July 2023

PwC Australia's

Superannuation and Asset Management Risk and Compliance Benchmarking Survey

Our 15th annual Superannuation and Asset Management Risk and Compliance Benchmarking survey focuses on the following key areas impacting the sector - continued regulatory change, investment governance and accountability and highlights the opportunities, challenges and calls to action these present.

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Executive Summary

The environment within which the Superannuation and Asset Management sector operates continues to be subject to significant regulatory evolution, with significant changes having occurred and more on the horizon.

The key areas considered in the 2023 PwC Superannuation and Asset Management Risk and Compliance Benchmarking Survey are:

01 Continued Regulatory Change

Our 2022 publication focussed on the introduction of new regulatory requirements, whilst this year's survey is focused on continuing to embed the regulatory change into business as usual operating models. Key considerations include responding to increased communications, guidance and regulator enforcement, as well as identifying areas for continuous improvement in processes, systems and controls.

02 Investment Governance

During the year Australian Prudential Regulation Authority (APRA) revised Prudential Standard SPS 530 Investment Governance, which became effective from 1 January 2023. In addition, Prudential Guidelines (SPG 530) was released recently in July 2023. This has seen significant uplift in Registrable Superannuation Entity's (RSE) requirements to update Investment Governance Frameworks with respect to investment valuation governance, stress testing, liquidity and cash flow management, as well as greater fund manager monitoring.

03 Accountability

The Financial Accountability Regime (FAR) is expected to be passed in the 2023 Winter Parliamentary Sitting and will apply to all APRA regulated entities, including RSEs. FAR, if implemented well, can act as the catalyst to bring together all recent regulatory change programs by supporting Accountable Persons in meeting their obligations. Implementation of FAR is not about designing new processes and controls but tailoring existing frameworks and controls to include an accountability lens. It's purpose is to connect governance, culture and accountability across the organisation.

01 Continued Regulatory Change

Recent years have seen significant changes in the regulatory environment in which the Superannuation and Asset Management sector operates. These changes are as a result of the introduction of new and revised regulatory requirements, as well as increased scrutiny by regulators, some of which has been in response to the recommendations arising from the Financial Services Royal Commission.

Specifically, the following developments have seen the industry spend the last 24 months responding to further regulatory change and assessing the impact on their operating models and processes:

- the introduction of new regulatory guides RG 78 *Breach reporting by AFS licensees and credit licensees*, RG 271 *Internal dispute resolution* and RG 274 *Product design and distribution obligations;* and
- the increased focus on Environment, Social and Governance (ESG).

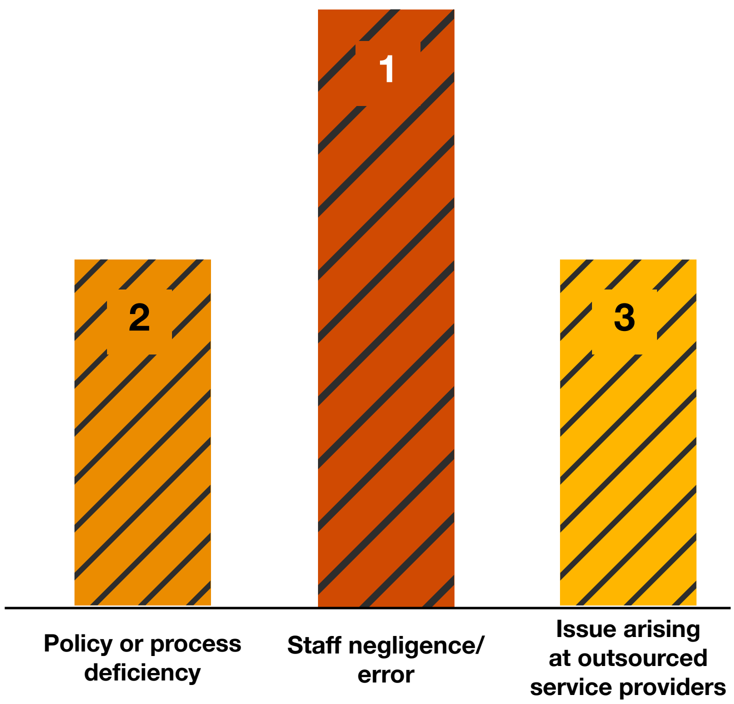
Last year the focus was on the preparedness and implementation of the regulatory changes whilst this year the focus has been on the embedment of regulatory change into business as usual operations across the ecosystem. We explore some of these below.

Incidents and breaches - Almost 24 months on from the introduction of RG 78

The introduction of RG 78 in October 2021 had a significant impact on the industry in terms of assessing incidents and breaches and whether these constituted reportable breaches. There has been ongoing communication from Australian Securities & Investments Commission (ASIC) on their expectations of the industry through their industry reviews, including incorporation into ASIC's 2022–23 priorities, where ASIC referenced a focus on improving the operation of the reportable situations regime, and more recently changes to RG 78 announced in April 2023.

The industry appears to have adapted to the required reporting regime and built in processes to aid in reviewing incidents and breaches on a more timely basis. A key element to this process is the identification of the root cause of the incidents and breaches to determine the appropriate remediation activity required and prevent further recurrence of the incidents and breaches. This year's survey identified that the top three root causes were staff negligence, deficiencies in policies or process and issues arising at outsourced service providers.

Top three root causes of reportable breaches



Our survey also indicated that 60% of respondents implemented changes to their policies and controls in response to the breaches reported in the last 12 months, with the key changes being the introduction of new processes, systems and controls, improvement to internal review processes and more active monitoring of outsource providers controls. This alignment between root cause and remediation is a positive observation.

Have reported breaches resulted in changes to policies and controls?

Yes 60%

No 40%

In April 2023, ASIC released updated guidance providing changes to RG 78, including the prescribed form for lodging reportable breaches and other items raised during their industry consultation process. ASIC raised concerns that licensees should consider whether the existence of multiple breaches attributable to staff negligence indicates a broader systemic root cause such as deficiency in processes and procedures arising from a lack of adequate staff training.

Design and Distribution Obligations - Design and Distribution Obligations - remaining relevant is paramount

In May 2023, ASIC issued Report *762 Design and distribution obligations: Investment Products*, following the issuance of 26 Target Market Determination (TMD) stop orders that ASIC took against 19 Responsible Entities who are investment product issuers.

The report highlights improvements required in relation to:

- appropriate tailoring of TMD templates, including a clearly defined TMD with sufficient granularity, not relying solely on past performance as an indicator of future performance and ensuring consistency with other disclosure documents;
- the appropriate tailoring of distribution conditions; and
- incorporating marketing, the sales process, third party distributor arrangements, distributor training, risk controls, due diligence, as well as monitoring and supervision into reasonable steps.

During the initial phases of implementation, we saw a concentration of 'compliance at a point in time' however it is clear that the obligations are here to stay and need more of a focus on the risk of ongoing non-compliance. To date, ASIC has primarily focused on compliance with the TMD requirements. Moving forward, ASIC will place a stronger focus on compliance with the reasonable steps and review obligations. There is a need to consider review triggers resulting from changes to products, customer demographics and distribution structures, a good example of this is the implication of triggers resulting from superannuation fund mergers.

Following the issuance of the stop orders, most of the organisations surveyed have assessed their current TMDs against the key themes reported by ASIC and are making relevant updates to their TMDs. Organisations are also turning their minds to business continuity planning in the case that a stop order is received from ASIC, including communication with key stakeholders, both internally and with ASIC and members/investors, as well as processes and procedures to follow to ensure the matter is dealt with effectively and efficiently.

53% **Percentage of participants which report key metrics relating to TMDs and PDSs to their boards**

ESG and Greenwashing - a sharpened focus

The potential for funds to overrepresent the extent to which their practices are environmentally friendly, sustainable or ethical is referred to in the market as “**greenwashing**”.

ASIC Guidance “How to avoid greenwashing when offering or promoting sustainability-related products” highlighted a number of examples of disclosures to avoid - including using vague terminology, misleading headline claims and failure to disclose how and when sustainability targets will be met.

Globally, regulatory focus on the development and release of reporting standards (including the International, EU and US standards) has sharply accelerated the focus on climate and sustainability risk management and reporting. Domestically, these standards are in the final stages of consultation with Treasury releasing the consultation on climate-related financial disclosure in late June 2023. This has clarified the scope of reporting entities, and is expected to capture RSE licensees. in the first group of entities (reporting for the 2024–25 financial year). Thresholds will reduce in 2026-27 and in 2027-28 in two phases, bringing entities within the wider Asset Management into scope.

Correspondingly, coordination will be required across the industry to enable participants to comply, with RSEs in particular dependent on implementation by Asset Managers to ensure availability of relevant data, disclosure and assurance requirements will increase over a 3 year period from the first date of reporting for in-scope entities.

ASIC has been proactive in communicating regulatory standards and undertaking enforcement actions to respond to greenwashing risks. Following the release in June 2022 of ASIC's information sheet on greenwashing titled “How to avoid greenwashing when offering or promoting sustainability-related products,” the regulator recently announced that it had made 35 interventions in the subsequent nine months. These addressed net zero statements and targets, use of terms such as ‘carbon neutral’, ‘clean’ or ‘green’ fund labels, and scope and application of investment exclusions and screens.

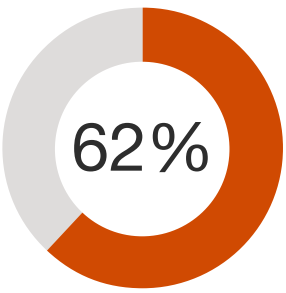
ASIC’s recent greenwashing interventions:

23
total corrective disclosure outcomes

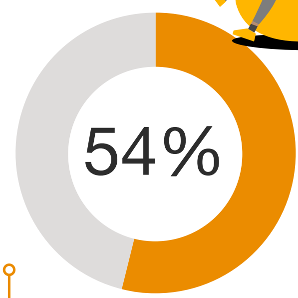
11
infringement notices issued

01
civil penalty proceeding commenced

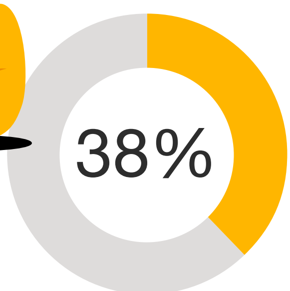
Regulatory focus on ESG disclosures is driving considerable change as noted through the survey results:



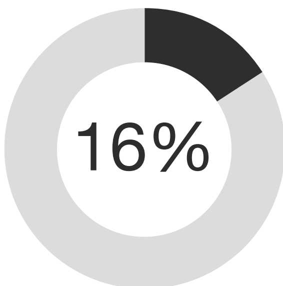
of respondents had made a change to one or more aspects of their operations



are making changes to website or other marketing materials



are making changes to internal policies and external disclosure documents



had directly made changes to their investment portfolio

Respondents feel they have the capability to deal with changes to climate risk management but should remain alert to emerging complexity and increasing expectations

Scope 3 emissions* are all indirect emissions (not included in scope 2) that occur in the value chain of the reporting company, including both upstream and downstream emissions.

While the scope of change in climate risk management and reporting is significant, a majority of respondents report feeling equipped to meet the challenge. Regulatory developments are significant and will require changes in how organisations identify, manage and report on sustainability risks.

- APRA's final Prudential Practice Guidance - SPG 530 *Investment Governance* places significant emphasis on the incorporation of climate risk and ESG reporting as a component of the Investment Governance framework. This is expected to lead to ongoing changes as organisations embed the responses required to manage these risks. Of particular note, only 31% of respondents reported making changes as a result of the new prudential standard SPS 530 requirements which came into effect 1 January 2023. Organisational focus will be required to ensure compliance with the requirements and guidance, and in particular that climate and sustainability risks are appropriately contemplated by their governance frameworks.

- Exposure Draft standards on Climate reporting (including IFRS S2) has confirmed that reporters will be expected to report on Scope 3 emissions in accordance with the Greenhouse Gas Protocol. Financed emissions associated with financing and investment activities will be the most significant aspect for the Asset Management industry. Significant complexity is involved in developing estimates of financed emissions due to the scope and variability in the underlying entities.

  In the context of these developments, organisations were confident in their ability to respond to these risks. 62% of respondents felt that they have the right people with the relevant skills and systems to manage the ESG risks and opportunities within investment portfolios including climate risk exposures. While this is a positive observation, industry participants should remain alert to emerging complexity and increasing expectations.

31%

of respondents reported making changes as a result of the new prudential standard SPS 530 requirements which came into effect 1 January 2023

62%

of respondents felt that they have the right people with the relevant skills and systems to manage ESG risks and opportunities

*Scope 3 emissions are indirect greenhouse gas emissions generated as a result of activities undertaken either upstream or downstream in the value chain of an entity's operations (excluding direct emissions captured by Scope 1 emissions and indirect emissions from the generation of purchased energy captured by Scope 2 emissions)

Continued Regulatory Change: calls to action

01 Consider ASIC's updated guidance in RG 78 and whether the existence of multiple breaches attributable to staff negligence is an indicator of broader systemic issues.

02 Review and consider the revised 'grouping test' in RG 78 to identify instances where multiple breaches may be grouped into one report to ASIC to make the breach reporting process more efficient.

03 Consideration should be given to DDO review triggers resulting from changes to products, customer demographics and distribution structures.

04 Business continuity planning should be updated to contemplate a proposed response to a stop order received by ASIC on TMDs/ reasonable steps to ensure the matter is dealt with effectively and efficiently.

05 In response to ESG enforcement and emerging requirements, move forward on 'no regrets' actions including: establish and develop governance, processes and controls over sustainability, monitor regulatory developments and establish a roadmap for sustainability reporting and risk management.

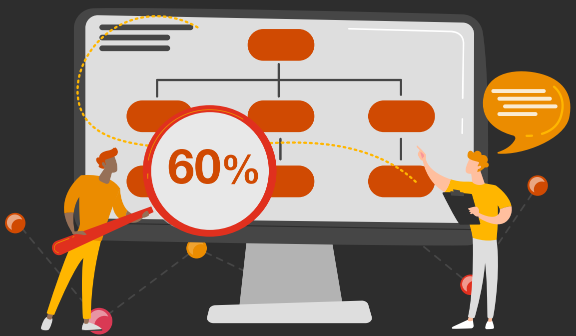
02

Investment Governance

During the year APRA released an updated Prudential Standard (SPS 530) which became effective from 1 January 2023 and applies to all RSE licensees.

Respondents have noted there has been a wide variety of changes to their investment operations and systems as a result of the new SPS 530.

Of particular interest this year's survey indicated:



- **60%** of respondents noted **changes to their governance practices** around the valuation of investments, investment performance monitoring, stress testing of investments and fund manager due diligence. With regards to valuation governance and investment performance monitoring, **65%** of respondents indicated they had **put in place structures** to ensure that the persons responsible for the valuation of investments and measuring performance were operationally independent from those responsible for making investment decisions.

- **25%** of respondents noted **changes to board and investment committee oversight** as a result of the new SPS and SPG 530. This included the use of formal valuation committees and external independent valuers.

- **60%** of respondents stated that they had **implemented system changes** relating to investment data and performance reporting to assist in obtaining the right level of information to make informed decisions over investment governance and therefore meet the requirements of SPS 530.

In response to SPS 530, the key action for RSE Boards is to ensure that their investment governance framework (IGF) is up to date with the new requirements contained in the prudential standard and guidance. Furthermore, this is not a set and forget exercise as RSE boards and those charged with investment governance must ensure that the IGF is operating effectively both within the fund and through the oversight of external fund managers. The IGF should also be part of the 3 lines of defence to ensure independent oversight of the control environment surrounding the fund's investments.

Particular areas of focus should include:

Investment stress testing

RSE Boards are required to complete formal stress testing processes annually. The program must include details on the role and responsibilities of people involved. There should be processes in place for data checks, and a detailed outline on methodology, aims and the specific stress tests to be done by investment option, which is to be approved by the board.

Valuation governance

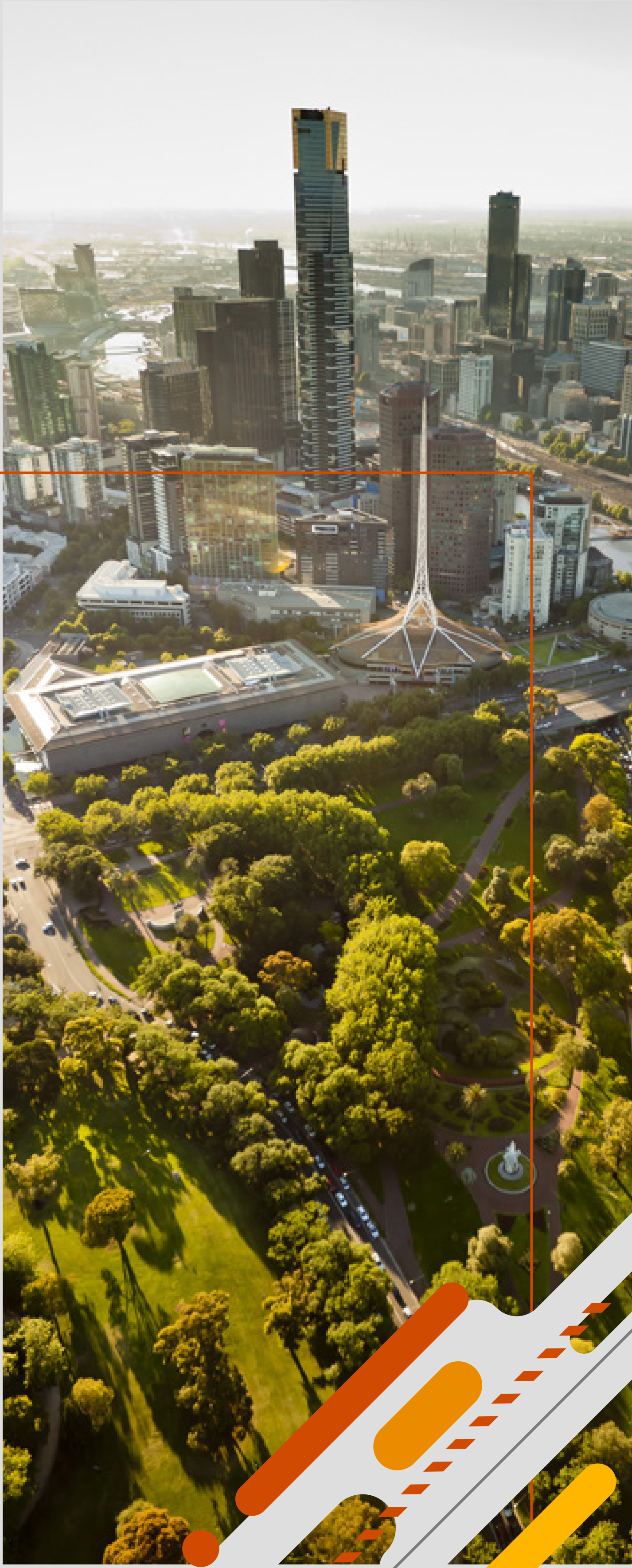
RSE's must create a valuation governance framework to identify and manage valuation risk. The valuation policy must be Board approved and outline their roles and procedures, including the need for operational and structural independence between the persons responsible for investment decision-making and those responsible for undertaking the valuation of investments. It also needs to identify under what conditions an investment valuation is accepted, rejected, or reassessed. There will be triggers which decide whether or not the valuation is completed outside of the regular valuation cycles.

For Asset Managers, as a result of the new SPS 530 requirements, there will be greater scrutiny by superannuation funds on the manager's valuation approach, pricing sources, timing of valuations and the roles involved to assess whether managers have structure independence within their valuation governance. This is particularly relevant for Asset Managers who manage illiquid assets, where there has been a focus from managers on reviewing their valuation governance and processes, as highlighted in the following PwC publication Asset & Wealth Management Benchmarking Insights - Alternatives Navigating Uncertainty in Private Investment Valuation: Q4 2022 Snapshot.

Liquidity and cash flow management

RSE's must include stress tests on their liquidity profile as part of their liquidity management plan. This is to understand their ability to meet obligations during periods of stress in the absence of market or funding liquidity. Again, this needs to give details of the roles and responsibilities of people involved in the process of managing the risk. Details on what the key metrics show are important to inform there is suitable oversight of risk. This must be reported to and reviewed by the Board and other specified members.

Investment Governance: Calls to action



Calls to action for Boards, noting that while the function may be outsourced, the Board retains the responsibility.

01 Ensure there is effective board and board investment committee oversight of the valuation of investments (particularly private market assets), inhouse funds management, external manager due diligence (including operational due diligence), stress testing scenarios and results including stress testing liquidity. For example, board and investment committee involvement and sign-off of the stress testing scenarios and results.

02 Consider if there is sufficient independence in the valuation of investments and performance monitoring and reporting from those responsible for investment decision making. This could include having a separate valuation committee with members who are not involved in investment decision making functions.

03 Funds and fund managers are expected to have in place appropriate systems and processes for managing the accuracy of investment data (data governance) and independently calculating performance returns and monitoring investment risk.

04 Ensure there are policies, procedures and controls in place in relation to the ESG elements of the Investment Governance Framework (IGF). For example, in areas such as external manager due diligence of their ESG compliance, managing restricted securities, engagement with investee companies/active ownership and managing investments with exposures to climate risk.

03

Accountability

Financial Accountability Regime

On 16 July 2021, Treasury released the consultation package which included the Exposure Draft and Explanatory Memorandum for the implementation of the FAR. The FAR is the government's response to recommendations made by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry to extend the Banking Executive Accountability Regime (BEAR) to strengthen the responsibility and accountability of the directors and most senior and influential executives of financial institutions. The FAR follows many of the provisions of its predecessor, the BEAR and includes both accountability and remuneration obligations.

The FAR will apply to all RSE Licensees. The draft FAR bill is expected to be passed in the 2023 Winter Sitting of Parliament.

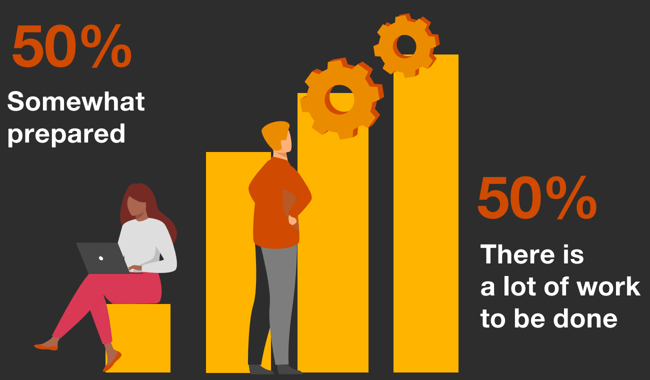
The proposed implementation date for RSE's is 18 months after commencement of the FAR following Royal Assent. There is an expected implementation date of Q1 2025. The legislation identified 2 types of entities being Enhanced and Core , with the Enhanced entities being defined as those whose Total assets > $10bn. Total assets relates to the combines total assets of all RSE's under the trusteeship of a given RSE.

Only Enhanced entities are required to submit Accountability Statements and Maps, however all entities will need to prepare them.

Although classification is driven by Total assets, APRA and ASIC will also have the ability to reclassify entities below this threshold to a Enhanced entity where they are of the view that the entity's governance and accountability would benefit from developing and submitting Accountability Statements and Maps.

Respondents stated that they were generally at the preliminary phases of planning for the implementation of FAR, noting however that remuneration (deferrals and consequent management) aspects had already been considered for implementation of CPS 511 *Remuneration*, especially for those RSEs who are significant financial institutions.

How prepared are you for FAR?



A key lesson learnt from implementation of the BEAR is to not underestimate the complexity or time required to implement the regime, and many RSE Licensees are underway in planning for implementation and some are already starting to see some benefits, especially those RSEs who have merged or are merging.

Some benefits of the regime include:

- Greater clarity and transparency over roles, responsibilities and accountabilities;
- Enhanced collaboration both at the Executive level and across the organisation;
- Greater opportunity to reinforce a culture of accountability;
- Ability to remove complexity and simplify governance structures and arrangements; and
- Faster decision making with more deliberate and efficient socialisation process.

Risk culture

Supporting an effective accountability framework is the need for a strong risk culture, with risk culture being a subset of organisational culture. It refers to the ‘way we do things around here’, and the impact this has on how risks are managed and decisions are made.

Risk culture continues to rise sharply up leadership agendas due to increasing oversight from regulators, shifts in society’s values and priorities, and the rising number of examples where the common root cause of issues has been pockets of poor risk behaviour. In 2022, APRA performed a risk culture benchmarking survey across 16 entities within the superannuation sector, highlighting APRAs continued focus on risk culture.

Performing risk culture assessments

Across the industry, organisations are increasingly working to understand their risk culture and how this impacts their ability to manage risk and make effective decisions through the performance of risk culture assessments.

Employee surveys continue to be a popular and efficient method for assessing risk culture, with most organisations now opting to do a standalone risk culture survey to gain richer insights. However, there are limitations with survey only assessments, and more organisations are complementing their assessments with qualitative data sources (e.g. behavioural observations, interviews, focus groups etc). Qualitative data sources can provide rich insights into the behavioural drivers and root causes behind the survey responses - an opportunity to understand both the ‘what’ and the ‘why’.

While some organisations utilise their own risk culture specialists (predominantly within the risk team) to perform the risk culture assessments and drive risk culture uplift initiatives, a number of organisations are increasingly engaging external risk culture experts to perform independent risk culture assessment on a periodic basis.

Has the target risk culture for the organisation been formally defined?

0%

of respondents have formally defined their target risk culture, but 100% have a plan to do so in the next 6 - 12 months

Defining target state culture

There is an increasing expectation from APRA for organisations to have a risk culture framework in place which articulates the target risk culture and subsequently demonstrate how they are measuring progress against it.

Respondents noted a diverse range of elements that are most important for target risk culture and this highlights the need for the target risk culture to be bespoke for the organisation and reflective of its own circumstances (including operations, size and complexity), common themes in organisations that do this well include:

- Alignment of the target risk culture to the organisation's purpose and values;
- Identification of underlying risk behaviours to achieve the target risk culture; and
- Responsibility at all levels to drive the target risk culture, including the board.

What do you consider to be the most important elements for a target risk culture?

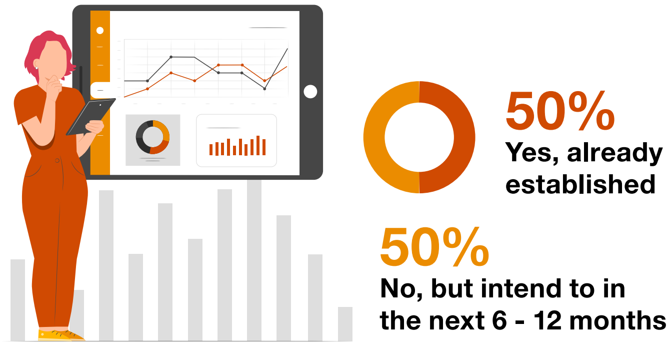
1. Leadership and tone from the top
2. Accountability and responsibility
3. Systems, policies and controls
4. Continuous improvement

Measuring progress

Measuring risk culture is not easy, and comes with associated challenges such as the availability, applicability and quality of the metrics that are obtained. It is something that organisations are grappling with and approaches are evolving.

50% of respondents noted that they intended to develop an approach in the next 6 to 12 months to periodically measure and report on risk culture.

Has your organisation developed an approach to periodically measure and report risk culture?



When identifying the relevant metrics, organisations should look to identify metrics which provide insights into the effectiveness of interventions and will measure the extent to which risk mindsets and behaviours are shifting over time to the target state. The metrics should include a combination of leading and lagging indicators, behavioural KPIs and perception, process and outcome measures.

More advanced approaches include developing a statistically validated measurement model with metrics identified and mapped to the target risk culture, leveraging the use of predictive analytics and artificial intelligence.

Accountability: Calls to action

01 **Identify key FAR stakeholders**

Many organisations have begun to identify their key FAR stakeholders and set up a FAR project working group (Executive sponsors, typically Head of People and Culture and CRO) to support the implementation and to drive communication and awareness of FAR across the organisation.

Establishing a central team responsible for implementing and embedding the regime is crucial to setting the organisation up for success. Organisations should identify the appropriate home of the “Office of the FAR” including its key roles and responsibilities, as well as the input that will be required by other areas of the organisation, to facilitate the effective and timely management of the regime once implemented.

02 **Consider your structure**

Whilst the FAR captures the most senior executives and directors, it is a regime which impacts the entire organisation. Organisations should define what FAR means for the organisation, structure and governance arrangements. This includes identifying the in-scope entities including any Significant Related Entities (for RSE Licensees these are Connected Entities).

03 **Reasonable steps framework**

The RSE Licensee surveyed and that we are working with are beginning to see that most of the work for FAR relates to reasonable steps and demonstrating how an Accountable Person and the entity discharges their accountability obligations.

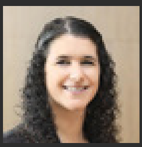
Organisations are designing programs that draw on existing and new regulatory change to support reasonable steps and to embed the FAR across the organisation e.g. CPS 511, including consequence management, CPS 230 *Operational Risk Management* and Risk Culture programs. Some RSE's are looking at their GRC tools to see how they can use them for effective implementation of FAR and CPS 230.

04 Obtain a clear understanding of the current state risk culture, using both quantitative and qualitative data gathering methods.

05 Develop a risk culture target definition and identify the supporting risk culture attributes and examples of desirable/undesirable risk behaviours.

06 Develop a risk culture dashboard aligned to the target risk culture with metrics mapped to each attribute. Identity leading and lagging metrics with relevant thresholds.

Contact Us



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