment and liquidity risk are generally not incorporated into the risk profile rather they are discussed and captured in other risk forums and committees. (The business units that support the REs hold Risk Management Forums monthly or quarterly which provide a forum to identify and assess material risks as part of the business units overall risk profile. These ongoing forums are also attended by Line 1 (MA) and Line 2 Risk).
28. Consistent with other comments we have made, the member notes that current risk systems address risks generally at an entity level rather than at a scheme level. Given the controls in place all risks are seen as being

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appropriately managed. However, as noted in B4Q3, if risks at **scheme level** became an obligatory requirement, then we would expect that the costs could potentially be material. As noted above, in our view such an expectation in any event would not be possible to achieve, nor would it achieve any sensible supervisory objective

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***B4Q2 To what extent do you already implement these risk management arrangements?***

29. Responding members indicated that broadly speaking these types of arrangements already are implemented. In relation to paragraph (a) of this question, we refer to our previous comments in respect of “REs for hire” and the processes that are adopted in that context.

***B4Q3 Please provide details of any costs or benefits that may result from the proposed guidance. If possible, please quantify.***

30. Our view is that the draft RG should benefit the industry by setting minimum expectations for REs in terms of identifying and assessing risks. This should be of particular benefit for REs with less mature risk management systems and enable those REs to implement better practices and meet regulatory expectations.

31. However, the potential costs involved will depend on your approach and expectations, particularly with regard to REs for hire in the context of our response on paragraph B4 (a) and the industry’s ability to implement your guidance in a practical sense.

32. In addition, as we have previously noted, we have assumed that risks do not need to be documented at scheme level in group contexts. If however, further documentation of risks at **scheme level** became an obligatory requirement, then we would expect that the costs could potentially be material. As we have said, we do not see such an approach as practicable nor achieving a policy objective.

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***(Managing risks)***

***B5Q1 Do you agree with our proposed guidance? If not, please give reasons.***

33. Responding members have expressed general agreement with the observations here in respect of paragraphs (a), (c) (d) and (e). However, as you would appreciate many of our RE members are part of wider corporate groups. Thus, we would suggest that, in terms of paragraph (b), performance of stress testing at an RE level is unnecessary if such testing is performed at a group or whole-of-organisation level. The reasons for this are as follows-

(a) a group's balance sheet and liquid asset position, inclusive of its RE business, is already stress tested on an ongoing basis;

(b) REs generally have a low liquidity risk;

(c) REs generally hold a significant amount of high quality liquid assets and already have processes in place to manage liquidity risk (and ensure solvency) in order to meet AFSL/APRA regulatory requirements; and

(d) an RE's liquidity at a business level has no correlation to the liquidity of a fund as an RE's corporate assets and fund/scheme assets are segregated as required by trust law and the *Corporations Act*.

34. Accordingly, we would ask that you reconsider the issue in light of these comments.

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***B5Q2 To what extent do you already implement these risk management arrangements?***

35. Responding members' risk management systems appear to be broadly consistent with ASIC's expectations listed under B5 (a), (c), (d) and (e) and draft RG 000.84 – RG 000.95 and RG 98 000.98 – RG 000.103. However, following on from the above, for those members who are members of a corporate group, then in respect of paragraph B5 (b) and draft RG 000.96 and RG 000.97, some accommodation for that group structure should be

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made. As mentioned, stress testing of a head entity's balance sheet occurs- which would include a subsidiary RE's business and accounts. Such an RE would have a low liquidity risk profile given the regulatory requirements and necessary segregation of assets as outlined above. Accordingly, such REs would manage business liquidity risk prudently and we suggest that your guidance should recognise these structures and existing processes.

36. Some further observations may be made here-

(a) REs generally have well established risk management systems which focus on the identification and management of a range of risks, including operational and liquidity risk. This in a group context may be conducted by investment managers for the various schemes undertaking assessment of portfolio operational and liquidity risks;

(b) A common approach here at a group level is to adopt a three *Lines of Defence* framework which reflects the belief that to be effective, a risk management capability must be embedded within the business. This allows for robust risk identification through *Risk Management Forums* as together with implementation of Operational Compliance Plans for business units and incorporation of control testing to ensure control monitoring and assurance. It also allows REs to identify risks on a residual basis and how to manage these risks;

(c) A range of stress and scenario testing commonly is performed on behalf of the business. Examples include:

(i) customised scenario (what-if) stress tests generally run on a frequent periodic basis, say, monthly and the outputs/results are discussed at regular team meetings.;

(ii) scenarios analysis / stress testing;

(iii) business units hold Risk Management Forums, periodically, say either monthly or quarterly, which also act as a forum for the leaders of those business units to report on their reviews and monitoring of identified risks as part of their business unit's risk profile. This is also attended by Line 1 and Line 2 Risk and is an ongoing process;

(iv) most entities will have robust Board reporting processes in place including regular risk reports to Boards, outlining implementation of say a the Risk Management Accountability Model or other relevant risk model. Risk reports commonly also are provided to committees such as Risk Committees. Similarly, *Breach Reports* are provided to special; purpose committees such as Breach Review or Reporting Committees.

***B5Q3 Please provide details of any costs or benefits that may result from the proposed guidance. If possible, please quantify.***

37. The proposed guidance may benefit the industry by increasing the frequency and level of sophistication with regard to stress testing.

***(Summary of Key Risks)***

***B6Q1 Are there any additional risks or risk treatments that we should include in the draft appendix? If so, please provide details.***

38. Responding members have indicated that the Appendix provides a useful guide for the industry. Appropriate risk treatments will vary, however, depending on the particular circumstances and the size, nature and complexity of the RE.

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***(Good Practice for Responsible Entities)***

***C1Q1 Do you agree with our proposed guidance on good practice measures? If not, please give reasons.***

39. Broadly speaking, and subject to the comments which follow, responding members agree with the guidance as a whole. However, stress testing and scenario analysis programs which go beyond traditionally tested risks, such as liquidity, market and investment risks, will require a significant increase in the sophistication of such programs across the industry. Thus, we suggest that an appropriate transitional period be considered and that a facilitative approach be taken by ASIC for that period.

40. There are two areas however where we suggest that there be further consideration and review in terms of this proposed guidance, that is,

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*(a(iv)) publicly disclose appropriate details of the responsible entity's risk management system; and*

*(c(iii)) include in the compliance plan procedures for ensuring that the key risks identified for the responsible entity and relevant scheme are managed on an ongoing basis.*

41. We do not see the benefit to consumers by providing a range of potentially complex risk management documentation that adds unnecessary costs to develop and maintain. Particularly in the context of groups which operate dual regulated entities and business units this will impact a range of products outside of managed investment schemes. Groups accordingly would need to develop specific RE risk management system documentation;
  42. Similarly, in our view, to add further details to publicly available Compliance Plans, will not provide meaningful insights to the products that consumers are investing in or considering investing in. Existing disclosure documentation provides the key risks for an investor to consider when investing in the product in accordance with ASIC requirements
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***C1Q2 To what extent do you currently adopt the proposed good practice measures?***

43. The response to this approach will differ between REs depending on their current practices. A substantial member for example has indicated that it currently has in place the good practice measures listed under (a), (b) and parts (ii) and (iii) of (c). In relation to paragraph (c) (i), the member notes that stress testing is currently conducted by stressing liquidity, market and investment risks. Operational events and scenarios that would trigger the group's crises management plan are currently only considered when forming a view on the group's business interruption insurance requirements. However, the member and the group will consider broadening its stress testing methodology to incorporate operational and outsourcing risks as part of the next review of its stress testing framework.
44. By way of general observations-
  - (a) in a group context, members note that they currently adopt the majority of the proposed good practice measures;

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- (b) there will be a formal group risk management frameworks and policies that cover the identification and assessment of risks and controls;
- (c) group-wide, an electronic compliance and risk management system is used, documenting and monitoring the business's risk and compliance obligations;
- (d) the RMF is robust and embedded within relevant business units. The RMF includes all key components such as formalised policies, processes, training, monitoring and reporting;
- (e) the *three lines of defence model* is used for its designated risk management function. Dedicated Line 1 and 2 are embedded in the business. Risk Management Forums are held monthly/quarterly. A key role of Line 2 is to constantly independently review and challenge business to ensure that it is consistently adopting formalised risk management systems;
- (f) a governance structure is in place and dedicated risk reporting to Boards forms part of that process;
- (g) a dedicated Chief Risk Officer is appointed for the group;
- (h) business units measure and collate risk indicators relevant to their business (called Key Risk Indicators) which are regularly reported through to Line 1 and Line 2 Risk and are assessed and discussed at Risk Management Forums;
- (i) regular stress testing/scenario analysis is conducted;
- (j) written plans for treating risks are available. For example Regulatory Affairs have constant engagement with regulatory bodies and disseminate updates to business units, there are policy;
- (k) documents on a range of risks including conflicts of interest and outsourcing polices exist and procedure manuals documented for a number of operational processes, there are breach registers in place in relation to breaches/events, there are Business Continuity Plans in place, ongoing staff compliance training is a mandatory requirement, service level agreements are in place between entities and external providers;
- (l) Compliance Plans document key risks and associated controls to mitigate these risks and have assigned owners/subject matter experts who attest on an annual basis that these controls are appropriate and relevant in managing these risks;
- (m) risk management frameworks are subject to numerous periodic independent reviews, in particular, where there is a group operating dual regulated entities. These include MIS and SPS

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compliance plan audits and triennial reviews for investment governance, conflicts and risk management;  
(n) in these circumstances, as we have mentioned, further guidance on the two proposed good practice measures outlined under response C1Q1 would be appreciated given that there is a range of activities already directed to appropriate risk management.

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***C1Q3 Are there any other good practice measures that should be included to help responsible entities enhance their risk management systems? If so, please provide details.***

45. The comments we have received concerning the draft RG, including the good practice measures, indicate that the guidance is appropriate for industry to ascertain what is the expected for the minimum level of maturity with respect to their risk management systems and ultimately comply with s912A(1)(h) *Corporations Act*. However, it would be beneficial if ASIC could continue to provide additional guidance and insight on emerging risks impacting REs (large, medium and small) across our industry. This would allow REs to have a uniform knowledge base as to the risks that can impact their schemes and themselves.

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Please contact Paul Callaghan on (02) 8235 2526 if you have any questions on our submission.

**Yours Sincerely**



**Paul Callaghan**

**General Counsel**